

Canadian Pacific(CP)

\$217.70 (As of 04/15/20)

Price Target (6-12 Months): **\$231.00**

Long Term: 6-12 Months

Zacks Recommendation:

Neutral

(Since: 02/14/19)

Prior Recommendation: Outperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

4-Sell

Zacks Style Scores:

VGM:D

Value: F

Growth: B

Momentum: C

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. 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. We expect the company's first-quarter performance to be hurt due to the coronavirus-induced low volumes. Detailed results will be available on Apr 21. High debt levels also raise concerns.

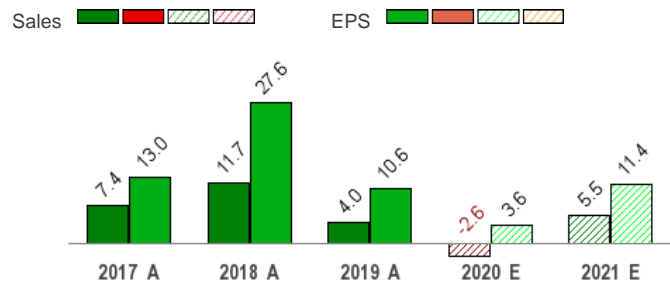
Price, Consensus & Surprise



Data Overview

| | |
|----------------------------|---------------------------------------|
| 52 Week High-Low | \$275.13 - \$173.26 |
| 20 Day Average Volume (sh) | 451,337 |
| Market Cap | \$29.7 B |
| YTD Price Change | -14.6% |
| Beta | 1.04 |
| Dividend / Div Yld | \$2.36 / 1.1% |
| Industry | Transportation - Rail |
| Zacks Industry Rank | Bottom 8% (233 out of 253) |

Sales and EPS Growth Rates (Y/Y %)



| | |
|---------------------------|------------|
| Last EPS Surprise | 1.7% |
| Last Sales Surprise | 1.0% |
| EPS F1 Est- 4 week change | -5.5% |
| Expected Report Date | 04/21/2020 |
| Earnings ESP | -0.4% |
| P/E TTM | 17.6 |
| P/E F1 | 17.0 |
| PEG F1 | 1.5 |
| P/S TTM | 5.1 |

Sales Estimates (millions of \$)

| | Q1 | Q2 | Q3 | Q4 | Annual* |
|------|---------|---------|---------|---------|---------|
| 2021 | | | | | 6,037 E |
| 2020 | 1,433 E | 1,421 E | 1,421 E | 1,483 E | 5,721 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 | | | | | \$14.31 E |
| 2020 | \$2.84 E | \$3.07 E | \$3.46 E | \$3.48 E | \$12.84 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.

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 04/15/2020. The reports text is as of 04/16/2020.

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.

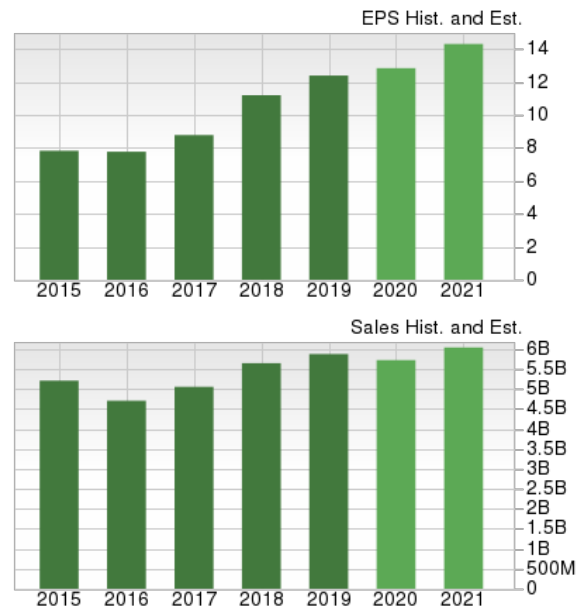
Canadian Pacific is constantly looking to cut costs in a bid to drive bottom-line growth. To this end, operating ratio (operating expenses as a percentage of revenues) improved 140 basis points to 59.9% in 2019. The precision scheduled railroading model adopted by Canadian Pacific is enabling it to control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

- ▲ 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. 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 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.

