

## Canadian Pacific(CP)

**\$270.15** (As of 02/11/20)

Price Target (6-12 Months): **\$284.00**

Long Term: 6-12 Months

**Zacks Recommendation:**

**Neutral**

(Since: 02/14/19)

Prior Recommendation: Outperform

Short Term: 1-3 Months

**Zacks Rank:** (1-5)

**3-Hold**

Zacks Style Scores:

VGM:D

Value: D

Growth: C

Momentum: F

### Summary

Shares of Canadian Pacific have outperformed its industry in a year, mainly on higher freight revenues and its consistent efforts to add shareholder value. With freight revenues rising 6.4% in 2019, the top line grew 6.5%. As far as shareholder-friendly measures are concerned, the company returned \$1.5 billion to shareholders via buybacks and dividends in 2019. Canadian Pacific's 2020 earnings view is also encouraging. Additionally, the company's acquisition of Central Maine & Quebec Railway strengthened its presence in eastern United States. However, declining coal volumes raise concerns. Segmental volumes declined 8% in the fourth quarter, inducing a 10% decrease in revenues. The downtrend is expected to continue in 2020 due to low natural gas prices and other factors. High debt levels also raise concerns.

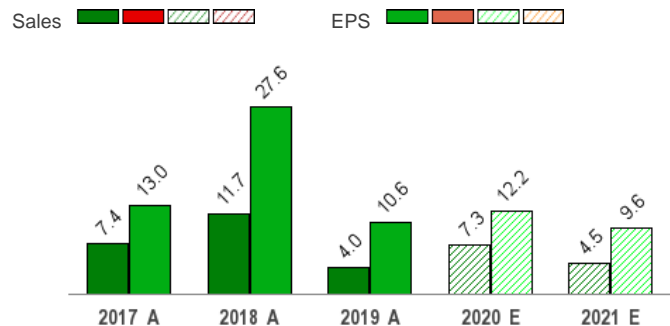
### Price, Consensus & Surprise



### Data Overview

52 Week High-Low	\$275.13 - \$195.34
20 Day Average Volume (sh)	388,322
Market Cap	\$37.0 B
YTD Price Change	6.0%
Beta	1.11
Dividend / Div Yld	\$2.51 / 0.9%
Industry	<a href="#">Transportation - Rail</a>
Zacks Industry Rank	Bottom 35% (166 out of 254)

### Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	1.7%
Last Sales Surprise	1.0%
EPS F1 Est- 4 week change	-0.2%
Expected Report Date	04/28/2020
Earnings ESP	0.0%

### Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021					6,583 E
2020	1,431 E	1,581 E	1,600 E	1,648 E	6,302 E
2019	1,329 A	1,478 A	1,496 A	1,568 A	5,872 A

### EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021					\$15.24 E
2020	\$2.76 E	\$3.51 E	\$3.77 E	\$3.86 E	\$13.90 E
2019	\$2.09 A	\$3.21 A	\$3.48 A	\$3.61 A	\$12.39 A

\*Quarterly figures may not add up to annual.

P/E TTM	21.8
P/E F1	19.4
PEG F1	1.7
P/S TTM	6.3

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 02/11/2020. The reports text is as of 02/12/2020.

## Overview

Canadian Pacific Railway Limited, founded in 1881 and headquartered in Calgary, Canada, operates a transcontinental railway network in Canada and the United States. The company focuses on providing logistics and supply chain expertise services.

Canadian Pacific serves the principal business centers of Canada from Montreal to Vancouver, as well as the U.S. Northeast and Midwest regions. The company has extended its network reach by establishing alliances and agreements with other Class I railways in North America, which allows it to provide services and access markets across North America beyond its own rail network. As of December 31, 2018, Canadian Pacific operated 18,264 track miles.

Canadian Pacific also serves markets in Europe and the Pacific Rim through direct access to the Port of Montreal in Quebec, and the Port of Vancouver in British Columbia, respectively. Moreover, its equipment includes owned and leased locomotives, railcars etc. At 2018-end, 1,389 locomotive units were owned and 34 leased.

