

Canadian Pacific(CP)

\$257.06 (As of 06/16/20)

Price Target (6-12 Months): **\$272.00**

Long Term: 6-12 Months

Zacks Recommendation:

Neutral

(Since: 03/17/19)

Prior Recommendation: Outperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

3-Hold

Zacks Style Scores:

VGM:B

Value: D

Growth: B

Momentum: A

Summary

Akin to the first quarter, we expect Canadian Pacific's results to be impressive in the second-quarter of 2020 despite coronavirus-related concerns. Results are likely to be aided by low costs and higher freight revenues. Moreover, courtesy of the precision scheduled railroading model, operating ratio is likely to improve in the June quarter. However, volumes might take a hit due to a low demand situation in not just North America but globally as well. The company's automotive business is also likely to remain challenged going forward due to temporary plant shutdowns. In fact, volumes are expected to decline in mid-single digits in 2020. Consequently, adjusted earnings per share are expected to be flat. Primarily due to the coronavirus-related woes, shares of the company have declined more than 3% since the beginning of February.

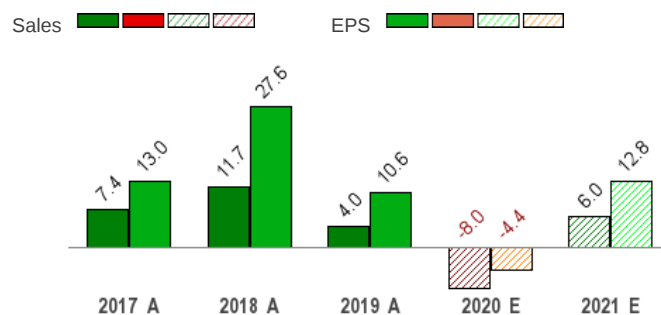
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$275.13 - \$173.26
20 Day Average Volume (sh)	372,994
Market Cap	\$34.9 B
YTD Price Change	0.8%
Beta	0.95
Dividend / Div Yld	\$2.36 / 0.9%
Industry	Transportation - Rail
Zacks Industry Rank	Bottom 29% (180 out of 253)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	15.4%
Last Sales Surprise	7.9%
EPS F1 Est- 4 week change	1.1%
Expected Report Date	07/21/2020
Earnings ESP	9.2%
P/E TTM	18.9
P/E F1	21.7
PEG F1	1.9
P/S TTM	5.8

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021					5,727 E
2020	1,523 A	1,217 E	1,303 E	1,390 E	5,403 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					\$13.37 E
2020	\$3.30 A	\$2.47 E	\$2.90 E	\$3.18 E	\$11.85 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 06/16/2020. The reports text is as of 06/17/2020.

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.

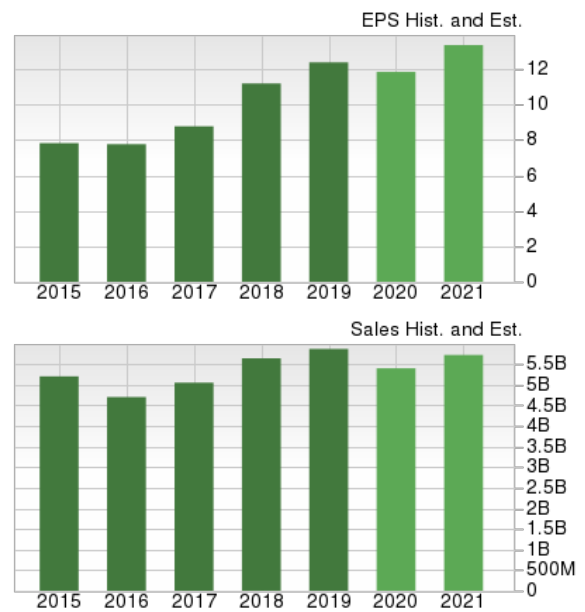
Canadian Pacific is constantly looking to cut costs in a bid to drive bottom-line growth. To this end, operating ratio (operating expenses as a percentage of revenues) improved 140 basis points to 59.9% in 2019. The precision scheduled railroading model adopted by Canadian Pacific is enabling it to control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

▲ Although Canadian Pacific has temporarily suspended share buybacks since March to counter the challenges posed by coronavirus, its efforts to reward investors through share buybacks and dividend payments are otherwise impressive. During the first quarter of 2020, the company repurchased shares worth \$468 million. Additionally, during 2019, it returned \$1.5 billion to shareholders through share buybacks and dividends. Also, 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 marked the fourth straight year of dividend increase.

