TFSA Investors: Railroads Speed Down the TSX

Description

Savvy investors interested in betting on the transportation industry next year should consider the **Canadian Pacific Railway** (TSX:CP)(NYSE:CP) or **Canadian National Railway** (TSX:CNR)(NYSE:CNI).

Last year, the transportation industry performed well on the Toronto Stock Exchange, averaging capital returns of approximately 20%. Much of that gain is due to the superior market performance of the Canadian Pacific Railway. As one of Canada's oldest railroads, Canadian Pacific stock outperformed the industry with a share price surge of around 23%.

Canadian National Railway lagged behind Canadian Pacific on the stock exchange. Nonetheless, next year could be its turn to deliver alpha-level returns to shareholders. The company has released exciting news about expanding partnerships and record-high agricultural shipments.

Canadian National Railway

Founded in 1919, CN transports enterprise cargo for export and import. The railway serves retailers, farmers, and manufacturers in the transport of products throughout Canada and the United States. CN boasts strong business relationships with **GM**, **Imperial Oil**, and **Suncor**.

Last week, Canadian National announced GM as the first tenant of CN's new Vancouver automotive compound. CN will continue to transport finished vehicles and assembly parts on behalf of GM.

In the company's 2018 annual earnings report, CN announced diluted earnings per share (EPS) of $5.87 and a 10% increase in revenue from 2017. Canadian National offers shareholders almost twice the free cash flow of Canadian Pacific Railway. Many investors consider free cash flow as one of the best measures of profitability because it accounts for capital investment expenditures.

Canadian Pacific Railway

Founded in 1881, CP is one of Canada's most significant engineering projects. The corporation transports grain, fertilizer, sulphur, and other products for the agricultural industry. Also, the automotive and natural resource industries rely on the railway to connect the North American supply chain throughout Canada and the United States.

In the company's 2018 annual earnings report, CP announced a revenue increase of 12% along with diluted earnings per share of $13.61, 2.3 times the diluted earnings of CN. CP emphasizes improved operating ratio in its business strategy. To deliver shareholders the most value, the company strives to increase its train's speed and length while decreasing idle time at terminals.

Foolish takeaway

While Canadian Pacific will give investors more value per share than Canadian National, CP stock is also 2.5 times more expensive than CN. These valuations seem appropriate when considering the differences in EPS between the two stocks. Given that CP offers 2.3 times more earnings per share than CN, it makes sense that it would also trade at 2.5 times CN's share price.

However, it seems as if Canadian Pacific's run-up in price may be leveling off. To justify further capital gains, Canadian Pacific would need to increase the value per share it offers investors relative to Canadian National.

Moreover, Canadian National distributes a higher percentage of its earnings to shareholders. Canadian National's five-year average dividend yield is 1.59%, while Canada Pacific only offers an average dividend yield of 0.88%.

Thus, investors may want to bet on higher relative performance from Canadian National next year as prices normalize between the two competing stocks.

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Author
debraray