



Canadian Pacific Railway Limited (CP)

Updated August 3rd, 2021 by Kay Ng

Key Metrics

Current Price:	\$74	5 Year CAGR Estimate:	6.7%	Market Cap:	\$50B
Fair Value Price:	\$61	5 Year Growth Estimate:	10.0%	Ex-Dividend Date:	09/23/21
% Fair Value:	121%	5 Year Valuation Multiple Estimate:	-3.8%	Dividend Payment Date:	10/25/21
Dividend Yield:	0.8%	5 Year Price Target	\$99	Years Of Dividend Growth¹:	5
Dividend Risk Score:	A	Retirement Suitability Score:	D	Last Dividend Increase¹:	10.5%

Overview & Current Events

Canadian Pacific Railway Limited is a railroad company that operates about 13,000 miles of railways in Canada and the U.S. It is one of two class 1 railroads in Canada (Canadian National Railway (CNI) is the other). CP connects the Atlantic coast to the Pacific coast across six Canadian provinces and 11 U.S. states. The company was founded in 1881 and is headquartered in Calgary, Alberta. Its 2020 revenue diversification is as follows: 54% in energy & chemicals, 22% in metals & minerals, 12% in automotive, and 12% in forest products. The numbers in this report are in U.S. dollars unless specified otherwise.

Canadian Pacific reported Q2 2021 earnings results on 07/28/21. For the quarter, revenues rose by 15% to CAD\$2 billion, and adjusted diluted earnings-per-share (EPS) climbed 27% to CAD\$1.03. CP's operating ratio (operating expense relative to revenues) increased by 3.1% to 60.1%, including a cost related to the Kansas City Southern acquisition. Otherwise, its adjusted operating ratio (excluding the acquisition costs) would have improved 1.7% to 55.3%.

In May, Kansas City Southern (KCS) terminated its merger agreement with CP and gave it a break-up fee of \$700 million, as the former agreed to merge with Canadian National Railway instead. Should CN Rail succeed, it would create the first U.S.-Mexico-Canada rail network that will increase its competitiveness against CP.

CP maintained its 2021 forecast, estimating its adjusted EPS to increase at a double-digit rate, as this forecast did not include any impacts from the previous KCS acquisition.

Growth on a Per-Share Basis

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
EPS	\$3.16	\$4.04	\$6.03	\$7.28	\$7.27	\$7.72	\$8.70	\$10.88	\$12.39	\$13.87	\$3.06	\$4.93
DPS	\$1.10	\$1.30	\$1.32	\$1.20	\$1.01	\$1.27	\$1.59	\$1.91	\$2.37	\$2.65	\$0.61	\$1.08
Shares¹	170	174	175	166	153	146	145	142	138	135	660	580

Because CP had a share split of five for one in May 2021, the estimates for 2021 and 2026 are much smaller than 2020's numbers. Canadian Pacific's earnings per share grew by 17.9% from 2011 to 2020, but the relatively high earnings growth rate was due to an economic recovery subsequent to the last financial crisis in 2007/08. Currency rate movements between the US\$ and CAD\$ will also cause earnings volatility for U.S. investors. As a railroad, CP is somewhat dependent on the state of the economy because the volumes that the company transports are affected by economic activity. Those traffic volumes are the key factor for the company's revenue performance, which, in turn, is needed to grow the company's bottom line. COVID-19's widespread negative impact on economic activities can dampen the company's growth as demonstrated by its lower-than-normal Q1 revenue growth that tends to translate to lower-than-normal earnings growth. That said, CP generates some of the highest return on equity (ROE) in the industry. Since 2014, its ROE has been at least 23%. In 2020, it was incredible at 34%. Moreover, the company's tendency to buy back shares can soften the blow of lower economic activities in certain industries. The pandemic situation is dynamic. For now, we estimate the economy may see some form of normalization by end of 2021 or early 2022. We expect an EPS

¹ Years of Dividend Growth in CAD\$; TTM dividend increase based in CAD\$; Shares in millions.

Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.



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growth rate of 10% through 2026, but CP certainly has the room and potential to increase its dividend-per-share (DPS) at a rate of about 12%.

Valuation Analysis

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	Now	2026
Avg. P/E	19.4	20.0	21.3	24.4	22.4	17.8	18.2	16.4	18.4	20.6	24.3	20.0
Avg. Yld.	1.8%	1.6%	1.0%	0.7%	0.6%	0.9%	1.0%	1.1%	1.0%	0.9%	0.9%	1.1%

Canadian Pacific is valued at about 24.3 times this year's expected earnings at writing. The stock is a little pricey here, as the company's average price-to-earnings ratio was 19.9 between 2011 and 2020. With an expected EPS growth rate of about 10%, we don't expect the stock to stray far away from a price-to-earnings ratio of 20 for too long.

