Don’t Bet on a Canadian Pacific Railway Limited Takeover of Norfolk Southern Corp.

Description

It appears that **Canadian Pacific Railway Limited** (TSX:CP)(NYSE:CP) is not letting the failure of merging with **CSX Corp.** (NYSE:CSX) hold it back. Reports came out on Monday that it was beginning to explore a takeover of **Norfolk Southern Corp.** (NYSE:NSC), which is currently worth US$23.85 billion.

The tie up, while not as beneficial to Canadian Pacific as the CSX one, would give Canadian Pacific access to the entire eastern United States. Norfolk Southern has approximately 20,000 miles of track across 22 states. What Canadian Pacific likely sees as beneficial is that its network of rail will connect with Norfolk Southern in Chicago and Kansas City, giving it access to all of the major ports along the eastern seaboard.

On top of that, the two railroads carry similar cargo: intermodal shipments. Intermodal shipments are products and goods that are shipped in large containers. This is appealing because it would allow Canadian Pacific to transport goods from Canada all the way through the United States without needing to stop or change trains.

Unfortunately, regulators stand in the way

The problem is that the Surface Transportation Board (STB) of the United States is very much against large railroads merging. The reality is that there is very little competition in the railroad business. According to *Bloomberg*, the seven-largest U.S. and Canadian railroads account for over 90% of rail revenue. Taking two of those firms and combining them doesn’t exactly help competition.

And this isn’t entirely speculation. On December 20, 1999, BNSF (which Warren Buffett bought) and **Canadian National Railway Company** announced that the two firms would be merging. This new company would have been called the North American Railways and would have had a 50,000 mile long track network that would be the biggest in the country.

The STB intervened and said that it required a 15-month moratorium on the merger. After significant time was spent in court, the companies called off the merger. In 2011, the STB said in a ruling that the merger of two Class I railroads (which Canadian Pacific and Norfolk Southern are) would require a demonstration in the preservation of competition.

I'm having a hard time seeing how the two companies are going to be able to prove to the STB that competition will continue to thrive. If you cut out one of the major players, suddenly there are fewer companies to choose from. That could harm competition.

My recommendation is to wait for some good news from the STB. If the feeling is that the organization is not going to interfere in the acquisition, this move might make sense. However, if the STB looks to get involved, expect to see Canadian Pacific drop, which would provide an opportunity to buy more shares on the cheap end. Sometimes bad news can be good news over the long term.

CATEGORY

1. Investing

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

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