



## CN Rail Stock Looks Severely Undervalued

### Description

**CN Rail** ([TSX:CNR](#))([NYSE:CNI](#)) is struggling to recover from the [correction](#) (that's 10% drop from peak to trough) it suffered when it decided to outbid **CP Rail** for sought-after railway prize in **Kansas City Southern**. Kansas City Southern, or KSU, has a relatively small network in the southern U.S. that extends into Mexico. Whoever wins the right to acquire the firm will have an enviable network that spans Canada, the U.S., and Mexico, as well as a wide moat surrounding north-to-south freight shipments.

The price for KSU, which currently sits at US\$33 billion, is not cheap, though. And if CN Rail and CP Rail take their bidding war to the next level, shareholder value could stand to take a huge hit. At this juncture, it seems like CP Rail is playing the waiting game rather than upping its bid for KSU. At the time of writing, U.S. regulators have already given CP Rail the green light. CN Rail is waiting (and expecting) the same, but will it get it?

## CN Rail outbid CP Rail, but will it get approval from regulators?

As one of the smaller North American railways, CP Rail will have an easier time with federal regulators. CN Rail may be a tad too big to gain approval, even if it does have the deal that's better for KSU shareholders. Personally, I think CP Rail will walk away as the winner of KSU because the merger of the two rail networks will still represent one of the smaller railways out there.

In any case, I find CN Rail's current valuation to be ridiculously low. The stock is priced as though it has already walked away as the winner from the bidding war, when in reality, CP Rail may get the deal it wants at close to the price it wants.

In prior pieces, I'd noted that CN Rail had a high chance of correction to the upside if it lost the bidding war to its top Canadian rail rival. In the case of KSU, I think the loser of the bidding war will actually be the winner, given the hefty price tag that will have to be paid.

## CN Rail stock: What about valuation?

At the time of writing, shares of CN Rail trade at 4.8 times book value, seven times sales, and 28.3 times earnings, which are either in line or below that of the industry average multiples of 6.1, 7.2, and 27.1, respectively.

CN Rail is hardly a cheap stock based on traditional valuation metrics. That said, given the favourable environment set up in the 2020s and the exceptional stewards running the show, I don't think CN Rail stock is nearly as expensive as it could be.

## Foolish takeaway

With a KSU deal mostly baked in, I'd look to load up on CN Rail shares here, regardless of which Canadian railway wins the bidding war for KSU. The outlook for the rest of the year looks more than favourable, and with much room for the operating ratio to improve, I think CN Rail could find itself right back on the high track, perhaps far sooner than most bears expect.

In the meantime, COVID-19 pressures and bidding war woes will act as a drag on the stock. As both pressure points go away, though, CN Rail is likely to go back into [rally mode](#). All aboard!

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