



Air Canada (TSX:AC) Will Likely Need a Federal Bailout

Description

Air Canada ([TSX:AC](#)) has been a major casualty of the COVID-19 crisis in Canada. Since February 20, its stock has declined 59% due to a virtual shutdown of its operations. Early on in the COVID-19 crisis, Air Canada was forced to cancel 90% of its flights. Since then, it's gone on to shut down all flights to the United States.

While Air Canada's Q1 earnings haven't been released yet, it's clear that they're going to be bad — and at least one portfolio manager thinks that they're going to be disastrous. In a recent interview with *BNN Bloomberg*, Brian Madden of Goodreid Investment Counsel said that Air Canada will likely need a federal bailout, adding that such a bailout could dilute equity, harming current shareholders.

It's a scary prospect. But it wouldn't be the first time that Air Canada needed government assistance. In 2009, facing a \$2.85 billion pension shortfall, Air Canada received a \$600 million bailout—half of it from the federal government. Arguably, the financial problems the company faced then aren't as bad as the ones it's dealing with now.

Likely cash flow problems

The most important thing to note about Air Canada is that it is very likely running out of cash.

When an airline cancels 90% of its routes, that takes a bite out of revenue. Unfortunately, expenses don't necessarily decline in lockstep with sales. A certain proportion of any company's expenses recur whether it is operating or not. These include interest charges, rent, property maintenance and storage.

Air Canada has several such expenses. A big one is interest, which cost the company \$515 million in 2019. Another big one is employee compensation. Some of that is being covered by a government subsidy, enabling Air Canada to re-hire 16,500 employees. However, the wage subsidy doesn't cover benefits; further, it requires companies to keep paying 25% of workers' wages.

Refunds

A big clue about Air Canada's financial position came in the form of refunds.

In March, the company abruptly started [refusing to give refunds](#) to passengers whose flights were cancelled because of COVID-19. It was a drastic change for the company, which had previously been giving refunds freely.

According to *Vice*, customers who called into complain about the lack of refunds were told that the company simply didn't have the cash to pay for them. They were given vouchers instead.

Air Canada's refusal to give refunds strongly suggests the company is running out of money. First, as per *Vice*, some passengers were basically told as much. Second, the abrupt change of policy had an air of desperation. As late as March 10, there were reports that customers were getting full refunds on flights that had to be cancelled due to COVID-19.

By March 18, the company made a dramatic change and switched to vouchers — a decision that wouldn't have been made lightly. The fact that it was made suggests that Air Canada is indeed running out of money. If that's the case, then the company may need [another bailout](#).

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Date

2025/08/27

Date Created

2020/04/26

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