Do You Really Want to Buy These Railroad Stocks at 5 Times Their Book Value?

Description

Railway stocks are some of the best-known investment choices in the infrastructure sector. While they tend to be overvalued and rarely sell for anything near their book price, rail stocks are often seen to be dependable, and have long been a favourite of domestic investors looking for dividends.

Here are two of the very best Canadian railroad stocks with one from the U.S. for comparison. However, do you really want to buy railway stocks with these kinds of valuations?

Canadian National Railway (TSX:CNR)(NYSE:CNI)

“North America’s Railroad” is today overvalued by almost twice its future cash flow value. What other signs do we have that this stock is overvalued? We have a P/E of 15.6 times earnings, which isn’t too bad, although Canadian National Railway also has a PEG of 2.7 times growth, which highlights a 5.7% expected annual growth in earnings.

The real no-no here, though, is that P/B of 5 times book. In short, if Canadian National Railway had to replace everything in its inventory tomorrow, it would cost five times less per share than you would be paying for it. Perhaps a dividend yield of 1.55% makes up for this, though income investors may want to look elsewhere.

Canadian Pacific Railway Ltd. (TSX:CP)(NYSE:CP)

Overvalued by about double its future cash flow value, Canadian Pacific Railway has very similar multiples to its domestic competitor above: a P/E of 16.2 times earnings, PEG of twice growth (again, reflecting a low 8.2% expected annual growth in earnings), and P/B of 5.5 times book. Add in a dividend yield of 1.02% and you have a seemingly unremarkable stock at present.

Union Pacific Corp. (NYSE:UNP)

At $149 a share, Union Pacific is fairly priced today, at only $10 over its future cash flow value. The rest of its value indicators are mediocre: a very good P/E of 10.2 times earnings is let down by a high PEG of 3.7 times growth, and an overheated P/B ratio of 5.5 times book. A 2.7% expected annual growth in earnings is testament to the fact that nobody seems to be laying railway tracks anymore.

However, Union Pacific pays a better dividend yield than that of its two Canadian competitors here, at 2.15%. Also compare Union Pacific's return on equity 57% last year to Canadian National Railway's 32% or Canadian Pacific Railway's 35%, and it would appear that American railways are making better use of shareholder's input.

The bottom line

As predicted, the three stocks here are trading nowhere near their book prices, with P/B ratios all somewhere around the five times book region. Growth is fairly low across the board, with our American pick giving the lowest reading for expected future earnings. However, Union Pacific offers the best dividend, and has the highest ROE, meaning that shareholder interaction is more integral to its business model.

Would-be investors should look to the U.S. and Canadian economies, as well as any overseas contracts that could drive hidden growth — and therefore hidden upside. All three stocks would have been great buys when their stocks were better valued. Without that upside, though, these railroad stocks look like they've stalled for now.

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