Safety, Quality, Competitive Advantage, & Recession Resiliency

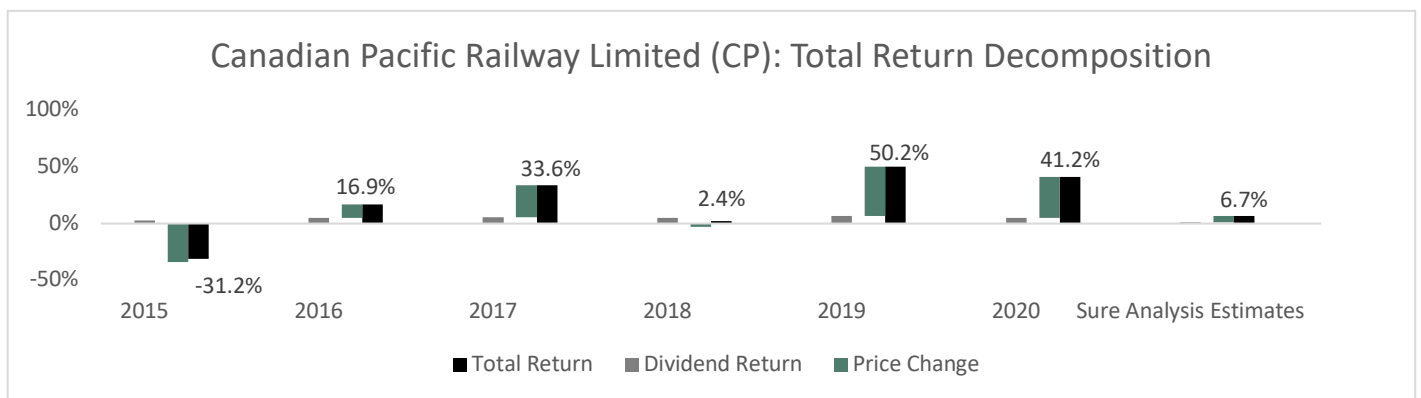
Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
Payout	35%	32%	22%	16%	14%	16%	18%	18%	19%	19%	20%	22%

Canadian Pacific's dividend payout ratio is low, as the company has paid out less than 20% of its profits as dividends since 2014. Its dividend is safe and management plans to expand the payout ratio to 25-30% of adjusted EPS over time, but because of a low dividend yield, Canadian Pacific is not a good pick for income investors. Management tends to prioritize share repurchases, which makes Canadian Pacific more suitable for investors who seek stock price appreciation. Canadian Pacific is one of two class 1 railroad companies in Canada, which provides a tremendous moat. There are very high barriers to entry, which is why it is very unlikely that new market entrants would try to steal market share from either of the two major railroads. Neither Canadian Pacific nor its peer Canadian National Railway is interested in a price war. It is thus probable that the two will maintain their profitable duopoly. Due to the impact that the strength of the economy has on Canadian Pacific's traffic volumes, the company is somewhat vulnerable to recessions. COVID-19 has caused economic disruptions, but we're confident CP will continue to be resilient.

Final Thoughts & Recommendation

Canadian Pacific reported resilient business results for 2020. The stock has comeback strongly since the March market crash. We estimate total returns of 6.7% in the stock, coming from earnings growth of 10% per year, a forward yield of 0.8%, and a valuation compression of -3.8% per year. We rate the security as a hold at current prices and a potential buy on substantial dips.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Revenue	5236	5697	5956	5996	5259	4706	5057	5645	5871	5754
Gross Profit	1862	2312	2771	3011	2883	2504	2758	3012	3253	3255
Gross Margin	35.6%	40.6%	46.5%	50.2%	54.8%	53.2%	54.5%	53.3%	55.4%	56.6%
SG&A Exp.	734	796	697	649	586	341	357	374	377	784
D&A Exp.	496	539	549	500	466	483	510	537	532	581
Operating Profit	1028	1297	1826	2121	2053	1792	1988	2209	2450	2471
Operating Margin	19.6%	22.8%	30.7%	35.4%	39.0%	38.1%	39.3%	39.1%	41.7%	42.9%
Net Profit	576	484	850	1337	1059	1207	1856	1506	1838	1824
Net Margin	11.0%	8.5%	14.3%	22.3%	20.1%	25.7%	36.7%	26.7%	31.3%	31.7%
Free Cash Flow	-599	180	693	611	734	685	650	896	1012	844
Income Tax	128	152	243	509	476	418	72	492	532	566

Balance Sheet Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Total Assets	13821	14804	16022	14257	14151	14256	16012	15605	17123	18539
Cash & Equivalents	46	335	447	195	468	122	269	45	102	115
Accounts Receivable	507	549	545	605	465	438	546	598	616	647
Inventories	135	137	155	152	135	136	121	127	139	163
Goodwill & Int. Ass.	188	162	152	152	152	150	149	148	158	287
Total Liabilities	9267	9680	9357	9424	10695	10825	10893	10733	11711	12799
Accounts Payable	379	323	336	351	244	261	320	348	347	
Long-Term Debt	4674	4714	4579	4961	6455	6441	6488	6385	6704	7663
Shareholder's Equity	4554	5124	6665	4833	3456	3431	5119	4872	5412	5740
D/E Ratio	1.03	0.92	0.69	1.03	1.87	1.88	1.27	1.31	1.24	1.34

Profitability & Per Share Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Return on Assets	4.2%	3.4%	5.5%	8.8%	7.5%	8.5%	12.3%	9.5%	11.2%	10.2%
Return on Equity	12.3%	10.0%	14.4%	23.3%	25.6%	35.1%	43.4%	30.1%	35.8%	32.7%
ROIC	6.3%	5.1%	8.1%	12.7%	10.8%	12.2%	17.3%	13.2%	15.7%	14.3%
Shares Out.	170	174	175	166	153	146	145	142	138	135
Revenue/Share	30.69	32.89	33.74	34.38	32.66	31.27	34.57	39.40	42.15	42.31
FCF/Share	-3.51	1.04	3.93	3.50	4.56	4.55	4.44	6.25	7.26	6.21

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.

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