Canadian Pacific Railway Limited’s Q2 Earnings Suggest an Improving Economy

Description

Canadian Pacific Railway Limited (TSX:CP)(NYSE:CP) reported its Q2 earnings on Wednesday. Earnings showed strong year-over-year revenue growth of 13% with total sales reaching over $1.6 billion for the quarter. Net income was up for the fourth consecutive quarter and reached a record level of $480 million, up 46% year over year. Earnings per share (EPS) for the period were $2.77, beating estimates of $2.72.

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Reduction in operating expenses

In addition to revenue growth, the company has also made strides in reducing its expenses. Although overall operating expenses are up 7%, a percentage of revenue expenses are down. The operating margin for Q2 was 41%, compared to just 38% from a year ago. Profit margins saw even larger increases from 22% last year up to over 29% for this past quarter. However, much of the improvement in profit margin came from gains on foreign exchange which were up $49 million this quarter.

Breakdown of freight revenue

A reason why railroads are associated with improving economies is because they are a main source of transport for many items, including commodities. Some of the item that are transported through CP Rail include grain, coal, potash, metals, minerals, and many others.

Specifically, grain-related transport made up the majority of the freight revenue for CP Rail, accounting for 23%. Grain revenues were up 20% from a year ago and added $61 million for the railway operator. The metals, minerals, and consumer products segment added $50 million and increased 10% from a year ago. Energy, chemical, and plastic added $30 million, as did potash.

Those segments made up $171 million of the company’s total increase in revenue ($192 million), or 90% of the total change. The largest decline for the operator came from automotive products, which declined by $14 million, a year-over-year drop of 15%.

Improved cash flows

Cash flow from operations for the first two quarters are up 26% compared to last year, and free cash flow doubled during that period. This might present another opportunity for CP Rail to increase its dividend in the future. Earlier this year, the company's dividend was hiked by 12.5% and now yields an annual return of 1.11% with $0.5625 paid every quarter.

Where the stock might go from here

With the strong earnings result, CP Rail's EPS for the trailing 12 months will jump from $10.10 up to about $11.17. This improvement in EPS would drop the company's price-to-earnings multiple from over 20 down to about 18.2. If the price moves back up to a multiple of 20, the share price could jump to $223, which, as of the close of Wednesday, would be an increase of 9.7%.

The stock price for CP Rail has gone up over 6% since the start of the year. The company's last earnings results led the stock up to highs of over $218 before coming down to current levels. Over the past 12 months, the stock has increased over 11% in price. After Wednesday's strong results, the shares might be due for another incline.

Looking ahead

Railroads have been associated with strong economies. Since 2009, the share price for CP Rail has increased by over 400%. With the Canadian economy picking up a bit of steam, it might mean even more potential growth for the railroad operator.

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