



Canadian Pacific Railway (TSX:CP): A Stock to Buy and Own Forever?

Description

Have you ever just wanted to own a Canadian stock that you could tuck away and hold forever? Well, **Canadian Pacific Railway** ([TSX:CP](#))([NYSE:CP](#)) certainly fits the criteria. This company has been operating as an essential Canadian business since 1881!

Known as Canada's east-west railway, its [transportation infrastructure](#) has been vital for moving bulk "everything" across our expansive country. The company has been hugely successful both by operating efficiently and providing top-grade customer reliability. Had you bought this Canadian stock 10 year ago and held it to today, you'd be sitting on a sweet 658% gain!

This Canadian stock will no longer just be "Canadian"

As of yesterday, it looks like that all is changing. Canadian Pacific is hoping to become the first and only, diversified North American railroad network that spans across Canada, the United States, and Mexico.

On Sunday, Canadian Pacific announced that it has [entered a merger agreement](#) with **Kansas City Southern** (NYSE:KSU). Leveraging its elevated stock price (it is trading just below all-time highs), Canadian Pacific has offered a combination of stock and cash for a total value of US\$29 billion, or US\$275 per share. That is a 23% premium to KSU's share price last Friday. This will also include the assumption of US\$3.8 billion of KSU debt.

Introducing Canadian Pacific Kansas City stock

The merged stock and business will be called Canadian Pacific Kansas City, or CPKC. To fund the deal, CP will issue 44.5 million shares and will take on US\$8.6 billion in bridge financing. This would increase CP's share count by almost 33%. After the completion of the deal, Kansas City shareholders would own around 25% of the combined entity.

So long as this merger is approved by the U.S. Surface Transportation Board (STB) (and that is a big *if*

), I think the deal could certainly have some merit. Firstly, it gives the combined entity an intriguing competitive advantage. It will be the only integrated rail system that completely spans across North America.

One railroad across Canada, North America, and Mexico

Although the combined entity will still be the smallest of the top six class-one railroads in the U.S., it can directly link trade between Canada, the U.S., and Mexico. It creates one seamless network. This could provide significant cost savings for customers requiring North America-wide transportation.

If a customer wanted to transport vehicles manufactured in Mexico to Canada, this line suddenly looks like an incredibly efficient means. Likewise, the combined entity will link access to ports on the Great Lakes, the North Pacific, North Atlantic, the Gulf Coast, and the South Pacific.

Synergies, operational efficiencies, and earnings growth

There are opportunities for synergies and operational efficiencies. Both railroads share an interchange and connection facility in Kansas City. Consequently, connecting and integrating the two lines will have very little additional expense.

Likewise, there are a number of routing efficiencies that can occur. This can reduce fuel usage, the number of stops, and service disruptions. Canadian Pacific has one of the best operating ratios in the industry. It can apply some of its operational expertise to enable improvements in Kansas City's assets as well.

In fact, the combined entity hopes to unlock \$780 million of synergies in as little as three years after the transaction. CP believes the deal could be immediately accretive to adjusted diluted earnings in 2021. After, it could then generate double-digit growth accretion after that.

Certainly, CP will have elevated levels of debt (four times debt to EBITDA) after the transaction. However, management believes it can utilize internally generated cash flows to bring its debt down to historical averages (2.5 times) within three years.

A top Canadian stock no matter

It is difficult to tell if the deal will be approved by regulators. However, CP continues to be a top Canadian stock I am bullish about. It is almost impossible to build new rail infrastructure in today's world. Growth by acquisition may be the prudent way to cement years of growth ahead. Considering that, I think this all Canadian (and now American/Mexican) stock could continue to produce strong returns for shareholder for many years ahead.

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