Canadian Pacific Railway Limited Sets its Sights on Expansion

Description

The nation's second-largest railway hopes to leap-frog the competition by forming the largest railway company in North America by merging with another railway.

Canadian Pacific Railway Limited (TSX:CP)(NYSE:CP) has targeted Virginia-based **Norfolk Southern Corp.** (NYSE:NSC) in a stock and cash deal that is valued at over US$28 billion.

Let's take a look at what the deal could mean for the combined company as well as the railway industry as a whole.

About the initial offer

Canadian Pacific's initial proposal was for a 50-50 stock and cash offer that would see shareholders of Norfolk Southern walk out with $46.72 in cash and 0.348 in stock of the new merged company for each share of Norfolk Southern that they currently own.

In terms of ownership, this would provide shareholders of Norfolk Southern a 41% share in the ownership of the combined company, which would be listed on both the Toronto and New York stock exchanges.

Norfolk has already responded to the initial offer, labeling it as "grossly inadequate." Norfolk then followed that up by describing the offer as an "unsolicited, low-premium, non-binding, highly conditional indication of interest." In any event, the stage is now set for an improved offer and further dialogue between the two companies to come up with acceptable terms.

Canadian Pacific's CEO Hunter Harrison commented on the offer and subsequent rejection, reiterating the need for the two companies to discuss pricing and other issues. He noted that the initial offer was not going to be the final offer.

What the deal represents

For Canadian Pacific, the deal will further diversify the company by lowering its exposure to falling commodity prices by gaining access to the large U.S. consumer markets.

Another core benefit through this merger for both companies would be the increased network size. Canadian Pacific has a very strong presence in western Canada; it has over 22,000 km of track and access to the Pacific coast. Norfolk, on the other hand, has a strong presence in the southeastern U.S. with access to both the Gulf of Mexico as well as the Atlantic. The combined company would have over 55,000 km of track and serve all three ports.

Finally, the deal would alleviate traffic in Chicago, which is a major bottleneck for rail traffic. Currently, upwards of a full day can be required to move a rail car through the terminal and onwards to the following line. This would not only help the new combined company but other competitors as well by unclogging the tracks near and around Chicago.

An improved offer from Canadian Pacific is widely expected to be introduced within the next few weeks.

In my opinion, Canadian Pacific is one of the best options available for an investor seeking growth in the railway industry. The stock has retreated a bit since the initial deal was rejected, making it an opportune moment to buy.

CATEGORY

1. Investing

TICKERS GLOBAL

1. NYSE:CP (Canadian Pacific Railway)
2. NYSE:NSC (Norfolk Southern Corporation)
3. TSX:CP (Canadian Pacific Railway)

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