Should You Buy Canadian Pacific Railway Limited Before its Earnings Report?

Description

Canadian Pacific Railway Limited (TSX:CP)(NYSE:CP) is reporting its third-quarter earnings results on Tuesday. Should investors consider its shares today? First, let's take a look at Canadian Pacific's business.

The business

Depending on the length of the haul and the commodity, railroads can be 1.9 to 5.5 times more fuel efficient than trucks. So, rail-based transportation is cost effective and environmentally friendly. Canadian Pacific also makes safety one of its highest priorities.

Canadian Pacific operates a transcontinental railway in Canada and the United States with about 22,050 km of tracks, providing logistics and supply chain expertise.

If you decide to invest in Canadian Pacific, you aren't doing it for the income, but for the growth, since Canadian Pacific starts you off with only a 0.7% yield.

Sales growth and earnings growth

From 2010 to 2014 Canadian Pacific's sales grew, and seem to have stabilized around a 7% growth rate in recent years. In 2011, its earnings per share (EPS) took a dive. So, in June 2012 Mr. Hunter Harrison was appointed as president and chief executive officer. He was the former CEO of Canadian National and Illinois Central, so he has plenty of experience.

Year	Sales Growth	EPS Growth
2010		
2011	3.9%	-12%
2012	10%	28%
2013	7.7%	48%
2014	7.9%	32%

Since Harrison entered the scene, the EPS has continued to grow at a double-digit rate every year. This is partially at the expense of the dividend, which has remained frozen at 35 cents per quarter, per share since 2012. And some capital was used to reduce the share count. From 2012 to now, roughly 2.3% of outstanding shares were retired.

Since Harrison took the helm as CEO, the railroad company has improved efficiency, reduced costs, and grown. Between 2012 and 2014, revenue grew at a compound annual growth rate (CAGR) of 7.8%, and EPS grew at a CAGR of 40%. Comparatively, between 2005 and 2012, the revenue grew at a CAGR of 3.8%, and EPS grew at a CAGR of 4%.

Valuation

Canadian Pacific trades at a high multiple of over 20 at $197 per share. Expecting double-digit growth in its EPS, its shares are considered to be in the fair value range. The very cautious investor could wait for a multiple 18 in case earnings turn out to be lower than estimated. At a multiple of 18, the shares would trade around $180.

In conclusion

I'm not encouraging the timing of the market, but around earnings report time, the market can get especially emotional about a company. Canadian Pacific could go up or down 5% in one day.

Because Canadian Pacific shares are fairly valued, Foolish investors can act cautiously by buying half a position now and finishing off the position after the earnings report. That is, if you plan to buy $5,000 worth of shares, you can buy $2,500 worth today, and buy more after the earnings report.

If the price goes up, it means the company is doing better than expected. If not, then you might be able to spend that $2,500 on more shares at a lower price.

CATEGORY

1. Investing

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