Consistent improvement in operating ratio (operating expenses as a percentage of revenues) is appreciative.

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 53.6. This compares unfavorably to the figure of 50 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.

Canadian Pacific's high debt levels raise concerns.

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.

Valuation

Canadian Pacific's shares are down 14.6% in the year-to-date period and 1.2% over the trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Transportation sector are down 15.2% and 25.5% in the year-to-date period, respectively. Over the past year, the Zacks sub-industry is down 13.8% while the sector is down 25.6%.

The S&P 500 index is down 11.8% and 2.4% in the year-to-date period and in the past year respectively.

The stock is currently trading at 15.35X forward 12-month price to earnings, which compares to 15.54X for the Zacks sub-industry, 16.35X for the Zacks sector and 18.98X for the S&P 500 index.

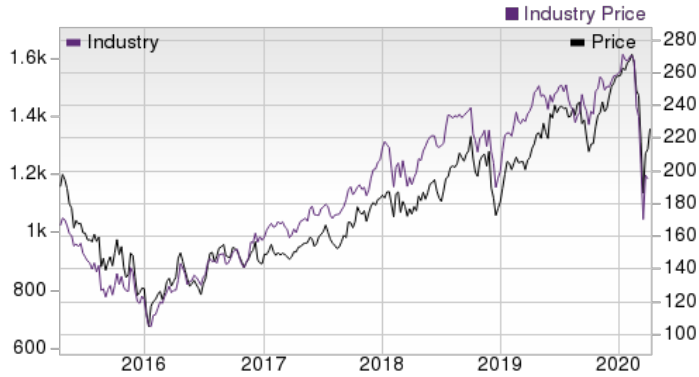
Over the past five years, the stock has traded as high as 20.8X and as low as 12.26X, with a 5-year median of 16.85X. Our Neutral recommendation indicates that the stock will perform in-line with the market. Our \$231 price target reflects 16.28X forward 12-month earnings.

The table below shows summary valuation data for CP

| Valuation Multiples - CP | | | | | |
|--------------------------|---------------|-------|--------------|--------|---------|
| | | Stock | Sub-Industry | Sector | S&P 500 |
| P/E F12M | Current | 15.35 | 15.54 | 16.35 | 18.98 |
| | 5-Year High | 20.8 | 19.35 | 17.05 | 19.34 |
| | 5-Year Low | 12.26 | 13.46 | 10.47 | 15.19 |
| | 5-Year Median | 16.85 | 16.63 | 13.16 | 17.45 |
| EV/EBITDA TTM | Current | 13.06 | 11.91 | 6.43 | 10.4 |
| | 5-Year High | 16.99 | 31.25 | 11.16 | 12.87 |
| | 5-Year Low | 8.05 | 7.86 | 5.69 | 8.27 |
| | 5-Year Median | 12.34 | 12 | 7.39 | 10.78 |
| P/S F12M | Current | 4.76 | 4.67 | 0.95 | 3.16 |
| | 5-Year High | 6.01 | 5.47 | 1.42 | 3.44 |
| | 5-Year Low | 3.06 | 3.04 | 0.85 | 2.54 |
| | 5-Year Median | 4.58 | 4.5 | 1.21 | 3.01 |

As of 04/15/2020

Industry Analysis Zacks Industry Rank: Bottom 8% (233 out of 253)



