Why Is Canadian Pacific Up Over 60% in the Past Year?

Description

In early February 2012, hundreds of **Canadian Pacific** (TSX:CP, NYSE:CP) investors and analysts gathered in a conference room at the Hilton in downtown Toronto. They were there to see activist investor Bill Ackman make the case for his “Nominees for Management Change”, which included replacing then-CEO Fred Green with former **Canadian National Railway** (TSX:CN, NYSE:CN) CEO Hunter Harrison.

Mr. Ackman made an overwhelming case that CP’s performance thus far was unacceptable. By nearly every financial measure, whether based on profitability, returns, market share, or stock price performance, CP lagged its peers.

The company badly needed a shakeup, and there was no better candidate than Hunter Harrison, who had developed a sterling reputation as head of Illinois Central and CN. CP’s investors embraced the idea, and when the writing was on the wall, both Mr. Green and CP’s then-chairman resigned, paving the way for Mr. Harrison.

After becoming CEO, Mr. Harrison proved that he was serious about cutting costs. In December 2012, he announced plans to slash 25% of the company’s workforce over the next four years. But that was only the start. The company also had plans to reduce its fleet of locomotives and railcars, while shutting down three intermodal rail yards.

In 2013, CP’s results were even better than forecast. The company increased its average train weight and train length by 16% and 12% respectively. In Q3, despite fewer carloads, freight revenue increased by 6%. The company’s operating ratio, which measures operating expenses as a percentage of net income, fell by 880 basis points relative to Q3 2012, down to 65.9%. As a result, CP’s adjusted earnings per share was 45% higher than the year-ago quarter.

Under Mr. Harrison's watch, Canadian Pacific has trimmed down in other ways. The company has moved its headquarters from a glass tower in downtown Calgary to a nearby rail yard. CP has also agreed to sell a portion of the DM&E assets that Mr. Harrison's predecessor acquired back in 2008 (there is a broad consensus that the DM&E acquisition was a mistake).

CP's shareholders have been richly rewarded by Mr. Harrison's efforts. The stock appreciated by 60% in 2013, reaching $160 by the end of the year – before Mr. Ackman announced his nominees, CP shares were trading in the $50s. Other factors have certainly worked in the company's favour, such as an improving economy and the growth of crude by rail.

But Hunter Harrison deserves the bulk of the credit for CP's turnaround, which has come faster than even Mr. Ackman could have hoped for. There is little doubt that he, along with CP's other shareholders, would agree with Morningstar's decision.

CATEGORY

1. Investing

TICKERS GLOBAL

1. NYSE:CP (Canadian Pacific Railway)
2. TSX:CP (Canadian Pacific Railway)

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