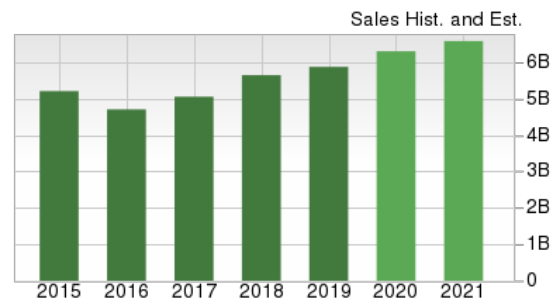
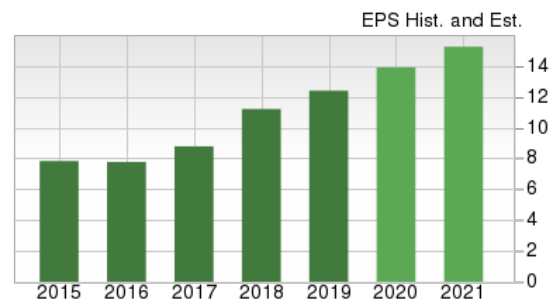
Canadian Pacific is constantly looking to cut costs in a bid to drive bottom-line growth. To this end, operating ratio (operating expenses as a percentage of revenues) improved 540 basis points to 61.3% in 2018. The precision scheduled railroading model adopted by Canadian Pacific is enabling it to control costs. The model improves efficiencies and optimizes assets.

Canadian Pacific derives revenues from **Freight transport** (accounted for approximately 97.8% of the total revenues generated by the company in 2018) and **Other** (non-freight) **services** (2.2%).

Freight revenues, which improved 12% year over year in 2018, are earned from transporting bulk, merchandise and intermodal goods, and include fuel recoveries billed to the customers. Freight segment consists of Grain (22% of freight revenues in 2018), Coal (9%), Sulfur and Fertilizer (3%), Forest products (4%), Energy ,Chemicals and Plastics (17%), Metals, Minerals and Consumer products (11%), Potash (7%), Automotive (5%) and Intermodal (22%).

Other revenues are generated mainly from leasing of certain assets, switching fees, routine land sales and income from business partnerships.

Notably, the company's fiscal year coincides with the calendar year.



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## Reasons To Buy:

- ▲ We are impressed with the company's efforts to reward investors through share buybacks and dividend payments. In May 2019, the company hiked its dividend payout by 27.5% to C\$0.83 per share (C\$3.32 annually). Evidently, this raise marks the fourth straight year of dividend increase. The company is also active on the buyback front. The company completed the 4% share buyback program launched in October 2018. Through the program, Canadian Pacific returned more than \$1.6 billion to shareholders, repurchasing 5.7 million shares. Moreover, last December, the company received acceptance from Toronto Stock Exchange for its new share repurchase program to purchase (for cancellation) up to 4.8 million shares under a normal course issuer bid (NCIB). The NCIB commenced on Dec 20, 2019 and will run through Dec 19, 2020. Additionally, during 2019, the company returned \$1.5 billion to shareholders through share buybacks and dividends. Impressive free cash flow generation should lead to a further uptick in such shareholder-friendly activities. Notably, the company's free cash flow increased 5% year over year to \$1.4 billion in 2019.
- ▲ The company's top line is benefiting from impressive freight revenues at key units. With freight revenues rising 6.4% in 2019, the company's top line grew 6.5%. Consistent improvement in operating ratio (operating expenses as a percentage of revenues) is also appreciative. This key metric improved 140 basis points to 59.9% in 2019. Lower the value of the metric the better. The metric is expected to improve in the current year as well. The company's 2020 earnings view also holds promise. For the current year, earnings are anticipated to rise in the high single-digit to low double-digit range from C\$16.44 reported in 2019. Additionally, volumes (measured by revenue ton miles) are expected to expand in mid-single digits.
- ▲ The company's acquisition of Central Maine & Quebec Railway (CMQ), completed in December 2019, should foster growth going forward. Apart from strengthening the company's presence in the eastern United States, the buyout enhances customer experience by providing a smooth, secure and efficient access to the ports at Searsport, ME, and Saint John, New Brunswick via Eastern Maine Railway Company (EMRY) and New Brunswick Southern Railway (NBSR). Canadian Pacific's automotive unit is projected to continue with its impressive show in 2020 (revenues rose 9% in 2019), reaping benefits from a full-year of Vancouver auto compound. Substantial rise in revenues (23% in 2019) at the Energy, chemicals and plastics unit is also noteworthy.

