Canadian Pacific Railway Limited Finishes 2017 With a Strong Q4: Is it a Buy for 2018?

Description

Canadian Pacific Railway Limited (TSX:CP)(NYSE:CP) released its fourth-quarter results on Thursday, which showed the company beating expectations as it capped off a strong year. Revenue for the quarter was up 5% from a year ago, and CP Rail saw slightly higher growth for the full year.

Net income saw an even more noticeable improvement in Q4 with profits of $984 million more than doubling last year's tally of $384 million. For the full year, the company netted a profit of $2.4 billion, which is up more than 50% from a year ago and represented an incredible 37% of sales, which is also an improvement over the 26% profit margin the railway operator achieved in 2016.

Let's take a closer look at the results to see if the stock is a good buy today.

A strong economy behind a lot of the growth

It doesn't come as a big surprise that CP Rail had a great quarter and a strong year. We've seen **Canadian National Railway Company** recently add workers just to meet demand, as volumes have been continuing to rise. The economy has been growing well, and another rate hike is further proof of that.

When the economy does well, traffic on railways is typically up since we see more consumer goods and raw materials being transported. The number of carloads that transported metals, minerals, and consumer products was up 27% in Q4 while traffic from energy, chemicals, and plastics increased 16% from a year ago. Potash and forest products were also up 7% and 6%, respectively.

If the economy starts to slow down, and there are reasons why it might, that could see a reversal of fortunes for CP Rail. Investors will want to pay close attention to how the economy responds to rising interest rates and minimum wages this year.

Income tax recovery provides a strong finish to the year

By looking at the bottom line, investors might be excited to see the terrific growth in profits that CP Rail achieved in Q4. However, a closer look shows us that operating income was up just 5%.

A big reason for the significant improvement in CP Rail's profit came as a result of U.S. tax reform. The company revalued its deferred-tax liabilities, and the significant reduction in corporate tax rates in the U.S. more than offset rate increases in British Columbia and Saskatchewan, producing a net recovery of $527 million for CP Rail.

From an income tax expense of $143 million a year ago, the company had a net recovery of $363 million in Q4, a swing of $506 million, which makes up 84% of the $600 million improvement in net income this quarter.

Guidance remains optimistic

President and CEO Keith Creel is very optimistic about 2018, and in the earnings release he stated that "I have never been more excited about the potential for CP as we write the next chapter in our compelling story, one focused on sustainable, profitable growth." For 2018, the company expects to see similar revenue growth while diluted per-share earnings are projected to see increases in the double digits.

Is the stock a buy?

If you're bullish on the Canadian economy, then CP Rail could be a great buy, as more traffic on its railways will lead to stronger top and bottom lines for the company.

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