

Canadian Pacific(CP)

\$295.32 (As of 08/12/20)

Price Target (6-12 Months): **\$340.00**

Long Term: 6-12 Months

Zacks Recommendation:

Outperform

(Since: 07/10/20)

Prior Recommendation: Neutral

Short Term: 1-3 Months

Zacks Rank: (1-5)

2-Buy

Zacks Style Scores:

VGM:C

Value: C

Growth: C

Momentum: C

Summary

Canadian Pacific delivered better-than-expected earnings per share for second-quarter 2020 despite coronavirus-related concerns. Results are aided by low operating costs (down 11.5% year over year). The operating ratio also improved in the June quarter despite dismal revenues owing to low costs. Adoption of the precision scheduled railroading model increased efficiency and reduced costs as well. The record Canadian grain movement in the June quarter drove results too. The fact that the Zacks Consensus Estimate for current-year earnings has moved 2.8% north over the past 60 days highlights the optimism surrounding the stock. However, total carloads took a hit (down 12%) in the June quarter from muted freight revenues (down 9.3%). Moreover, high capital expenses are hurting the bottom line.

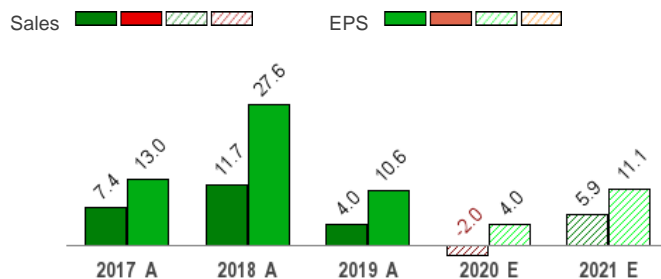
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$299.71 - \$173.26
20 Day Average Volume (sh)	399,587
Market Cap	\$40.0 B
YTD Price Change	15.8%
Beta	0.96
Dividend / Div Yld	\$2.83 / 0.8%
Industry	Transportation - Rail
Zacks Industry Rank	Bottom 17% (210 out of 253)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	6.9%
Last Sales Surprise	-0.6%
EPS F1 Est- 4 week change	5.1%
Expected Report Date	10/28/2020
Earnings ESP	0.0%

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021					6,092 E
2020	1,523 A	1,293 A	1,385 E	1,468 E	5,752 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					\$14.32 E
2020	\$3.30 A	\$2.94 A	\$3.20 E	\$3.53 E	\$12.89 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	22.2
P/E F1	22.9
PEG F1	2.0
P/S TTM	6.8

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 08/12/2020. The reports text is as of 08/13/2020.

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, 2019, Canadian Pacific operated 18,903 track miles.

Canadian Pacific, whose fiscal year coincides with the calendar year, 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 2019-end, 1,291 locomotive units were owned and 88 leased.

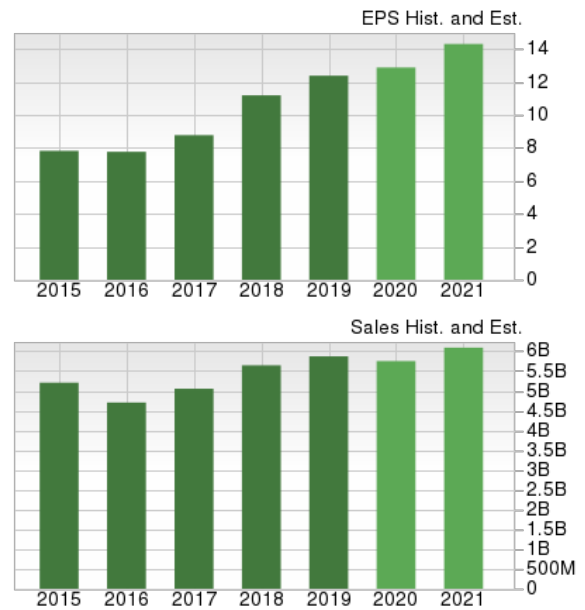
Canadian Pacific is constantly looking to cut costs in a bid to drive bottom-line growth. To this end, operating ratio (operating expenses as a percentage of revenues) improved 140 basis points to 59.9% in 2019. The precision scheduled railroading model adopted by Canadian Pacific is enabling it to control 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 2019) and Other (non-freight) services (2.2%).

