

Canadian Pacific(CP)

\$261.85 (As of 01/14/20)

Price Target (6-12 Months): **\$275.00**

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:C

Value: D

Growth: C

Momentum: A

Summary

Shares of Canadian Pacific have outperformed its industry in a year, mainly due to prudent cost management. With consistent cost containment, the company's operating ratio has been improving. Its measures to add shareholder value are also appreciative. Under a normal course issuer bid (for which it received acceptance in December 2019), the company can purchase up to 4.8 million shares. Canadian Pacific's buyout of Central Maine & Quebec Railway is a further positive. However, Canadian Pacific experienced weak volumes in the fourth quarter amid macroeconomic headwinds and geopolitical tensions. Moreover, poor harvest weather in Canada is hurting grain volumes significantly. The company's high debt levels and capital expenditures also add to its woes. Capex is projected to have been C\$1.6 billion in 2019.

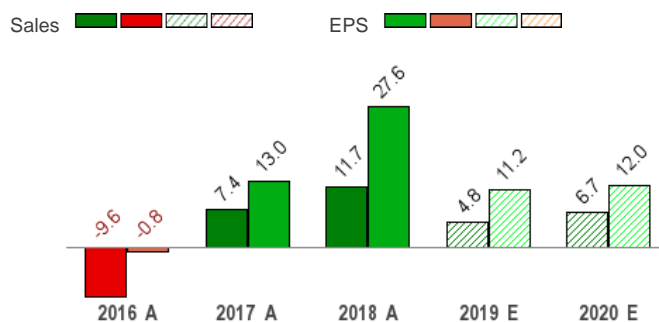
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$267.63 - \$191.70
20 Day Average Volume (sh)	276,875
Market Cap	\$35.9 B
YTD Price Change	2.7%
Beta	1.15
Dividend / Div Yld	\$2.54 / 1.0%
Industry	Transportation - Rail
Zacks Industry Rank	Bottom 12% (223 out of 254)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	2.1%
Last Sales Surprise	-0.6%
EPS F1 Est- 4 week change	0.1%
Expected Report Date	01/29/2020
Earnings ESP	0.0%
P/E TTM	21.4
P/E F1	18.8
PEG F1	1.7
P/S TTM	6.2

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2020	1,459 E	1,593 E	1,607 E	1,635 E	6,310 E
2019	1,329 A	1,478 A	1,496 A	1,535 E	5,914 E
2018	1,312 A	1,356 A	1,452 A	1,518 A	5,645 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2020	\$2.84 E	\$3.56 E	\$3.86 E	\$3.94 E	\$13.94 E
2019	\$2.09 A	\$3.21 A	\$3.48 A	\$3.54 E	\$12.45 E
2018	\$2.13 A	\$2.45 A	\$3.15 A	\$3.45 A	\$11.20 A

*Quarterly figures may not add up to annual.

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 01/14/2020. The reports text is as of 01/15/2020.

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.

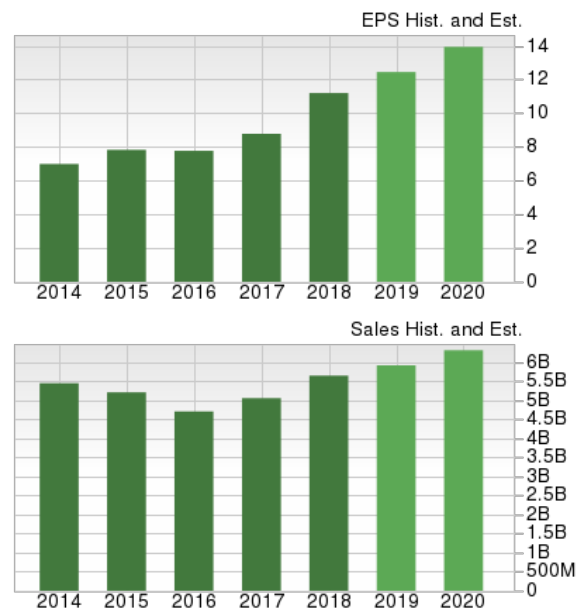
Canadian Pacific is constantly looking to cut costs in a bid to drive bottom-line growth. To this end, operating ratio (operating expenses as a percentage of revenues) improved 540 basis points to 61.3% in 2018. The precision scheduled railroading model adopted by Canadian Pacific is enabling it to control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



