Air Canada Stock: Look Out Below?

Description

Air Canada (TSX:AC) recently revealed an extensive financial aid package from the government. The market initially reacted positively to the news, but Air Canada stock is now losing altitude.

Air Canada rescue package

Air Canada finally agreed on an aid package from the Canadian government that will help the airline navigate the rest of the pandemic.

Negotiations began last November. At that point, Air Canada's liquidity position appeared substantial enough to ensure the airline would make it through a tough winter with the hopes of ramping up capacity again in the spring. Optimism was in the air, as positive COVID-19 vaccine results fueled hopes of a quick end to the pandemic.

When 2021 arrived, however, the situation got worse. The Canadian government put tighter restrictions on international travelers and shut down flights to popular winter holiday destinations.

It became more obvious that Air Canada needed help and now the deal is done.

On the positive side, the airline gets access to as much as $5.879 billion in liquidity through the government's Large Employer Emergency Financing Facility.

The loan components range from cheap rates of 1.211% to cover ticket refunds to a series of other credit facilities that start at just 1.5% above the Canadian Dollar Offer Rate. Things get more expensive after that and borrowing rates run as high as 9.5%, depending on how long Air Canada needs the funds.

Air Canada is also selling a $500 million equity stake to the government at roughly $23.17 per share. The agreement includes warrants for more than 14.5 million additional shares at a price of close to $27.27. If the government exercises the full warrants, Canadian taxpayers would once again become significant shareholders of Air Canada.

Watch out for the conditions

With expected net cash burn as high as $1.5 billion for Q1, and Q2 shaping up to be little better, Air Canada's bargaining position likely deteriorated, forcing the company to accept some conditions it might otherwise have preferred to avoid.

Investors should be somewhat concerned.

Air Canada is required to restart all regional domestic routes it axed to preserve cash flow. The reinstatement of these flights before there is ample demand to make them break even could extend the company's financial woes.

Employee numbers must also remain at the April 1, 2021, level. This could force Air Canada to cancel any further restructuring efforts to help stop the cash burn.

In addition, Air Canada is required to follow through on the purchase of 33 **Airbus** A220 planes. Airbus bought the former CSeries business from **Bombardier**. The planes are made in Canada. Air Canada cancelled part of the A220 order last November. Being forced to buy the 12 planes it decided it no longer needed could put further pressure on the financial recovery of the airline.

Other conditions include restrictions on dividends and share buybacks. These have potential negative impacts for shareholders.

Is Air Canada stock a good buy?

The financial assistance is helpful, but the terms of the deal could delay the airline's return to profitability.

Air Canada stock trades near $25.50 at the time of writing. It was $15 last fall and hit $30 last month. A slow drift back down to $20 wouldn't be a surprise over the coming weeks. I would avoid the stock right now and look for other deals in the market.

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