Why You Should Still Avoid Canadian Pacific Railway Limited as its Share Price Slides

Description

Up until November of this year, everything was going right for **Canadian Pacific Railway Limited** (TSX: CP)(NYSE: CP). CEO Hunter Harrison was cutting costs and improving efficiency. Volumes were growing, especially in the crude-by-rail business. And the company's share price had skyrocketed to well over $230, from less than $50 in September 2011.

But more recently, the story has been a little different – since November 27, the shares are down by more than 13%. So is this an opportunity to pick up a great company for a discount? Below we take a look.

An overreaction

November 27 was also the day that Saudi Arabia decided to maintain OPEC production levels, sending oil prices crashing around the world. So it is pretty easy to see why CP's shares have fallen so much: investors are afraid that North American energy production won't live up to expectations, resulting in a hit to CP's crude-by-rail business.

But these concerns are way overdone. First of all, crude-by-rail still accounts for well less than 10% of CP's volumes. Secondly, lower oil prices result in lower diesel prices, which should help CP further reduce costs – in 2013, diesel accounted for over 20% of CP's expenses. Finally, lower oil prices will help other parts of North America's economy, which could easily result in more volumes for rail operators like CP.

Still overpriced

That being said, this doesn't mean you should jump at CP's shares. Below we take a look why.

To put this all in perspective, over the past 12 months, CP has earned roughly $6.30 in income and $4.30 in free cash flow per share. These are very small numbers for a company with a $200 stockprice. Normally you'll only see fast-growing companies trading this expensively, but CP's revenuesgrew by less than 10% per year from 2009 to 2013.

Granted, CP's earnings grew much faster. But this is because Mr. Harrison was cleaning up a very messy company, with very inefficient operations. Now that CP's cost numbers are more in line with competitors, earnings growth won't be so easy to come by.

CP also has one of the lowest dividend yields on the **S&P/TSX 60**, currently at 0.6%. In fact only seven companies in the index have lower yields.

You're no better off with CN

The story is very similar to that of **Canadian National Railway Company** (TSX: CNR)(NYSE: CNI), whose shares have also sunk by just over 13% since November 27. The company has also faced concerns about the slowing crude-by-rail businesss, but the shares still trade at very lofty levels, and the dividend yield remains under 1.4%.

So this is a perfect example of two overvalued stocks becoming less overvalued. In my opinion, you should simply avoid the shares.

CATEGORY

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