



Is the Air Canada Acquisition Delay a Sign of Denial?

Description

The year 2020 started on a strong note for Canada's largest air carrier **Air Canada** ([TSX:AC](#)). In 2019, it made new records in operating revenue (\$19 billion), passengers carried (51.5 million), and liquidity (\$7.4 billion). These strong earnings drove AC stock to its all-time high of \$52.7 in mid-January.

This year, the airline planned to expand its international services, reintroduce **Boeing** 737 Max aircraft, and close the acquisition of **Transat AT** ([TSX:TRZ](#)).

But the COVID-19 outbreak in March disrupted the airline industry. To contain the coronavirus, global governments banned all non-essential travel. Global airlines grounded their aircraft, which burnt a big hole in their pockets.

In light of the current market environment, the airline industry's priority has shifted from expanding the business to [preserving liquidity](#). All the acquisition deals signed before the pandemic have come under jeopardy.

The Air Canada-Transat deal before and after the pandemic

In August 2019, AC agreed to acquire Transat, Canada's third-largest airline that specializes in leisure travel, to expand its network. The deal valued Transat at \$720 million, or \$18 per share, representing a 260% premium on its original share price of \$5.

Even though AC offered such a high premium for the deal, its stock rose 7.7% when the agreement was signed. This indicates the importance of the deal to shareholders.

However, the pandemic has drastically changed the global market conditions for the airline industry. All airlines, including AC, are reducing capacity. The \$720 million all-cash deal to acquire Transat will eat away 11% of AC's \$6.5 billion in liquidity.

AC can't afford to lose such a large amount of cash at a time when it is struggling to survive. Moreover, the pandemic has decreased Transat stock price by 63% to \$6, thereby making the value of the AC-

Transat deal expensive.

Even though AC and Transat hasn't made any announcements, the pandemic could delay, revise, or cancel their contract.

Regulatory approvals delay Air Canada-Transat deal

Apart from the pandemic, the AC-Transat deal is facing scrutiny from Competition Bureau of the government of Canada and the European Commission. The regulators are concerned that the deal will affect competition, as the combined company will command up to 60% share of the trans-Atlantic market.

There is no deadline for the Canadian government's decision. European Commission launched a 90-day investigation expected to close in September. But it has recently suspended the investigation while waiting for the companies to provide requested data. These regulatory approvals have delayed the deal to the fourth quarter.

According to the original agreement, the transaction was [scheduled](#) to close on June 27 with an option to extend the deadline up to December 27, 2020. If AC walks out of the deal, it would have to pay \$40 million in termination fee.

Is Air Canada trying to cancel the Transat acquisition?

There are rumours that AC is seeking the Canadian government's help to cancel the Transat deal. If Transport Minister Marc Garneau does not approve the acquisition until December 27, the contract will automatically stand cancelled, and AC will not have to pay the termination fee. Cormark Securities analyst David Ocampo believes that AC could terminate the deal using force majeure clause for unforeseeable circumstances.

What investors should know

If the AC-Transat deal is terminated, it will have an opposite impact on the two stocks. AC stock will rise by the mid-single-digit as the airline will succeed in preserving cash to withstand the crisis.

Transat stock will fall by the double digits as investors are holding the stock to sell them at \$18 per share to AC. Buying into any of the two stocks is a gamble.

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