Freight revenues, which improved 6% year over year in 2019, 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 2019), Coal (9%), Sulfur and Fertilizer (6%), Forest products (4%), Energy ,Chemicals and Plastics (20.1%), Metals, Minerals and Consumer products (9.9%), Automotive (4.6%) and Intermodal (20.9%).

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



Reasons To Buy:

- ▲ Canadian Pacific reported better-than-expected earnings per share in second-quarter 2020 despite coronavirus-related concerns. Results were aided by low operating costs (down 11.5% year over year). Operating ratio (operating expenses as a percentage of revenues) also improved in the June quarter, despite dismal revenues, owing to low costs. Adoption of the precision scheduled railroading model increased efficiency and reduced costs. The record Canadian grain movement in the June quarter also aided results. Notably, freight revenues from the grain segment improved 5.8% year over year.
- ▲ We are impressed by the company's efforts to reward its shareholders. To this end, the company hiked its dividend payout by 15% to C\$0.95 per share (C\$3.8 annually), mainly owing to increased efficiencies, courtesy of the precision scheduled railroading model. Notably, over the long term, the company expects adjusted dividend payout ratio in the 25-30% range. Moreover, the company decided to restart its share buyback program, which was suspended earlier this year due to coronavirus-triggered uncertainties.
- ▲ The company's acquisition of Central Maine & Quebec Railway network, should foster growth going forward. Apart from strengthening the company's presence, 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). Additionally, the company should be able to brave the challenges in the auto industry this year, by reaping benefits from a full-year of its Vancouver Automotive Compound.

The precision scheduled railroading model should continue aiding the bottom line by lowering costs.

Risks

- Canadian Pacific is suffering from freight-revenue weakness (roughly flat year over year in first-half 2020) mainly due to coronavirus-led disruptions. Weakness in freight revenues is limiting top line growth as freight revenues account for bulk of total revenues. Overall carloads (down 2% in first-half 2020) are also being hit by the above weakness. Notably, crude volumes are declining due to steep decline in demand as a result of coronavirus, among other factors. Further frac sand volumes are expected to remain under pressure due to energy market weakness. The company's automotive business is also likely to remain challenged going forward due to temporary plant shutdowns. Notably for 2020, Canadian Pacific anticipates volumes, measured in revenue ton miles, to decline in mid-single digits (prior to the coronavirus woes volumes were expected to rise in mid-single digits).
 - 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. Such high capital expenditures amid adversities can have a significant impact on the bottom line.
 - Canadian Pacific is a highly leveraged company. The company's long-term debt at the end of the second quarter was \$9.5 billion, compared with \$8.2 billion at the end of December 2019. Additionally, the ratio of its total debt to total capital ratio at the end of the June quarter was 0.56 which is above the reading of 0.55 at 2019-end. Moreover, 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.
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Last Earnings Report

Q2 Earnings Beat at Canadian Pacific

Canadian Pacific's second-quarter 2020 earnings (excluding 42 cents from non-recurring items) of \$2.94 (C\$4.66) per share surpassed the Zacks Consensus Estimate of \$2.75. However, quarterly earnings declined 8.4% year over year. Quarterly revenues of \$1,292.8 million (C\$1,792) missed the Zacks Consensus Estimate of \$1,299.9 million. The top line also fell 12.5% on a year-over-year basis due to drop in freight revenues.

Freight revenues, contributing 97.8% of the top line, fell 9.3% on a year-over-year basis. Notably, the company's freight segment consists of Grain (up 5.7%), Coal (down 24.3%), Potash (up 7.4%), Fertilizers and sulphur (up 22.2%), Forest products (up 3.8%), Energy, chemicals and plastics (down 1.4%), Metals, minerals and consumer products (down 35.1%), Automotive (down 67.3%) and Intermodal (down 10.1%). In the reported quarter, total freight revenues per revenue ton-miles (RTMs) were up 1% year over year. Also, total freight revenues per carload climbed 3.1% from the year-ago quarter's reported figure.

Operating income declined 6.3% in the quarter under review. Operating expenses fell 11.5% year over year. Consequently, operating ratio (operating expenses as a percentage of revenues on an adjusted basis) improved to 57% in the second quarter from 58.4% in the year-ago quarter. Notably, lower value of this key metric bodes well. Increased efficiencies owing to the precision scheduled railroading model adopted by Canadian Pacific drove the metric.

