Air Canada Secures Government Aid: What Does This Mean for AC Stock Investors?

Description

Air Canada (TSX:AC) finally reached a financial aid agreement with the Canadian government. Investors want to know if this is a good time to buy Air Canada stock or bail out now that the details of the deal have emerged.

Air Canada aid deal

Air Canada began aid negotiations with the government back in November. The long process finally came to an end with the announcement of a massive $5.9 billion deal.

Under the agreement, Air Canada has access to $5.879 billion in liquidity provided under the government's Large Employer Emergency Financing Facility (LEEFF).

Air Canada's press release says the package includes a $500 million share sale to the government at roughly $23.18 per share. The stock's closing price before the announcement was $27.

The agreement also provides the federal government with warrants for 14,576,564 shares at approximately $27.27 per share over 10 years. If Canada exercises all its warrants the federal government would control a 14.1% stake in Air Canada.

Air Canada receives $1.5 billion in a secured revolving credit facility at a 1.5% interest premium to the Canadian Dollar Offered Rate (CDOR). This is the rate at which banks are willing to lend to companies. It is a good deal for Air Canada, as it provides cheap financing. For example, the CDOR for a three-month loan on April 12 was 0.435%.

Air Canada also gets access to $2.475 billion composed of three unsecured non-revolving credit facilities of $825 million. The first one is for five years at a 1.75% premium to CDOR. The second is a six-year tranche at 6.5% per year that jumps to 7.5% in the sixth year. The third is a seven-year tranche at 8.5% increasing to 9.5% after five years.

A final $1.4 billion is being made available, as an unsecured credit facility tranche for seven years at 1.211%. This is designed to cover costs of refunding non-refundable tickets for flights cancelled during the pandemic.

Is the deal good for Air Canada investors?

If the government aid was just composed of loans with flexible terms, investors would generally be happy, but the deal gets more complicated.

The airline is required to resume service to nearly all of the Canadian regional communities that saw flights suspended due to COVID-19. This could get expensive if bookings don't rebound fast enough to make the flights profitable.

Air Canada has to maintain its employee level as of April 1, 2021. The airline trimmed staff by more than 50% since the start of the pandemic. The job-protection measure could have a negative impact on restructuring efforts needed to meet the new realities of the airline sector.

Finally, Air Canada must complete its original agreement to purchase 33 A220 planes. The deal was made before the pandemic when Air Canada was much larger and capacity growth warranted the addition of the new jets. The planes are made by **Airbus** in Quebec. Airbus bought the A220 business (formerly CSeries) from **Bombardier**.

Air Canada will also complete its existing order for 40 **Boeing** 737 Max aircraft.

Air Canada might not see capacity rebound to 2019 levels for several years. Being forced to follow through on the large plane orders could add substantial costs.

Restrictions on dividend payments, share buybacks, and executive pay are also included in the terms.

Given the conditions surrounding the deal, investors might want to wait to see how things pan out over the coming months before buying Air Canada stock. Access to ample liquidity is positive, but the road to profitability remains unclear.

The share price initially jumped to $28.40 on the aid news and then dropped to $25.20 as the market digested the details. At the time of writing, the shares trade near $26. This still appears expensive.

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