Is Canadian Pacific Railway Limited Still a Good Investment?

Description

Canadian Pacific Railway Limited (TSX:CP)(NYSE:CP) has been one of Canada's best performing stocks in the past three years, but investors are wondering if the rally is about to go off the rails.

Turnaround success

CP's turnaround is mostly credited to CEO Hunter Harrison, who came out of retirement in 2012 to reform one of North America's most inefficient railways.

Harrison previously ran **Canadian National Railway**, and was recruited by activist investor Bill Ackman to help put CP back on track. In just three years, the industry veteran has delivered impressive results.

When Harrison took the job, CP's operating ratio was north of 80%. The metric is widely used in the rail industry as a measure of efficiency. Essentially, the ratio represents the cost of adding each additional dollar of revenue, so a lower number is better.

Harrison slashed staff and shut down inefficient rail yards. He also went through the entire organization with a fine-toothed comb and has significantly reduced expenses.

The results have been fantastic and CP's shareholders have watched their shares triple since Harrison became the CEO.

Earnings

CP just reported the lowest first-quarter operating ratio in the company's history, hitting 63.2%, down from 70% in Q1 2014. The company also delivered record Q1 profits. Net income increased by 33% and hit a record $1.67 billion, or $1.92 per diluted share. Adjusted earnings per share jumped 59% to $2.26.

Most of CP's lines of business continue to do well, although the rapid growth in crude oil shipments has slowed due to the rout in the energy patch.

Risks

Last October, CP unveiled a plan to double earnings per share by 2018. Part of that plan includes running faster trains and adding more cars on some routes.

Recent rule changes announced by both U.S. and Canadian governments will restrict speeds for trains carrying dangerous cargo, such as crude oil, but the speeds CP is aiming for still falls within those ranges.

Governments have set the limit at 40 mph through major cities and 50 mph in other areas. Rail cars will also have to be upgraded to meet new safety standards. When Harrison announced the ambitious growth plans last fall, he said the company was looking to get average trains speeds up to 25-30 mph.

Should you buy?

Canadian Pacific Railway Limited is not a cheap stock and analysts are concerned the slowdown in crude-by-rail shipments will start to put pressure on earnings. On the operating side, most of the easy gains have been achieved and it might be difficult for the company to significantly reduce expenses moving forward.

The stock is trading at a three-month low and the negative trend could continue if the market suspects a rotation out of the railways is in the works. As a long-term investment, the company is a good pick, but new investors might get a better entry point in the coming months.

CATEGORY

1. Investing

TICKERS GLOBAL

1. NYSE:CP (Canadian Pacific Railway)
2. TSX:CP (Canadian Pacific Railway)

Category

1. Investing

Date
2025/08/30
Date Created
2015/05/13
Author
aswalker