Liquidity

The company exited the second quarter with cash and cash equivalents of C\$277 million compared with C\$133 million at the end of the year-ago quarter. Long-term debt amounted to C\$9,457 million compared with C\$8,158 million at the end of December 2019.

2020 Outlook

The company now anticipates adjusted earnings per share to grow on a year-over-year basis relative to 2019's adjusted EPS of \$16.44. However, capital expenditures are still anticipated to be C\$1.6 billion in 2020. Moreover, revenue ton miles are estimated to decline in mid-single digit. Effective tax rate is anticipated to be approximately at 24.8% compared to 25% previously.

Quarter Ending **06/2020**

Report Date	Jul 22, 2020
Sales Surprise	-0.55%
EPS Surprise	6.91%
Quarterly EPS	2.94
Annual EPS (TTM)	13.33

Recent News

Record Grain Movement — Jul 7, 2020

Canadian Pacific announced that it has set a monthly record in June by moving 2.76 million metric tonnes (MMT) of Canadian grain and grain products. With this, the company has broken its previous June record of moving 2.4 MMT Canadian grains in 2014.

Moreover, Canadian Pacific has also set a record by moving 8.41 MMT of Canadian grain and grain products during the second quarter of 2020. With this, the company has also broken its previously set record of moving 7.9 MMT Canadian grains in the fourth quarter of 2019.

Valuation

Canadian Pacific shares are up 15.8% and 25.8% in the year-to-date period and over the trailing 12-month period, respectively. Stocks in the Zacks sub-industry are up 7.9% while those in the Zacks Transportation sector are down 2% in the year-to-date period. Over the past year, the Zacks sub-industry and the sector are up 18% and 7.4%, respectively.

The S&P 500 Index is up 3.8% in the year-to-date period and 17.5% and in the past year.

The stock is currently trading at 21.45X forward 12-month price to earnings, which compares to 20.51X for the Zacks sub-industry, 34.21X for the Zacks sector and 22.6X for the S&P 500 index.

Over the past five years, the stock has traded as high as 21.45X and as low as 12.26X, with a 5-year median of 16.84X. Our Outperform recommendation indicates that the stock will perform better than the market. Our \$340 price target reflects 24.69X 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 F12M	Current	21.45	20.51	34.21	22.6
	5-Year High	21.45	20.51	34.21	22.62
	5-Year Low	12.26	13.46	10.44	15.25
	5-Year Median	16.84	16.88	13.65	17.58
EV/EBITDA TTM	Current	14.78	15.11	9.77	12.55
	5-Year High	16.99	31.25	11.09	12.84
	5-Year Low	8.05	7.86	5.41	8.24
	5-Year Median	12.53	12.25	7.24	10.9
P/S F 12M	Current	6.71	6.2	1.35	3.65
	5-Year High	6.71	6.2	1.41	3.65
	5-Year Low	3.06	3.04	0.85	2.53
	5-Year Median	4.85	4.59	1.2	3.05

As of 08/12/2020

Industry Analysis Zacks Industry Rank: Bottom 17% (210 out of 253)



Top Peers

Company (Ticker)	Rec	Rank
Canadian National Railway Company (CNI)	Outperform	3
United Parcel Service, Inc. (UPS)	Outperform	1
Berkshire Hathaway Inc. (BRK.B)	Neutral	2
CSX Corporation (CSX)	Neutral	3
Kansas City Southern (KSU)	Neutral	3
Norfolk Southern Corporation (NSC)	Neutral	3
Union Pacific Corporation (UNP)	Neutral	3
WEST JAPAN RAIL (WJRY)	Neutral	4

