Canadian Pacific Railway Limited Is Cutting Jobs, But Can the Stock Recover?

Description

Canadian Pacific Railway Limited (TSX:CP)(NYSE:CP) released plans this week to eliminate 1,000 positions this year as shipping volumes continue to dip, cutting into profits. Since 2012 the railway has cut over 6,000 jobs, including 1,200 in 2015. While the move should save on corporate costs, will it be enough to reverse the stock's slide of nearly 40% in just 12 months?

Wrong place, wrong time

As its name suggests, Canadian Pacific's sales are dominated by business in Canada with the majority of freight loads originating domestically. As a country largely dependent on commodities, the recent slide in energy and metal prices has hit the company hard as shipping volumes continue to drop. Even worse, commodity shipping is one of the railroad's more profitable lines of business as pricing power is typically much higher.

When you break it down, Canadian Pacific's business was ripe for a downfall. A massive 42% of volumes come from bulk sources such as grain or coal with another 17% coming from metals, minerals, and crude oil. Prices in all of these commodities are down more than 50% in the past 18 months.

With farmers, miners, and oil producers all looking to slash costs, Canadian Pacific is losing its ability to charge outsized margins. The current market is a perfect storm for the company.

The rest of the business is no consolation

Historically, China has contributed over a third of global growth, including rising demand for nearly every commodity. With the country posting its lowest growth rates in over 15 years, many say that the commodity super cycle is over. If this is the case, can Canadian Pacific rely on the rest of its business to offset any weaknesses?

As mentioned, nearly 60% of volumes are for commodity-related products, so even if other volume types are less prone to collapse, it's still a difficult gap to fill. Breaking down the business, this task looks nearly impossible as 10% of volumes come from chemicals and plastics, while an additional 6%

comes from automotives. With the Canadian economy teetering on the edge of recession, it's likely that these volumes will fall this year.

The remainder of the business is largely intermodal, so if Canada's GDP remains under pressure, this won't represent any saving grace either.

Can a merger save the day?

In November 2015 Canadian Pacific proposed a merger between itself and **Norfolk Southern Corp.** (TSX:NSC) that would double the size of the company. If it goes through, it would go a long way in diversifying Canadian Pacific's revenue streams, while likely boosting profits as the combined company could connect and leverage many of its complementary lines.

A merger, however, is becoming less likely. The U.S. Federal Railroad Administration will scrutinize the "significant safety hurdles" that would result from merging any of the major railroads. Additionally, competitors such as **Burlington Northern Santa Fe** and **Union Pacific Corporation** have been strongly lobbying the government to turn down the deal.

For now, it looks like Canadian Pacific doesn't have much of a safety net. Unless you're a huge commodities bull, avoid bottom-picking the stock.

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