



CN and CP Rail Stocks Just Went on Sale!

Description

Don't look now, but **CN Rail** ([TSX:CNR](#))([NYSE:CNI](#)) stock is under considerable pressures thanks in part to its top peer **CP Rail** ([TSX:CP](#))([NYSE:CP](#)), which is slated to scoop up **Kansas City Southern** railway in a US\$25 billion cash and stock deal. Undoubtedly, CN Rail will face much stiffer competition once the CP Rail's historic merger completes. That said, I do think Mr. Market is overreacting by marking down CN Rail stock by 3% on Monday.

In a [prior piece](#), I highlighted the absurdly high price tag that CP Rail had to pay to scoop up Kansas City Southern, one of the smaller rail players in the states. The US\$25 billion price of admission was not cheap, and that's reflected in the CP Rail stock's price action on Monday. Tie-ups between Class-I railways don't happen often, but when they do, you can bet that the entire industry is going to feel the shockwaves.

CP Rail makes its moat that much wider

The massive railway tie-up is still subject to regulatory approval. Given CP Rail and Kansas City Southern are both relatively small railways versus the likes of their peers, the deal is likely to get the green light.

However, I do not believe that CN Rail will be as negatively impacted over the long run as most CN investors seem to think. The 3% plunge in CN Rail stock was vicious, and I think it's overblown beyond proportion, even though CP Rail will be moving in on CN Rail's turf over the coming years, as it evolves from a domestically-focused railway to a transcontinental powerhouse.

CP Rail's moat was already wide before the deal. With Kansas City Southern's assets thrown into the mix, the company now has a vast moat comparable to the likes of CN Rail. CP and CN investors hate the deal, and I can't blame them. It's expensive and will amp-up competitive pressures in the Canadian railway scene.

That said, any such dips in either CN or CP Rail stock are buying opportunities in the grander scheme of things. Why? Both rail kingpins can thrive together. Although it'll be more of a zero-sum game, both

names are worth adding on the recent bout of weakness ahead of a historic economic reopening that could be huge for the rails.

Should you buy CN Rail or CP Rail stock?

It doesn't matter if you're a CN or CP Rail shareholder: this weekend's historic merger is bad news.

CN shareholders are worried about lost business from CP, which could be the world's first railway to span Canada, the U.S., and Mexico. And CP shareholders don't seem to be a huge fan of the lofty price paid. CP Rail is paying up a 23% premium on top of Friday's closing price, making it tough for the rail giant to justify the hefty price paid over the near- to medium-term.

CP stock tumbled nearly 6% on Monday, derailing its powerful rally out of its March 2020 depths. Meanwhile, shares of Kansas City Southern popped over 11% on the day, enriching KSU shareholders who stuck by the name despite its frothy multiple.

The big rail merger could bring forth integration risks that could stop CP Rail's margin improvements in its tracks. Over the longer-term, though, CP CEO Keith Creel can pull it off. If CP Rail's rally has been derailed, I'd be tempted to jump in. However, I remain a bigger fan of CN Rail's valuation given that its operating ratio has more room to run, and expectations are looking quite modest, even with the economic boom on the horizon.

Foolish takeaway

While I'd encourage Canadians to own both companies, I have to side with CN Rail here, as the stock looks far [cheaper](#). As CP Rail focuses on integration, CN Rail has room to improve its profitability metrics, which lost a step amid the pandemic.

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