Air Canada (TSX:AC): Is the $5.9 Billion Bailout Causing Trouble?

Description

Air Canada (TSX:AC) has long been in the works with the Canadian government to negotiate a bailout deal, and it is finally happening. The flag-carrying airline recently revealed a massive $5.9 billion aid package provided by the government. The anticipation of a bailout caused an uplift for the stock, but the airline seems to be on a downward path again.

The rescue package

It is no secret that Air Canada needed a bailout package from the government to make it through the pandemic. After a lengthy negotiation period that began in November 2020, the airline finally agreed on the aid package.

Air Canada's liquidity position seemed robust enough for it to pull through the tough period when negotiations began. The airline was positioning itself to pull up its landing gears and soar in spring by ramping up its capacity. Optimism increased, as the vaccine rollout fueled the hopes of a quick end to the pandemic.

However, the situation became worse as 2021 began. The Canadian government was forced to place stricter regulations on international travelers, shutting down flights to popular holiday destinations. Air Canada's need for the rescue package became more immediate, and now the deal has been finalized.

The good thing about the deal is access to almost $5.9 billion in liquidity from the government for the airline. The lower 1.211% interest rates will allow Air Canada to clear its dues for its more expensive borrowing rates running as high as 9.5%.

The airline is also selling a $500 million stake to the government. The deal has also outlined warrants for over 14.5 million additional shares in the company. If the government exercises its warrants, Canadian taxpayers could become the more significant stakeholders in the airline.

Conditional bailout

Air Canada's bargaining position likely worsened, forcing the company to accept certain unfavourable conditions that it might have preferred to avoid. The expected net cash burn for Q1 and Q2 in fiscal 2021 is as high as $1.5 billion, making the compromise no surprise. Air Canada investors might have cause for concern.

The company is required to restart all the regional domestic routes that it previously shut down to preserve its cash flow. Reinstating these routes before there is a significant demand could counteract the company's cost-cutting measures and slow down its recovery to profitability.

The airline must also retain the same employee numbers as of April 1, 2021, further reducing its chances of restructuring to reduce cash burn. The airline also needs to follow through on its purchase of 33 Airbus A220 planes. The airline canceled part of its orders and did not purchase 12 of the 33 A220 planes it did not need.

Being forced to purchase the planes that it does not need could add further pressure on its financial recovery. Restrictions on share buybacks and dividends could also negatively impact shareholder returns.

Foolish takeaway

The financial aid offered by the Canadian government's bailout plan for the airline will undoubtedly be helpful for the battered stock. However, the terms of this bailout could lead to a significant delay in Air Canada's return to becoming a profitable company.

Air Canada is trading for $24.15 per share at writing. The stock is down by almost 19% in less than a month. Its valuation can whittle down to $20 in the coming weeks. I would consider waiting on the sidelines and looking at other stocks for now for better upside potential.

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