Better Railway Stock: Canadian National Railway (TSX:CNR) or Canadian Pacific Railway (TSX:CP)?

Description

Rail transport isn't the trendiest industry in the world. But with the backing of billionaires like Warren Buffett and Bill Gates, it has the smart money seal of approval. In 2009, Warren Buffett made waves by investing in the old school rail company BNSF, citing rail's cost efficiency over other transportation methods. Since then, BNSF has turned into a major money maker for Buffett's **Berkshire Hathaway**, proving The Oracle right yet again.

In Canada, the rail industry's overperformance has been even more pronounced than it has been globally. Whereas the TSX has returned just 3% over the past 12 months, **Canadian National Railway** (TSX:CNR)(NYSE:CNI) and **Canadian Pacific Railway** (TSX:CP)(NYSE:CP) have together averaged 16.5%.

The numbers don't lie: Canadian Railways are outperforming the benchmark. But between the two big players, which is the better stock? We can start by looking at earnings and balance sheet metrics.

Growth and financial soundness

Both CN and Canadian Pacific are financially healthy, growing companies. CN has $41 billion in assets compared to just $11 billion in long-term debt, with a 16% revenue growth rate and 24% year-over-year adjusted EPS growth. Canadian Pacific, on the other hand, has $21 billion in assets compared to $14 billion in liabilities, along with 17% revenue growth and a 28% increase in operating income.

EPS situation explained

If you've perused CN and/or Canadian Pacific's recent reports, you may have noticed that both companies reported major GAAP earnings declines in spite of strong growth in revenue and operating income. This is because both companies were impacted in U.S. tax law changes that caused net income to spike in Q4 of 2017.

Basically, the companies received influxes of cash from taxes they had already paid that were refunded. Such windfalls do not recur, so naturally GAAP net income was much lower in Q4 2018 than in the same period of 2017 for both companies. Consequentially, metrics like operating income, free cash flow and adjusted EPS are better ways to both companies' Q4 2018 results.

Dividend income

Finally, we get to the topic of dividends. Both CN and Canadian Pacific are dividend payers, with the former yielding 1.74% and the latter yielding 0.99%. CN has the higher yield between the two. It also has the higher five-year dividend growth rate, at 16.8%, although Canadian Pacific has the higher three-year growth rate at 21.5%. Both of these companies are increasing their dividends at above average rates, although CN's long-term trajectory seems to offer slightly more income potential.

Bottom line

Railway stocks are great contrarian buys in early 2019. With strong growth, low P/E ratios and modest but fast-growing dividend income, these stocks are set to outperform. Both CN railway and Canadian Pacific Railway are great picks. However, with both stocks roughly the same in terms of financial health and earnings growth, I'm inclined to give CN the nod just because of its higher dividend yield.

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Date
2025/08/18
Date Created
2019/02/16
Author

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