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. Impressive free cash flow generation should lead to a further uptick in such shareholder-friendly activities. Notably, the company's free cash flow increased 11% year over year in the first nine months of 2019.
- ▲ We are impressed with Canadian Pacific's efforts to check costs. Prudent cost management owing to the precision scheduled railroading model is aiding the company in generating significant earnings growth. Additionally, the company's top line is benefiting from impressive freight revenues at key units. Backed by cost-cutting endeavors and higher revenues, operating ratio (operating expenses as a percentage of revenues) has been improving over the last several quarters. This key metric improved to 56.1% in the third quarter from 58.3% in the prior year. Lower the value of the metric the better. The metric is expected to have improved in the fourth quarter as well. Detailed results will be available on Jan 29. The company's expectation of a double-digit earnings growth in 2019 also holds promise.
- ▲ The four-year agreement with the union representing its mechanical employees (unifor), ratified in December 2018, is a major positive. The company has received other encouraging updates on the labor front. The agreements are huge positives as satiated labor groups generally imply greater operational efficiency. Impressive volume growth at the Fertilizers and sulfur as well as in Energy, chemicals and plastics sub-groups are also appreciative. Notably, volumes at the Fertilizers and sulfur unit rose 20% in the third quarter while the same at the Energy, chemicals and plastics unit increased 12.7%. The company's acquisition of Central Maine & Quebec Railway (CMQ), completed in December 2019, is also encouraging. Apart from strengthening the company's presence in the eastern United States, the buyout will enhance 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 efforts to reward shareholders through dividends and share buybacks are encouraging. Initiatives to check costs also bode well.

Reasons To Sell:

- ▼ Poor harvest weather in Canada is affecting grain volumes significantly. Due to this headwind, grain volumes slipped 1% in the third quarter. Per John Brooks, executive vice-president of Canadian Pacific Railway, the western Canadian harvest was nearly 30% below normal last year. The slow harvesting is anticipated to have continually put pressure on the movement of grain throughout last year, per Brooks. Additionally, the company has been struggling with low U.S. grain volumes due to a soft P&W export market, thanks to the ongoing trade dispute with China.
- ▼ Amid macroeconomic headwinds and geopolitical tensions, Canadian Pacific witnessed weak volumes in the fourth quarter. Consequently, for 2019, the company expects revenue ton mile (RTM) to have increased in low-single digits compared with mid-single digit volume growth anticipated previously.
- ▼ With Canadian Pacific investing significantly to upgrade its facilities, the company is incurring significant amount of capital expenses. Capital expenditures increased 5.8% year over year to C\$1.15 billion in the first nine months of 2019. The same is projected around C\$1.6 billion in 2019. 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 47.9 for its industry. Long-term debt at the end of third-quarter 2019 amounted to C\$8,308 million compared with C\$8,190 in December 2018. 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.

Canadian Pacific's soft grain volumes and high capital expenditures are quite concerning.

Last Earnings Report

Canadian Pacific Q3 Earnings Beat, Revenues Miss

Canadian Pacific's third-quarter 2019 earnings (excluding 11 cents from non-recurring items) of \$3.48 per share (C\$4.61) surpassed the Zacks Consensus Estimate of \$3.41. Quarterly earnings also increased year over year. The bottom line was aided by the company's prudent cost management, courtesy of the precision scheduled railroading model.

Although quarterly revenues of \$1,495.5 million (C\$1,979 million) increased year over year, the same fell short of the Zacks Consensus Estimate of \$1,504.5 million. Rise in freight revenues led to the year-over-year top-line improvement.

Freight revenues rose 4.2% year over year and contributed 97.6% to the top line. Notably, the company's freight segment consists of Grain (up 6.5%), Coal (up 7%), Potash (down 10%), Fertilizers and sulfur (up 20%), Forest products (up 2.6%), Energy, chemicals and plastics (up 12.7%), Metals, minerals and consumer products (down 3.4%), Automotive (up 2.4%) and Intermodal (up nearly 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 3% from the year-ago reported figure.

Operating income increased 10% in the quarter under review. Operating expenses inched up marginally year over year. Operating ratio (operating expenses as a percentage of revenues on an adjusted basis) improved to 56.1% from 58.3% in the prior-year quarter, driven by this railroad operator's efforts to control costs. Notably, lower the value of this key metric bodes well. Capital spending at the end of the first nine months of 2019 was C\$1.15 billion.

Liquidity

The company exited the third quarter with cash and cash equivalents of C\$145 million compared with C\$61 million at the end of 2018. Long-term debt amounted to C\$8,308 million compared with C\$8,190 million in December 2018.

Outlook

Amid macroeconomic headwinds and geopolitical tensions, Canadian Pacific sees weak volumes in the fourth quarter.

For 2019, the company expects revenue ton mile (RTM) to increase in low-single digits. Moreover, adjusted earnings per share are projected to rise in double digits year over year compared with C\$14.51 per share reported in 2018. Capital expenditures are still estimated around C\$1.6 billion for the current year.

Quarter Ending **09/2019**

Report Date	Oct 23, 2019
Sales Surprise	-0.60%
EPS Surprise	2.05%
Quarterly EPS	3.48
Annual EPS (TTM)	12.23

Recent News

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.

Dividend Update — Dec 16, 2019

Canadian Pacific's board cleared a quarterly cash dividend of C\$0.83 per share. The amount is payable to shareholders on Jan 27, 2020, of record as of Dec 27, 2019.

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 35.4% over the trailing 12-month period. Over the past year, stocks in the Zacks sub-industry and the Zacks Transportation sector are up 19.8% and 13.3% respectively.

