With Rates on the Rise, This Is the Golden Goose

Description

Following the rate hike last Wednesday, investors have to take a step back and ask themselves what higher rates mean for long-term returns. Although long-term interest rates are little changed, the reality is that many companies will now have to rethink investing in long-term capital projects, as the investments will have to be financed at higher rates of interest. Although this may slow down the long-term capital expenditures for many companies, the silver lining is that many companies will still make these investments, but they will be much more cost conscious.

In an increasingly cost-conscious environment, every penny spent will be analyzed, which may lead to better planning and more cost-effective deliveries.

As the price of oil dipped to under US$40 per barrel in early 2016, many companies began shifting distribution away from railroads and went with long-haul trucks. Although the costs were similar, the delivery time was substantially shortened. Now, more than 18 months later, costs need to be re-evaluated, and railroads may become the biggest beneficiaries.

At a current price of slightly less than $195, shares of **Canadian Pacific Railway Limited** (TSX:CP)(NYSE:CP) have cooled over the past year, declining by almost 4% as the Canadian economy has continued its positive momentum. With a total debt load which has remained almost stagnant since the end of 2015, the company has rewarded investors by increasing the dividend to a quarterly rate of $0.56 per share and by buying back more than seven million shares since the end of 2015.

Given the higher costs of borrowing money, another catalyst for Canada's railroads may come in the form of higher oil prices. With higher interest rates, many oil companies may not be prepared to shoulder the higher risks of interest costs when borrowing money to fund new projects. The result may just be that less oil is produced, thereby reducing supply as demand continues to increase gradually year over year.

When analyzing shares of Canadian Pacific Railway, it is important to consider a number of factors. In the most recent quarter, revenues have increased by 13.3%, while earnings per share (EPS) have increased by 49%. On a year-over-year basis from fiscal 2015 to 2016, the company saw a decline in revenues but managed to increase EPS by 29%. As the trend has been improving for shareholders, the stock may now have paused long enough to begin another bull run over the coming years.

For investors considering the return on equity (ROE), the company has averaged a 30% ROE over the past two fiscal years (34% in 2016 and 26% in 2015), signaling that earnings may continue to rise. With quarterly earnings topping expectations for the first two quarters of the current fiscal year, shareholders presently have a chance to buy in to the golden goose before its true value is realized by other investors.

CATEGORY

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