



Why This Value Stock Is a Low-Risk, Warren Buffett-esque Play

Description

In this overvalued market, it is tough to find undervalued securities that have potential for growth. In searching for equities still trading at cheap multiples, I found **Transat A.T.** (TSX:TRZ). This is not just a cheap security, though. Some catalysts make this story worthwhile.

First, a brief background on my thinking.

[Warren Buffett](#) ran multiple partnerships for investors that were collectively known as the Buffett Partnerships. In their heyday, the partnerships focused on three strategies in investing: value companies, “work-outs,” and controlling stakes (or activist investing). A “work-out” was when Buffett would purchase a security in anticipation of a bullish catalyst likely to occur. In this case, we categorize the Transat story as a “work-out.”

On May 9, **Quebecor** CEO Pierre Karl Peladeau says he commissioned an investment firm to conduct a financial analysis of Transat and concluded that it would be an “interesting opportunity.” Shortly after that, a developer of Groupe Mach told the *Canadian Press* that he had already submitted an offer to purchase the company.

A bidding war for Transat is in the cards. Multiple Quebecois entrepreneurs and rumoured Canadian airlines such as **WestJet** want to have claims to the business or Transat’s attractive assets (like its fleet of 40 planes). As multiple bidders continue to bid up their respective offers, the price tag for shareholders will grow.

Transat’s business has been struggling. With notoriously low margins for [the airline business](#), the company has focused more on the hotel business, which is a higher-margin business. Before the news of the potential purchase, shares were flat YTD to reflect investor pessimism. Furthermore, according to Quebecor’s CEO, Quebecers like flying with Transat, giving it a strong moat through its “Quebecois” brand name.

The Quebecois government is likely to approve the deal, as they want to see Transat’s headquarters continue to operate in the province. Transat’s management team is also likely to sell, as they require funds for further expansion into the hotel business. They would also need guidance and resources,

both of which capable buyers are willing to provide for them. As we observe, there are many moving parts to the deal and a chance for investors to participate.

In Warren Buffett's book of arbitraging strategies, he participates when a deal is likely to go through. There are multiple factors that go into the likelihood of a successful deal. When the seller is willing to sell, that eliminates the need for the buyers to engage activist investing, because cooperation is likely. We see this in the case of the Transat bid.

Unless the management team does not want to work with a specific company, they would welcome resources and guidance. Buffett is also more likely to participate in a deal if companies are not too large, as this could result in antitrust issues from the government approving the deal. In this heady market, with cheap money and enthusiastic shareholders, a deal, or a bidding war, will most likely be successful.

If the deal does not go through, Transat's business is still a stellar one and currently fairly valued, even after its rise in late April.

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