The company's precision scheduled railroading model should help in efficiently dealing with the coronavirus concerns.

▲ Amid coronavirus concerns, the precision scheduled railroading model should help the company efficiently deal with the crisis. Thanks to this business model, operating expenses dipped 1.2% year over year in the first quarter. Consequently, operating ratio (operating expenses as a percentage of revenues) improved to 59.2% in the quarter from 69.3% in the year-ago period. What is more encouraging is that, despite the coronavirus-induced softness in some of the segments, the company's freight revenues rose 15.9% in the first quarter.

▲ 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, reaping benefits from a full-year of Vancouver auto compound.

Reasons To Sell:

- ▼ Although the impact from coronavirus was limited on volumes in the first quarter of 2020, the adversities with respect to volumes are expected to rise in the second quarter and thereafter. Notably, crude volumes are declining due to steep decline in demand as a result of coronavirus, among other factors. Give this volatile environment, the company anticipates a low demand situation in not just North America but globally as well. 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). Additionally, adjusted earnings per share are expected to be approximately flat year over year. Earlier, adjusted earnings per share were predicted to increase in the high single-digit to low double-digit range.
- ▼ 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 first quarter was \$9.8 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 March quarter was 0.59. This compares unfavorably to the figure of 0.56 for its industry. 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.

The company anticipates volumes to decline in mid-single digits in 2020 due to coronavirus-led low demand.

Last Earnings Report

Canadian Pacific Q1 Earnings & Revenues Beat

Canadian Pacific's first-quarter 2020 earnings (excluding \$1.08 from non-recurring items) of \$3.3 (C\$4.42) per share surpassed the Zacks Consensus Estimate of \$2.86. Quarterly earnings also improved more than 55% year over year, primarily owing to low operating expenses.

Quarterly revenues of \$1,523.3 million (C\$2,043) surpassed the Zacks Consensus Estimate of \$1,412.3 million. The top line also increased in double digits year over year owing to rise in freight revenues.

Freight revenues rose 15.9% year over year and contributed 97.9% to the top line. Notably, the company's freight segment consists of Grain (up 10%), Coal (down 5.1%), Potash (down 1.7%), Fertilizers and sulfur (up 22.8%), Forest products (up 6.8%), Energy, chemicals and plastics (up 55.9%), Metals, minerals and consumer products (up 9.2%), Automotive (up 14.5%) and Intermodal (up 6.6%). 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 7% from the year-ago reported figure.

Operating income surged 53.6% in the quarter under review. Operating expenses dipped 1.2% year over year. Consequently, operating ratio (operating expenses as a percentage of revenues on an adjusted basis) improved to 59.2% in the first quarter from 69.3% in the year-ago period. Notably, lower value of this key metric bodes well. Capital spending during the first quarter was C\$355 million.

Liquidity

The company exited the first quarter with cash and cash equivalents of C\$247 million compared with C\$352 million at the end of the year-ago period. Long-term debt amounted to C\$9,804 million compared with C\$8,158 million at the end of December 2019.

2020 Outlook Impacted by Coronavirus

With softness in demand due to coronavirus, the company now anticipates volumes, measured in revenue ton miles, to decline in mid-single digits in the current year (previously volumes were expected to rise in mid-single digits). Additionally, adjusted earnings per share are expected to be approximately flat year over year. Earlier, adjusted earnings per share were predicted to increase in the high single-digit to low double-digit range from C\$16.44 reported in 2019. However, capital expenditures are still anticipated to be C\$1.6 billion in 2020.

Quarter Ending **03/2020**

Report Date	Apr 21, 2020
Sales Surprise	7.86%
EPS Surprise	15.38%
Quarterly EPS	3.30
Annual EPS (TTM)	13.60

Valuation

Canadian Pacific shares are up 0.8% in the year-to-date period and 10.1% over the trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Transportation sector are down 4.3% and 12% in the year-to-date period respectively. Over the past year, the Zacks sub-industry and the sector are down 0.9% and 7.6%, respectively.

The S&P 500 index is down 4.8% in the year-to-date period but up 5.1% in the past year.

The stock is currently trading at 20.49X forward 12-month price to earnings, which compares to 18.92X for the Zacks sub-industry, 35.83X for the Zacks sector and 22.09X for the S&P 500 index.

