3 Reasons Why, Even at $311, Canadian Pacific Railway (TSX:CP) Is a Cheap Stock

Description

Canadian Pacific Railway (TSX:CP)(NYSE:CP) recently delivered a stunning quarter, yet the stock hasn't responded in kind. Here are three reasons why, even at $311 per share (as of writing), CP is a cheap stock.

Tremendous Q2 earnings

On July 16, CP reported revenues of $1.98 billion, up 13% from the second quarter 2018, and diluted EPS of $5.17 per share, a 70% increase over the same period. Interestingly, revenues increased across all segments, with particularly strong performances in grains and energy. The latter segment should be of no surprise, as crude-by-rail volumes continue to remain elevated thanks to Canada's supply glut.

The second quarter also saw an impressive 6% year-over-year increase in revenue tonne miles (RTMs), in spite of unfavourable winter conditions in the early part of this year.

Best operating ratio in North America

Strong quarter aside, CP also has the strongest operating ratio, period, of any railway operator in North America. The operating ratio (OR) is a much-followed metric by analysts, as it gives insight into the costs of running a railway, contrasted against its revenues, with a low OR being desirable — all things equal.

In CP's case, its second-quarter OR of 58.4% was the lowest among its peers, but, more importantly, this figured signaled a year-over-year reduction of an amazing 5.8%. Going forward, CP has also guided this strong operational performance to continue, with mid-single-digit gains in RTMs, double-digit EPS growth, and further 100-basis-point (or potentially up to 200 basis points) improvements in its operating ratio.

Strong execution implies ability to withstand economic downturns

CP's industry-leading execution through its precision-scheduled railroading (PSR) model means the company is able to meet growth targets, despite an uncertain macroeconomic backdrop. With strong year-over-year improvements in cost-cutting measures, CP is able to run lean, reduce headcounts, and schedule loads efficiently, as the economy begins to slow. Furthermore, strong grain, potash, and intermodal volumes in Q2 signify that CP is relying on more than just crude by rail to meet its top-line growth.

In summation, don't be fooled by CP's share price and look instead to its value proposition. By all measures, CP's management is hitting all the right buttons and pulling all the right levers.

Moreover, the value case is further bolstered thanks to CP's shareholder rewards programs. For example, the company has an extensive buyback program that has taken $7 billion shares off the market and has increased dividends/share by 86% since 2015, while targeting a stable 25-35% payout ratio.

With such a strong quarter on the books and a management team that clearly knows what they're doing, the recent share weakness in CP presents a buying opportunity for the long term.

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vmatsepudra