TIC Investment Banking

The map is not finished being drawn, Three railroads, wide moats, and a merger that redraws the map.



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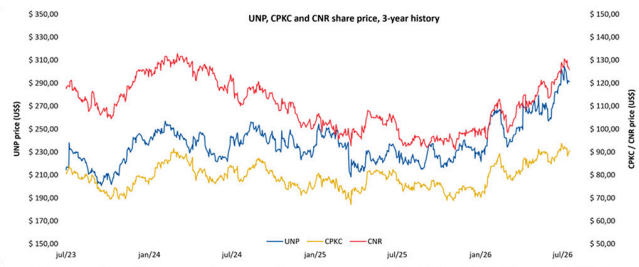


Figure 1: Share price performance of UNP, CPKC and CNR over the last three years. UNP on the left-hand axis; CPKC and CNR on the right-hand axis.

1. Executive Summary

On July 29, 2025, Union Pacific announced an agreement to acquire Norfolk Southern for a price of $320 per share, roughly $85B in EV, in a cash-and-stock deal that would create the first transcontinental railroad in U.S. history. The announcement reopened a question the industry thought settled a generation ago which is "How many railroads should North America have?" The Surface Transportation Board (STB) accepted the merger application in May but is pending supplemental information, and the companies still target a mid-2027 close. Nothing about the outcome is a foregone conclusion and everything about it matters for the 3 companies we will focus on in this report.

Consolidation attempts in this industry have a habit of failing before succeeding. Canadian Pacific (CP) tried and failed to buy Norfolk Southern (NS) in 2015-16. Canadian National (CNR) agreed to buy Kansas City Southern (KCS) in 2021 at $325 per share, only for the regulator to reject the deal and hand the prize to CP at a lower price. That merger, completed in 2023, created Canadian Pacific Kansas City (CPKC) which is the only railroad connecting Canada, the U.S. and Mexico, and its early success is part of the reason Union Pacific (UNP) is now willing to risk $2.5B in breakup fees testing the regulator's appetite for one even bigger. We consider CPKC, CNR and UNP to be the most interesting expressions of the industry's economics and in this article we will examine their business, the networks and the competitive advantages that protect that business, the regulator (STB) and unions that constrain them, the operators who run them, and, ultimately, what an investor should pay for them. In short:

CPKC

It has the better growth story, although it is the smallest of the three by revenue, it is the only 3-nation network which gives them a multi-year synergy runway and structural Mexico tailwinds that earn it the group's premium multiple so at least part of it should be priced in already.

Union Pacific

It is a bet on the largest and most profitable of the 3 and although growth has stalled, the company is now using its balance sheet and its regulatory goodwill on the Norfolk Southern deal and it is all about deal approval.

Canadian National

It is the incumbent at a discount, it still enjoys access to 3 coasts, exclusive access to Prince Rupert and the industry's Precision Scheduled Railroading (PSR) pedigree and, now trading at the group's lowest multiple, appears to be a value play although one can argue the discount is warranted after several years of self-inflicted stumbles.

2. How a Railroad Makes Money

A freight railroad sells one thing which is moving cargo. Revenue is the product of volume, measured in revenue ton-miles (RTMs), and yield, the price charged per ton-mile. Volume follows the physical economy, harvests, drilling, construction, imports moving inland from the ports and exports moving inland to the ports. Yield follows contract pricing, which the industry has managed to push at or slightly above cost inflation for two decades, plus fuel surcharges that pass diesel shocks through to the customer with a slight lag, which is worth remembering when a quarter's yield looks strangely strong or weak, the normalized values tell the real story.

The margin metric the industry lives and dies by is the operating ratio (OR) which is just operating expenses as a percentage of revenue or in other words 1 minus the typical Operating Margin, meaning the lower the OR, the better. A railroad running at a 60% operating ratio keeps 40 cents of every revenue dollar as operating profit. Because the network's costs are mostly fixed (track, locomotives, crews on duty whether the train is full or not), small changes in volume and price produce outsized changes in the OR, which is why a 2-point improvement moves the stocks the most.

No conversation about the OR gets far without mentioning PSR, pioneered by Hunter Harrison at CNR in the 2000s and exported by his disciples to nearly every other Class I railroad since. It replaced the old hub-and-hold model with fixed timetables, meaning trains leave on a schedule, assets stay in motion, yards hold freight for hours instead of days. Its arithmetic is brutal and effective. It means fewer locomotives, fewer cars, fewer people moving the same or more freight. It took CNR's operating ratio from the high 70s to the low 60s and, as the playbook spread, compressed the whole industry's ORs toward the high 50s. Its critics note the flip side, longer trains, leaner staffing and less slack, a trade-off that regulators have scrutinized intensely since the 2023 East Palestine derailment.

The 3 companies in this article are all, in different degrees, Harrison's heirs, a story we will return to in the management section. Two more structural features shape the model. First, railroads are common carriers meaning they are legally obliged to haul what shippers present, including hazardous materials, and they carry the liability when something goes wrong. The cargo's value is insured by the shipper but the derailment is the railroad's problem. Second, this is a very capital-intensive business. Class I railroads reinvest roughly 15-20% of revenue every year simply maintaining and upgrading their networks. The reward is the MOAT which will be discussed next but in essence it's the network, which, once built and maintained, cannot be replicated by anyone.

Commodity mix determines how cyclical each railroad's version of this model is. Bulk franchises (grain, potash, fertilizer) are steady and weather-driven, energy and chemicals track industrial production, intermodal, the containerized consumer freight that competes directly with trucking, is the most economically sensitive and the most price-competitive lane. Coal deserves its own footnote because it is two different businesses wearing one name, thermal coal for power plants is in secular decline across North America, while metallurgical coal for steelmaking, which, for instance, dominates CPKC's book through its export agreement with Teck, follows global steel demand instead. The mix each company carries, and the geography it carries it across, is where their stories start to diverge.

3. Networks and Geography

A glance at the map above tells you most of what you need to know about competition in American freight rail. 6 Class I railroads share the continent but almost nowhere do more than 2 of them compete for the same freight. The West is split between UNP and BNSF (the privately held Berkshire Hathaway railroad), the East belongs to CSX and NS and Canada is divided between CNR and CPKC. The result is regional duopolies, stitched together at interchange points like Chicago, Kansas City, Memphis and New Orleans, where freight moving across regions is handed from one carrier to another.

That handoff matters more than it might seem because Interchanges add days of transit time, yard congestion and cost such as in Chicago, the busiest junction of all and the industry's most notorious bottleneck. Geography within each duopoly is not symmetrical either. CNR is the only railroad that touches the 3 coasts using its Y-shaped network that runs from the Pacific through Vancouver and, exclusively, Prince Rupert (which has anchored its intermodal growth), to the Atlantic at Halifax, and down through Chicago to the Gulf of Mexico bypassing Chicago's congestion by making use of the EJ&E line it acquired in 2009. CPKC also serves Vancouver, Canada's largest port as well as the Gulf Coast and on Mexico's Pacific coast, the deep-water port of Lázaro Cárdenas, giving shippers an alternative to congested US West Coast gateways.

It is in Mexico that the map becomes an investment thesis for CP.

