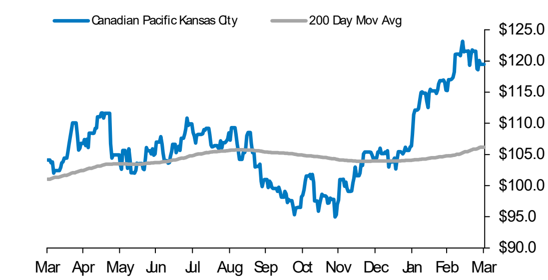
Canadian Pacific Kansas City (CP-T)

Sector: Industrials

Company Overview

Canadian Pacific Kansas City (CPKC) provides rail and intermodal freight transportation services over a network of approximately 20,000 miles across Canada, the U.S., and Mexico.

Canadian Pacific Kansas City Limited			
BMO CM Rating	Outperform	Target Price	125.00
Current Price	119.43	Dividend	0.76
52-Week High	123.37	Yield	0.64%
52-Week Low	94.45	BVPS	44.51
Market Cap ($M)	111,360	P/BV	2.7x
FYE (MM/DD) 12/31	2023A	2024E	2025E
EPS	3.84	4.36	5.17
P/E	31.1x	27.4x	23.1x
EPS Growth	-	13.6%	18.6%



Source: Bloomberg

Investment Thesis

BMO Capital Markets (BMO CM) believes that the combination of CP Rail and Kansas City Southern networks significantly expands the addressable freight market for the merged entity and catalyzes a period of strong organic volume growth that will extend well into the coming decade.

Recent Developments

Q4 adjusted EPS of $1.18 was up 3.5% y/y and was 6% above both consensus and BMO CM's forecast of $1.11. Freight revenues were 1.7% above BMO CM's model including RTM and yield that were 0.3% and 1.3% higher. Opex (ex. fuel & acquisition costs) was 1.3% below BMO CM's estimate, and up only 3.6% q/q despite an 11% q/q increase in RTM volumes. The strong sequential performance drove an impressive 300bp q/q improvement in Operating Ratio (OR) to 58.7%, which outperformed BMO CM's 59.4% forecast. F2023 adjusted EPS of $3.84 was up 1.9% y/y and in line with guidance of flat to slightly up.

The company is on track to reach target leverage of 2.5x by late F2024 or early F2025, at which point management will re-evaluate the capital allocation strategy including increasing shareholder distributions. With respect to the potential accommodation of a passenger rail concession in Mexico, CPKC indicated that it does not expect any such service to impact its five-year financial framework outlined during the June 2023 investor day.

Underpinning the outlook is low single-digit RTM volume growth and strong pricing. OR should benefit from moderating inflationary pressures and strong re-pricing opportunities including within the KCS book of business where the value of the combined network is beginning to be realized. This outlook is consistent with BMO CM's prior forecast including RTM and revenue growth of 2.8% y/y and 7.4% y/y. With non-fuel costs stepping down in H2/23 and management expectations for flat headcount in the coming year, operating leverage appears to be supportive of BMO CM's 14% EPS growth forecast to $4.39 in F2024.

Target Price & Methodology

BMO CM's $125 target price is based on a discounted forward P/E of 21.0x F2027.

Key Risks

Freight demand deteriorates, and CP realizes merger synergies slower than expected.