



Which Is the Better Buy: Canadian Pacific Railway Limited or Canadian National Railway Company?

Description

Economic growth is favourable to railway companies, as they transport industrial and consumer goods. With the economy growing, railway stocks should perform well this year and in the years to come.

In Canada, **Canadian Pacific Railway Limited** ([TSX:CP](#))([NYSE:CP](#)) and **Canadian National Railway Company** ([TSX:CNR](#))([NYSE:CNI](#)) are the two largest railway companies. While those two companies are both solid investments for the long term, you may wonder which one is a better buy for the short to medium term.

Let's have a look at the latest quarterly results of those two railway companies to see which one is a better investment at the moment.

Canadian Pacific Railway

Canada's second-largest railway released its 2017 [fourth-quarter results](#) on January 18. Helped by higher shipments, profits beat analysts' estimates.

Canadian Pacific Railway's net income surged to \$984 million in the fourth quarter, up from \$384 million a year earlier. The jump in profit was mainly due to an income tax gain of \$527 million related to the new U.S. tax code.

Excluding items, CP Rail earned \$3.22 per share — \$0.02 higher than analysts' estimates and up 5.9% from a year earlier. Revenue for the quarter rose 4.6% to \$1.71 billion.

CP Rail reported an operating ratio — operating costs as a percentage of revenue — of 56.1% for the fourth quarter, slightly down from 56.2% a year earlier. The lower the ratio, the more efficient the railroad.

The Calgary-based company sees the potential for higher pricing in 2018 as capacity gets tighter on rising demand.

CP Rail plans to invest between \$1.35 billion to \$1.5 billion in capital programs in 2018 to improve service, productivity and safety. The company last raised its dividend in May 2017. The dividend was raised by 12.5% to \$0.5625 per share quarterly for a yield of 0.98%.

The railway company had an adjusted diluted EPS of \$11.39 in 2017 and is expected to have an average annual EPS growth of 13% for the next five years. CP has a P/E-to-growth (PEG) ratio of 1.35 and a ROE of 35%.

Canadian National Railway

Canada's largest railway reported its 2017 [fourth-quarter results](#) on January 23. Profit was lower than expected, hurt by higher costs.

Canadian National Railway's net income surged to \$2.61 billion in the fourth quarter, up from \$1.02 billion a year earlier due to an income tax gain of \$1.76 billion.

Excluding items, CN Rail earned \$1.20 per share — \$0.02 lower than analysts' estimates and down 2.4% from a year earlier. Revenue rose 2% to \$3.29 billion.

Last year, the Montreal-based company experienced some of the largest volume growth witnessed in the last decade; however, by the end of the year, demand had exceeded capacity.

CN Rail operating expenses rose 9% in the latest quarter, mainly due to higher costs from increased volumes, a harsh winter, and higher fuel prices.

CN Rail operating ratio was 60.4% for the quarter, higher than 56.6% last year.

To help resolve the capacity constraint issue, the railway company plans to hire additional staff this year and is planning a capital program of \$3.2 billion, with \$700 million to expand its capacity. However, additional new capacity likely won't be available until the second half of 2018, so performance will be hurt until then.

On the plus side, CN Rail raised its dividend by 10% to \$0.455 per share quarterly, which gives a yield of 1.88%.

The railway company had an adjusted diluted EPS of \$4.99 in 2017, and is expected to have an average annual EPS growth of 10% for the next five years. CN has a PEG ratio of 1.7 and a ROE of 25%.

Which railway company stands out?

CN Rail will get back on track eventually, but in the meantime, CP Rail is on a better track.

CP's earnings are growing faster than those of CN, and CP's ROE is higher, suggesting that CP is more profitable than CN. CP also has a lower PEG, meaning that it is cheaper than CN, so investors pay less for more growth. CP is also raising its dividend faster than CN.

For these reasons, I would choose CP Rail over CN Rail.

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2. NYSE:CP (Canadian Pacific Railway)
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