Air Canada (TSX:AC) Stock Bailed Out: Time to Buy?

Description

Finally, after months of negotiation with the federal government, **Air Canada** (TSX:AC) has reached a deal that allows it to access up to $5.879 billion in liquidity. The deal is a mix of loans, equity, and warrants.

Entering the pandemic, Air Canada had a decent balance sheet. It wasn't the airline's fault that the novel coronavirus pandemic clipped its wings, virtually halting flights around the world, resulting in the company raising $6.8 billion in liquidity during the pandemic. Air Canada's debt-to-equity ratio ballooned nearly 3.3 times to 757% from a year ago.

The nearly $5.9 billion rescue package serves as additional liquidity to help smooth out Air Canada's recovery.

The bailout is not just about Air Canada

What's important to note is that the bailout is not just about Air Canada. It's one of the government's many ways to help the economy. In this case, in particular, it's helping restore the airline industry that's a critical part of the economy.

The Canadian government's rescue package requires Air Canada to refund passengers whose flights were cancelled due to COVID-19, cap executive compensation at $1 million, and restore service to regional airports.

The refunds put money back into people's pockets. They're likely to spend this money somewhere since flights are restricted.

Capping executive compensation could reduce costs for the airline. This is much needed in these highly uncertain times for the company.

Restoring operations at regional airports means job creation. People who have jobs will spend more money, thereby helping fuel the economy.

What the financial package means to current shareholders

The Canadian government is providing a low-interest credit facility of $5.4 billion to Air Canada. The company can draw funds from it for up to seven years. About $1.4 billion will go to thousands of customers who have cancelled flights.

The government is also buying $500 million worth of Air Canada stock at $23.1793 per share, which was a 14% discount from the Monday's market close price of $27. Not surprisingly, Tuesday witnessed the stock trading lower. This stake is roughly a 6% dilution to existing AC stock shareholders.

Additionally, the deal provides the government with 14.6 million warrants at $27.2698 over 10 years, with 50% vesting immediately. The warrants along with the previous equity stake could dilute shareholders by up to 10%.

Investors can see the government stake as positive or negative. The positive is that the government owns a piece of the company, which means it supports it and is confident that it will recover.

The negative? At one point, the government will sell its Air Canada stake (probably after it has recovered to more normal levels), at which time the stock could fall meaningfully.

The Foolish takeaway

The airline is an essential part of the economy. In 2019, a "normal" year, it brought in +$19 billion of revenue. The revenue dropped off the cliff to under $6 billion in 2020.

The Canadian government's bailout package is helping Air Canada through these stressful times for the company, improving the company's liquidity. On a recovery to more normalized operations, Air Canada stock can trade at least in the $40 range for +49% upside.

So, if you already own the stock, you might as well continue holding it. If you're still on the sidelines, you might as well wait to see if it will get close to $23 (which is right about where the government is buying shares) in the near term.

Still, at this point, there's a lot of uncertainty. Therefore, size your high-risk AC stock position accordingly.

CATEGORY

1. Investing

POST TAG

1. Editor's Choice

TICKERS GLOBAL

1. TSX:AC (Air Canada)

PARTNER-FEEDS

1. Business Insider
2. Koyfin
3. Msn
4. Newscred
5. Quote Media
6. Sharewise
7. Yahoo CA

Category

1. Investing

Tags

1. Editor's Choice

Date
2025/08/27
Date Created
2021/04/14
Author
kayng