



## Air Canada (TSX:AC): Still a Bankruptcy Risk

### Description

In 2020, **Air Canada** ([TSX:AC](#)) has been a loser for several months amid the market turbulence. During May 2020, the market saw considerable gains, but Air Canada remained 68.20% down from the start of the year. At writing, the **S&P/TSX Composite Index** is down just 8.92% from the beginning of the year.

Investors have lost confidence in the airline. With a billion-dollar loss posted in its quarterly earnings report and falling revenue, it is more than kind to say that Air Canada is in a very challenging situation.

I have talked about the possibility of [Air Canada being a value buy](#). The airline has made an announcement for new funding that can help it bolster its liquidity.

### Wave of funding

After an abysmal month in May, Air Canada announced that it was raising \$575.6 million by selling 35.4 million new shares at \$16.25 per unit. The value of the issuance increased when AC added \$1 billion worth of convertible bonds. Owners of the convertible bonds can easily convert them into stocks, making them equal to equities being issued by the airline.

This move by Air Canada aligned with Warren Buffett's thesis about selling airline stocks — a step that will have far-reaching effects, even after recovery of operations. With the issuance of new shares, Air Canada has millions more in outstanding shares than before.

Each shareholder now has a smaller claim on AC's earnings, and the claim can become even lower if bondholders convert their bonds into equities.

### Worrying signs

A company as mature as Air Canada issuing new shares to cater to its operating costs is a troubling sign. While the funds might be necessary, the company's attempt at securing more funding through

issuing more shares is a clear indicator that it is in bad shape.

The more shares issued by a company, the lower the claim each investor has on earnings. It means that the company will need to generate a higher profit to achieve the same earnings per share it previously achieved before issuing new shares.

## The possibility of a second wave

The current funding may help the airline get the funds to cover its operating costs at the expense of diluting shareholder claims on revenue. However, the new funding cannot guarantee that the airline is out of reach of bankruptcy. In case there is a second wave of infections from COVID-19, Air Canada can still be in substantial trouble.

The move made by Air Canada is a likely play at a timely arrival of a vaccine that can curb the novel coronavirus. However, there are no signs of a viable solution to stop the disease yet. In the worst-case scenario, the pandemic will drag on past 2021. In that case, no amount of financial flexibility can help Air Canada from seeing its wings clipped.

The environment that Air Canada is operating in is strife with dangers everywhere you look. If there is indeed a second wave of infections, Canada's borders may remain closed. AC's domestic operations may decline even further. There is more of a chance for the airline nosediving to single digits on the stock market — possibly towards \$0.

## Foolish takeaway

We are seeing the stock market rally right now. However, the [broader market upswing](#) could only be a temporary move. There is a chance that the V-shaped recovery is short-lived. With the seemingly better-performing stocks posing a risk, an asset like Air Canada is not something for the conservative investor to even consider.

If you want safety for your capital, I would recommend trying to stay as far away from the stock as possible. However, if you can spare a small chunk of your TFSA funds and are willing to take on the risk, Air Canada could be the perfect all-or-nothing bet.

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