Margins Make All the Difference for This Small-Cap Stock

Description

It's always nice to be recognized by the investment community. In the past month, **Cargojet Inc.** (TSX:CJT) has made not one, but two lists.

The first is **RBC Dominion Securities's** Imagine 2025 list — a group of 69 North American stocks that'll benefit from the developing trends it sees in the world.

The second is **Royal Bank of Canada's** 20-stock, Small-Cap Conviction List, the broker's annual look at which stocks under a $2 billion market cap will do well over the next 12 months.

As I said, while it's nice to make these lists, the company ultimately has to deliver the goods. Cargojet, which specializes in air cargo in Canada, does just that.

The margins have it

Fool contributor Chris MacDonald focused on Cargojet's virtual lock on the Canadian air cargo market — it has 95% of the air cargo market in this country — and the significant cash flow generated by a prepayment business model that's hard to beat.

Those are great points, indeed. It's truly built itself a wide moat that's highly impenetrable. However, it's the company's margins that have me frothing at the mouth.

In its first-quarter earnings released at the beginning of May, Cargojet actually saw its gross margin drop by 70 basis points year over year to 23.4%. On the surface, that might seem like a negative. However, the gross profit on a dollar basis actually increased by 10.5% to $23.1 million from $20.9 million a year earlier.

While you always want to see the gross margin percentage moving higher on a quarterly basis, it doesn't always work out that way. Some quarters, you lose some margin only to make it up down the road. It's the nature of the business.

What's more important is the long-term trend. In that regard, Cargojet is doing just fine.

On a trailing 12-month basis, Cargojet's gross margin is 27.5%. A year ago it was 25.9% and almost half that again the year before that. Despite the small downturn in Q1 2018, Cargojet's margins haven't been this healthy since 2009.

Farther down the income statement, you'll see that the company's operating expenses in the quarter actually dropped by $700,000 on a $12.1 million increase in revenues. Add back in its interest costs of $6 million in the quarter, and Cargojet's EBIT profit margin increased by 70 basis points in the quarter to 12.6%.

At the very bottom of the income statement, Cargojet's earnings per share increased 37.5% to $0.33, despite a 25% increase in the number of shares outstanding year over year.

An expensive stock

Not only does MacDonald consider Cargojet stock pricey, so does another Fool colleague, Joey Frenette, who recently suggested its trailing P/E ratio of 33 is a bit rich.

That said, they both are believers in the company's position within the Canadian cargo industry.

For me, it's all about cash flow. If a company is growing cash flow, I'm a lot more confident in its future. In the trailing 12 months through the first quarter, Cargojet generated $78 million in operating cash flow, or about $5.78 a share.

At its current share price, it's trading around 10.9 times cash flow. Historically, it's traded around this multiple — sometimes higher, sometimes lower, I'd describe CJT stock as fairly valued at this time and certainly not expensive given the role it's playing in Canada's growing e-commerce industry.

Cargojet has a market cap of $846 million. Assuming it continues to maintain its lovely margins, I expect it to go over $1 billion as early as this time next year — perhaps sooner.

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