Canadian Pacific Railway Limited: Should Investors Hop on This Train?

Description

Canadian Pacific Railway Limited (TSX:CP)(NYSE:CP) has dropped 20% in the past six months, and investors who missed the big rally in 2013-14 are wondering if this is a good time to start a position in the stock.

Let's take a look at the current situation to see if CP deserves to be in your portfolio right now.

Earnings

CP delivered strong second-quarter adjusted earnings of $2.45 per share. That's a 16% increase over the same period last year and is a good indication to investors that the railway is chugging along quite well despite the slowdown in oil shipments.

The oil-by-rail business has boomed over the past few years and that growth is partly responsible for CP's outsized earnings and share-price gains. Some pundits are concerned that the crude boom in now bust, and CP will continue to suffer as a result.

The insane growth rate of crude-by-rail shipments is certainly slowing down, but the segment isn't going to disappear. Western Canadian producers are still pumping and mining as much oil as they can, and they still face severe pipeline bottlenecks.

Keystone XL will have to wait for a new U.S. administration before it gets approved, and Energy East doesn't look like it will be built in the next five years as originally hoped.

This means CP's oil-transport business should continue to do well, even though the rapid growth has leveled off.

The company's other segments are doing well. CP delivered year-over-year gains in its forestry, chemical, and crop nutrients shipments, and the overall freight numbers were in line with Q2 2014.

Improvements in efficiency

CP used to be one of North America's most inefficient railways. That has changed under the leadership of Hunter Harrison, who has worked hard to get the operating ratio down from 80% to a very impressive 62% in the most recent quarter.

The metric is important because it indicates the amount of revenue the railway is actually using to run the business.

The big efficiency gains are the second reason earnings have rocketed higher over the past three years. At this point, most of the easy wins have already been achieved on the expense side, and CP will have to work a lot harder to squeeze out more gains.

Risks?

Western Canadian farmers are having a tough year, and one estimate puts the crop decline as high as 25%. That could impact CP's agriculture revenues in the coming months.

Another item to consider is the new regulations put in place to improve oil-by-rail transport safety. CP and its peers are required to upgrade rail cars to meet new standards, and the costs associated with that process could impact earnings if the company is unable to pass the expenses on to its customers.

Should you buy Canadian Pacific Railway?

Railway companies are great long-term holdings because they operate in an industry with huge barriers to entry. There simply isn't going to be a new rail network built to compete along CP's existing routes.

The shares trade at a reasonable 15.8 times forward earnings, so current stockholders should be comfortable maintaining their positions. New investors could see a better entry point in the coming months, but the stock is probably a safe long-term buy at the current price.

CATEGORY

1. Investing

TICKERS GLOBAL

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