What's Next for Air Canada (TSX:AC) After its Transat Buyout Failure?

Description

The two-year-old fuss over **Air Canada** (TSX:AC) buying **Transat A.T.** (TSX:TRZ) finally came to an end this weekend. The European competition council rejected the proposed takeover after concerns over lowering competition.

Air Canada Transat merger called off

The country's biggest passenger airline Air Canada and holiday travel specialist Transat have notable presence on the Canada-Europe routes. The combination would have given Air Canada an unfair advantage, resulting in more concentration on those routes and higher airfares.

Transat is a much smaller company in comparison to Air Canada. It carried around five million passengers in 2019 — almost 10% that of Air Canada. The acquisition offered Air Canada an expansion in the holiday travel space and Transat's decently sized fleet.

The pandemic and travel restrictions have substantially changed the landscape of the global aviation industry. The deal became all the more attractive for AC when it reduced the offer from $18 to $5 in October last year. However, Air Canada has to try something new now if it wants to expand in the leisure travel market.

Challenges mount for Transat

Without a doubt, the buyout rejection puts Transat in a tough spot. In fiscal Q1 2021, it reported a 94% decline in revenues and a loss of $60 million. It has been burning cash at a fast clip with no signs of operations reviving. The management has already stated that it's "impossible to operate" amid the pandemic and ongoing restrictions.

The deal was more important to Air Transat, as it would have gotten a shelter of the relatively healthy parent. Now the takeover is cancelled, it will likely have to look for a new buyer or new funding sources. Transat stock, which has halved amid the pandemic in the past year, might trade weak this week.

Air Canada has to shell out a termination fee of $12.5 million to Transat now. It is much better placed to combat the crisis compared to Transat. The flag carrier has a strong balance sheet and also has more avenues to raise new capital. Many airlines are sailing in the same boat these days with no revenues and big losses. However, Air Canada stands tall among global peers with its lower cash burn rate. Its disciplined cost management played out really well amid the pandemic.

Air Canada stock has almost doubled in the last six months. However, its Q1 2021 earnings will most likely repeat the 2020 performance. Slower vaccinations and concerns about more restrictions could also jeopardize its rally in the next few months.

What's next for AC stock?

One big driver for AC stock this year has been the expected government bailout. A sizeable bailout package could substantially improve Canadian airlines' prospects. However, it's been months now, and nothing concrete has come up so far.

At the same time, faster vaccinations could play a more crucial role than the bailout. It could help revive air travel demand sooner than expected and aid airline companies lower their cash burn.

A crisis is indeed an opportunity in disguise. Although Air Canada-Transat merger has failed, AC might try and grow organically once it gets clarity about its operations post-pandemic. Importantly, how the situation at Transat plays out amid its direr challenges remains to be seen.

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Date
2025/08/20
Date Created
2021/04/05
Author
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