



Warren Buffett Told You So: The Air Canada (TSX:AC)-Transat (TSX:TRZ) Deal Loses Value

Description

Things aren't getting any better for **Air Canada** ([TSX:AC](#)). The billionaire value investor Warren Buffett had warned in April itself that the airline industry has lost its valuation. No doubt about that. Just last week, AC [slashed the price](#) for its **Transat A.T.** (TSX:TRZ) deal by almost 74%, sending AC stock down 4% to \$16.09.

Air Canada-Transat deal

Last year, AC signed a deal to acquire international tourism company Transat A.T. At that time, leisure travel was booming, and the deal looked sweet, even at \$18 per share. Hence, AC upped its bid from \$15 to \$18, as it knew it could monetize on Transat's air traffic. But then the most unexpected thing happened. The entire world's airlines were grounded in March because of the pandemic. Airlines are operating at just 5% of last year's capacity, and AC is no exception.

The airline industry loses value

AC lost 70% of its valuation and now has a market capitalization of just \$4.8 billion. The rate at which the airline is burning cash at \$15-\$17 million per day; it won't be long before its losses exceed its market cap. Its first-half loss has already reached \$2.8 billion, and it is likely to rise to \$4 billion after adding third-quarter loss.

It's not just AC that lost value. Even Transat lost 76% of its valuation because of the pandemic. Transat stock is trading at \$3.83 and has a market cap of \$144.6 million. It makes perfect sense for AC to make the most of the current environment and reduce the Transat bid price by 74% from \$18 to \$5. The new price values Transat at \$190 million, which is still a 30% premium from its current valuation.

The Transat board unanimously agreed to the reduced price. In the current environment, even \$190 million looks appealing. The new deal is expected to be complete by February 2021 at the latest if it obtains shareholder, regulatory, and all other necessary approvals.

In April, Warren Buffett sold its airline stocks at a loss, as he knew that these stocks have lost value. He noted that the pandemic has pushed airlines into multi-year losses. I won't be surprised if the AC-Transat deal falls apart, as the airline industry holds on to cash.

Air Canada liquidity concerns

AC is struggling to maintain liquidity. It has taken some extreme measures, like halving its workforce and reducing its fleet size by a third to reduce its cash burn. It accessed financial markets more often to clutch on to every opportunity to raise capital.

At the end of the second quarter, AC had \$9.1 billion in liquidity, some of which were from short-term loans. With [international travel restrictions extended](#) till Halloween and AC working at less than 20% capacity, the concerns were mounting around the debt maturing next year.

AC is handling one challenge at a time. It has refinanced \$1.52 billion of this short-term debt with long-term debt. It is now accessing its aircraft fleet to raise capital from sale and leaseback transactions. So far, it raised \$485 million from these transactions.

Should you buy Air Canada stock?

I agree with Warren Buffet that airline stocks are nothing but a value trap. They are not a long-term bet, as their immediate future is in the doldrums. I did vouch for a short-term volatility play in AC's stock price range of \$14-\$20.

But October is a pretty volatile month, even for AC. It will release its third-quarter earnings near the end of the month. It might be that investors are overthinking, and AC earnings may not be that bad. But if they are, the stock could lose its support at \$14. It is better not to sail in this weather, or you might get caught in the whirlpool.

CATEGORY

1. Coronavirus
2. Investing

TICKERS GLOBAL

1. TSX:AC (Air Canada)

PARTNER-FEEDS

1. Business Insider
2. Koyfin
3. Msn

4. Newscred
5. Quote Media
6. Sharewise
7. Yahoo CA

Category

1. Coronavirus
2. Investing

Date

2025/08/30

Date Created

2020/10/13

Author

pujatayal

default watermark

default watermark