The company's 2020 earnings outlook raises optimism. Its measures to add shareholder value are also impressive.

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### Reasons To Sell:

- ▼ Slump in coal volumes is quite worrisome and may hurt prospects in the subsequent quarters. With volumes shrinking 8% in the fourth quarter, revenues fell 10% at the unit. Coal volumes are predicted to slide slightly in 2020 as well due to multiple factors including low natural gas prices that are affecting U.S. coal volumes significantly. Additionally, escalating operating expenses might dent the bottom line moving ahead. Notably, operating expenses rose 4.1% in 2019.
- ▼ With Canadian Pacific investing significantly to upgrade its facilities, the company is incurring significant amount of capital expenses. Capital expenditures increased 6.2% year over year to C\$1.65 billion in 2019. The same is projected around C\$1.6 billion in 2020. This is limiting bottom-line growth.
- ▼ Canadian Pacific is a highly leveraged company. This is indicated by the fact that the ratio of its long-term debt-to-capitalization (expressed as a percentage) currently reads 53.5. This compares unfavorably to the figure of 48.8 for its industry. Its debt-to-equity (expressed as a percentage) currently exceeds 100. A high debt-to-equity ratio implies that the company is funding most of its ventures with debt.

Soft coal volumes and higher operating expenses may affect growth.

## Last Earnings Report

### Canadian Pacific Q4 Earnings & Revenues Beat

Canadian Pacific's fourth-quarter 2019 earnings (excluding 4 cents from non-recurring items) of \$3.61 per share (C\$4.77) surpassed the Zacks Consensus Estimate of \$3.55. Quarterly earnings also increased 5% year over year despite higher operating expenses.

Quarterly revenues of \$1,567.6 million (C\$2.07 billion) surpassed the Zacks Consensus Estimate of \$1,551.5 million. The top line also inched up 3% year over year on rise in freight revenues.

Freight revenues rose 3.1% year over year and contributed 97.8% to the top line. Notably, the company's freight segment consists of Grain (up 4%), Coal (down 10%), Potash (down 26%), Fertilizers and sulfur (down 11%), Forest products (up 3%), Energy, chemicals and plastics (up 33%), Metals, minerals and consumer products (down 14%), Automotive (up 13%) and Intermodal (down 1%). In the reported quarter, total freight revenues per revenue ton-miles (RTMs) were up 6% year over year. Also, total freight revenues per carload climbed 4% from the year-ago reported figure.

Operating income inched up 1.8% in the quarter under review. Operating expenses climbed 4% year over year. Operating ratio (operating expenses as a percentage of revenues on an adjusted basis) deteriorated to 57% from 56.5% in the prior-year quarter. Notably, lower value of this key metric bodes well. Capital spending during 2019 was C\$1.65 billion.

### Liquidity

The company exited the fourth quarter with cash and cash equivalents of C\$133 million compared with C\$61 million at the end of 2018. Long-term debt amounted to C\$8.16 billion compared with C\$8.19 billion in December 2018.

### 2020 Outlook

The company anticipates its 2020 adjusted earnings per share to increase in the high single-digit to low double-digit range from C\$16.44 reported in 2019. Volume growth (measured by revenue ton miles) is expected in mid-single digits. Capital expenditures are estimated at \$1.6 billion.

Quarter Ending **12/2019**

Report Date	Jan 29, 2020
Sales Surprise	1.04%
EPS Surprise	1.69%
Quarterly EPS	3.61
Annual EPS (TTM)	12.39

## Recent News

### Dividend Update — Jan 28, 2020

Canadian Pacific's board cleared a quarterly cash dividend of C\$0.83 per share. The amount is payable to shareholders on Apr 27, 2020, of record as of Mar 27.