Industry Comparison Industry: Transportation - Rail				Industry Peers		
	CP	X Industry	S&P 500	CNI	CSX	KSU
Zacks Recommendation (Long Term)	Outperform	-	-	Outperform	Neutral	Neutral
Zacks Rank (Short Term)	2	-	-	3	3	3
VGM Score	C	-	-	C	C	C
Market Cap	40.02 B	22.57 B	23.75 B	73.15 B	57.40 B	17.36 B
# of Analysts	10	7	14	10	10	8
Dividend Yield	0.83%	1.60%	1.68%	1.60%	1.39%	0.87%
Value Score	C	-	-	C	C	C
Cash/Price	0.01	0.05	0.07	0.01	0.05	0.04
EV/EBITDA	14.40	12.65	13.35	14.44	11.08	16.39
PEG Ratio	2.03	2.84	2.98	3.72	2.81	1.83
Price/Book (P/B)	7.43	3.73	3.20	5.40	4.72	3.66
Price/Cash Flow (P/CF)	17.92	13.72	12.97	16.84	12.54	17.03
P/E (F1)	22.91	24.83	22.17	26.00	21.35	27.39
Price/Sales (P/S)	6.81	5.37	2.54	6.92	5.23	6.30
Earnings Yield	4.36%	3.94%	4.31%	3.85%	4.68%	3.65%
Debt/Equity	1.27	0.81	0.77	0.70	1.33	0.81
Cash Flow (\$/share)	16.48	6.11	6.94	6.11	5.98	10.81
Growth Score	C	-	-	C	D	C
Hist. EPS Growth (3-5 yrs)	14.04%	12.62%	10.41%	6.34%	23.81%	11.73%
Proj. EPS Growth (F1/F0)	4.03%	-11.20%	-6.32%	-9.89%	-15.73%	-2.61%
Curr. Cash Flow Growth	5.41%	1.21%	5.22%	6.26%	0.86%	8.60%
Hist. Cash Flow Growth (3-5 yrs)	5.60%	5.61%	8.55%	3.06%	8.74%	5.61%
Current Ratio	0.81	1.08	1.33	0.97	1.62	2.44
Debt/Capital	55.89%	45.91%	44.59%	41.11%	57.01%	44.59%
Net Margin	29.48%	20.55%	10.13%	25.66%	26.39%	20.63%
Return on Equity	34.28%	18.49%	14.59%	20.92%	24.24%	13.80%
Sales/Assets	0.34	0.32	0.51	0.32	0.28	0.28
Proj. Sales Growth (F1/F0)	-2.01%	-8.54%	-1.40%	-8.54%	-12.15%	-7.37%
Momentum Score	C	-	-	B	C	C
Daily Price Chg	1.39%	1.24%	0.67%	0.99%	-0.15%	-0.24%
1 Week Price Chg	2.47%	4.62%	2.30%	2.34%	2.23%	8.84%
4 Week Price Chg	11.47%	10.14%	4.87%	10.27%	6.18%	18.26%
12 Week Price Chg	20.95%	17.96%	13.54%	22.95%	9.76%	23.73%
52 Week Price Chg	25.86%	16.18%	6.06%	13.11%	16.18%	57.08%
20 Day Average Volume	399,587	292,903	2,006,991	1,002,258	3,441,320	1,387,005
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
(F1) EPS Est 4 week change	5.11%	0.38%	1.95%	1.36%	-1.15%	0.24%
(F1) EPS Est 12 week change	10.02%	-1.44%	2.72%	3.63%	-2.79%	-1.57%
(Q1) EPS Est Mthly Chg	4.01%	0.15%	0.84%	0.19%	1.81%	-1.26%

Zacks Stock Rating System

We offer two rating systems that take into account investors' holding horizons: Zacks Rank and Zacks Recommendation. Each provides valuable insights into the future profitability of the stock and can be used separately or in combination with each other depending on your investment style.

Zacks Recommendation

The Zacks Recommendation aims to predict performance over the next 6 to 12 months. The foundation for the quantitatively determined Zacks Recommendation is trends in the company's estimate revisions and earnings outlook. The Zacks Recommendation is broken down into 3 Levels; Outperform, Neutral and Underperform. Unlike many Wall Street firms, we have an excellent balance between the number of Outperform and Neutral recommendations. Our team of 70 analysts are fully versed in the benefits of earnings estimate revisions and how that is harnessed through the Zacks quantitative rating system. But we have given our analysts the ability to override the Zacks Recommendation for the 1200 stocks that they follow. The reason for the analyst over-rides is that there are often factors such as valuation, industry conditions and management effectiveness that a trained investment professional can spot better than a quantitative model.

Zacks Rank

The Zacks Rank is our short-term rating system that is most effective over the one- to three-month holding horizon. The underlying driver for the quantitatively-determined Zacks Rank is the same as the Zacks Recommendation, and reflects trends in earnings estimate revisions.

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	C
Growth Score	C
Momentum Score	C
VGM Score	C

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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