Canadian Railway Merger: 2 Giants After the Same U.S. Company

Description

Oligopoly is quite common in Canadian markets. Few banks control most of the market, the telecom sector is ruled by three giants, and two railway giants, **Canadian National Railway** (TSX:CNR)(NYSE:CNI) and **Canadian Pacific Railway** (TSX:CP)(NYSE:CP), have consolidated most of the railway business in the country.

But the two Canadian railway giants have a significant presence across the border as well. And both companies are looking to expand that presence by acquiring **Kansas City Southern**, a US$26.5 billion (market cap) pure transportation holding company. Actually, CNR is the one that's about to acquire the U.S.-based railway company for about US$30 billion, and the vote to decide this acquisition is just a few days away.

Canadian Pacific is trying to poach Kansas City Southern from CNR's clutches, but it hasn't made a comparable offer yet. It originally offered US$25 billion, and it's now offering US$27 billion in equity to buy the company. Despite the lower price, the company is counting on deal certainty to solidify its bid.

As a Canadian investor, both CNR and CP look enticing enough, regardless of who wins the game for Kansas City Southern.

The case for CNR

Canadian National Railway is the older Dividend Aristocrat by far. It has been growing its payouts for a quarter of a century, making it an Aristocrat across the border as well. The 1.8% yield, however, is not enticing enough to attract investors on its own, even considering the company's stellar dividend history. There are a few older Aristocrats that are offering much more powerful yields.

But CNR’s forte is in its capital growth prospects. The company has been growing quite steadily for the last decade and has a 10-year CAGR of 16%. And since its current valuation is just moderately overpriced (not aggressively), the prospects of the company maintaining its growth rate are quitebright. And if the Kansas City deal goes through, the company will solidify its U.S. presence, which islikely to reflect positively in its future financials.

The case for CP

CP offers a different ratio of yield and growth prospects, albeit it’s leaning the same way — i.e., more growth and lower dividends. The railway giant only became a Dividend Aristocrat recently and has grown its payouts for the past five years. The company is offering a relatively low yield of 0.84%. It’s also a smaller company compared to CP, based on market capitalization. It has a market cap of $61.2 billion, while CNR is at $95.6 billion.

But one area where CP undoubtedly shines is its capital-growth history. The stock is powerfully consistent when it comes to growth and has returned over 148% to its investors in the last five years. The 10-year CAGR of 23.8% is significantly better than CP and for a relatively better price.

Foolish takeaway

Even though the addition of Kansas City Southern might benefit either of the Canadian railway giants, the cost of acquisition will impact CP more significantly. The price would be about half of the company’s total market capitalization, and if it has any toxic debt, its weight, combined with the weight of acquisition, might weigh down CP more than it might impact CNR.

You might consider waiting for the acquisition deal to go through before choosing one of the two growth stocks.

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