Railroad Stocks Have Pulled Back: Which Should You Consider?

Description

Both **Canadian National Railway Company** (TSX:CNR)(NYSE:CNI) and **Canadian Pacific Railway Limited** (TSX:CP)(NYSE:CP) have generated tremendous wealth for their long-term shareholders. The stocks have delivered returns far greater than what the general market has delivered in the last decade alone.

Outperforming the market

A $10,000 investment made in Canadian National Railway at the start of 2007 has since transformed into ~$43,700, or an annualized rate of return of ~14.8%.

In the same period, the same investment in Canadian Pacific Railway has transformed into ~$33,900, or an annualized rate of return of ~12.1%. If that amount were invested in the **S&P 500** at the time, it would only have transformed into ~$19,600, or an annualized rate of return of ~6.5%.

It's interesting to note that in a little more than 10 years, the seemingly small 2.7% additional rate of return from Canadian National Railway over Canadian Pacific Railway amounted to $9,800 of excess gains.

In the last five years, the two companies continued to outperform the market, but Canadian Pacific

Railway took the lead this time. In this period, Canadian Pacific Railway's earnings per share (EPS) tripled, while Canadian National Railway's EPS increased by *only* 90%.

The business performance of the railroads relies on the underlying economies to do well. However, the valuations at which investors buy and the future growth rates of the companies are big factors that contribute to future returns as well.

Valuation and growth

Let's see which may be a better investment today.

At ~$101 per share, Canadian National Railway trades at a multiple of ~20.4, while The Street consensus estimates it will grow its EPS by 8.7-10.1% per year for the next three to five years. So, at best, the stock is fairly valued.

At ~$194 per share, Canadian Pacific Railway trades at a multiple of ~17.5, while The Street consensus estimates it will grow its EPS by 11.3-12.6% per year for the next three to five years. So, the stock is undervalued.

Investor takeaway

Although Canadian Pacific Railway is a better-valued investment than Canadian National Railway today, some investors like the latter company for its consistent dividend growth.

Canadian National Railway has increased its dividend for 21 consecutive years. The company's 10-year dividend-growth rate is 16.5%. Its quarterly dividend per share is 10% higher than it was a year ago. For the next few years, investors can expect healthy dividend growth of roughly 8-10% per year.

In conclusion, total returns investors should consider Canadian Pacific Railway over Canadian National Railway today. If you like Canadian National Railway's consistent dividend growth, consider the stock at a lower valuation — perhaps below $90 at a multiple of ~18.

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