



Rating
Buy

Company
Canadian Pacific

North America
 Canada

Industrials
 Railroads

Reuters Bloomberg
 CP.N CP US

Seldon Clarke
 Associate Analyst
 +1-212-250-5959
 seldon.clarke@db.com

Price at 30 Oct 2017 (USD) 174.74
 Price Target 209.00
 52-week range 177.61 - 139.33

Shifting Gears; Initiate Buy/\$209 price target

Following its multi-year implementation of Precision Railroading, CP is shifting gears from cost take-out to top-line growth. As such, we see at least 15% upside in shares as CP leverages its reduced cost base, improved service levels, and recent capacity investments to retake market share. We expect this to translate to 30% cumulative EPS growth over the next two years, reflecting mid-single digit revenue growth, significant operating leverage, and accelerated share repurchase. Against this backdrop we see CP's relative valuation discount as unsustainable, which underpins our positive stance to shares. Initiate Buy.

CP is putting the pieces together to leverage a better network

After bringing its cost base closer in-line with CNI, CP has undertaken a number of initiatives aimed at growing its top-line and taking market share. Further, it has made a number of capacity investments in order to improve service levels and more profitably handle volume growth across its network and reinvigorated its sales/marketing efforts to expand existing relationships and win new business. At the end of the day, we believe CP is poised to drive best in class volume growth and increase operating leverage as it targets higher margin business. To this point, we forecast volume growth (measured by revenue ton-miles [RTM's]) to increase at a 3.1% CAGR over the next two years compared to 2.4% CAGR at CNI. In addition to CP's company-specific initiatives, we see outsized tailwinds for CP's domestic intermodal, crude by rail, and potash businesses which support our view of best-in-class volume growth.

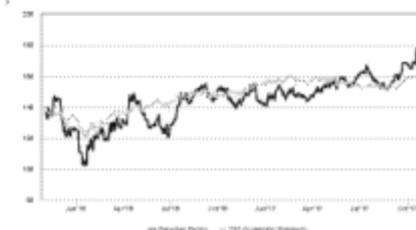
CP's discounted valuation does not reflect earnings potential

CP currently trades at 17.5x NTM EPS estimates, which is about 3% below its 5-year avg. and nearly 10% below CNI's current multiple. CP's de-rating (both on an absolute and relative basis) has coincided with a 20% decline in merchandise volumes from 2014 to 2017E while CNI's merchandise RTM's are now back in-line with 2014 levels. Given our expectation for CP to generate best-in-class RTM growth over the next several years, we see potential for shares to re-rate higher as improved operating leverage translates to higher earnings growth.

Valuation and risks

Our \$209 price target is based on 17.5x our 2019 EPS estimate, which is supported by our DCF framework (3.75% terminal growth and 7.9% WACC). Downside risks include a sharp decline in commodity prices, lower pricing, NAFTA, and recession.

Price/price relative



| Performance (%) | 1m | 3m | 12m |
|-----------------|-----|------|------|
| Absolute | 4.0 | 10.7 | 22.2 |
| TSE Composite | 2.4 | 5.8 | 8.2 |

Source: Deutsche Bank

Stock & option liquidity data

| | |
|-------------------------------------|----------|
| Market Cap (USD) | 25,418.3 |
| Shares outstanding (m) | 145.5 |
| Free float (%) | 100 |
| Volume (30 Oct 2017) | 73,246 |
| Option volume (und. shrs., 1M avg.) | 42,935 |

Source: Deutsche Bank