Top Peers

| | |
|---|---------|
| Berkshire Hathaway Inc. (BRK.B) | Neutral |
| Canadian National Railway Company (CNI) | 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 |

| Industry Comparison Industry: Transportation - Rail | | | | Industry Peers | | |
|---|------------|------------|-----------|----------------|-------------|-------------|
| | CP Neutral | X Industry | S&P 500 | CNI Neutral | CSX Neutral | KSU Neutral |
| VGM Score | D | - | - | F | D | C |
| Market Cap | 29.69 B | 29.69 B | 19.18 B | 54.91 B | 47.12 B | 12.90 B |
| # of Analysts | 10 | 7 | 14 | 10 | 10 | 8 |
| Dividend Yield | 1.09% | 2.16% | 2.24% | 2.17% | 1.71% | 1.19% |
| Value Score | F | - | - | F | F | D |
| Cash/Price | 0.00 | 0.04 | 0.06 | 0.01 | 0.04 | 0.01 |
| EV/EBITDA | 11.03 | 10.67 | 11.46 | 11.18 | 9.55 | 12.74 |
| PEG Ratio | 1.51 | 2.00 | 2.08 | 2.57 | 1.94 | 1.20 |
| Price/Book (P/B) | 5.60 | 2.64 | 2.58 | 4.04 | 4.02 | 2.72 |
| Price/Cash Flow (P/CF) | 13.21 | 10.31 | 10.15 | 12.62 | 10.18 | 12.41 |
| P/E (F1) | 17.02 | 15.96 | 17.24 | 18.58 | 15.48 | 18.07 |
| Price/Sales (P/S) | 5.06 | 3.87 | 1.99 | 4.88 | 3.95 | 4.50 |
| Earnings Yield | 5.90% | 6.27% | 5.64% | 5.38% | 6.45% | 5.53% |
| Debt/Equity | 1.15 | 0.78 | 0.70 | 0.66 | 1.35 | 0.68 |
| Cash Flow (\$/share) | 16.48 | 6.11 | 7.01 | 6.11 | 5.98 | 10.81 |
| Growth Score | B | - | - | D | C | B |
| Hist. EPS Growth (3-5 yrs) | 10.99% | 9.46% | 10.92% | 6.49% | 21.86% | 9.46% |
| Proj. EPS Growth (F1/F0) | 3.64% | 3.05% | -2.92% | -5.51% | -5.68% | 7.59% |
| Curr. Cash Flow Growth | 5.41% | 2.96% | 5.93% | 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 | 0.53 | 0.98 | 1.24 | 0.66 | 1.52 | 1.48 |
| Debt/Capital | 53.58% | 43.90% | 42.36% | 39.68% | 57.41% | 40.48% |
| Net Margin | 31.31% | 23.84% | 11.64% | 28.25% | 27.91% | 18.80% |
| Return on Equity | 32.42% | 15.87% | 16.74% | 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) | -2.54% | 0.00% | 0.00% | -6.48% | -4.15% | 0.38% |
| Momentum Score | C | - | - | B | C | D |
| Daily Price Chg | -4.48% | -2.57% | -3.26% | -2.57% | -2.64% | -3.72% |
| 1 Week Price Chg | 5.91% | 7.33% | 16.01% | 4.51% | 12.74% | 11.06% |
| 4 Week Price Chg | 16.75% | 17.01% | 16.73% | 10.33% | 19.46% | 22.72% |
| 12 Week Price Chg | -15.68% | -18.94% | -22.44% | -18.27% | -18.39% | -18.60% |
| 52 Week Price Chg | 1.19% | -17.23% | -14.41% | -17.23% | -22.87% | 9.24% |
| 20 Day Average Volume | 451,337 | 451,337 | 3,301,889 | 1,266,424 | 5,426,737 | 1,495,852 |
| (F1) EPS Est 1 week change | -3.25% | -3.25% | 0.00% | -3.78% | -2.38% | -4.07% |
| (F1) EPS Est 4 week change | -5.50% | -5.50% | -6.78% | -8.27% | -5.38% | -7.48% |
| (F1) EPS Est 12 week change | -7.72% | -8.23% | -9.07% | -13.53% | -8.75% | -6.64% |
| (Q1) EPS Est Mthly Chg | -8.85% | -11.98% | -11.31% | -11.09% | -11.89% | -16.63% |

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 | F |
| Growth Score | B |
| Momentum Score | C |
| VGM Score | D |

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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