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

Description

It has been a while since I've taken a look at Canada's premier railroad companies. In fact, if you are interested in TSX-listed railroads, then there are only two options: **Canadian Pacific Railway** (TSX:CP)(NYSE:CP) and **Canadian National Railway** (TSX:CNR)(NYSE:CNI).

As Canada's only publicly listed railroads, they form an industry duopoly. Given the strength of the railway business model, both companies make excellent investments. However, at any given time, there is usually one that stands out above the other.

Which one is the better buy today? Let's take a look.

Performance

The railroad is a cyclical industry that is intrinsically linked to the economy. As rail operators ensure the flow of goods across the country, growth is dependent on a strong economy.

Recently, there have been signs that inflation is slowing and the inverted yield curve has raised concerns of an impending recession. If we enter a recession, it won't be a good thing for rail operators. Consumers tend to save more and spend less, which leads to less consumption.

It's why Federal banks cut interest rates. This makes saving less appealing and encourages spending which in turn, keeps the economic engine turning. A good thing for railways. Declining rates are also a positive because it will mean lower interest expense as railways are a capital intensive business.

It is therefore not surprising to see Canada's railroads post strong results in this environment. Year to date, CP Rail is up 27.49%, which tops the 20.49% posted by CN Rail.

Looking further out, CN Rail has outperformed as its share price has jumped by an average of 10% annually. In comparison, CP Rail has averaged 7.3% annual growth.

Edge: It's a tie! Whereas CP has outperformed over the short term, CN shareholders have enjoyed greater long-term returns.

Valuation

Now that we have established both have a history of delivering consistent returns, which stock provides the best value today?

Canadian Pacific is currently trading at 19.42 times earnings and has P/E to growth (PEG) ratio of 2.85. Over the next five years, the company is expected to grow earnings by 8.23% annually. The company isn't cheap, and it's trading at an 8% premium to its historical average of 17.95 times earnings.f

It is a similar case at Canadian National, which is trading at 20.41 times earnings with a PEG ratio of 3.07. It is trading at a steep 24.37% premium to its historical P/E of 16.41 and it has a slightly higher expected five-year growth rates (8.45%).

Edge: Although neither company is cheap, Canadian Pacific is trading at a more reasonable valuation.

Dividend

Canada's railroads also have a storied history of dividend growth. Canadian National Railway is a Canadian Dividend Aristocrat with a 24-year dividend growth streak. This is tied for the tenth-longest dividend growth streak in Canada. The company yield's 1.77% and has grown its dividend by an annual average rate of 15% over the past 10 years.

For its part, Canadian Pacific has a modest four-year dividend growth streak. It was once a Dividend Aristocrat, but lost its status after a period of dividend stagnation. It has a negligible 1.07% yield, although it last raised dividends by 27% this past June and has shown a renewed commitment to growing the dividend.

Edge: There is no contest here: Canadian National Railway is the better option for income investors.

Canada's top railroad stock

This was a tough call, but today I'm giving the edge to CP Rail.

From a technical perspective, neither company has the momentum advantage and neither one is cheap. At current levels, I would rate them both a neutral. However, Canadian Pacific's relative valuation makes it a slightly better buy today.

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mlitalien