Air Canada Increases Refunds: How Does This Impact the Stock?

Description

Air Canada (TSX:AC) just increased refunds on some tickets.

The news provides thousands of customers with some hope that they might get their money back for flights cancelled due to COVID-19. Investors might not be as excited. In fact, there could be a contrarian buying opportunity on the horizon.

Refund risks

The airline is under pressure from customers to get money back on cancelled trips. Instead of refunding tickets, Air Canada switched many tickets to vouchers. The low-priced tickets that didn't come with cancellation provisions essentially became a coupon for a future flight.

This has a significant impact the company's liquidity. In a recent statement, Air Canada said it had reimbursed $1 billion to customers who paid for the more expensive refundable tickets but continues to hold $2.6 billion of customer money on tickets for flights already paid but not used.

The expanded refunds are not on all tickets. Air Canada is reimbursing flights originating in the European Union, Switzerland, and Iceland that were cancelled due to the virus outbreak. After intense pressure, it appears the airline is changing its position to meet E.U. regulations.

One-way flights from Canada to Europe are not covered in the new refund program. Round-trip tickets from Canada to Europe are also not included.

WestJet recently expanded its refund policy to include flights to the United States or the United Kingdom.

Refunding all tickets would put Air Canada in additional financial stress. The government sided with the company in recent months on that issue and avoided pressure to force Canadian airlines to reimburse all flights cancelled due to the pandemic.

One solution could be a loan from the government to cover the value of the ticket refunds.

Liquidity

Air Canada reported a net loss of $1 billion for Q1 2020.

Unrestricted liquidity was $6.5 billion at the end of March. In April, the company took a US$600 million term loan secured by planes and spare engines. Air Canada also concluded a bridge financing of $788 million for 18 A220 planes.

Air Canada subsequently raised an additional $1.6 billion. The sale of stock at $16.25 per share raised about $575 million. In addition, the company issued $1 billion in new unsecured senior convertible notes.

This pushed total liquidity above $9.5 billion, giving the airline solid breathing room.

Air Canada said it is burning through more than $20 million per day in Q2. The company reduced the 38,000-person payroll by roughly 20,000. In the Q1 statement the company said Q2 capacity was reduced by 85-90% compared to the second quarter of last year.

Should you buy the stock?

If the airline is eventually forced to refund the full $2.6 billion in prepaid tickets, it will provide a serious hit to the balance sheet.

Canada continues to maintain travel restrictions, despite intense pressure from airlines and the broader business community. The recent spike in coronavirus cases in the United States doesn’t bode well for a quick recovery in air travel.

At the time of writing, Air Canada trades for $16.75 per share. A steep correction in the broader equity market due to second-wave fears would likely hit the airlines hard. In that scenario, it wouldn’t be a surprise to see Air Canada retest the March closing low near $12.

Given the uncertain outlook for air travel in the coming months, I would probably search for other cheap stocks today.

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