CN Rail Beats CP Rail’s Bid: Which Should You Buy?

Description

On the surface, the answer to the question posed in the title of this article seems pretty clear. In a bid for the **Kansas City Southern** railroad, Canadian railways **Canadian Pacific Railway** (TSX:CP)(NYSE:CP) and **Canadian National Railway** (TSX:CNR)(NYSE:CNI) both showed interest.

However, after it seemed set in stone that CP Rail would win the bid with its US$25 billion deal, CN Rail then swooped in with a 21% premium — a total of US$29.9 billion!

So, on the surface, it seems that with CN Rail as the winner of the Kansas City Southern rail acquisition that it would be the one to buy today. This was a huge win for the company, as the Kansas City rail gives exposure from Canada down to Mexico

But don’t go diving in just yet.

The CN Rail case

The US$29.9 billion bid by CN Rail included $325 for each Kansas City Southern share and $200 a share in cash and 1.059 CN shares. In comparison, CP Rail offered $275 per share, including $90 in cash.

Yet while the move sent Kansas City Southern shares up on Tuesday, the news caused CN shares to drop and CP Rail shares to rise. So, what gives?

Shareholders may worry that there will be too many costs associated with the new route. The deal should generate cash flow, though incrementally, as the business makes a transition. In the meantime, this acquisition creates a huge debt the company will need to pay down long term.

Yet CN Rail management is confident that its earnings before interest, taxes, depreciation, and amortization (EBITDA) will eventually be $1 billion. This comes from increased revenues coming from lower-cost shipping alternatives in comparison to its current trucking routes.

And it's not over yet. The company still has some regulatory hoops to jump through. This can be a long process in the United States to prove the company is operating in the public's interest. Yet that didn't seem to matter to CN Rail when it jumped into a bidding war, likely caused by the current cheap financing available.

The CP Rail case

All of these same facts would have been true for CP Rail had the company taken on the acquisition. CP Rail would have had access from Canada to Mexico, and it would have taken on a huge debt in the process. Investors looking for the continued strong revenue reports would have been relieved to see the deal fall out, especially in the short term.

But long-term investors may not be as thrilled. The company has come a long way since the reboot of 2012. It's done a lot of cost cutting along with a lot of reinvestment. This has caused shares to soar in the last few years, and last year was no exception.

Meanwhile, CN Rail seems better positioned than CP Rail for the acquisition any way. It has a larger footprint, with not as much overlap in its route compared to Kansas City Southern. This can save a lot of travel time when shipping products that bring in serious revenue.

Foolish takeaway

It comes down to why you're investing. If you're looking to invest short term, then I would maybe stick it out with CP Rail stock. The company is up 47% in the last year and 754% in the last decade for a compound annual growth rate (CAGR) of 24%! Solid earnings since the reinvigoration back in 2012. It also offers a 0.82% dividend yield. You're likely to continue seeing what you've seen the last decade: strong growth and income that's steady as a rail.

However, this might be a prime opportunity for investors to get in on CN Rail if they plan to stick it out for decades to come. Honestly, when it comes to either company, they are solid. Shares are still up 35% in the last year and 408% in the last decade for a CAGR of 17.63%. It also has a dividend yield of 1.65%.

But yes, it will take a while for CN Rail to pay down this debt. While it might mean there's a slowdown in the next year or two, it's likely to speed up significantly over the next decade. Basically, CN Rail now has the opportunity that CP Rail created for itself back in 2012.

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