### New Buyback Program — Dec 18, 2019

Canadian Pacific received acceptance from Toronto Stock Exchange for its new share repurchase program to buy (for cancellation) up to 4.8 million shares under a normal course issuer bid (NCIB). The NCIB commenced on Dec 20, 2019 and will run through Dec 19, 2020. Under its previous NCIB (which expired on Oct 23, 2019), the company bought back 5.68 million shares at an average price of \$283. Canadian Pacific repurchased approximately 41 million shares since 2014.

### Development of Multi-Commodity Transload Terminal – Nov 22, 2019

Canadian Pacific plans to build a multi-commodity transload terminal near its Côte Saint-Luc yard in Montreal. The company collaborated with TYT Group, a freight transportation service provider in Quebec, to realize this project. The new transload terminal will provide customers with multi-commodity transload services and logistics solutions in core urban centers along the east coast, thus extending Canadian Pacific's foothold in markets without direct access to rail. Additionally, it will help the company expand its footprint in the Montreal area. The terminal will be operated by TYT Group.

## Valuation

Canadian Pacific's shares are up 36.7% over the trailing 12-month period. Over the past year, stocks in the Zacks sub-industry and the Zacks Transportation sector are up 14.3% and 2.7% respectively.

The S&P 500 index is up 21.1% in the past year.

The stock is currently trading at 19.22X forward 12-month price to earnings, which compares to 18.25X for the Zacks sub-industry, 13.14X for the Zacks sector and 19.3X for the S&P 500 index.

Over the past five years, the stock has traded as high as 20.8X and as low as 12.26X, with a 5-year median of 16.9X. Our Neutral recommendation indicates that the stock will perform in-line with the market. Our \$284 price target reflects 20.2X forward 12-month earnings.

The table below shows summary valuation data for CP

Valuation Multiples - CP					
		Stock	Sub-Industry	Sector	S&P 500
P/E F 12M	Current	19.22	18.25	13.14	19.3
	5-Year High	20.8	19.35	17	19.34
	5-Year Low	12.26	13.46	10.48	15.18
	5-Year Median	16.9	16.68	13.16	17.47
P/B TTM	Current	6.77	5.88	3.23	4.33
	5-Year High	9.16	5.94	4.65	4.42
	5-Year Low	4.24	2.21	2.68	2.85
	5-Year Median	5.87	4.41	3.41	3.62
P/S F 12M	Current	5.84	5.55	1.13	3.56
	5-Year High	6.02	5.55	1.44	3.56
	5-Year Low	3.06	3.04	1.02	2.54
	5-Year Median	4.6	4.43	1.21	3

As of 02/11/2020

## Industry Analysis Zacks Industry Rank: Bottom 35% (166 out of 254)



## Top Peers

Berkshire Hathaway Inc. (BRK.B)	Neutral
Canadian National Railway Company (CNI)	Neutral
Kansas City Southern (KSU)	Neutral
Norfolk Southern Corporation (NSC)	Neutral
Union Pacific Corporation (UNP)	Neutral
United Parcel Service, Inc. (UPS)	Neutral
WEST JAPAN RAIL (WJRY)	Neutral
CSX Corporation (CSX)	Underperform