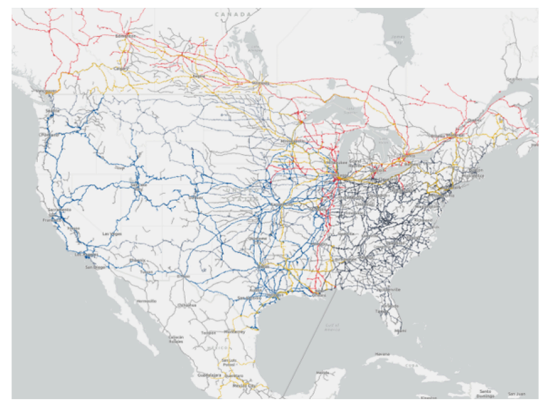


Figure 2: The Class I rail network of North America by operator. The West is split between UNP and BNSF, the East between CSX and NS, Canada between CNR and CPKC, stitched together at Chicago, Kansas City, Memphis and New Orleans.

When CP completed its merger with KCS, it created the only railroad connecting Canada, the United States and Mexico, operating single-line service from Canadian ports and the upper Midwest down through Texas into central Mexico over more than 3,000 miles of Mexican track. Single-line means no interchange required, the same railroad, the same train plan and one waybill from origin to destination. Freight that previously changed hands between 2 or 3 carriers to cross the border now stays on CPKC's network, which is both a cost saving and a service improvement, and it hands CPKC pricing power on lanes where no other railroad can offer the same service. Management has leaned on exactly this advantage by finding real revenue synergies thanks to new business won on north-south corridors.

Two structural tailwinds make the corridor more valuable over time. Nearshoring, reinforced by USMCA and by shippers' post-pandemic desire for shorter supply chains, is shifting manufacturing capacity to Mexico, and most of what those plants produce moves north. At the same time, a growing Mexican middle class is consuming more of what moves south, from Canadian grain to US tech devices and other finished goods. Tariffs however, cut against this, rail contracts treat them largely as a pass-through cost, so the risk isn't really margin but rather volume. There are two important caveats to mention. First, Mexico exposure itself is not unique, UNP owns roughly 26% of Mexican carrier Ferromex and has historically derived about 10% of its revenue from cross-border traffic. What is unique to CPKC is the single-line service. Second, CPKC operates in Mexico through government concessions rather than owned track, which, in the extreme, layers expropriation risk onto the corridor, though the franchise has run since 1997 with little government interference.

All of this sits on top of what may be the widest moat in the industrial economy. Nobody will ever build a new mainline railroad. The land assembly alone is impossible today, but 10s of billions of grading, track and bridges are required to replicate a network, so the 6 Class I railroads compete only with each other and with the highway. Against trucking, the economics are lopsided because a train moves a ton of freight roughly 4x as fuel-efficiently as a truck, and on lanes where both modes compete, rail is typically able to undercut on pricing while still earning attractive margins. Then there are the economies of scale, the industry consolidated from more than 40 Class I railroads in 1980 to today's 6 which means each railroad is bigger and can spread fixed costs over a bigger revenue pool. Additionally, on most lanes a shipper now has 1 or 2 at railroads at best allowing for rational pricing rather than competing each other's returns away.

M&A are how these dynamics change, and they cut both ways. A combination does not create new track, but it converts interchange traffic into single-line service, deepening the acquirer's cost and service advantage on the combined corridors, precisely what CPKC bought in KCS, and what UNP is now attempting at transcontinental scale with NS. In other words, the map is not finished being drawn and even though these mergers give pricing power to the railroad companies, that isn't necessarily bad for society because these mergers also allow to cut interchange costs meaningfully and pass those savings on to shippers and cut transportation timelines so the STB certainly has to consider both sides of the coin when looking at the UNP-NS deal.

4. Regulation on M&A and Labour

The Surface Transportation Board (STB) is the independent federal agency with exclusive jurisdiction over the economics of the freight railroad sector. It is responsible for approving or blocking M&A, authorising line abandonments, arbitrating rates and overseeing service practices. To understand the agency's behaviour, we must dive into the industry's history.

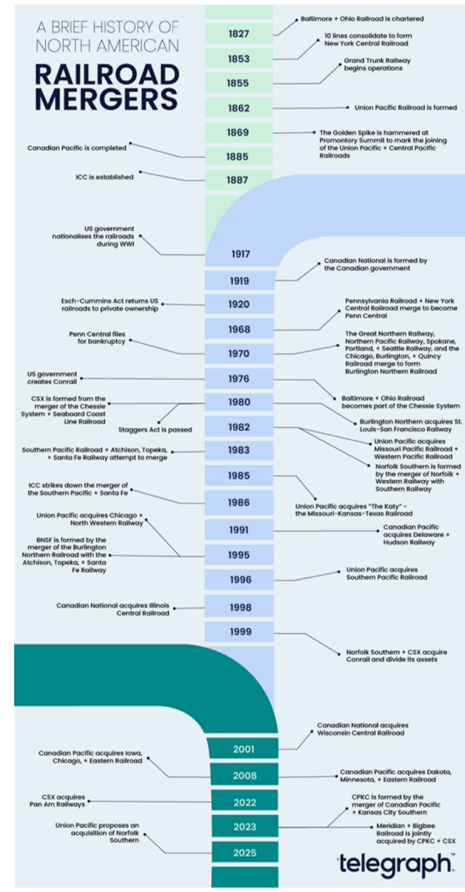


Figure 3: Two centuries of North American railroad consolidation, from the chartering of the Baltimore & Ohio in 1827 to Union Pacific's 2025 proposal for Norfolk Southern. Source: Telegraph.

Until 1980, American railroads were regulated by the Interstate Commerce Commission, which controlled the rates, the routes and the lines. Railroads could neither reprice their services nor walk away from loss-making lines which led to an industry structurally unable to compete with deregulated and flexible trucking running on roads paid for by taxpayers. The sector collapsed in the 70s, epitomised by Penn Central's 1970 bankruptcy, the largest in American corporate history at the time, and by the cascade of insolvencies that followed, leaving roughly a 20% of the American rail network in bankruptcy proceedings. The regulator's job in that era was therefore managing corpses and deciding which failed lines survived, who absorbed them, and how minimum service was preserved.

Congress concluded that regulation itself was killing the industry and passed the Staggers Rail Act in 1980.

The Act swept away the old restrictions, giving railroads the freedom to set prices, negotiate confidential contracts directly with shippers, abandon unprofitable lines through an expedited process and, crucially, consolidate. Two decades of relentless merger activity followed, as the more than forty Class I railroads that existed in 1980 folded into one another until only today's 7 remained. The industry returned to profitability, reinvested in its network at a scale the regulated era never permitted and clawed back market share from the highway, making Staggers a triumph.

Deregulation worked so well that it created the opposite problem. Instead of dozens of weak railroads competing for survival, the industry consolidated into a few regional giants, many enjoying near-monopoly positions across their territories. This gave rise to so-called captive shippers, power plants, grain elevators or chemical complexes with physical access to a single railroad and no competitive alternative at any price. This inverted the regulator's role, the STB stopped worrying about the companies' solvency and started preventing them from abusing their dominant position.

At the height of the merger wave, in 1996, UNP acquired the Southern Pacific Railroad, then in terminal decline with chronic crew shortages, a degraded locomotive fleet and maintenance cut to the bone. UNP believed it could absorb and rehabilitate the network, but the integration of two massive parallel systems produced the worst operational collapse in the industry's history in 1997. The paralysis centred on Houston and the Texas Gulf Coast, with thousands of containers and harvests stranded, forcing the regulator to issue emergency orders and grant rival BNSF more than 4,000 miles of trackage rights as a competitive remedy. The litigation never closed, as recently as late 2024, BNSF petitioned the STB accusing UNP of violating the access commitments made almost 30 years earlier.

