Has Canadian Pacific Railway Limited Bottomed?

Description

Canadian Pacific Railway Limited (TSX: CP)(NYSE: CP) has rallied 9% in the past few sessions after dropping below $200 per share for the first time since July.

The rout in the oil market has investors concerned that Canadian Pacific will transport less crude moving forward as producers are forced to cancel expansion projects and reduce exploration expenditures.

Let's take a look at Canadian Pacific to see if the concerns are warranted and whether or not you should buy the stock heading into 2015.

Oil transport

Despite the difficulties being experienced by oil producers, Canadian Pacific should see an expansion in the number of carloads of crude it transports in 2015. In fact, the company just confirmed it expects to increase its oil-by-rail deliveries to 200,000 carloads in 2015. That would be almost 70% higher than the 2014 forecast.

In its Q3 2014 earnings statement, Canadian Pacific said crude deliveries grew 33% in the first nine months of the year and represented about 8% of revenue.

Western Canadian producers still face a pipeline bottleneck and will continue to ship oil by rail. Concerns about production are probably warranted for the shale producers in the Bakken region, but big Canadian producers with deep pockets and existing operations are likely to produce even more oil in an effort to offset lower prices.

Grain deliveries

Canadian Pacific also moves a lot of grain for Western Canadian farmers. The 2014 crop came in lower than the previous year but farmers are still having trouble getting the railways to provided enough rail cars to ship their product to overseas buyers.

In August, the government told Canadian Pacific and **Canadian National Railway** that they had to move more than 530,000 tons of grain each per week until the end of November. Canadian Pacific met its requirements.

The lack of rail cars is not good news for farmers but it means Canadian Pacific is operating at peak capacity.

Intermodal transport

Canadian Pacific has expanded its intermodal business as more customers continue to choose rail carriers over truckers for long-haul deliveries. The company's international intermodal shipments dropped in the third quarter but domestic intermodal carloads grew by 19% over the same period in 2013.

Intermodal growth could slow as lower diesel prices could make trucking companies more competitive next year.

Concerns for 2015

Oil shipments are probably not a concern for investors going into 2015 but a few other items could be worth watching. In the wake of a number of train disasters, the U.S. and Canadian governments are considering safety legislation that would require trains to reduce their speeds. New rules have already been put in place regarding the safety of oil cars and further requirements could come in 2015.

Canadian Pacific plans to drive revenue and margins higher in the next few years by increasing train speeds and adding as many as 50 cars to its routes. The proposed safety measures could slow down the growth plan.

Management has done an excellent job of improving the railway's efficiency. Canadian Pacific's operating ratio for the third quarter hit a record low of 62.8%. Most of the easy gains have been achieved and investors should see the ratio stabilize in 2015, meaning margin improvements will be harder to come by.

Canadian Pacific's shares are still expensive. At 34 times earnings the market expects excellent execution. If the company misses earnings estimates on any of its 2015 reports, the stock could get hit hard. As a long-term holding, Canadian Pacific is a solid pick, but the shares could see more volatility in 2015.

If you are looking for top stocks to add to your 2015 watch list, but are concerned about the volatility in the Canadian market, the following free report is worth reading.

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1. NYSE:CP (Canadian Pacific Railway)
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aswalker