A Leadership Shake-Up at Canadian Pacific Railway Limited

Description

This week, **Canadian Pacific Railway Limited** (TSX:CP)(NYSE:CP) announced a few changes to its management team and board of directors.

First, executive VP and CFO Mark Erceg is stepping down immediately. He is leaving the role fewer than 16 months after he was appointed. Erceg initially joined the company in 2015 after serving five years as CFO of **Masonite International Corp.** and 18 years at **Procter & Gamble Co**. According to the press release, he will be taking a new job as CFO of an unnamed American company listed on the New York Stock Exchange.

Nadeem Velani has been appointed interim VP and CFO in his stead. Velani is also fairly new to the company, joining in 2013. Fortunately, he spent 15 years at competitor **Canadian National Railway Company**.

Separately, the company announced that famed hedge fund manager Bill Ackman has resigned from the board of directors, effective immediately. Ackman and his firm, Pershing Square, sold out of their position in Canadian Pacific last month. Ackman is well known for his investing acumen, and his presence (along with his vote of confidence by owning shares) will be missed.

In response, the company added Jill Denham and William Fatt as directors to the board. Denham is a long-time financial services executive, while Fatt is the former CEO of FRHI Hotels & Resorts.

What does the future hold?

Executive and director departures are typically not positive, especially when they involve key members such as Bill Ackman. It's worth noting that Ackman had held shares since 2011, leading the company through an impressive turnaround. He sold his entire stake of 9.8 million shares worth around $1.5 billion.

"Canadian Pacific has completed an incredible transformation since our initial investment in 2011," Ackman said in a statement. "Hunter Harrison and Keith Creel have restored to greatness one of North America's top railroads and have set the company on the path to continued success." Analysts on *CNBC* called it “one of the greatest corporate turnarounds.”

If the company is on solid footing, why sell shares? The main factor appears to be valuation.

Even after a recent dip, shares still trade near all-time highs. The company’s price-to-earnings valuation, while off its atypical highs, is still around 20 times. That’s higher than any period previous to 2011 when Ackman first took his stake. Canadian National Railway, a close competitor, trades at only 18 times earnings. Even that is high when compared with its historical trade range.

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While the valuation remains full, conditions have deteriorated dramatically.

As its name suggests, the majority of Canadian Pacific’s freight loads originate 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 24 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. It’s no wonder why Ackman called it quits.

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