What You Need to Know About Canadian Pacific's Latest Earnings Report

Description

There is nothing more Canadian than shrugging off cold winter weather. And on Tuesday, that's exactly what **Canadian Pacific** (TSX: CP)(NYSE: CP) did as it reported first-quarter earnings. Despite the rough conditions, which shortened train lengths, drove up costs, and increased loading and unloading times, CEO Hunter Harrison is not changing his outlook for the year.

Canadian Pacific is still targeting revenue growth of 6-7%, earnings growth of 30%, and an operating ratio (expenses as a percentage of revenue) of 65% for the year. For the quarter, results were ahead of expectations. The operating ratio improved by 3.8 percentage points over 2013, and diluted EPS rose 16% to $1.44. Analysts were expecting $1.41.

Not all good news

Of course Canadian Pacific is still upset about Canada's new regulatory developments, something that has also annoyed rival **Canadian National Rail** (TSX: CNR)(NYSE: CNI). Included in the new regulations is a minimum level of grain shipments, which Canadian Pacific is meeting. The government is also expanding "interswitching" rights, which mandate that Canadian Pacific must transport goods to a competing railway at regulated (unprofitable rates) if that's what a customer wants.

The Canadian government is also accelerating its review of the Canada Transportation Act, which could lead to even more regulations later this year.

Returning cash to shareholders

Canadian Pacific is far more profitable than when Mr. Harrison took over two years ago. So he has to decide what to do with all that cash. The good news is that he is committed to returning it to shareholders.

The bad news is that he is placing an emphasis on buybacks, apparently done to appease the company's many American investors. According to Bloomberg, over 73% of CP's shares are held inthe United States, which charges hefty taxes on dividends from foreign companies like CanadianPacific.

The problem with buybacks is Canadian Pacific's stock price, which has been on a tear. Buybacks only really create value when a company's shares are undervalued – with Canadian Pacific stock trading over $170 per share, such a case is much harder to make than it was two years ago. Canadian investors should prefer a dividend increase with that money; the stock currently yields only 0.8%. But Canadians are in the minority.

Foolish bottom line

That being said, Canadian Pacific has been wonderful for shareholders from both countries since Mr. Harrison took over, so it is hard to criticize him for something like this. And with strong demand continuing forits services, the future looks bright for the company too. Even if the weather doesn't always cooperate.

CATEGORY

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