CN Railway (TSX:CNR): Why Investors Hate the KSU Deal

Description

Canadian National Railway (TSX:CNR)(NYSE:CNI) went on an impressive rally recently. After news broke that its **Kansas City Southern** (NYSE:KSU) deal structure was rejected, the stock proceeded to rise 10.7% in just two trading days.

What on earth happened here?

When you hear about a company's M&A deal getting rejected by regulators, you'd normally take it as a negative. The company tried to do something and failed — that's a loss, right?

Well, not necessarily. As it turns out, a lot of big CN shareholders think that the KSU deal isn't worth it, and that CN would be better off without it. Some of these investors are even trying to get CNR's management ousted, to replace them with executives they think are better. In this article, I'll explore several reasons why major CNR shareholders hate the KSU deal, and share my own thoughts on the proposed acquisition.

The winner's curse

One thing you need to keep in mind when considering the CNR-KSU deal is the economic phenomenon known as the "winner's curse."

This is a phenomenon that occurs in auctions when several parties aggressively bid up the price of an asset and end up offering too much. In the end, the auction winner pays a premium price for what might just be a lemon.

There may be a bit of a winner's curse thing going on with CN's KSU bid. You see, the company didn't just come up with the idea to buy out KSU out of nowhere. It was actually **Canadian Pacific Railway** (TSX:CP)(NYSE:CP) that first bid for Kansas City, offering $29 billion. This got CN smelling an opportunity. It then began a bidding war with CP rail that ended with CN offering $33 billion — a price that CP couldn't match. So, CN won the bidding war … but at a heavy cost.

KSU is very expensive at CNR’s offer price

Based on the price CNR offered for KSU, it looks like the former is paying a princely price. The implied valuation multiples based on a $33 billion price tag are as follows:

- Price/sales: 12
- Price/earnings: 53
- Price/book: 7.5

Put simply, these are very high valuation multiples for a railroad. CN itself only trades at 27 times trailing 12-month earnings, for example. It’s paying almost twice that multiple for KSU. And Kansas City doesn’t have the kind of growth that would justify a premium price tag. Over the last five years, KSU has grown revenue by 3.5% annualized and seen its earnings decline. That’s not a great look. And yes, CN could find some synergies between itself and KSU that could increase shareholder value. But enough to make up for this negative long-term trend? It’s not a sure thing.

Foolish takeaway

If the CN/KSU saga can teach us anything, it’s this: a win is not always a win.

If a company pays too much for an asset, it may find itself a loser, even if it “won” in the auction sense. It looks like that’s what happened with CN and KSU. So maybe investors should be grateful the deal got blocked.

CATEGORY

1. Dividend Stocks
2. Investing

TICKERS GLOBAL

1. NYSE:CNI (Canadian National Railway Company)
2. NYSE:CP (Canadian Pacific Railway)
3. TSX:CNR (Canadian National Railway Company)
4. TSX:CP (Canadian Pacific Railway)

PARTNER-FEEDS

1. Business Insider
2. Koyfin
3. Msn
4. Newscred
5. Quote Media
6. Sharewise
7. Smart News
8. Yahoo CA

PP NOTIFY USER

1. andrewbutton
2. kduncombe

Category

1. Dividend Stocks
2. Investing

Date
2025/08/26
Date Created
2021/09/12
Author
andrewbutton