Transat A.T. (TSX:TRZ) Will Crash if Air Canada (TSX:AC) Cuts the Rope

Description

If you think **Air Canada** (TSX:AC) is walking on thin ice, then **Transat A.T.** (TSX:TRZ) is hanging on to the cliff with its rope in AC's hand. The pandemic changed the face of international travel, creating massive oversupply and very little demand. World airlines are operating at just 20-25% capacity, and AC is no different. Hence, it came as no surprise when AC stock lost 70% value during the pandemic, falling from $50 to $15.

There is a reason why AC is retiring a third of its fleet, suspending services to more than 30 routes, and cutting 20,000 jobs. It is downsizing. It knows air travel won't return to pre-pandemic levels for at least three years. AC itself is walking on thin ice, carrying a $5 billion burden of net debt. It is hoping for a helping hand from the government in the form of a bailout. How will this ailing airline support international tour operator **Transat?**

Air Canada and Transat tied to a rope

AC entered a deal to acquire Transat last year when leisure travel was at its peak. Everyone was going on holiday. Transat even forced AC to up its bid from $15 to $18 per share, and the airline willingly agreed. Then came the pandemic. It destroyed tourism. Forget about international leisure travel, people couldn't even step out of their homes.

As the world went deeper into the pandemic, AC learned that the future of business travel is bleak. Companies will avoid business travel if things can work online. Companies can't put their employees' health at stake. The only hope AC has is with leisure travel. People want to go on holidays, even in this COVID era, but travel restrictions are stopping them.

Hence, AC decided to stick to its Transat deal but brought the tour operator to the negotiation table. In October, AC asked for a 74% discount and revised its bid price from $18 to $5, and Transat agreed. The revised deal will cost AC $190 million. Transat shareholders have approved the deal as they know that without AC, they will be lost in the pandemic.

Transat is worse off than Air Canada

Transat’s fiscal 2020 fourth-quarter revenue is down 96% year over year, and its full-year loss is $496.5 million. While nothing is good in Transat’s income statement, its balance sheet is also alarming. The tour operator has $335 million in current net debt, as it has more than $600 million in customer deposits. Like AC, it has issued vouchers instead of cash refunds for canceled flights.

Will regulators cut the rope Transat is hanging onto?

The Transat–AC deal has to secure regulatory approval from the European Union and the Canadian government. The European Union is already scrutinizing the deal for reduced competition on routes to and from Europe. Then there is the Canadian government, which is working out an airline-specific bailout.

Even before hinting at a bailout amount, the government has put conditions in front of AC. To get a bailout, AC must refund the ticket money for canceled flights and restart service to routes it suspended during the pandemic. AC CEO Calin Rovinescu is clear in his message: he wants to see the money and then talk refunds.

If the Canadian government comes up with a bailout package that Rovinescu agrees to, you could see some development. Either the government could put another bailout condition to end the Transat deal or give regulatory approval for the deal. Deal or no deal, you will get the verdict in February 2021.

But if there is no deal, Transat will be stuck with $600 million of customers’ deposits and less than $680 million in cash. In an analyst’s call, Transat’s chief financial officer Denis Petrin said, “We are signaling that there might be a question mark on our ability to continue as a going concern, considering that additional financing will be necessary if there is no transaction.”

Investor takeaway

Transat stock is a gamble. If AC deal is rejected by regulators, Transat’s future could be in jeopardy. Maintain a 10-foot distance from the tour operator.

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