Industry Comparison Industry: Transportation - Rail				Industry Peers		
	CP Neutral	X Industry	S&P 500	CNI Neutral	CSX Underperform	KSU Neutral
<b>VGM Score</b>	<b>D</b>	-	-	<b>F</b>	<b>D</b>	<b>C</b>
Market Cap	37.01 B	37.01 B	24.17 B	67.35 B	61.43 B	16.37 B
# of Analysts	10	6	13	10	9	7
Dividend Yield	0.94%	1.69%	1.77%	1.72%	1.22%	0.94%
<b>Value Score</b>	<b>D</b>	-	-	<b>D</b>	<b>D</b>	<b>D</b>
Cash/Price	0.00	0.03	0.04	0.01	0.03	0.01
EV/EBITDA	14.98	12.13	13.89	13.37	11.79	15.50
PEG Ratio	1.72	1.93	2.05	1.93	1.46	1.41
Price/Book (P/B)	6.85	3.59	3.27	4.95	5.18	3.45
Price/Cash Flow (P/CF)	17.73	14.01	13.60	15.48	13.13	15.75
P/E (F1)	19.44	19.09	19.00	20.11	18.70	21.20
Price/Sales (P/S)	6.30	4.96	2.66	5.99	5.15	5.71
Earnings Yield	5.15%	5.24%	5.26%	4.97%	5.35%	4.72%
Debt/Equity	1.15	0.78	0.71	0.66	1.35	0.68
Cash Flow (\$/share)	15.23	6.09	6.89	6.09	5.98	10.81
<b>Growth Score</b>	<b>C</b>	-	-	<b>D</b>	<b>B</b>	<b>B</b>
Hist. EPS Growth (3-5 yrs)	10.99%	10.99%	10.85%	6.49%	21.86%	9.46%
Proj. EPS Growth (F1/F0)	12.18%	9.93%	7.22%	6.83%	0.67%	16.40%
Curr. Cash Flow Growth	19.36%	2.96%	8.88%	6.26%	0.86%	8.60%
Hist. Cash Flow Growth (3-5 yrs)	6.46%	5.61%	8.36%	3.06%	8.74%	5.61%
Current Ratio	0.57	0.93	1.22	0.66	1.52	1.48
Debt/Capital	53.52%	43.90%	42.90%	39.68%	57.41%	40.48%
Net Margin	31.31%	23.84%	11.81%	28.25%	27.91%	18.80%
Return on Equity	32.44%	15.87%	16.98%	23.28%	27.49%	13.69%
Sales/Assets	0.35	0.35	0.54	0.34	0.31	0.30
Proj. Sales Growth (F1/F0)	7.35%	3.83%	4.06%	5.29%	-0.91%	5.68%
<b>Momentum Score</b>	<b>F</b>	-	-	<b>D</b>	<b>D</b>	<b>B</b>
Daily Price Chg	0.91%	-0.02%	0.45%	-0.16%	-0.46%	-1.02%
1 Week Price Chg	0.45%	0.85%	2.47%	0.85%	2.00%	1.88%
4 Week Price Chg	3.17%	1.46%	0.95%	0.24%	5.17%	6.86%
12 Week Price Chg	13.47%	3.46%	5.05%	2.02%	10.58%	10.43%
52 Week Price Chg	35.35%	15.60%	16.18%	15.60%	10.40%	63.46%
20 Day Average Volume	388,322	745,456	1,999,386	876,882	4,058,848	1,138,694
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
(F1) EPS Est 4 week change	-0.20%	-0.83%	0.00%	-2.13%	-3.72%	1.19%
(F1) EPS Est 12 week change	-0.28%	-1.92%	-0.18%	-7.46%	-5.50%	0.83%
(Q1) EPS Est Mthly Chg	-2.85%	-3.76%	0.00%	-8.66%	-5.69%	-2.57%

## Zacks Style Scores

The Zacks Style Score is as a complementary indicator to the Zacks rating system, giving investors a way to focus on the highest rated stocks that best fit their own stock picking preferences.

Academic research has proven that stocks with the best Value, Growth and Momentum characteristics outperform the market. The Zacks Style Scores rate stocks on each of these individual styles and assigns a rating of A, B, C, D and F. We also produce the VGM Score (V for Value, G for Growth and M for Momentum), which combines the weighted average of the individual Style Scores into one score. This is perfectly suited for those who want their stocks to have the best scores across the board.

Value Score	<b>D</b>
Growth Score	<b>C</b>
Momentum Score	<b>F</b>
VGM Score	<b>D</b>

As an investor, you want to buy stocks with the highest probability of success. That means buying stocks with a Zacks Recommendation of Outperform, which also has a Style Score of an A or a B.

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