CP Rail (TSX:CP) Just Had a Record-Breaking Quarter: Is the Stock a Buy?

Description

CP Rail (TSX:CP)(NYSE:CP) announced yesterday a record-breaking first quarter for 2020. The railroad saw results beat on many metrics.

Revenue skyrocketed 16% year over year to a record $2 billion. Operating metrics were impressive, with its operating ratio (operating costs as a percentage of revenue) dropping 1,010 basis points to 59.2%. The industry average is between 60% and 70%, so that is very good. Diluted earnings decreased year over year by 4%, but adjusted diluted earnings increased 58% year over year.

Railways operate best when economies are strong and trade is active. This is completely evidenced by CP Rail's first-quarter results. Strong volumes in grain, energy products, and intermodal transport led to the solid revenue beat.

However, considering the broad economic impacts of COVID-19, we need to ask whether CP is a good investment right now. It did lower its 2020 earnings guidance to be neutral based on a decrease in anticipated volumes. Is it still a buy today?

CP Rail is a lean operating machine

I think it is. CP Rail is a lean operating machine. It implemented precision scheduled railroading (PSR) about 10 years ago, ahead of many competitors. As a result, it has consistently increased transportation capacity and simultaneously reduced costs.

Its operational efficiency was clearly evidenced in this quarter's strong results. Its operating ratio is among the best in the industry. Operating metrics such as train speed, length, and weight all improved and revenue tonnes per mile increased 6%.

This train will weather the storm

CP rail is known as Canada's east-to-west rail line. This may be beneficial, as the impacts of collapsing crude volumes will be less impactful than for competitors. Grain, potash, and fertilizers are CP's largest transportation segment, comprising 31% of its volumes.

In fact, it owns 54% of the market share for Canadian grain transportation. This bulk segment should remain resilient, as volumes are based on seasonal and agricultural factors, rather than secular economic conditions. In its Q1 conference call, management affirmed that volume in this segment should remain strong for the year.

Only 17% of CP's overall volumes are energy related. 5% are directly tied to crude transportation. Fortunately, most of CP Rail's crude volumes are secured by multi-year contracts, so revenue impacts should be modest.

CP Rail is on the right track

CP Rail is positioning itself for long-term growth. In its Q1 statement, management surprised analysts by maintaining its 2020 $1.6 billion capex program.

Uncertain times like these can actually be beneficial for CP. The company can more efficiently deploy its capital budget, because material costs are lower, staff are available, and tracks are vacant for maintenance optimization. As a result, capital investments over this year could be very accretive once the economy stabilizes and normal volumes resume.

This stock is chugging higher

CP Rail has a solid balance sheet with about $400 million of cash, a $1.9 billion undrawn credit facility, and no debt maturities until 2021. Management affirmed it will not raise the dividend or complete any buybacks right now. It does, however, plan to revisit its shareholder-reward program later this year.

All in all, the strong quarter, a depressed stock price, and a confident management team make CP Rail a compelling long-term investment. Management wants to grow better, not just bigger, which I like. While overall transportation volumes are still uncertain, I believe CP can make the economic downturn a catalyst for optimizing efficiencies and maximizing future growth.

The bottom line

CP Rail's stock is 19% below its February highs. Its dividend yield is 1.1%, 20 basis points above its five-year average. The stock has a price-to-earnings multiple of 18 times, which is slightly cheaper than **CN Rail**, which is at 19 times.

Alongside CN, CP Rail holds a duopolistic stake in the Canadian transportation sector. This company is foundational to Canada's economy. Right now is great time to hop on the railway, buy this stock, and let the returns "chug" into your pocketbook.

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Date
2025/08/25
Date Created
2020/04/22
Author
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