The 1997 collapse directly shaped the regulator's "golden rule", formalised in 2001, a merger between Class I railroads no longer merely has to avoid harming competition, it must demonstrate that it actively enhances it and serves the public interest, with proactive mitigation plans against service disruptions and tangible gains for shippers. The burden of proof switched sides, and with it the fate of every consolidation attempt that followed.

The rule's practical application is best understood through the most recent episode. CP - KCS, consummated in 2023 as CPKC. Its approval rested on the two networks meeting at a single point in Kansas City and having no geographic overlap, creating the first uninterrupted rail corridor linking Canada, the United States and Mexico under the USMCA without removing a single competitive alternative for shippers. CP was also the smallest of the Class I railroads, which eased concerns about concentration of power. Finally, the deal was made possible by an STB-authorised voting trust meaning CP paid for the financial rights to KCS in December 2021, while both companies operated fully independently throughout the regulator's 2-year review.

CNR tried to intercept the deal with a higher offer of $33.7 billion against CP's $31 billion, but in August 2021 the STB refused to let it use a voting trust, ruling that a CNR–KCS combination would create horizontal overlap in the American Midwest and too much market concentration. Without that mechanism, the bid collapsed, and KCS returned to CP's lower offer, the key difference is that UNP-NS are not using that mechanism at all.

STB’s behaviour pattern is to approve mergers that join complementary networks and create new connections and those whose networks overlap and would eliminate competition. The current and largest merger application in the industry's history of UNP-NS will be judged against exactly this criterion.

Additionally, Post-East Palestine regulation now threatens to block the lever of train length. The improvement in the sector's ORs over the past decade has come from progressively longer trains, PSR and traffic concentration. For reference, in Q1 of 2026 UNP’s average train measured 9746 feet, nearly 3 km.

The Railway Safety Act, first proposed in 2023 and reintroduced in 2026, marks a break with America's performance-based regulatory tradition in favour of strict technical mandates. The costliest requirement is the installation of wayside defect detectors at average intervals of 15 miles, tightening the industry's historical norm of roughly 25, with an estimated cost of $1.1 to $2.2 billion for the sector. The operational impact, however, is larger than the upfront cost. Denser sensors and tighter tolerances force 9,000-foot trains to stop more frequently, often on stretches where no siding is long enough to hold them, and each unplanned stop risks spreading congestion across the network. The Act's remaining provisions strike at PSR's other lever, labour productivity by making it legally mandated to have minimum of 2 crew members per train, compulsory manual inspections on top of automated systems (erasing the ROI in continuous monitoring) and maximum fines raised from $100k to $10M per serious violation. Overall, prescriptive regulation takes aim at all the levers behind the golden decade of operating ratios.

The same tension plays out inside the companies. PSR structurally requires fewer workers per ton-mile. A decade of cuts combined with punitive attendance policies and post-pandemic labour scarcity gave the unions bargaining power. The result came in the on-property agreements UNP signed in 2025 with SMART-TD and BLET, bypassing the slow national bargaining round in exchange for five years of labour peace.

The financial price was steep, cumulative wage increases of 18.77%, alongside better healthcare coverage. However, the truly structural clauses sit in the operational annexes.

The end of "outside earnings deductions" returns the full financial risk of wrongful dismissal to the employer, closing a two-decade practice of subtracting hypothetical income from back-pay settlements. The expanded time-off package includes earlier vacation thresholds and, for the first time, seven days of paid, penalty-free sick leave. As a result, UNP is forced to keep a larger reserve workforce to maintain network fluidity. In practice, the 2025 agreements set a contractual floor under operational headcount. Even so, the efficiency drive has not slowed, in Q1 of 2026, UNP posted its best-ever start-of-year labour productivity of 1,163 car miles per employee, a 7% increase delivered by a workforce that was 5% smaller.

5. Operating Performance

Put the three companies side by side on the metrics that matter and a clear hierarchy emerges, along with the reasons to think it might not last. Start with scale. UNP moves roughly 2x the freight of CNR and CPKC do. But the growth rates run in exactly the opposite direction. CPKC's RTMs are up roughly 40% since mid-2021, transformed by the KCS merger and the synergy wins that followed, while CNR's and UNP's volumes over the same 5 Yrs are flat. The reality shows here is that absent a merger or a freight boom, a mature Class I railroad grows volumes at about the pace of industrial production, which is to say barely in the last decade but that doesn't mean the next decade will be the same.

On price, the currency question matters more than headline comparisons admit: CPKC and CNR report in Canadian dollars, UNP in US dollars, so raw yields per RTM are not comparable across the border without conversion. The like-for-like reading is that UNP earns the highest revenue per carload in the group (a function of length of haul and mix), CNR earns the strongest blended yield per ton-mile among the three once currency is adjusted for its shorter hauls, and CPKC's yield has grown fastest since 2021, boosted by the merger's longer average length of haul and Mexico traffic.

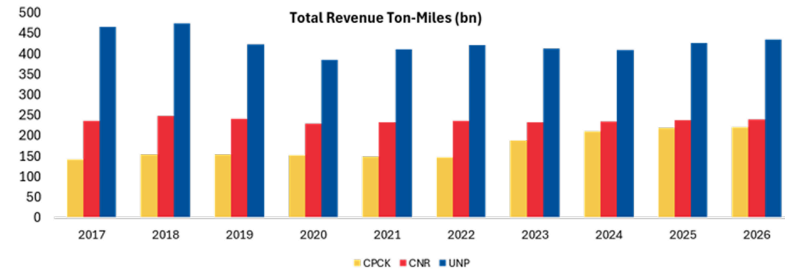


Figure 4: Total revenue ton-miles (bn), 2017 to 2026. UNP moves roughly twice the freight of either Canadian carrier, but only CPKC has grown volumes since 2021.

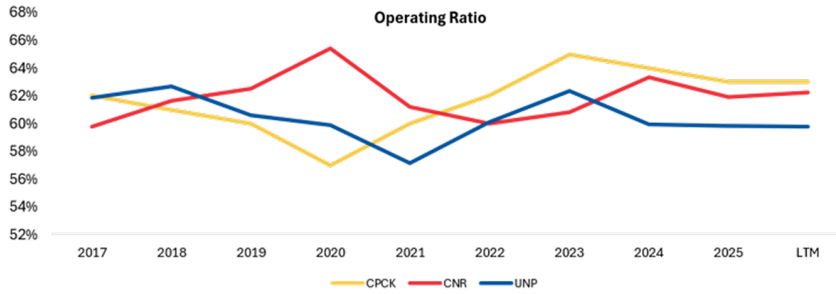


Figure 5: Operating ratio, 2017 to LTM. UNP is the group's most consistent operator; CPKC carries merger amortisation in its number.

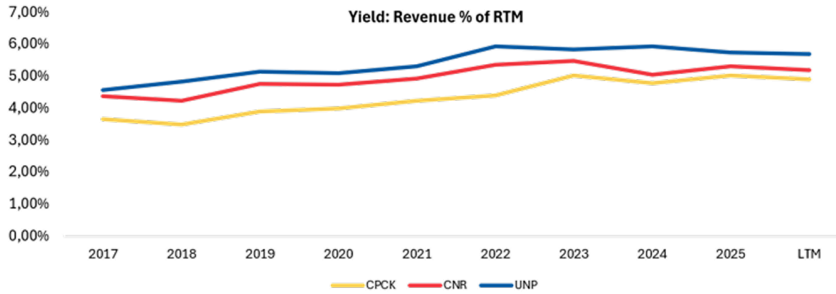


Figure 6: Yield, revenue as a percentage of revenue ton-miles, 2017 to LTM. CPKC and CNR report in Canadian dollars, so levels are not directly comparable across the border.

