Canadian National Railway (TSX:CNR) Stock: Still a Buy After 10% Rally?

Description

What a wild few days it's been for **Canadian National Railway** (TSX:CNR)(NYSE:CNI).

After news broke that the company's **Kansas City Southern** (NYSE:KSU) deal had been rejected, the company's stock actually rallied, rising 7% in a single day. As of this writing, the stock was up another 3.5%, bringing the total gains to 10.7%.

It's been an incredible thing to witness. On the one hand, you've got the company receiving its worst news in months; on the other, you've got it staging its biggest rally of the year.

What on earth could be going on here?

What's behind the rally?

While CNR's rally following negative M&A news seems perplexing, it's really not. The thing is, investors by and large don't consider the KSU deal a positive and are likely bidding CN stock up on its apparent failure.

CN's planned acquisition of KSU is going to be extraordinarily expensive. The deal was valued at $33 billion as of the most recent reports, yet KSU only did $619 million in earnings last year. So we've got an implied valuation of 53 times earnings here. That's pretty steep for a railroad. CN, for example, is presently trading at 27 times earnings, and some people think it's a little pricey at that level.

The price CN was set to pay for KSU was much higher relative to earnings than its own valuation in the stock market. And remember: railroads aren't exactly an explosive growth industry. They tend to crank out slow and steady earnings growth with economic expansion and improved operating efficiency, but they're not growth stocks.

Another possible concern was the effect of the KSU deal on CN's balance sheet. According to the *Wall Street Journal,* CNR had just $1.1 billion in cash and equivalents at the end of 2020. The company's Q2 report lists $3.4 billion in current assets. So this isn't a company that can just run out and buy a competitor for $33 billion. It would have to issue either debt or equity to close the deal, and that would possibly have a negative effect on the company's financial position.

Is CN Railway still a buy?

Having looked at the news regarding CN Railway's KSU deal, it's time to answer the question:

Is CN Railway still a good value?

My personal opinion is yes. In the most recent quarter, we saw CN's revenue and earnings strongly rebound from the COVID-19 downturn. All key metrics were up solidly year over year, and guidance was raised.

As for the KSU deal, that's harder to judge. It does look like CNR is offering a hefty sum for Kansas City based on its earnings, but there are other factors to keep in mind. Synergies between CNR and KSU could result in new shipping routes that would bring in more revenue than KSU would have on its own. So I'm not a pessimist on the deal. But I think CN Rail is fine without it.

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