



## Top Railroad Stocks in Canada: Buy, Wait, or Sell?

### Description

**Canadian National Railway** ([TSX:CNR](#))([NYSE:CNI](#)) and **Canadian Pacific Railway** ([TSX:CP](#))([NYSE:CP](#)) are the only class I railroads in Canada. This categorization implies they're large in scale and, on average, more fuel efficient than transportation by truck.

Both railway companies have operations in Canada and the United States, which improves the convenience of their clients. CN Rail's more than 31,500-km network spans Canada and Mid-America, connecting three coasts: the Atlantic, the Pacific, and the Gulf of Mexico. CP Rail has direct links to major ports on the west and east coasts.

## Canada's railroad stocks deliver homerun returns

The two large Canadian railway stocks have been great long-term investments. Since 2008, CN stock has been more than six-bagger, delivering total returns of more than 15% per year. In the same period, CP stock has delivered even more impressive returns of about 16% per year with a tad more volatility.

In the long run, the business performance of the railroad companies will depend more or less on the health of the economy. The following section illustrates how the economic boom and bust can impact their financial results.

## Pandemic impacts on railroad stocks in Canada

The first COVID-19 case was detected on December 31, 2019, but the situation started looking serious in March, as global cases started surging. This resulted in shutdowns in certain parts of the economy, particularly, in the second quarter.

By looking at the year-to-date results of CN Rail and CP Rail, we can get an idea of the pandemic impacts on the companies. Overall, CP's results have been more resilient than CN's.

In the first nine months of 2020, CN Rail reported revenue of \$10,163 million, down 10% year over

year (YOY). Adjusted net income was \$2,763 million, a decline of 16%.

Adjusted earnings per share (EPS) shrunk 15% to \$3.87. That said, CN Rail managed to increase its free cash flow (FCF) by 39% to \$2,087 million, primarily with a large (70%) reduction in its stock repurchase program against the same period last year.

In the same period, CP Rail reported revenue of \$5,698 million, which was essentially flat YOY. Adjusted net income was \$1,720 million, an increase of 5%. Adjusted EPS climbed 8% to \$12.62. CP Rail managed to generate FCF of \$476 million.

Although its FCF generation was notably lower than the amount of \$810 million generated in the comparable period in the prior year, it's important to highlight that CP repurchased a similar amount, more than \$900 million, of common stock.

## Current valuations

Despite the dip in its top and bottom line, CN stock is still up about 14% year to date. This already accounts for the 8% drop it experienced since it reported its Q3 earnings results a week ago. The selloff is likely due to the full valuation the stock is trading at.

At about \$135 per share, CN stock trades at about 23.2 times its normalized earnings. The stock would be more reasonably valued at a multiple of, say, 20, which would align more closely with its long-term normal P/E, representing a price target of \$116 and another potential sell off of about 14%.

Since CP is expected to grow its EPS this year, it makes more sense to use a forward estimated P/E of about 23.3. Since CP Rail is expected to grow EPS at a higher rate than CN Rail, CP stock is a better buy.

## The Foolish takeaway: Should you buy, wait, or sell?

[CN Rail](#) and [CP Rail](#) are great businesses. They are doing well even through this pandemic and will do even better in years of economic growth. If you already own the stocks, you might choose to hold them given their track record of outperformance.

However, the stocks are pretty fully valued. So, near-term upside is limited. Interested investors may be better off waiting for consolidation or a more meaningful sell off before buying with new money.

### CATEGORY

1. Coronavirus
2. Dividend Stocks
3. Investing
4. Stocks for Beginners

### TICKERS GLOBAL

1. NYSE:CNI (Canadian National Railway Company)
2. NYSE:CP (Canadian Pacific Railway)

3. TSX:CNR (Canadian National Railway Company)
4. TSX:CP (Canadian Pacific Railway)

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