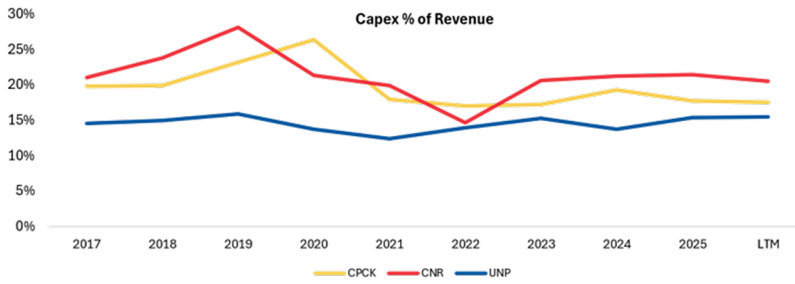


Figure 7: Capex as a percentage of revenue, 2017 to LTM. UNP reinvests the least, at 13-15%, against roughly 20% at CPKC and CNR.

The operating ratio tells the efficiency story in one line each. UNP is the group's best operator, holding a high-50s to 60% OR through the cycle and grinding it lower again under Jim Vena. CNR, the inventor of the PSR, spent years at a frustrating distance from its own former standard.

CPKC runs the worst OR of the three, 62.4% in 2025 including merger amortization, and simultaneously the most interesting one, because integration noise and deal amortization sit in that number and the ex-amortization trajectory points toward the high 50s.



Figure 8: Hunter Harrison, architect of Precision Scheduled Railroading and, directly or indirectly, mentor to the three CEOs running these railroads today.

The convergence question, whether CPKC closes the gap its peers have already closed, is worth several dollars per share and is the central assumption in our valuation section. Capital intensity is high. All three reinvest heavily, but not equally, UNP's capex runs about 13.5% of revenue, the leanest in the group, while CPKC and CNR both spend near 20%, CPKC on merger integration and Mexico capacity, CNR on network resilience after painful congestion episodes.

6. Management and Capital Allocation

Every industry has its formative figures and for freight rail it is Hunter Harrison. The man who built PSR at Illinois Central in the 90s, perfected it as CEO of CNR from 2003 to 2009, and then, in one of the great second acts in corporate history, was installed at CP by Bill Ackman. He took CP's operating ratio from the industry's worst to among its best in five years, left for CSX in 2017, and died that December, only months into the job.

The reason his account opens this section is that the industry's current leadership is, to a remarkable degree, coached by him. Keith Creel, CPKC's CEO, was Harrison's operational right hand at both CNR and CP and completed the KCS merger Harrison's CP had made possible. Jim Vena, UNP's CEO, is another CNR-schooled Harrison operator who first fixed UNP's operations as COO in 2019-2020 and returned as chief executive in 2023. Tracy Robinson, CNR's CEO since 2022, spent decades inside CNR's own PSR culture before running TC Energy's pipelines.

When investors debate these 3 companies, they are in part debating which student runs the master's playbook best. They are also debating who watches the students, because capital discipline in this industry has repeatedly been activist-enforced. Pershing Square's campaign at CP is the founding example. TCI Fund, itself a large CNR and CP holder, forced the issue at CNR in 2021 after the failed KCS bid, a campaign that ended with a new CEO and a refreshed board. Soroban Capital pushed UNP in 2023 to replace Lance Fritz and explicitly championed Vena for the job. 3 companies, 3 activist interventions inside a dozen years, each one arguing essentially the same thing, this asset is too good for the returns it is producing, how do we squeeze more out of it.It is a useful reminder that the moat protects the railroad, not necessarily the shareholder, extracting the moat's value has required outside pressure with uncomfortable regularity.

On capital allocation the 3 have settled into distinct postures. UNP is the mature capital returne with capex at 13.5% of revenue, the leanest in the group, a payout ratio near 50%, and leverage kept near the top of the investment-grade comfort zone, a balance sheet philosophy now being stress-tested by the $20 bn+ of incremental debt the NS acquisition requires, buybacks, ordinarily steady, have been paused to delever ahead of closing. CNR pairs a similar payout ratio with a long buyback tradition, one that has attracted criticism for its timing, repurchasing heavily at peak multiples in good years, a record our conclusion weighs when assessing management quality, and one that has pushed leverage up to about 2.7x to keep funding the buyback, with a plan to bring it back to 2.5x by 2027.

CPKC is the outlier by necessity and by choice, a payout ratio around 20%, leverage near 3x targeting 2.75x, and the group's heaviest reinvestment, directed at the Mexico corridor and synergy capture, capital returns are only now turning on, with a 5% buyback authorized in January 2026 and, announced alongside Q1 2026 results, the first dividend increase since CPKC's formation, a 17.5% raise.

In effect, UNP pays you now, though it has stepped back briefly to fund the deal, CNR pays you now and hopes it is not overpaying for its own stock, and CPKC asks you to wait while it compounds, having only just started to hand cash back. Which posture is right depends entirely on whether the growth CPKC is reinvesting for comes to fruition.

7. Union Pacific - Norfolk Southern deal

The proposed merger between UNP and NS represents the largest transaction in the history of the North American railroad industry and has the potential to create the first truly transcontinental railroad in the U.S. More than just another deal, the transaction brings together virtually every major theme discussed throughout this article, namely the network economics, PSR, capital structure, regulation, and competition. More than just another deal, the transaction brings together virtually every major theme discussed throughout this article, namely the network economics, PSR, capital structure, regulation, and competition.

7.1 Deal terms

The transaction was announced on July 29 2025, with an implied EV of approximately $85 bn. While the scale of the deal is enormous, its structure is relatively straightforward, NS shareholders will receive one UNP share plus $88.82 in cash for each NS share they own. This implies a value of $320 per NS share, representing roughly a 25% premium over the stock's 30-day volume-weighted average price prior to the announcement. In other words, UNP is paying approximately one quarter above what the market considered Norfolk Southern to be worth before merger discussions became public. It is worth noting, however, that as in CP's unsuccessful bid for NS in 2015/16, the exact premium depends on the reference price used. Relative to NS's closing price on the day before the announcement, the premium falls to approximately 12%,

reflecting the fact that the stock had already appreciated following market speculation about ongoing negotiations. The combined company has already adopted the name "The Union Pacific Transcontinental Railroad", and the transaction received overwhelming shareholder approval in November 2025, with more than 99% of votes cast in favor by shareholders of both companies, a level of support that stands in sharp contrast to the cautious market reaction immediately following the announcement.

Upon completion of the transaction, former NS shareholders will own approximately 27% of the combined company, which will remain headquartered in Omaha and continue to be led by UNP's current CEO, Jim Vena. Although the transaction has occasionally been presented as a strategic combination of equals, the ownership structure and governance make it clear that this is, in practice, UNP's acquisition of NS.

One technical choice matters, there is no voting trust. When CP pursued NS in 2015-16 it proposed closing into a trust while the STB deliberated, and the DOJ objected that this would in practice combine the companies before the review concluded, since shareholders would already be paid and both firms would already share incentives to act as one. UNP has learned that lesson and it will take control of NS only if and when the STB approves, delaying synergy capture but removing a major regulatory objection in advance. The deal carries a $2.5bn reverse termination fee payable by UNP if regulators block the deal, and is scheduled to expire in January 2028 with automatic extensions while the review runs.

