Canadian Pacific Railway Limited and Norfolk Southern Corp.: The Merger Is off

Description

In November 2015 **Canadian Pacific Railway Limited** (TSX:CP)(NYSE:CP) proposed a merger between it and **Norfolk Southern Corp.** (NYSE:NSC) that would double the size of the company. Today, it cancelled that proposal after facing stiff resistance from Norfolk's management team and shareholder base as well as customers and government officials.

"With no clear path to a friendly merger at this time, we will turn all of our focus and energy to serving our customers and creating long term value for CP shareholders," said Canadian Pacific's CEO Hunter Harrison.

What does this mean for the future of Canadian Pacific?

A merger would have been huge

If it had gone through, the combined company would have provided an irreplaceable opportunity to diversify Canadian Pacific's revenue streams as it still generates the majority of its freight loads in Canada.

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. 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. Merging with Norfolk would have been a quick fix to its overdependency on commodity transportation.

A combination would likely have boosted profits as both railroads could connect and leverage many of its complementary lines. Commodity shipping was one of Canadian Pacific's more profitable lines of business as pricing power is typically much higher. Mitigating profit declines through business synergies would have been a big bonus.

It's no wonder that other railroads were lining up to deny Canadian Pacific from becoming a more competitive company; both **Burlington Northern Santa Fe** and **Union Pacific Corporation** had been strongly lobbying the government to turn down the deal.

What's left?

Management will put on a tough face, but merging with a large competitor was clearly at the top of its list of priorities. In 2014 Canadian Pacific tried to start merger talks with **CSX Corporation**, but was quickly rejected. The company tried to rekindle talks but was rebuffed again.

According to John Larkin, an analyst at Stifel Nicolaus & Co, the company needed an acquisition to push up its value after it cut costs as much as possible and a bear market in commodities revealed its limited diversification. "They might look for some more opportunistic times, maybe when the regulatory environment is a little better," he said. "They will continue to look toward M&A to enhance their network."

Regardless of what happened with Norfolk Southern and CSX Corporation, a mega-merger remains in Canadian Pacific's future.

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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