Why Canadian Pacific Railway Limited’s Stock Is up 1% Today

Description

Canadian Pacific Railway Limited (TSX:CP)(NYSE:CP), Canada’s second-largest rail network operator, announced its second-quarter earnings results this morning, and its stock has responded by rising about 1%. Let’s break down the results and the fundamentals of its stock to determine if we should be long-term buyers today or if we should wait for a better entry point in the trading sessions ahead.

A dismal quarter of negative top- and bottom-line growth

Here’s a breakdown of 12 of the most notable statistics from Canadian Pacific’s three-month period ended on June 30, 2016 compared with the same period in 2015:

Metric	Q2 2016	Q2 2015	Change
Adjusted net earnings	$312 million	$404 million	(22.8%)
Adjusted earnings per share	$2.05	$2.45	(16.3%)
Freight revenues	$1.41 billion	$1.61 billion	(12.7%)
Non-freight revenues	$44 million	$41 million	7.3%
Total revenues	$1.45 billion	$1.61 billion	(12.2%)
Operating income	$551 million	$646 million	(14.7%)
Operating ratio	62%	60.9%	110 basis points
Operating cash flow	$512 million	$585 million	(12.5%)
Free cash flow	$137 million	$173 million	(20.8%)
Carloads	614,000	668,000	(8.1%)
Freight revenue per carload	$2,291	$2,409	(4.9%)

Weighted-average number of diluted shares outstanding	151.7 million	163.7 million	(7.3%)

What should you do with Canadian Pacific's stock now?

Canadian Pacific faced numerous headwinds in the second quarter, including lower-than-expected volumes, the wildfires in Alberta, and a strengthening Canadian dollar, and it led to a horrible financial performance. With this being said, I don't think the market has reacted correctly by sending its stock higher today, but I do think it represents a great investment opportunity for the long term for three reasons.

First, it's undervalued. Canadian Pacific's stock trades at just 17.8 times fiscal 2016's estimated earnings per share of $10.50 and only 15.6 times fiscal 2017's estimated earnings per share of $11.98, both of which are inexpensive compared with its five-year average price-to-earnings multiple of 27 and the industry average multiple of 25.2. These multiples are also inexpensive given its estimated 10.5% long-term earnings-growth rate.

Second, it has been repurchasing its shares. Canadian Pacific repurchased 5.13 million of its common shares for a total cost of $867 million in the second quarter. These repurchases were part of its normal course issuer bid that was announced earlier this year, in which it can repurchase up to 6.91 million of its common shares beginning on May 2, 2016, and ending no later than May 1, 2017. This activity shows that Canadian Pacific's management team believes its stock is undervalued at current levels and that it is fully dedicated to maximizing shareholder value.

Third, it has a safe dividend. Canadian Pacific pays a quarterly dividend of $0.50 per share, or $2.00 per share annually, giving its stock a yield of about 1.1%, and this yield is easily supported by its free cash flow. A 1.1% yield is far from high, but it will amplify shareholders' returns going forward, especially if they are reinvested.

With all of the information provided above in mind, I think Canadian Pacific represents a great long-term investment opportunity. Foolish investors who do not already have exposure to the rail industry should strongly consider beginning to scale in to positions today.

CATEGORY

1. Investing

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

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