7.2 Strategic Rationale and Synergies

The consolidation trend continues with this merger, but with one fundamental difference. The combined network would encompass more than 50k miles across 43 states, connecting nearly 100 North American ports under a single operator for the first time.

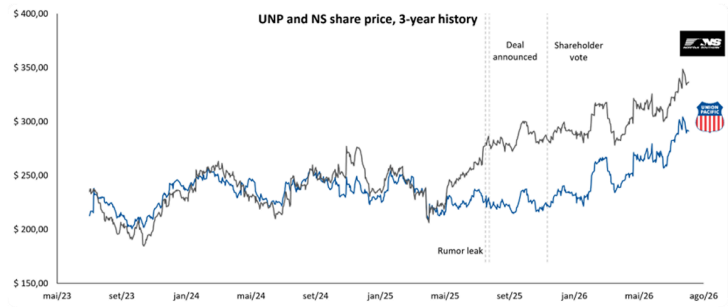


Figure 9: UNP and NS share prices over three years, marking the rumour leak, the 29 July 2025 announcement and the November 2025 shareholder vote.

It is all about the elimination of interchanges for single-line service and significantly enhancing rail's competitiveness against long-haul trucking and the overall Moat even further. Management expects to generate $2.75 bn of annual synergies within 3 years of closing, around $1.75 bn from revenue synergies and $1 bn from operating cost savings, including the interchange cuts, fewer yard switching operations, improved locomotive utilization, more efficient crew scheduling, and higher asset turns. Management also estimates that customers could collectively save around $3.5 billion annually, an important argument given that STB approval ultimately depends on demonstrating public benefits. These synergies should improve the combined company's OR over the next decade,but, as with any large-scale integration, these assumptions should always be taken with a pinch of salt.

7.3 Price, Financing and Capital Structure

The deal values the company at roughly 12-16x EV/EBITDA against a historical median of about 11.8x for North American rail transactions since 1994. UNP is paying above that historical average but it is doing so for an asset that has never been available before, the first genuinely complementary East-West combination and that arguably justifies a premium but only synergy delivery needs to be there to justify it. Financing is the more delicate part. Before the announcement UNP carried about $32bn of debt and NS about $17bn and completing the cash portion requires roughly $20bn of incremental borrowing.

Leverage rises materially and rating agencies have flagged downgrade risk even though UNP has paused buybacks attempting to delever as much as it can ahead of closing. Management expects leverage to return to normal levels based on the industry's strong cash generation, but the arithmetic is unforgiving, the higher the leverage, the smaller the margin for integration error and with potential rate hikes, this could be risky and lead it to debt overhang with no way to invest the required amounts in positive NPV projects to capture those synergies.

7.4 The STB's Decision

No transaction of this scale can proceed without approval from the STB and the review process has been far from straightforward. The companies submitted their initial application in December 2025, but the STB rejected it the following month as incomplete. A revised filing was submitted in April 2026, and the Board formally accepted the application in May 2026, while requesting additional information on issues including shared terminal access and interoperability with competing railroads. Throughout 2026, both companies have continued responding to these requests, and management currently expects the transaction to close in mid-2027, almost two years after its announcement but perhaps the most significant regulatory challenge is to demonstrate that the transaction actively enhances competition rather than simply avoiding competitive harm. As a result, the Board may, for instance, impose remedies, such as granting rivals access to parts of the combined network that could reduce some of the transaction's synergies.

UNP's July 2026 settlement with CNR, granting CNR a new Mexico gateway via Memphis in exchange for expanded UNP access on shared trackage, shows this kind of concession can happen bilaterally rather than waiting for a Board order. Opposition has been both broad and vocal, though it has recently narrowed. BNSF has emerged as one of the transaction's strongest critics, arguing that the merger would weaken rather than strengthen competition and has formally petitioned the STB to require UNP and NS to disclose additional documentation. CNR initially stood alongside BNSF in that petition but ultimately settled with UNP gaining the Mexico gateway described above and agreeing not to oppose the merger. CPKC has made no such deal, CEO Keith Creel has publicly argued that the transaction could result in a duopoly within the North American railroad industry, a somewhat ironic position given CPKC's own recent transformational merger.

Labor unions have likewise expressed concerns over safety and employment, reflecting the broader tension between PSR, which seeks greater operating efficiency through lower staffing requirements and the industry's longstanding labor protections.In response, UNP and NS have publicly committed to preserving all unionized jobs which helps strengthen their case before regulators.

Perhaps the strongest argument against the merger is not its immediate impact, but what it could trigger.Several analysts and industry publications have suggested that, should UNP successfully acquire NS, BNSF may feel compelled to respond with an acquisition of its own. The most obvious and frequently cited target is CSX, currently the only major Eastern railroad that would remain independent following the merger and there are industry reports suggesting that BNSF has already retained advisors to evaluate such a scenario, CSX itself faces pressure from activist investor Ancora, which has advocated for alternatives.

If such a transaction were to ultimately occur, the North American railroad industry would effectively be reduced to two dominant operators controlling roughly 90% of U.S. freight rail traffic. This level of concentration would be significantly higher than today and represents precisely the scenario cited by critics as evidence that the UNP-NS deal could fundamentally reshape competition even further. Whether or not this scenario ultimately materializes is hard to guess, however, its mere possibility helps explain why the STB cannot evaluate the transaction in isolation and must also consider the broader competitive dynamics that could follow if this merger becomes the catalyst for another wave of industry consolidation.

7.5 Market Reaction

The market's initial reaction on the announcement day was more skeptical than headlines suggested. On July 29, 2025, NS shares actually closed lower, down close to 3% intraday to around $278 as investors weighed regulatory risk against the headline premium. UNP's shares were also muted that day.

The cleanest way to read the market’s implied probability of deal approval is through NS’s share price, because NS’s payoff is contractually defined, each share is worth one UNP share + $88.82 if the deal closes, and something like its standalone value if it fails. At UNP’s price of $294.52, that consideration is worth $383.34 per NS share but it is worth remembering that UNP’s shares will move upon deal approval so this isn’t a locked number. Even so, assuming that number as lock, NS trades at $334.52, and against a blocked-scenario value estimate near its pre-rumor level of $245, the market is implying roughly a 65% probability of completion, a little better than a coin flip but not by much. Taking a look at our valuation estimate for UNP the picture looks very different. Our deal model values the approval scenario at $295.34 per UNP share against $264.95 if the deal is blocked, a spread of about $30, and UNP’s own price of $294.52 implies a completion probability closer to 97%, obviously, these are our estimates and what this means is that the market is being more bullish on an approval scenario than us but ultimately it comes down to what each investor is comfortable assuming and we believe that very bullish assumptions are priced in already and aren’t properly discounting deal completion risk nor the time value of the capital tied up until a mid-2027 supposed close date. You can see the charts

The market's reaction, both on day one and in the months that followed, is a reminder that a transaction can be strategically compelling without being viewed favorably in the short term.

7.6 Historical Precedents

NS has been here before. In 2015-16 Canadian Pacific, then led by Hunter Harrison after Bill Ackman’s activist campaign, made an unsolicited approach at a premium below 10%, NS’s board rejected it unanimously, citing regulatory risk, and the average rail acquisition multiple then was about 10.7x EBITDA against 12-16x today. The instructive difference is NS’s own condition. In 2015 it was a struggling railroad choosing a standalone turnaround; under Mark George, CEO since 2024, NS delivered an adjusted operating ratio of 65.8% in 2025, beat its productivity targets and grew EPS at a double-digit rate before merger talks began. NS sold despite succeeding, which is what makes this transaction strategic rather than defensive.

