Should TransCanada Corporation Buy Columbia Pipeline Group Inc.?

Description

On Thursday, shares of **TransCanada Corporation** (TSX:TRP)(NYSE:TRP) were temporarily halted after *The Wall Street Journal* reported that the company may acquire Houston-based **Columbia Pipeline Group Inc.** (NYSE:CPGX).

In a statement, TransCanada said that it was holding discussions with “a third party,” but the company did not identify Columbia by name. TransCanada also made it clear that “there is no assurance that these discussions will continue or that any transaction will be agreed upon.”

The market reaction was swift. Columbia shares gained as much as 18% on the day, while TransCanada’s stock slid by nearly 5% at one point.

This brings up some very obvious questions. What does Columbia do? Why is TransCanada interested? And should TransCanada shareholders be excited?

Why a merger makes sense

Columbia controls a network of natural gas pipelines in the northeastern United States, allowing the company to serve the prolific Marcellus shale gas formation. Meanwhile, TransCanada is finding itself increasingly displaced from the northeast by gas from the Marcellus. Thus a merger would give TransCanada access to a market that it is currently losing out to.

There are other reasons to like the merger. Columbia has very high-quality assets with 95% of revenue coming from fixed contracts. Furthermore, the company’s share price had slumped by nearly 40% in the previous year, even though its adjusted EBITDA grew. So perhaps TransCanada could scoop up Columbia for a bargain price.

Of course, there are other benefits. Like any other merger, there should be some cost savings. A merger would also give TransCanada a very expansive network, allowing the company to offer customers a wide range of energy-transportation options.

Better yet, financing shouldn’t be a real issue. Columbia has a very strong balance sheet, meaning there's the potential to add quite a bit of debt. And TransCanada could simply spend money on Columbia that would have been spent on Keystone XL.

Why shareholders should be worried

So if a merger is so beneficial to TransCanada, why did the company's shares trade lower?

First of all, even though Columbia's shares are down, it doesn't mean TransCanada would be getting a bargain. A merger would probably be valued at roughly US$10 billion, which equals 25 times Columbia's distributable cash flow.

More importantly though, a merger could be a sign of weakness. After all, TransCanada's business is being hampered by a lack of access to Marcellus, and if *The Wall Street Journal* is correct, then the company is looking at buying its way out of that predicament. And it's these types of situations that acquirers tend to overpay.

That being the case, this is all just speculation for now. We'll have to wait and see what happens.

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