CN Rail and CP Rail Stock Are on Sale! Which to Buy Amid a Bidding War?

Description

Top Canadian railway rivals **CN Rail** (TSX:CNR)(NYSE:CNI) and **CP Rail** (TSX:CP)(NYSE:CP) have both been under considerable pressure in recent weeks thanks to the bitter battle for which **Kansas City Southern** is the prize. CP Rail's initial offer sparked a mild sell-off in both CN and CP Rail stock.

CN Rail was quick to recover, until CEO J.J. Ruest and company served up an offer of their own. CN Rail's US$30 billion offer was simply too good to refuse for the shareholders at Kansas City Southern. Almost immediately, the managers at Canadian Pacific slammed Canadian National, going as far as calling the sweetened offer a "fantasy." The bitterness between the two rivals is really nothing new, but this potential bidding war in the works really takes it to the next level.

CN Rail and CP Rail duke it out over Kansas City Southern

As of right now, it seems like CP Rail is signaling that it does not intend to sweeten its offer over CN Rail's. Given CP Rail's managers are disgruntled by CN and the likelihood they don't want to lose to their top peer, I believe, signals that CP Rail could be in a spot to at least match CN Rail's bid, perhaps with a greater chunk of cash. I don't think CP Rail will let CN Rail walk away with its prize, even though the price it'll stand to pay is rich.

Bidding wars are never good for shares of the acquirers. And CN and CP Rail shareholders have the right to be concerned. At the time of writing, CNR stock is fresh off a fast-and-furious correction (a 10% drop from peak to trough). CP flirted with a correction last week, but shares were quick to bounce, bringing CP stock now down just 4% from its highs. Undoubtedly, it appears that shareholders think that Canadian National will walk away as the winner of Kansas City Southern.

However, with regulatory scrutiny likely to be harsher on CN, given it's one of the largest railways in North America, there is a chance that the deal could fall through, leaving CP Rail in a good spot to retort. In such a scenario, I believe CP could match rather than have to one-up CN Rail's latest offer, which is already really sweet for Kansas City Southern shareholders.

Which rail stock is the better buy?

I think CP Rail is likelier to win Kansas City Southern. I think CN Rail is already too powerful with its access to all three North American coasts. Kansas City Southern's network will give CN Rail direct access to north and south movements between Canada, the U.S., and Mexico. Regulators may object to such an extensive network, and if they do, CP Rail could swoop in and take its prize back.

Even if CP Rail did acquire Kansas City Southern, the resultant network would still be on the smaller side as far as railways are concerned. As such, regulators probably wouldn't be nearly as concerned about such a deal.

In any case, I think CNR stock is a far better buy here. It's fresh off a correction, and if CP Rail ends up winning the right to acquire Kansas City Southern, CNR stock could recover the 10% lost very quickly. And if CN Rail does win the potential bidding war, I'd still buy the stock and hold for the long term, as it'd have the most enviable railway in North America.

Sure, CN is paying a pretty penny, but rail acquisitions are hard to come by these days. That more than justifies the premium price tag ahead of what could be an economic boom for the ages. I view CN stock as severely undervalued and would encourage contrarians to buy the correction before shares bounce back.

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Date

2025/07/20
Date Created
2021/04/29
Author
joefrenette

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