Air Canada (TSX:AC) Finally Got its Bailout!

Description

Air Canada (TSX:AC) has finally struck a deal with the federal government. Canadian taxpayers are injecting $5.9 billion into the nation's largest airline to save jobs and keep the business afloat. However, the deal comes with strings attached that could impact investors over the long term.

Here's a closer look at the Air Canada bailout deal and why the stock hasn't reacted as you would expect to this latest development.

Air Canada bailout

Yesterday, Deputy Prime Minister Chrystia Freeland announced the government's decision to "step in to support Air Canada, its nearly 15,000 active employees and its customers." The deal is being deployed through Ottawa's Large Employer Emergency Financing Facility (LEEFF) program.

The headline figure is $5.9 billion. If this was a straightforward bailout, Air Canada stock would be skyrocketing. Instead, the stock is down 1.9% in early morning trading. That's because the bailout is mostly in the form of debt and equity.

$4 billion is offered as a federal loan. This means the company will eventually have to pay the taxpayers back. Another $1.4 billion is offered as a "voucher refund facility," which means it's ear-marked to refund customers who bought tickets during the lockdown.

The remaining $500 million is in the form of equity. The federal government will acquire 21.6 million of Air Canada's shares at $23.18 per share, which is 12.5% lower than its current trading price.

Effectively, the government has played hard ball and secured a great deal for taxpayers. The deal benefits customers through refunds and Air Canada employees through job assurances, and it mitigates the risk for taxpayers through financial assets. However, it adds debt burden and creates dilution for Air Canada shareholders.

Shareholder impact

The bailout deal is tougher than a straightforward government handout. The equity portion of the deal means Air Canada will have to issue new shares to hand over to the government. Analysts expect 7-9% equity dilution over time. This deal also marks the first time taxpayer money is involved in the airline sector since privatization in 1989.

The deal also expands the company's debt burden. Currently, Air Canada has $12.9 billion in debt on its books. That's more than seven times greater than the value of shareholder equity. This deal expands the debt by 31.7%.

The deal may have dashed some shareholder expectations, which is why the stock is trading lower. Dilution and more debt isn't good news. But Canada's economy reopening in the second half of the year should bolster Air Canada's position. As pent-up demand for travel is unleashed, revenue and income could swiftly recover.

Overall, this deal is great for Canadian jobs and taxpayers but less than ideal for shareholders.

Bottom line

Government bailouts are usually considered "free money." Indeed, previous bailouts of the airline sector have created immense wealth for early investors. However, this latest deal is much tougher than expected. It gives the government an equity stake in the business and adds to its debt burden.

As a taxpayer, you should be proud. As an investor, you might want to turn your attention to the upcoming recovery in travel that could bolster Air Canada's fortunes.

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Date
2025/07/23
Date Created
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