Expect This Railroad to Beat the Market

Description

Railways are a key economic driver and are particularly attractive in a growing economy. Of late, Canada's largest railway company, **Canadian National Railway** (TSX:CNR)(NYSE:CNI), has underperformed the market and **Canadian Pacific Railway Limited** (TSX:CP)(NYSE:CP). Year to date, the company has lost approximately 9% of its value, while Canadian Pacific has managed to eke out a 0.65% gain. CN Rail's downtrend has presented investors with an opportunity to pick up this dividend aristocrat at a rare discount.

The company's underperformance has been two-fold. First, the company's 2018 guidance came in below analyst's expectations. This led to an immediate 2% drop in its share price. Second, the company has been blamed and has taken ownership of the grain supply issues in western Canada. In response, the company removed CEO Luc Jobin and has earmarked approximately $250 million in 2018 to expand operations in western Canada. The company's logistical challenges and departure of its CEO led to analyst downgrades and further downward pressure on the stock.

Although coal and oil shipments have slowed, CN Rail is not a one-trick pony. The company is well diversified with approximately 20,000 miles of tracks across North America that connect the Atlantic and Pacific oceans and the Gulf of Mexico. It carries over 300 million tonnes of cargo, serving exporters, importers, retailers, farmers, and manufacturers, and its freight includes seven different commodities. Furthermore, evidence points to pipeline capacity issues in western Canada fueling increased demand for crude rail shipments in 2018.

Thanks to its recent slide, CN Rail is now trading at more attractive valuations than Canadian Pacific. The company is trading at a discount to Canadian Pacific's price-to-book and price-to-earnings ratios. Likewise, CN Rail has a considerably higher profit margin and is significantly less leveraged than Canadian Pacific.

CN Rail has proven to be a reliable option for income investors. It currently ranks ninth on the Canadian dividend aristocrat list, with a 23-year dividend-growth streak. It has a 10-year double-digit dividend-growth rate and currently yields 1.92% — the highest it's been in over five years. In comparison, mis-management led to CP Rail suspending its dividend growth between 2013 and 2015, and it lost its status as a dividend-growth company. It has a small two-year dividend-growth streak, and its less than 1% yield is unimpressive.

CN Rail's recent slide been categorized as a symptom of expanding too much, too quickly. Historically, CN Rail has commanded a premium over Canadian Pacific, but at today's prices, CN Rail is now the one discounted. Investors are encouraged to be opportunistic and pick up this dividend aristocrat, which has handily beaten the market over the past three, five, and 10 years.

CATEGORY

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