Canadian Pacific Railway Limited's (TSX:CP) Q2 Results Could Be Cause for Concern

Description

Canadian Pacific Railway Limited (TSX:CP)(NYSE:CP) released its quarterly earnings on Wednesday. The company continued to show strong growth. Revenues were up 7% in Q2; however, profits declined by over 9%. Let's take a look at the results to get a deeper look at how the railway operator did in its most recent reporting period and why it wasn't able to see an increase in its bottom line.

Carloads up despite labour issues

Earlier this year, CP Rail faced the possibility of a labour disruption impacting its operations. However, it was able to resolve the issue without any major issues, and total carloads transported during the quarter were up 2% from last year.

Energy, chemicals, and plastics saw the most growth, with a 26% increase in carloads. Fertilizer and sulphur, however, was down 14%.

Fuel costs and foreign exchange keep net income down from last year

While CP Rail did see good revenue growth for the quarter, unfortunately, its costs were up by even more. More expensive oil prices are starting to take a toll on the company, as fuel costs were up 44% from last quarter, despite only seeing a 4% increase in revenue tonne miles.

Unlike last year, CP didn't get a benefit from foreign exchange, and a $67 million gain last year became a $48 million loss this quarter for a combined effect of $115 million.

Between foreign exchange and fuel costs, CP Rail saw its costs rise by $185 million from these two items, which would have easily turned the $44 million decline in net income this quarter into a positive.

Company has high hopes for the rest of the year, with an asterisk

With labour issues aside, CEO Keith Creel was optimistic about the remaining two quarters of the year:

"With labour stability in place, strong underlying network performance and a robust demand environment, the path is clear and the opportunities are many. We will continue to take a disciplined and strategic approach to growing the franchise."

While the CEO was definitely bullish in his outlook, what sticks out to me is that he did not quantify the level of growth that is expected and was definitely reserved in his outlook by using the words *well positioned* and *disciplined*, which suggests to me there's a level of apprehension there.

Whether the concern is tariffs or rising interest rates, there's definitely some uncertainty in how well the Canadian economy will perform under current conditions, and I wouldn't be surprised if CP Rail is taking a more cautious tone because of that.

Is CP Rail a buy?

With the stock around $250 by the close of Wednesday, CP Rail's stock has risen around 20% in the past year, and it's not far off its 52-week high. While its price-to-earnings ratio is a very reasonable multiple of 15, its price-to-book ratio of over five is a bit expensive.

While CP Rail has some uncertainty behind it with labour issues now resolved, trade wars may place even bigger question marks around the business. That, unfortunately, makes the stock a bit too risky for me, and it's why I'd avoid investing in CP Rail, at least for the time being.

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Date

2025/08/26
Date Created
2018/07/19
Author
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