The relevant approval precedent remains CP-KCS: complementary end-to-end networks, minimal overlap, approved in about two years, integrated without a meltdown. UNP-NS is bigger in every dimension, and the cautionary precedents are UNP’s own 1996 Southern Pacific merger, which gridlocked the Southwest for months, and the Conrail carve-up that followed. What remains uncertain is everything that matters: the timing and conditions of the STB’s decision, possible remedies like terminal access or switching obligations that hand value back to shippers and rivals, the BNSF-CSX response, and the integration itself.

If approved, this deal reshapes the industry for decades; if rejected, it defines the outer limit of Class I consolidation. Either way, it is the event this article was written around.

8. Valuation

Valuing a railroad is a matter of forecasting volume and price by forecasting revenue ton-miles (RTMs) and multiplying it by the yield earned on them. The operating ratio converts that revenue into operating profit. From there, DA, Capex, and ΔNWC and taxes make the bridge to FCF, which we discount at each company's cost of capital. Each of the inputs change from company to company and some simply depend on the investor's view for the future. Regarding discount rates, the same "Rail Beta" from Damodaran was used and discount rates change based on the company's target capital structure and the cost of debt (measured by the Credit Ratings of the 3 companies)

One important question is how long should we project before taking the TV and that is where a wide moat comes in. The Moat is more than just a qualitative comfort, it also reflects the investor's view on how long a business can earn returns above its cost of capital. For businesses with this wide of a Moat, we are comfortable projecting CFs explicitly for longer than usual, in this case 10 Yrs, before taking the TV.

8.1 CPKC

CPKC is the expensive one, and it has been for a while. At roughly 24x Fwd PE it trades at a clear premium to UNP at about 22x and CNR at 21x, and the gap is wider on EV/EBIT, around 25x against 20 and 19x respectively.

The case for that premium rests on growth the other two cannot replicate in RTMs from the merger with KCS against, essentially flat volumes at UNP and CNR, these merger revenue synergies as well as cost synergies are still ramping, and there is also the structural story, the only single-line network into Mexico, positioned in front of nearshoring flows and Mexican consumer growth.

	Leverage Metrics		Credit Ratings			WACC inputs			
Company	Net Debt / EBITDA	D/E	S&P	Moody's	Fitch	Target D/E	Rd	Re	WACC
CPKC	12,1x	0,2x	BBB+	Baa1		0,25x	4,95%	9,23%	8,12%
CN	9,9x	0,3x	A	A1	A+	0,25x	4,73%	9,23%	8,09%
UP	9,5x	0,2x	A-		A-	0,25x	4,84%	9,23%	8,11%

Figura 10: Valuation inputs by company: leverage, credit ratings, target capital structure, cost of debt, cost of equity and resulting WACC.

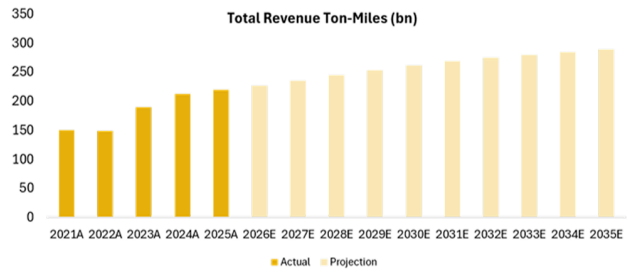


Figure 11: "CPKC: total revenue ton-miles (bn), 2021A to 2035E."

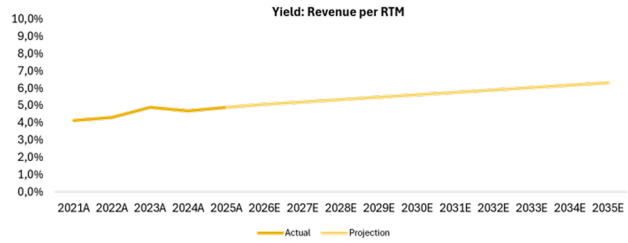


Figure 12: "CPKC: yield, revenue per revenue ton-mile, 2021A to 2035E."

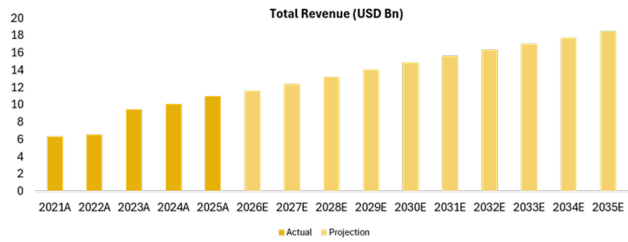


Figure 13 "CPKC: total revenue (US$bn), 2021A to 2035E."

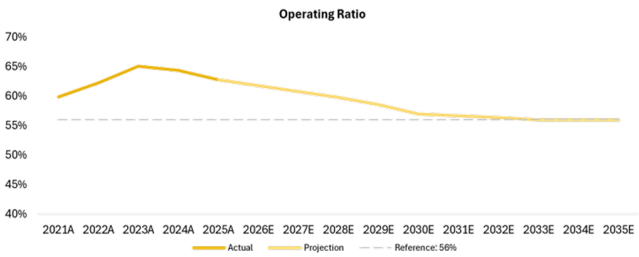


Figure 14: "CPKC: operating ratio, 2021A to 2035E, against a 56% reference line."

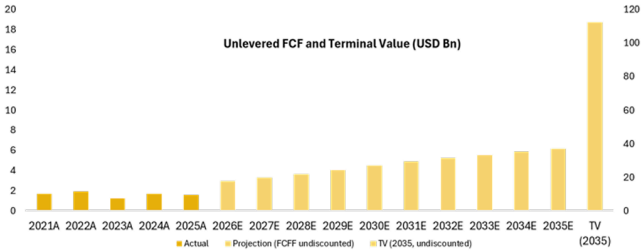


Figure 15: "CPKC: unlevered free cash flow and terminal value (US$bn), FCFF on the left-hand axis and 2035 TV on the right."

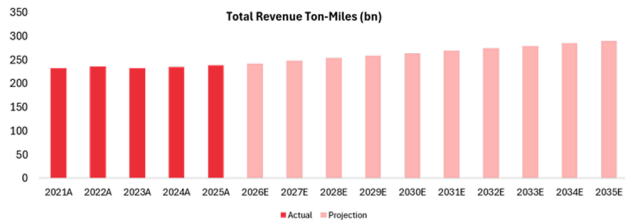


Figure 16: "CNR: total revenue ton-miles (bn), 2021A to 2035E."

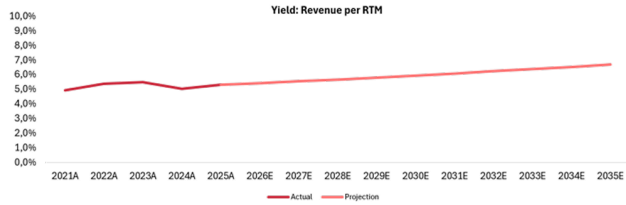


Figure 18: "CNR: yield, revenue per revenue ton-mile, 2021A to 2035E."

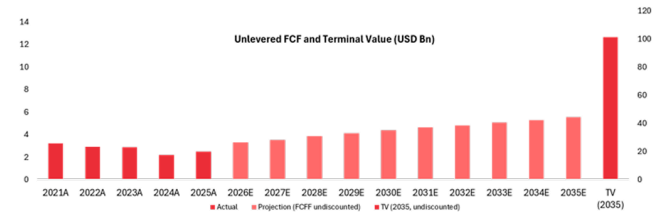


Figure 17: "CNR: unlevered free cash flow and terminal value (US$bn), FCFF on the left-hand axis and 2035 TV on the right."

