Canadian Pacific Railway Limited: Is it Still a Double-Digit Growth Story?

Description

With its rail network, **Canadian Pacific Railway Limited** (TSX:CP)(NYSE:CP) has delivered double-digit earnings growth even as the company faces challenges. For instance, trucking has taken some of the business. As the price of oil remains low, trucking businesses have increased competitiveness due to lower operating costs.

Should you add Canadian Pacific Railway to your portfolio today?

The business

With its 14,800 miles of track, Canadian Pacific Railway transports goods in Canada and the United States. Grain transport makes up 23.3% of revenues, and have had high single-digit growth in that area year-to-date. Potash and fertilizer makes up 10.4% of revenues and have had double-digit growth year-to-date. However, going into the winter, we're likely to see slower demand for fertilizer.

Forest products and chemicals and plastics make up 3.6% and 10.8% of revenues, respectively, and both showed year-to-date double-digit growth. However, crude and automotive have had double-digit declines in revenue year-to-date, and together they make up 10.9% of revenues.

Year-to-date, Canadian Pacific Railway experienced demand decline in crude, metals and minerals, and automotive areas. However, the business still experienced 4% revenue growth overall.

Recent performance and 2015 forecast

From its second-quarter results, the company's operating ratio, an indicator of efficiency, fell to a record low of 60.9%. At the same time, operating income climbed 10% to $646 million, adjusted earnings per share advanced 16% to $2.45, and revenues remained essentially flat.

For 2015, the company anticipates revenue growth to be 2-3%, operating ratio to remain below 62%, and 2015 adjusted diluted EPS of $10-10.40. This would imply earnings growth of 17.6-22.4% from the previous year.

Dividend and share buybacks

Canadian Pacific Railway continues its share buyback program. Since 2013, about 4.5% of shares have been retired. In the last 12 months, the business generated $4.65 free cash flow per share. The company pays $1.4 per share in dividends annually and has a low payout ratio of about 15%, so its dividend is very safe.

Although there has been talk in the boardroom about dividend raises, continued buybacks are much more likely. To the long-term shareholder, share buybacks are not a bad thing. Your stake in the business grows without you having to buy more shares. On the other hand, dividend increases imply shareholders would have to pay more taxes on the dividend if the shares are held in a non-registered account.

Valuation

After the share price declined by over 23% from a 52-week high of $247 per share, and based on adjusted earnings, the company is trading at a price-to-earnings ratio of about 19. For a company that's expected to grow around 16% per year (including share buybacks), Canadian Pacific Railway's multiple looks reasonable.

I believe the concern here is that demand might further soften, which might mean that the company will grow at low double-digits instead of mid-double-digits. If that happens, Canadian Pacific Railway could trade at an even lower multiple.

In conclusion

Canadian Pacific Railway has the ability to raise dividends, but buying back and retiring shares is more likely given the company's actions in the past few years. Investors are likely to buy Canadian Pacific Railway for its double-digit growth anyway. The recent weakness in its shares is a good opportunity to ease into the high-growth railway in case demand continues to slow, leading to slower growth.

CATEGORY

1. Dividend Stocks
2. Investing

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