Over the past five years, the stock has traded as high as 21.39X and as low as 12.26X, with a 5-year median of 16.82X. Our Neutral recommendation indicates that the stock will perform in-line with the market. Our \$272 price target reflects 21.68X 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	20.49	18.92	35.83	22.09
	5-Year High	21.39	19.35	37.98	22.11
	5-Year Low	12.26	13.46	10.48	15.23
	5-Year Median	16.82	16.74	13.31	17.49
EV/EBITDA TTM	Current	13.24	12.97	7.35	11.35
	5-Year High	16.99	31.25	11.17	12.85
	5-Year Low	8.05	7.86	5.44	8.25
	5-Year Median	12.17	12.11	7.33	10.82
P/S F 12M	Current	6.28	5.53	1.25	3.44
	5-Year High	6.51	5.53	1.42	3.44
	5-Year Low	3.06	3.04	0.85	2.53
	5-Year Median	4.61	4.52	1.2	3.02

As of 06/16/2020

Industry Analysis Zacks Industry Rank: Bottom 29% (180 out of 253)



Top Peers

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

Industry Comparison Industry: Transportation - Rail				Industry Peers		
	CP	X Industry	S&P 500	CNI	CSX	KSU
Zacks Recommendation (Long Term)	Neutral	-	-	Neutral	Neutral	Neutral
Zacks Rank (Short Term)	3	-	-	3	3	3
VGM Score	B	-	-	C	C	B
Market Cap	34.87 B	32.69 B	22.00 B	63.49 B	53.86 B	14.12 B
# of Analysts	10	7	14	10	10	8
Dividend Yield	0.92%	1.66%	1.92%	1.84%	1.48%	1.08%
Value Score	D	-	-	C	C	C
Cash/Price	0.01	0.05	0.06	0.01	0.05	0.01
EV/EBITDA	12.96	11.58	12.79	12.77	10.60	13.75
PEG Ratio	1.92	2.69	3.00	3.39	2.50	1.45
Price/Book (P/B)	6.72	3.15	3.04	4.52	4.53	2.97
Price/Cash Flow (P/CF)	15.60	11.97	11.81	14.62	11.76	13.75
P/E (F1)	21.71	21.76	21.70	23.19	19.46	21.76
Price/Sales (P/S)	5.75	4.52	2.34	5.66	4.57	4.83
Earnings Yield	4.61%	4.60%	4.33%	4.31%	5.14%	4.60%
Debt/Equity	1.41	0.69	0.77	0.69	1.39	0.68
Cash Flow (\$/share)	16.48	6.11	7.01	6.11	5.98	10.81
Growth Score	B	-	-	B	C	B
Hist. EPS Growth (3-5 yrs)	12.73%	11.08%	10.87%	6.78%	23.43%	11.08%
Proj. EPS Growth (F1/F0)	-4.37%	-11.64%	-10.58%	-12.32%	-13.31%	-1.05%
Curr. Cash Flow Growth	5.41%	2.96%	5.46%	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	0.78	1.03	1.29	0.76	1.73	1.32
Debt/Capital	58.50%	44.24%	45.06%	40.96%	58.09%	40.39%
Net Margin	29.95%	22.73%	10.53%	29.76%	27.74%	20.11%
Return on Equity	35.29%	16.49%	16.06%	22.99%	27.27%	14.63%
Sales/Assets	0.36	0.34	0.55	0.34	0.31	0.30
Proj. Sales Growth (F1/F0)	-7.96%	-9.08%	-2.59%	-10.75%	-9.84%	-5.04%
Momentum Score	A	-	-	C	C	C
Daily Price Chg	1.98%	0.63%	1.81%	1.57%	0.30%	0.32%
1 Week Price Chg	-5.18%	-5.18%	-7.25%	-3.18%	-7.34%	-9.41%
4 Week Price Chg	10.96%	6.67%	8.30%	9.80%	6.67%	4.19%
12 Week Price Chg	24.37%	21.44%	28.43%	18.68%	26.77%	21.44%
52 Week Price Chg	10.07%	-7.60%	-3.34%	-2.63%	-9.49%	27.61%
20 Day Average Volume	372,994	372,994	2,618,631	836,781	4,061,100	982,187
(F1) EPS Est 1 week change	0.59%	0.00%	0.00%	0.47%	0.00%	0.00%
(F1) EPS Est 4 week change	1.14%	0.00%	0.00%	0.84%	0.00%	0.00%
(F1) EPS Est 12 week change	-12.80%	-14.92%	-14.98%	-14.88%	-13.03%	-14.92%
(Q1) EPS Est Mthly Chg	1.17%	0.00%	0.00%	0.47%	0.00%	0.00%

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	B
Momentum Score	A
VGM Score	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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