The Railroad Bidding War Is Over: Time to Buy CN Rail?

Description

Since March, investors had their eyes glued on **Canadian National Railway** (TSX:CNR)(NYSE:CNI), **CP Rail** (TSX:CP)(NYSE:CP), and **Kansas City Southern** (TSX:KSU). These railroad stocks have generated a tonne of buzz following an initial CP bid to buy out KSU.

However, a higher competing offer from CN has ultimately won out. CN and KSU are now poised to become the largest intra-continental railroad in North America. For investors, this is a big deal.

However, the question remains: is now the time to buy CN ahead of this merger? Let's discuss.

A little backstory

In late March, CP and KSU announced they had entered a merger agreement. The agreement saw CP acquiring KSU with an enterprise value of US$29 billion, of which US$3.8 billion was debt. In this offer, KSU was valued at US$275 per share with a 23% premium to the closing price of March 19.

Fast forward a few weeks, and this deal has been rescinded. A competing offer by CN to buy KSU for US$33.7 billion in April ended the bidding war. Indeed, CP indicated the deal wasn't likely to pass regulatory approval, and they wouldn't increase their bid. After all, the premium they initially offered was substantial.

The deal CN offered effectively valued KSU shares at US$325 per share. This deal also offered KSU investors $200 per share in cash, much higher than CP's initial cash component offered. Accordingly, KSU shareholders unsurprisingly chose to side with the CN offer. As part of the deal, CN agreed to pay CP a US$700 million breakup fee to terminate the existing merger agreement in place.

Is CN a buy at these levels?

There is certainly a case to be made that CN looks to be in a much better competitive position following this merger. The largest railroad in Canada, CN is further down the list of North American railroads due to the size of U.S. counterparts.

However, this combination changes that dynamic completely. CN will be the only railroad spanning Canada, the U.S., and Mexico. For those bullish on the recent USMCA deal promoting North American trade, this is a huge deal. Shipping of bulk loads of commodity goods across these three countries continues to take off, as economic activity picks up. Indeed, for those bullish on the long-term growth the North American economy holds, CN appears to be one of the best ways to play this catalyst in the railroad space today.

A number of analysts have chimed in on the deal and think this will ultimately be beneficial to CN shareholders when it's all said and done. The company is paying a hefty premium to acquire KSU, and regulatory hurdles still remain. But if the deal goes through, the size and scale of the future CN rail will be formidable. That's a good enough reason as any to own highly economically sensitive assets like CN right now.

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