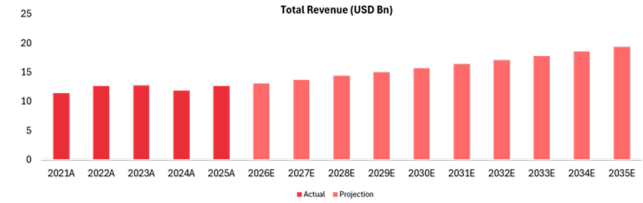


Figure 19: "CNR: total revenue (US$bn), 2021A to 2035E."

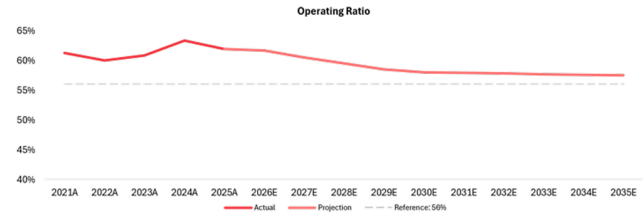


Figure 20: "CNR: operating ratio, 2021A to 2035E, against a 56% reference line."

CPKC also retains far more of its earnings than its peers, paying out roughly 20% of profits in dividends against nearly 50% at UNP and CNR, funding both heavy reinvestment and the buyback that resumed as post-merger leverage came down.

Our model translates that story into numbers as follows. On volumes, we take a genuine view in three places. Intermodal and automotive grow at around 5% per year, because that is where the single-line corridor wins freight from trucks and where nearshoring shows up first. Energy, chemicals and plastics also compound near 5% on Gulf Coast petrochemical strength. Potash accelerates sharply mid-decade as export capacity ramps, peaking near 9% growth, and coal drifts slightly negative throughout, resilient metallurgical exports but no growth. Everything else tracks the economy at 2-3%. The blend takes total RTMs from 219 billion in 2025 to around 262 billion by 2030, about a 3.6% CAGR that then fades toward 2% in the back half of our 10 yr horizon. On yield, the segments are not created equal. Merchandise carload pricing carries the industry's pricing power and compounds around 3% in our model. Bulk runs near 2.5%. Intermodal is deliberately the lowest at under 2%, because intermodal contracts are priced at the margin against truckload rates and a railroad cannot out-price the highway for long.

Mechanically, volumes and yield together take revenue from $11.0 billion in 2025 to roughly $14.9 billion by 2030, growth of about 6% per year.

Margins are where CPKC has the most to prove and the most to gain. The operating ratio was 62.8% in 2025, partly a function of merger amortization and noise. We glide it to 56% by 2030 and hold it near 55.5% thereafter, largely assuming CPKC closes the gap to its peers, helped by synergies and volumes that give it operational leverage. Contractual wage inflation of about 3% is embedded in that path. Capex fades from 15% of revenue toward 13.5% as merger-related investment rolls off.

The result is the FCF profile below, steady growth through the explicit period, with the TV shown in [colour of TV bar]. The terminal assumptions are deliberately sober, 2.5% perpetual growth on a balance sheet carrying roughly $17.2 billion of net debt. Add it up and our base case values CPKC at $75 per share against a market price of $90 (-15.5%).

To justify the current price on our model you need more bullish inputs. An operating ratio near 53% which is unprecedented, volume growth sustained above our path, and more pricing power. None of those are impossible, which is rather the point. The market is not wrong about what CPKC is but it is simply already paying for the version of CPKC where everything does go right.

8.2 CNR

CNR is the group's cheapest, at least on a multiple basis yet it is the furthest below our fair value estimate. At about 21x PE (FWD) it looks like the value play, but the growth just isn't there. Our projections for the Petroleum and chemicals segment get a modest bump before settling at trend. Metals and minerals take a small tariff dent in 2026 and recover. Forest products decline given lumber tariffs weak US homebuilding but stabilize late in the decade. Coal is flat in 2026, as per guidance, and then declines ~3% a year as the secular trend reasserts itself over recent contract wins.

Grain carries a regulatory quirk given that Canadian regulated grain pricing decelerates to about 1.7% for the current crop year, lowering near-term yield. Intermodal is CNR's best structural story, growing 4% off the Prince Rupert franchise before stabilizing but it also carries the lowest pricing power in which is capped by trucks and by the Mississippi barge alternative that makes some CNR customers less captive than the average rail shipper. The blend is roughly flat volumes in 2026, consistent with guidance and recovering to about 2.5% growth thereafter.

The operating ratio is projected to improve from 61.7% to 58% by 2030, assuming a return to competence, and capex is projected to be mid-teens % of revenue.

Add it up and our base case values CNR at $100 per share against a market price near $127, about -21%, the widest gap of the three estimates. The conclusion however is not that CNR is a short but rather that the discount on multiples is well deserved. A railroad that isn't really growing volumes, with its best franchise capped on price and its capex savings already in guidance, should trade below its faster growing peers, and in our numbers the market has not discounted it enough. What could change our mind is a sustained intermodal acceleration through Prince Rupert, an operating ratio that starts with a 5 or simply a better entry price which are all possible in the future.

8.3 UNP

UNP's valuation needs to answer 3 things, what is the railroad worth? what is the deal worth? And how likely is approval of the deal?

Our standalone model, which excludes the merger entirely, is deliberately the most generous of the three, because UNP has earned it. It has the group's best margins, leanest capex at 13.5% of revenue, and a CEO whose entire career specialty is operating leverage. We model volumes growing about 2% a year with thermal coal declining 4% inside an otherwise stable bulk franchise, pricing near 3% on merchandise.

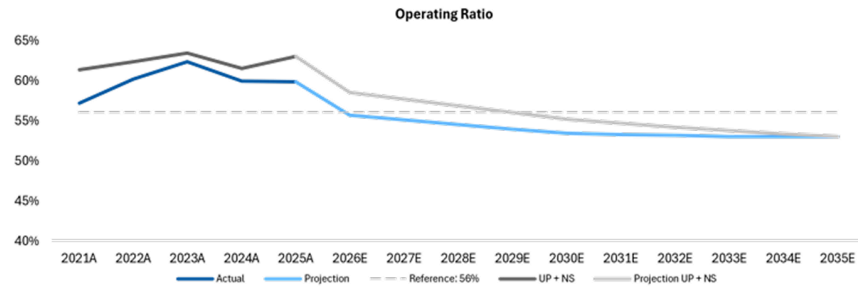


Figure 21: "UNP: operating ratio, 2021A to 2035E, standalone and UP + NS, against a 56% reference line."

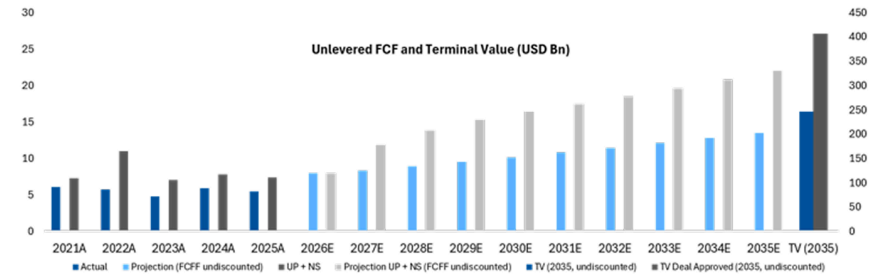


Figure 22: "UNP: unlevered free cash flow and terminal value (US$bn), standalone and UP + NS, FCFF on the left-hand axis and 2035 TV on the right."

