



CN and CP Rail Battle for Kansas City Southern: Who Will Win and Which to Buy?

Description

CN Rail ([TSX:CNR](#))([NYSE:CNI](#)) shocked the world on Tuesday with its unprecedented US\$30 billion bid for **Kansas City Southern** (NYSE:KSU), sparking the start of a bidding war against **CP Rail** ([TSX:CP](#))([NYSE:CP](#)) in what could be the last big mega-deal in the railway industry. Kansas City Southern stock soared over 15% on the day, while CN Rail and CP Rail stocks plunged viciously by 6.3% and 2.2%, respectively.

Undoubtedly, bidding wars are bad news for shareholders of both Canadian railway companies. The risks of overpaying for an acquisition are considerably higher when there's fierce competition.

In any case, Kansas City Southern shareholders will walk away from this potential bidding war as massive winners at the expense of CN and CP Rail shareholders. But with both CN and CP Rail stocks nosediving on the news, does it make sense for investors to buy either CNR or CP shares on recent weakness? Or could more pain be ahead, as the potential bidding war takes it to the next level?

The battle to acquire Kansas City Southern

CN Rail and CP Rail are fierce competitors in Canada's rail market. They're the big two, and they call the shots. The competition really heated up when CN Rail one-upped its top peer with an offer that would see CN Rail pay a hefty 21% premium to CP Rail's US\$25 billion deal.

Up for grabs is the first and only railroad to span Canada, the U.S., and Mexico. Whichever Canadian rail wins the brewing bidding war will have an incredible rail network (and moat) that is unlikely ever to be matched. It's virtually impossible to build out a new rail network these days, given the lofty investment, regulatory hurdles and all the sort. As such, acquisitions are really the only way to go to expand one's network.

Whichever Canadian railway wins the bid for Kansas City Southern will have to open up its wallet wide, though. That said, I do think the recent sell-off in CN, and CP Rail stock is a tad overblown, providing

long-term investors with a great opportunity to buy the dip.

The last great rail acquisition?

The premium that CN Rail would pay is quite frankly [absurd](#). Bidding wars are normally a destroyer of shareholder value, and investors are right to be [concerned](#) over the now US\$30 billion price tag that could continue to climb if CP Rail were to up its bid. In any case, I do think the pursuit of Kansas City Southern is a target that's well worth the premium price tag.

Why? It's a massive deal that will provide profound, even unfathomable long-term synergies for its victor. Kansas City Southern is so sought-after due to its minimal overlap for both Canadian railways. Through the eyes of both firms, it's the last piece of the puzzle and a move that could allow a front-row seat to the roaring 20s. More importantly, though, it could be the last big acquisition we'll ever see from the railway industry.

Which is the better buy?

After plunging nearly 7% in a day, I'd have to say that CN Rail is the better buy at these levels. Sure, the US\$30 billion price tag is hefty, but it may actually prove to be cheap if this is the last big railway deal of our time, not to mention how much better Kansas City Southern's rail network will be in the hands of the Canadian rail greats.

Moreover, I find there to be a risk that the U.S. Surface Transportation Board could stand in the way of the deal. CN Rail has one of the most extensive networks already, and I find the risks of a blocked deal will be higher in the case of CN. As such, the odds of an upside correction in CN Rail stock, I believe, are pretty high if the CN-Kansas-City-Southern deal were to fall through at the hands of regulators.

As for CP Rail, I think it has a greater chance of success. Regardless, if it chooses to sweeten the pot, one-upping CN Rail's US\$30 billion bid, CP stock could find itself under even more considerable pressure.

CN Rail stock is a buy in my books, whereas CP is a hold.

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Author

joefrenette

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