



Alert: Rare Opportunity to Earn a Free 20% Return on This CN Rail (TSX:CNR) Stock Deal

Description

Mergers and acquisition transactions sometimes present investors with an opportunity to make free money just by capitalizing on valuation discrepancies between the merging candidates. Such an opportunity, called an arbitrage, is available right now on **Canadian National Railway's** ([TSX:CNR](#))([NYSE:CNI](#)) acquisition target. You may want to check it out.

What's the trade opportunity?

Canadian National Railway (CN) intends to acquire all the outstanding shares of smaller United States railway line operator **Kansas City Southern** (NYSE:KSU) in a US\$33.6 billion deal.

Kansas City Southern (KCS) stock plunged by 7% on July 8 after *The Wall Street Journal* broke the news on President Joe Biden's new executive order that targets [limiting corporate dominance in the ocean and railway shipping industries](#) and weakening incumbents' monopoly pricing power. Trade in KSU shares closed at US\$262.87 per share on Monday.

CN Rail's offer is to pay Kansas City stock investors a combination of US\$200 cash per KSU share and 1.129 CN shares on deal close.

And CNR stock traded at US\$101.48 on the New York Stock Exchange on Monday.

Thus, an investor in KSU stock today could receive back their US\$200 cash and get 1.129 CNR shares at settlement if the merger goes through. That would amount to a valuation of US\$314.57 per Kansas City Southern share for an easy 19.7% gain on investment (given current stock price mismatches.)

Why aren't investors taking the free money?

Arbitrage opportunities don't usually exist for long on a stock market as efficient as the North American one. Normally, this nearly 20% "risk-free" opportunity on KSU stock wouldn't continue to exist for two

weeks. Investors should have bid up the target's stock price until the opportunity evaporated. But they haven't done so yet.

The issue is that there is a great deal of uncertainty concerning the CN Rail and Kansas City Southern merger. The deal has several hurdles to clear.

Firstly, Kansas City Southern's shareholders have yet to accept CN Rail's offer. A KCS shareholder vote is scheduled for August 19, 2021. Hopefully, that hurdle will be cleared next month.

Secondly, there are several regulatory approvals required for the merger to be successful. The U.S. Surface Transport Board (STB) should give its nod. This will be a lengthy process. The merger will create the first Canada/U.S./Mexico railway line, so the Mexico Competition Bureau needs to approve the transaction, too. And lastly, the latest anti-trust executive order by the Biden administration could create anti-trust problems for the transaction.

Will you take the free money?

Canadian Pacific Railway is also bidding to acquire Kansas City Southern at a current conversion equivalent of US\$263.33 per KSU unit. However, it's highly likely that once KCS investors accept Canadian National Railway's superior offer, the target's shares could rally to narrow the valuation gap.

That said, due to lengthy regulatory approvals, the settlement could be 24 months out.

Now, that's too long a waiting period to cash in on the "risk-free" gain. Actually, there remains the risk that one or all regulatory bodies may fail to approve the combination. The deal may never take place. The trade isn't risk-free yet.

However, it's not likely that investors who attempt to cash in on this opportunity will lose out. Both companies [can be held for a lifetime](#).

Kansas City Southern is expected to grow its revenues by nearly 16% year over year in 2021 and by 9% in 2022. The company's gross margins could expand from 38% in 2020 to a staggering 52% in 2021 and 50% in 2022. Earnings per share (GAAP EPS) could grow at a compound annual growth rate of 26.2% from 2020 to 2022. Investors could also pocket a 30% higher dividend from KSU stock in 2021 and another 7% dividend increase is expected for 2022.

I think investors in [undervalued](#) Kansas City stock could still win either way. A little patience will be necessary once you take a bite into the CNR/KCS merger arbitrage opportunity.

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