The S&P 500 index is up 24.5% in the past year.

The stock is currently trading at 18.72X forward 12-month price to earnings, which compares to 17.58X for the Zacks sub-industry, 13.08X for the Zacks sector and 19X 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 \$275 price target reflects 19.66X 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	18.72	17.58	13.08	19
	5-Year High	20.8	19.35	16.98	19.34
	5-Year Low	12.26	13.46	10.46	15.17
	5-Year Median	16.9	16.68	13.1	17.44
P/B TTM	Current	6.57	5.52	3.29	4.49
	5-Year High	9.16	5.76	4.67	4.49
	5-Year Low	4.24	2.21	2.68	2.85
	5-Year Median	5.87	4.4	3.42	3.61
P/S F 12M	Current	5.68	5.4	1.14	3.52
	5-Year High	6.02	5.4	1.44	3.52
	5-Year Low	3.06	3.04	1.03	2.54
	5-Year Median	4.6	4.43	1.23	3

As of 01/14/2020

Industry Analysis Zacks Industry Rank: Bottom 12% (223 out of 254)



Top Peers

Berkshire Hathaway Inc. (BRK.B)	Neutral
CSX Corporation (CSX)	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
Canadian National Railway Company (CNI)	Underperform

Industry Comparison Industry: Transportation - Rail				Industry Peers		
	CP Neutral	X Industry	S&P 500	CNI Underperform	CSX Neutral	KSU Neutral
VGM Score	C	-	-	F	D	C
Market Cap	35.92 B	26.26 B	24.31 B	67.31 B	58.41 B	15.79 B
# of Analysts	8	7	13	9	8	6
Dividend Yield	0.97%	1.67%	1.76%	1.73%	1.29%	1.00%
Value Score	D	-	-	F	C	D
Cash/Price	0.00	0.04	0.04	0.01	0.04	0.00
EV/EBITDA	14.60	12.25	14.12	13.10	11.45	13.49
PEG Ratio	1.67	1.87	2.05	2.08	1.38	1.34
Price/Book (P/B)	6.64	3.43	3.34	4.80	4.92	3.04
Price/Cash Flow (P/CF)	17.19	14.47	13.66	16.71	13.16	16.80
P/E (F1)	18.82	18.38	18.82	19.64	17.12	20.03
Price/Sales (P/S)	6.17	4.67	2.64	5.90	4.79	5.58
Earnings Yield	5.31%	5.44%	5.29%	5.09%	5.84%	4.99%
Debt/Equity	1.15	0.73	0.72	0.65	1.35	0.46
Cash Flow (\$/share)	15.23	5.67	6.94	5.63	5.67	9.48
Growth Score	C	-	-	D	C	B
Hist. EPS Growth (3-5 yrs)	10.01%	9.54%	10.56%	6.26%	19.91%	7.95%
Proj. EPS Growth (F1/F0)	12.05%	10.97%	7.49%	10.50%	4.74%	14.77%
Curr. Cash Flow Growth	19.36%	8.45%	14.83%	4.94%	35.99%	9.74%
Hist. Cash Flow Growth (3-5 yrs)	6.46%	6.34%	9.00%	4.63%	9.35%	7.63%
Current Ratio	0.57	0.89	1.23	0.71	1.41	0.78
Debt/Capital	53.52%	42.11%	42.99%	39.33%	57.38%	31.54%
Net Margin	NA%	23.75%	11.08%	29.62%	NA	20.23%
Return on Equity	32.62%	15.63%	17.16%	24.36%	27.67%	13.03%
Sales/Assets	0.35	0.35	0.55	0.35	0.32	0.29
Proj. Sales Growth (F1/F0)	%	4.51%	4.23%	5.64%	NA	5.39%
Momentum Score	A	-	-	B	F	B
Daily Price Chg	-0.32%	1.23%	0.73%	0.73%	-0.04%	-0.52%
1 Week Price Chg	0.16%	0.23%	0.39%	0.76%	0.64%	1.93%
4 Week Price Chg	2.55%	2.19%	1.84%	3.65%	3.55%	3.42%
12 Week Price Chg	19.17%	5.53%	6.48%	4.74%	3.28%	9.82%
52 Week Price Chg	35.15%	16.98%	23.15%	15.76%	14.67%	57.19%
20 Day Average Volume	0	163,310	1,578,594	562,495	0	918,942
(F1) EPS Est 1 week change	-0.29%	-0.15%	0.00%	-0.73%	-0.13%	0.27%
(F1) EPS Est 4 week change	0.06%	-0.48%	0.00%	-2.80%	-1.09%	-0.08%
(F1) EPS Est 12 week change	-0.20%	-2.25%	-0.48%	-7.52%	-2.04%	3.32%
(Q1) EPS Est Mthly Chg	4.67%	-0.90%	0.00%	1.08%	-3.81%	2.29%

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	D
Growth Score	C
Momentum Score	A
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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