5 Things to Watch for in Canadian Pacific Railway Limited’s Q3 Earnings Release

Description

Canadian Pacific Railway Limited (TSX: CP)(NYSE: CP) operates one of the largest rail networks in North America and its stock has been one of the market’s top performers in 2014, rising more than 25% compared to the TSX Composite Index’s return of a little more than 2%. However, the stock is down more than 12% in October as a result of overall weakness in the market.

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Source: YCharts

Canadian Pacific is scheduled to release third-quarter earnings on October 21 and better-than-expected results could help propel the stock back towards its highs. Let’s take a look at five of the most important factors the company will need to satisfy if its stock is going to react positively.

1. The results versus analysts’ expectations

To begin, it will be of the utmost importance for Canadian Pacific to meet or surpass analysts’ earnings per share and revenue expectations. Here is a chart of the current consensus estimates.

Metric	Expected	Year Ago
Earnings Per Share	$2.23	$1.88
Revenue	$1.53 billion	$1.53 billion

Source: Estimize

These estimates call for earnings per share to increase 18.6% and revenue to remained unchanged compared to the third-quarter of fiscal 2013.

2. Q4 Outlook

Secondly, it will crucial for CPR to provide outlook on the fourth quarter that meets or exceeds the expectations of analysts. Here is a chart of the current consensus estimates.

Metric	Expected	Year Ago
Earnings Per Share	$2.36	$1.91
Revenue	$1.61 billion	$1.61 billion

Source: Estimize

These estimates call for earnings per share to increase 23.6% and revenue to remain unchanged compared to the fourth-quarter of fiscal 2013.

3. Full-year outlook

While providing sufficient outlook on the fourth quarter, it will also be important for Canadian Pacific to reaffirm, or raise, its full-year outlook; this outlook, provided in its fourth-quarter report, anticipates earnings per share growth of 30% or more, revenue growth of 6%-7%, and an operating ratio of 65% or lower.

4. Operating ratio

As mentioned in the section above, Canadian Pacific expects its operating ratio to be 65% or lower in fiscal 2014 compared to 69.9% in fiscal 2013, so investors will want to be sure the ratio dips below 65% in the third quarter. The operating ratio is a way of showing the operating efficiency of a given company, and is calculated by dividing total operating expenses by total revenues. Canadian Pacific's operating ratio was 65.1% in the second quarter of 2014, a 680-basis-point improvement from the year-ago quarter, and was 65.9% in the third quarter of 2013, an 820-basis-point improvement from the year-ago quarter, so investors can use these percentages for recent and year-over-year comparisons.

5. Free cash flow

Lastly, watch for the total amount of free cash flow generated in the third quarter. The company reported $530 million in free cash flow in fiscal 2013, but it has already surpassed this total in the first half of 2014 alone by generating $534 million. It would be incredible if the Canadian Pacific could maintain this pace to double its free cash flow by generating another $250 million in the third quarter.

Should you buy a long-term position in Canadian Pacific today?

Canadian Pacific Railway is one of the most well-run rail networks in Canada and this has resulted in incredible returns for its shareholders over the last few years. The company's stock has posted a strong performance in 2014, returning more than 25%, but it sits more than 15% below its 52-week high reached just a few weeks ago, representing immense upside potential if it can surpass earnings expectations on October 21. Long-term investors should strongly consider adding positions today.

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1. Investing

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