



## Air Canada (TSX:AC) Bailout: What Are the Odds?

### Description

**Air Canada** ([TSX:AC](#)) is in a fix, as the recovery in air travel demand is slower than expected. Back in April, it expected international flying to resume in September, but then the government extended border restrictions till October. It could be extended to December, as the U.S., Europe, and Canada are seeing a surge in COVID-19 cases. Even if the restrictions ease early next year, leisure travel demand won't return till mid-2021. And business travel demand won't return for the next three to five years.

I am only talking about a return and not a complete recovery in travel demand to pre-pandemic levels. In the third quarter, U.S. airlines operated at 30% capacity, as passenger revenue doubled sequentially on the back of leisure travel. This is better than the 10% capacity in the second quarter. But there will not be continuous recovery, as domestic quarantines and slightly stricter international travel restrictions on some days will be a new normal.

### Does Air Canada need a bailout?

Like all airlines, AC was burning cash on salaries for its 35,000 employees and maintenance fees for its 180 aircraft. As the pandemic has disrupted demand for the next several years, this capacity is not sustainable. Hence, AC cut 20,000 jobs and retired 75 aircraft to slow the cash burn.

As AC can't fill the seats, it is reducing the seats to increase capacity. Over the next few quarters, even if the demand remains subdued, AC would operate at a higher capacity. I expect AC's [losses to widen to \\$5 billion](#) in the nine months of 2020. These losses are drying up its liquidity, and the options of raising more capital are also diminishing. Warren Buffett has already pulled his money out of airline stocks, clearly stating that he has no intention to fund airline losses.

If air travel doesn't return by mid-2020, AC will be left with little cash and more than \$13.5 billion in debt, thereby risking second bankruptcy. A government bailout would give AC the much-needed cash to stay afloat.

## Will the government bail out Air Canada?

Airlines are important for the economy. Every country needs its airline. The U.S. and European governments have already spent billions of dollars to bail out their airlines under specific conditions.

In an [interview](#) with CTV, Canada's intergovernmental affairs minister Dominic Leblanc stated that Canadians expect a “competitive air transportation system” when the economy recovers. Many Canadians have thousands of dollars stuck in AC, as the airline refunded the ticket money for canceled flights with vouchers. If AC goes bankrupt, all these Canadians would be left with vouchers they can't redeem.

Leblanc stated that the government just can't use taxpayers' money to give bailouts only to see AC go bankrupt. It needs to ensure, if there is a bailout, that AC revives and returns the ticket money to Canadians in cash or by redeeming vouchers.

Leblanc added that with so many factors in play, the government is working out various options to come up with a solution that benefits the economy at large.

## What are the options for the Canadian government?

A bailout is when the government injects taxpayers' money into a private company. A bailout can take different forms:

- Grants where the company doesn't need to return the money to the government'
- Long-term, low-interest loans; or
- Buying equity or preferred stocks.

The first two forms of bailout can benefit shareholders, as they inject cash in companies without affecting their holdings. However, the third form of bailout can dilute shareholders' interest.

Many governments bailed out their airlines in return for a stake or a commitment to emissions reduction. For instance, Germany bailed out Lufthansa for €9 billion in return for a 20% stake and two seats on the supervisory board. The U.S. government granted \$25 billion in payroll support to U.S. airlines in the form of grants, low-interest loans, and equity warrants.

The Canadian government is providing Canada Emergency Wage Subsidy (CEWS) under the condition that the companies will not cut jobs. The government can infuse more capital in AC through low-interest long-term debt and by buying its shares. It won't think of shareholders' interest, but of jobs and customers' money.

Bailout or no bailout, AC is not the stock long-term investors will want in their portfolio.

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