



Hold On! Is Air Canada (TSX:AC) Closer to Getting a Bailout?

Description

After four months of plucking the flower petals — the bailout will come, the bailout will not come — there is some positive news that a bailout could come. Sources familiar with the matter are saying that **Air Canada's** ([TSX:AC](#)) talks are going well, and a bailout could come anytime. It is this news that drove the stock more than 30% in February. However, the stock will not break the \$27.5 mark only on rumours. If there is an official bailout announcement, the stock could touch or even cross the \$30 mark.

Signs that a bailout is in the cards for Air Canada

In February, the Canadian government announced it is developing financial support for Canadian airlines, airports, and the aerospace sector. In the 2020 annual earnings, Air Canada's retiring CEO Calin Rovinescu sounded confident about the bailout.

This week, Unifor president Jerry Dias [told](#) the *Toronto Star*, "Based on the conversations I've had with the government and industry, I had already expected an announcement by now." He noted that AC has agreed to the first condition to refund ticket money for canceled flights.

All the above signs show that AC is close to a bailout. Another reason that makes me optimistic about the bailout is the CEO change. Calin Rovinescu was pretty stern and lobbied the government for a bailout on his terms. But the new CEO Michael Rousseau is more accommodative. He raised \$6.8 billion in financing for AC in 2020, when its credit rating was BBB-. Michael Rousseau could probably smoothen bailout talks and expedite the inflow of government money.

What does a bailout mean to Air Canada?

What is the big deal with the [bailout](#)? The United States provided its airline industry approximately US\$65 billion in financial support through loans, grants, and other assistance. It is this bailout money that has prevented its top airlines from collapsing.

All airlines are burning cash as they try to keep their grounded planes in working condition. AC is

burning \$15-\$17 million cash daily to fund capital expenditure, pay lease and debt service costs, and finance new aircraft deliveries. With no bailout, AC has been raising money at a 9% interest rate. That is a huge interest expense that can prevent AC from turning profitable for several years.

Increasing high-interest debt only spells bankruptcy trouble for an airline whose four-year profit was wiped in a year, and it has another year of losses ahead of it. A bailout will relieve AC from this 9% interest burden, helping it return to profit faster.

How will a bailout look like for Air Canada?

Now, the government can give bailout money in various forms:

- Grants or subsidies, where the airline doesn't need to return the money to the government;
- Low-interest loans for a long-term; or
- Buying equity, preferred stocks, or warrants.

The first two forms of bailout can benefit shareholders, but the third form of bailout can dilute shareholders' interest. But AC is bleeding cash. A bailout in any form can inject cash and relieve it from the 9% interest burden. Other things are secondary. AC has already received \$554 million in the Canada Emergency Wage Subsidy (CEWS) to help pay employees' salaries.

If AC wants a more sector-specific bailout, the Justin Trudeau government has put three conditions in place. Air Canada must

- Protect Canadians and the public interest, which I believe means keep air travel affordable;
- Provide ticket refunds for flights postponed or canceled because of the pandemic; and
- Restart some routes that AC suspended in the light of the pandemic.

Abiding by the above conditions will increase AC's cash burn. Whether the bailout is good news or not depends on the amount and the form of the bailout.

Final thoughts

Any announcement of a bailout will push Air Canada stock to a new post-pandemic high, but it won't be able to keep it there. You might see a correction a few days after the bailout. If you own the stock, that will be a good exit point for you. You can cash out from AC and put that money in growth stocks like **Magna International** or dividend stocks like **Enbridge**.

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