Is Canadian Pacific Railway Limited a Bargain After Declining 20%?

Description

Back in October **Canadian Pacific Railway Limited** (TSX:CP)(NYSE:CP) could do no wrong. The company had become far more efficient under the leadership of Hunter Harrison, and was benefiting from the growth of crude by rail. Its stock price had nearly quintupled in just three years, and there was no end in sight.

Since then, CP's shares have slumped, falling by about 20%. That begs the question: are CP's shares in bargain territory? We take a look below.

Why have the shares slumped?

The main reason why CP's shares have slumped has been the fall in oil prices, which has hurt the company in a couple of ways. First of all, crude-by-rail volumes have not met the lofty growth expectations set last year. Secondly, lower fuel prices may help the rails, but they help the trucking industry even more.

As a result, CP has had to revise its expectations downward. While reporting second-quarter earnings (which missed estimates), the company forecasted adjusted earnings-per-share growth of roughly 20%, on the back of 2-3% revenue growth. That compares with previous expectations for 25% earnings growth and 7-8% revenue growth.

If that weren't bad enough, there was a board dispute over "corporate governance matters," resulting in the resignation of two board members, including the chairman. CP has said all issues are resolved, but has also refused to give any more details.

How expensive are the shares now?

CP is now forecasting adjusted earnings per share of $10-10.40 for this year. So, at $200 per share, CP is trading at nearly 20 times this year's earnings. By most standards that's an expensive price, and CP is no exception.

There are a few reasons why CP doesn't deserve such a pricey multiple. First of all, there are some serious limits to CP's growth potential—low oil prices come to mind first. Furthermore, CP's efficiency improvements are largely completed, and it will be difficult to cut wasteful spending much further. Meanwhile, government regulations prevent the company from raising prices significantly.

Making matters worse, CP is in a very capital-intensive industry. Locomotives need replacing periodically. Rail cars do too, especially with new regulations on tank cars. Track maintenance is also very expensive. As a result, a large chunk of CP's profits have to be plowed back into the business every year. This all slows down earnings growth. And if you're wondering why CP's dividend yields less than 1%, there's your answer.

A better option

This brings up another obvious question: should we buy **Canadian National Railway Company** instead?

Personally, I wouldn't. At $80 per share, CN Rail also trades at about 20 times earnings, which is too high for a company in this industry.

CATEGORY

1. Investing

TICKERS GLOBAL

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Date
2025/07/21
Date Created
2015/07/22
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