Why Canadian Pacific Railway (TSX:CP) Is Soundly Beating the TSX Index

Description

Canadian Pacific Railway (TSX:CP)(NYSE:CP) has been outperforming the benchmark for years. Over the past 12 months, it has gained 19.9% to the TSX index's 3.3%. Over the past five years, it has returned 59% to the index's 12.5%. Since 2006, it has grown 363% to the TSX's 35%.

Basically, this stock is a market-beater over any timeframe you pick–save perhaps late 2015 and early 2016.

The question is, why? Railways are hardly the most innovative or popular companies in the world. Unlike tech stocks, they have no patent-protected miracle invention to boast. Unlike cannabis stocks, they aren't in a previously illegal industry that just opened the floodgates of legal sales. Unlike trendy clothing retailers, they aren't growing sales by leaps and bounds.

But here Canadian Pacific is, beating the market nonetheless. In this article I'll be exploring why that is the case, starting with one important factor that goes for any railway stock.

Excellent economics

As I've written before, the railway industry has excellent economics. The keys are cost efficiency and high barriers to entry. Trains are a more economical way to ship goods than trucks or planes. They beat trucks because each train can haul more than a truck could, without spending too much fuel. They also beat planes, despite burning slightly more fuel per kilometre, because their storage capacity is much larger. So trains are a low-cost transportation option, which ensures that railways get a ton of business.

That alone needn't make railway companies profitable, however. If everybody and their dog started a railway, there'd be massive competition in the industry, and operators would start competing on price points. Fortunately, they've also got high barriers to entry. Rail transport is a capital intensive industry in which it costs billions to start a new operation. This is an insanely difficult industry, which is why Canadian Pacific operates without competition over much of its service area.

Solid growth

How well have the aforementioned factors worked out for Canadian Pacific?

We can start by looking at revenue. In its most recent quarter, Canadian Pacific generated $2 billion in revenue, a 17% increase over the same quarter a year before. That's a solid growth rate in itself. But adjusted diluted earnings grew even more, at a whopping 41% year over year. For an established, 138-year-old-company, that's truly phenomenal growth–and the company expects to keep up double-digit growth all through 2019.

Exchange rate benefits

A final factor that favourably influences Canadian Pacific's fortunes is the CAD/USD exchange rate. Canadian Pacific does a lot of business with U.S., and collects U.S. dollar fees on some of its American runs. This works out well for the company, which reports income in Canadian dollars. The Canadian dollar is currently just $0.75 U.S. dollars, so every U.S. dollar Canadian Pacific earns becomes $1.33 CAD. This currently favourable factor could become a risk factor in the future: if the Canadian dollar starts rising, it will negatively impact the company's reported sales.

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andrewbutton