Canadian Pacific Railway Limited: Has the Stock Peaked?

Description

When oil started to fall in 2014, the valuation of **Canadian Pacific Railway Limited** (TSX:CP)(NYSE:CP) immediately took a hit. While the company was sure to experience low fuel costs, it started to lose pricing power on a business that's grown tremendously in recent years: crude by rail.

Today the valuation, while off its highs, remains well above long-term historical averages. Should investors wait for a further pullback?

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Are the problems short term?

Canadian Pacific has experienced a bit of turbulence lately.

In September it announced a few changes to its management team and board of directors.

Its executive VP and CFO Mark Erceg stepped down fewer than 16 months after he was appointed. Separately, the company announced that famed hedge fund manager Bill Ackman resigned from the board of directors, effective immediately. Ackman and his firm, Pershing Square, completely sold out of their position in Canadian Pacific last month.

Employees have also noted some volatility. Since 2012 the railway has cut over 6,000 jobs, including 1,200 in 2015 and over 1,000 in 2016.

The business hasn't been performing well historically either. A massive 42% of volumes come from bulk sources such as grain or coal with another 17% coming from metals, minerals, and crude oil, so the current ills across nearly every commodity have hit the company hard.

Long term, however, things don't look so bad.

First, the company's strong business moat remains a sustainable and formidable advantage. Sure short-term revenues may fluctuate based on fuel transportation oscillating between pipelines and train cars, but Canadian Pacific's rail network is still impossible to replicate from both a financial and regulatory standpoint.

As long as goods are being transported, Canadian Pacific will earn respectable profits. Trains can move a ton of freight over 470 miles on a single gallon of fuel, far outpacing just about every other mode of transportation.

Buy for the long haul

Along the way there will likely be bumps a bruises, but over the following few decades, Canadian Pacific is almost sure to prosper. It also has a strong history of rewarding shareholders. Since 2001, the company has more than tripled the size of its dividend. Since just 2014, it's bought back over 15% of its stock.

Current conditions will continue to push the stock around, but buy-and-hold investors shouldn't pay much attention.

But this company is even better

If you like Canadian Pacific, you'll love **Canadian National Railway Company** (TSX:CNR)(NYSE:CNI).

Canadian National consistently trades at a discount to Canadian Pacific, despite some of the best operating efficiencies in the industry. Today it trades at 11.5 times EV/EBITDA versus a valuation of 12.7 times for Canadian Pacific.

Over the past few years, Canadian National has also generated an average return on invested capital of about 15%. Canadian Pacific, meanwhile, has experienced wild swings from 5% to 13%. Return on equity for Canadian National (now at 25%) has also been much more stable than the of Canadian Pacific.

If you're choosing between railroads, stick with Canadian National and ditch Canadian Pacific.

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