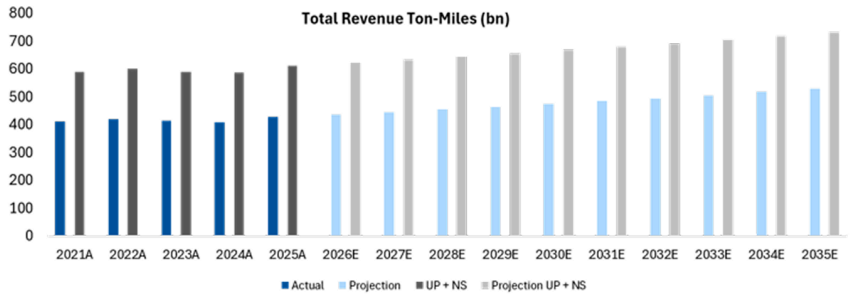


Figure 23: "UNP: total revenue ton-miles (bn), 2021A to 2035E, standalone and UP + NS.

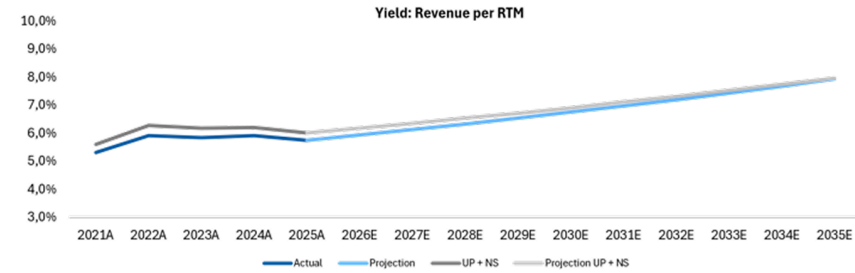


Figure 24: "UNP: yield, revenue per revenue ton-mile, 2021A to 2035E, standalone and UP + NS."

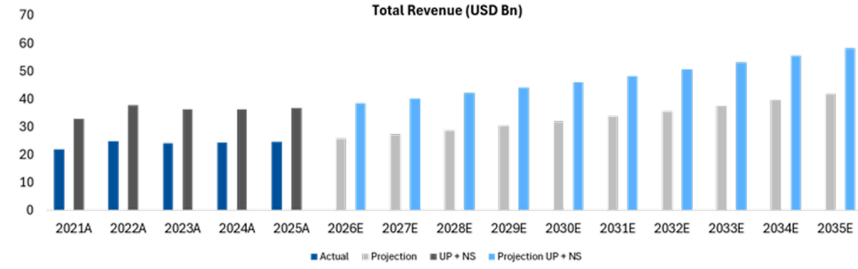


Figure 25: "UNP: total revenue (US$bn), 2021A to 2035E, standalone and UP + NS."

We also model an operating ratio improving from 59.8% to the mid-53s over the decade. That last assumption deserves its own caveat: it goes beyond management's stated pace of 60-80 basis points a year and effectively assumes Vena compounds PSR gains into the best sustained margins in the industry's history which may be stretched but possible given the track record and management quality.

Even so, we reach the same conclusion, even with a bullish standalone, we get $270 per share against a market price near $295, about -8%. However the merger certainly adds to this number even if it isn't a sure thing yet, even a decent probability of it occurring could surpass the $300 mark.

In the approval scenario, we model NS's own operational catch-up, its operating ratio fading from 64.2% toward industry and best in class UNP's standards as the turnaround Mark George was already delivering continues under new ownership. And second is synergies, which according to management should be around $2.75bn, ramp over the integration years and grow modestly thereafter.

All Financed with roughly $20bn of new debt and 225 million new UNP shares, in that scenario, a single UNP share is worth about $295 after accounting for dilution, the added net debt and the PV of the synergies which alone account for roughly $35bn, or $43 per UNP share. In the blocked scenario UNP keeps its standalone value less the $2.5bn reverse termination fee and sunk costs, about $265 per share. The spread between the two worlds is roughly $30 per share, a real prize but a bounded one. One important note is that we didn't change the discount rate because even though in the shorter term the capital structure would be more levered which could benefit from greater tax shields the other side of the coin is very real which is credit rating cuts and financial distress costs so all in all, we think these variables balance each other out in the short term and in the long run the target capital structure should be the same which matters more for TV.

We can also back out the implied probability of the acquisition going through by looking at the price of NS shares where the payoff is contractually defined at one UNP share plus $88.82 in cash (worth about $383 today) using NS's price of $335 we reach roughly a 65% probability of deal approval. Part of that gap is time value, since an arbitrageur buying NS today ties up capital until a mid-2027 close, but not all of it, a significant chance of the deal failing is still priced in. Putting the 3 together (standalone value of $265 * (1 - probability of approval) + $295 * probability of approval yields about $285. If the deal closes and it does so on schedule NS is the cheaper way to own UNP but if it fails, both UNP and NS shares should fall meaningfully and perhaps, for UNP, more than the $30 we estimate it would take to go back into fair value which could pose an interesting buying opportunity. The thing is, this 65% are just a number, it is hard to have a strong view on the STB's soul, there are solid arguments to approve but at the same time, it is a deal making the biggest most profitable player in a 6 player market even bigger. The bottom-line is that it is a superb railroad, perhaps modestly expensive but for good reason, if the deal does go through it could very well surprise on the upside and break industry profitability records but there is a lot of uncertainty regarding the deal which will weigh more heavily in the near term.

9. Conclusion

So, expensive or cheap? Mostly the former, though not egregiously so. All 3 railroads trade above what our DCF models suggest, modestly in UNP's case but with added uncertainty regarding the NS deal. Each company trades near the middle of its own 5-yr range multiples, so this is not a bubble in railroad stocks but we can say that it is a market that has understood what these businesses are and refuses to offer them at a discount. Nobody will build a competing mainline, trucking cannot match rail's cost per ton-mile on the lanes that matter, and in most regions shippers have 2 railroads to choose from, often just 1.

These are companies an investor can hold through almost anything, even through freight recessions, a pandemic, tariff regimes and the downtrend in most of its coal business, which is precisely why the market rarely lets them go cheap.

The catch is really just arithmetic, we are missing the "fair price" in the "buy a wonderful business at a fair price" motto. Currently the price already reflects its wonderfulness and so the return converges on the growth of the business itself, volumes tracking industrial production, pricing a point or so above inflation. That likely gets an investor to a high-single-digit annual return, respectable and durable, but not the market-beating outcome that justifies the research effort. Beating the market from here requires 1 of 3 things. First is a better entry point. Second is execution beyond what is priced, for instance, CPKC converting its Mexico corridor and synergy runway into volume growth that outruns the ultimate fade the market assumes, or UNP closing and integrating NS seamlessly without the service meltdowns that have followed every large rail merger before it. Third is the endgame itself, if the STB blesses the first transcontinental railroad, the remaining players will not stand still which is what makes the next months unusually eventful for a sector that typically measures change in decades. The STB's handling of UNP-NS, the defensive responses of BNSF and CSX, the reciprocal switching debate, the 2026-27 labor rounds, tariff policy and the pace of nearshoring volumes into Mexico will determine whether today's map, and today's multiples, survive the decade or not.

In short our verdict is: Wonderful businesses, wide moats, honest valuations so you can own them for what they are, watch the regulator for what they might become, or keep them in your watchlist in hopes of a day where the market forgets why it loved them.

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All operating and financial data from company filings, earnings releases and call transcripts.