



Strong Earnings at Caterpillar Inc. Bodes Well for Canada's CAT stocks

Description

Caterpillar Inc. ([NYSE:CAT](#)) stock was up almost 7% in morning trading after delivering first-quarter earnings that smashed expectations.

The maker of heavy equipment raised its outlook for 2017 full-year earnings to US\$3.75 per share excluding restructuring costs, US\$0.49 higher than analyst estimates. It now sees full-year revenues of at least US\$38.0 billion, US\$2 billion more than its January guidance.

Caterpillar is undergoing a restructuring plan that has it consolidating some of its manufacturing facilities around the world to maintain a cost structure in line with the current business environment. It expects to incur US\$1.3 billion in restructuring costs in 2017, US\$750 million higher than originally anticipated.

"Our team delivered outstanding operational performance and, for the first time in more than two years, same quarter sales and revenues increased," said Caterpillar Chief Executive Officer Jim Umpleby. "While we are raising the full-year outlook for sales and revenues, there continues to be uncertainty across the globe, potential for volatility in commodity prices, and weakness in key markets."

Caterpillar's CEO is exercising caution when it comes to its future business outlook despite the first quarter's good news.

Although the tone of Caterpillar's report bodes well for both of Canada's Caterpillar stocks, **Finning International Inc.** ([TSX:FTT](#)) and **Toromont Industries Ltd.** ([TSX:TIH](#)), is it enough to warrant investors buying either of Canada's publicly-traded CAT stocks?

Let's have a quick look.

Caterpillar's news gave Finning's stock some much-needed life April 25, boosting its stock price by almost 5% as of midday trading. Before the news, Finning stock was down 6.8% year to date; Toromont hasn't seen nearly the same pop from Caterpillar's news, but it's having a much better year up 10.3% as of April 24.

Over the past three years, there's absolutely no comparison between the two stocks: Finning and Toromont are averaging annual total returns of -2.9% and 22.4% respectively. Finning might have had a great bounce-back year in 2016, up 44.7%, 814 basis points higher than Toromont, but over the long haul, Toromont's easily been the better performer.

The future

In early February I [proposed](#) Finning and Toromont merge, bringing together two of the world's biggest Caterpillar dealerships with Toromont's growing refrigeration business; an excellent combination, I reasoned, because together they could weather storms faced by Caterpillar and other heavy equipment manufacturers.

Toromont was the **Royal Bank of Canada's** ([TSX:RY](#))([NYSE:RY](#)) ninth-largest stock pick on the bank's 2017 Focus List with a 5.0% weighting; Finning didn't make the cut.

The big difference between the two companies in fiscal 2016 was CIMCO, Toromont's refrigeration business, which saw operating income increase 37% to \$20.4 million on revenues of \$280.4 million, a 20% increase year over year. Unfortunately, CIMCO accounts for less than 15% of its revenue and 10% of its operating income.

Toromont's equipment group had \$1.6 billion and \$196.1 million in revenue and operating income respectively in fiscal 2016; this compares to \$5.6 billion in revenue and \$165 million in operating income for Finning in fiscal 2016.

Over the past decade, Toromont's wiped the floor with Finning when it comes to operating margins; I don't expect that to change. It's also delivered higher returns on invested capital than Finning. That's also unlikely to change.

Last May, I [recommended](#) investors sell Finning stock, in part because hedge fund manager David Einhorn was short Caterpillar stock. Finning's performance since then suggests my timing was wrong.

I'd be curious to know if Einhorn is still short.

Bottom line

Personally, I don't see Caterpillar as a short. However, like its CEO said in the Q1 2017 press release, there's reason to be cautious.

If you want to buy one of Canada's CAT stock on Caterpillar's good news, there's no question I'd make it Toromont. It's the better long-term buy in my opinion.

CATEGORY

1. Investing

TICKERS GLOBAL

1. TSX:FTT (Finning International Inc.)
2. TSX:RY (Royal Bank of Canada)

3. TSX:TIH (Toromont Industries Ltd.)

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1. Investing

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