



What the Bidding War in the Railroads Space Means for Investors

Description

The situation is heating up with Canada's two biggest railroad industry leaders – **Canadian Pacific Railway Limited** ([TSX:CP](#))([NYSE:CP](#)) and **Canadian National Railway** ([TSX:CNR](#))([NYSE:CNI](#)) – [locking horns](#) to acquire **Kansas City Southern** (NYSE:KSU).

This battle is one that's certainly intriguing to watch from the sidelines. Here's my take on how this will all play out.

The low-down on this deal

CP's initial offer to acquire Kansas City Southern for US\$275 per share took KSU stock on a nice ride. However, interestingly, KSU traded above US\$275 per share following the announcement. It appears investors were pricing in a second bid, or an increase of CP's initial offer price.

Well, it appears this has materialized.

Recently, CN Rail has stepped into the fold. The largest railroad in Canada proposed an acquisition offer of US\$325 per KSU share. Additionally, CN beefed up the cash component of the deal to US\$200 per share, versus the initial US\$90 cash amount investors would get with the CP deal.

Of course, this offer will likely put pressure on CP to raise their bid. It appears it's an all-out bidding war right now, and the higher bidder will take the prize.

That said, CP's CEO believes the offer from CN is moot. Why? Well, the argument is that a CN takeover of KSU would amount to a reduction in options for shippers going north-south in the U.S. Currently, shippers have four options in this space. A CN bid would reduce this choice down to three. Accordingly, regulators may not bit at such a deal.

Regardless, this bid represents a substantial premium of approximately 18% over and above CP's initial offer. We'll see how this plays out, but for now, it appears KSU's stock price just below US\$300 per share is factoring in some sort of bid increase.

Bottom line

The result of any deal between one of the Canadian railroads and KSU would be the most extensive rail network in North America. To date, a single railroad has never crossed Canada, the U.S. and Mexico. A combination of either CN or CP and KSU would change this.

That said, I do think the regulatory scrutiny with respect to this deal will be massive. Unless the Surface Transportation Board approves the deal, all this bidding could be for naught. The probability of the deal going through is something investors are pricing in right now. However, this is a risk investors need to keep in mind when buying any of these three rail stocks right now.

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TICKERS GLOBAL

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2. NYSE:CP (Canadian Pacific Railway)
3. TSX:CNR (Canadian National Railway Company)
4. TSX:CP (Canadian Pacific Railway)

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