Is Air Canada (TSX:AC) Headed for Bankruptcy?

Description

What a difference a month can make. It seems like just yesterday when the global economy was firing on all cylinders and air travel was at all-time highs. Now, merely a month later, the world is facing the very real possibility of a protracted recession and many travel and leisure companies are facing bankruptcy headwinds. For **Air Canada** (TSX:AC)(TSX:AC.B), these concerns are all too real and reminiscent of 2004, when the company was forced to restructure itself to survive.

Better balance sheet

However, the Air Canada of today has a much stronger balance sheet than it did 16 years ago. At the end of Q4, Air Canada had almost $6 billion in cash, as well as undrawn credit lines of $7.4 billion. Net debt (debt minus cash) was just 78% of 2019 EBITDA, while free cash flows for the year came in at $2 billion, up from $1.3 billion the year prior. In terms of its pension, Air Canada was in a surplus position of $2.5 billion as of January 1, 2019, though we can expect this to decrease once it gets revalued later this year owing to lower interest rates.

Fleet flexibility

The Air Canada of today also boasts increased flexibility in terms of its capacity and has not been locked into messy supplier contracts or cumbersome leases. Currently the airline's 89 aircraft can all be shelved as demand decreases to weather a protracted downturn. Furthermore, if history is any indication, air travel tends to rebound dramatically after a major shock. For example, within two years after 9/11, air travel had rebounded completely to previous levels. With Air Canada set to suspend international flights after March 31, we can anticipate a surge in demand, and an almost V-shaped recovery once COVID-19 has been beaten.

Fuel prices are at lows

Finally, the low oil price will add an incremental tailwind for Air Canada, as fuel and labour are the two biggest expenses for any airline. According to the International Air Transport Association (IATA), jet fuel prices have fallen by 49% in North America compared to a year ago.

The bottom line

I previously wrote that AC was a stock that I would avoid during this market downturn. While I'm still cautious around this name, each further decrease in the share price of this company increases the risk-to-reward ratio. Make no mistake about it, the Air Canada of today is drastically different than from years past and has more resources than ever to weather a downturn.

Moreover, time is on its side, as data from the IATA estimate the airline industry is facing an unprecedented loss of $113 billion in passenger revenues. Therefore, with each passing day, there is increased pressure on governments to support the travel industry. Given these facts, I have little doubt an aid package will be presented by the Federal government in the coming days that will alleviate the liquidity strain on Air Canada. In the meantime, Air Canada is well equipped to handle this recent bout of turbulence.

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