CN Rail (TSX:CNR) or CP Rail (TSX:CP): Better TFSA Buy?

Description

What a glorious run it's been for shares of **CN Rail** (TSX:CNR)(NYSE:CNI) and **CP Rail** (TSX:CP)(NYSE:CP) over the past several months. Both major railways will play a major role in lifting the Canadian economy out of its funk over the next several quarters.

With volumes likely to pick up traction into 2021, I think the recent dip in both rail stocks are buyable for TFSA investors looking for excess risk-adjusted returns as the world looks to recover from the coronavirus crisis. But which, if any, is the better buy for your TFSA portfolio at this juncture? Let's have a closer look at each name.

CN Rail

At the time of writing, CN Rail stock is down just shy of 9% from its high due to what I believe is a massive overreaction to the firm's sub-par quarterly results, which doesn't appear to change the 2021 recovery trajectory.

While CN Rail stock's valuation may have gotten ahead of itself going into the quarter, the name is worthy of a premium multiple as the stage looks set for a big revenue bump alongside what could be a huge improvement to its operating ratio, which, as you'd expect, has dragged for most of the year thanks to the disruptive crisis.

CN Rail is known as North America's most efficient railway for a reason. Why the firm's operating ratio (OR) deterioration may be concerning to some, I think the firm will have little trouble getting its OR back down to the mid-single-digits coming the coming year.

Even after the recent correction, CNR stock still looks pricy at 21.3 times next year's expected earnings and 7.0 times sales. Given the upside to be had in a 2021 economic recovery, though, I'd say the slightly less frothy premium price tag is well worth paying, especially given the relative degree of downside protection you'll get from the name if next year's recovery ends up being far rockier than most are expecting.

CP Rail

CP Rail stock has retreated alongside its peer, with shares now down 5.6% from its high. The number two Canadian railway has done a magnificent job of staying operationally efficient (58.2% operating ratio as of the last quarter) despite the profound pressures brought forth by the coronavirus crisis.

The railway's free cash flow (FCF) took a step back but is poised to bounce back abruptly next year alongside the Canadian economy. Management recently raised its 2020 guidance modestly and is now calling for at least mid-single-digit EPS growth.

At the time of writing, CP stock trades at 20.1 times forward earnings, and like CN, 7.0 times sales. CP has a lofty premium multiple that bakes in a strong economic recovery in 2021. Kay Ng, my colleague here at the Motley Fool, thinks that CP Rail is a better buy than CN Rail because of higher nearer-term EPS growth expectations.

Is CN Rail or CP Rail the better rail stock to buy for your TFSA right now?

Kay and I have agreed with one another on numerous occasions in the past. But this time, I'm afraid I have to disagree when she says CP Rail is the better rail stock to buy here.

CN Rail, I believe, is the far better bet following its 9% dip, as I see greater potential for margin improvement over the year ahead (CN's OR swelled to 60%, but looks poised to revert to the mid-50s). Moreover, CN's earnings bar looks to be that much lower following its brutal recent post-earnings flop.

As such, I think CN Rail stock is a far better bet and think shares have greater upside potential versus the likes of its smaller brother over the next 18 months.

CATEGORY

1. Coronavirus
2. 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)

PARTNER-FEEDS

1. Business Insider
2. Koyfin
3. Msn
4. Newscred

5. Quote Media
6. Sharewise

Category

1. Coronavirus
2. Stocks for Beginners

Date
2025/07/03
Date Created
2020/10/28
Author
joefrenette