Air Canada (TSX:AC) Stock: Brace for More Pain

Description

These days, **Air Canada** (TSX:AC) can't catch a break. Following a Q1 earnings release that showed a $1.05 billion net loss, the company's stock began a steep descent. As of this writing, it was trading for just $17, down from $52 in early January.

That's a already a steep descent. What's even more incredible is that it could get worse. So far, investors have seemingly been pricing stocks for a relatively quick recovery from COVID-19. For many industries, that could materialize. Air travel isn't one of them. As Warren Buffett said in his recent shareholders' meeting, air travel could be depressed for years after lockdowns end. And that would translate into more pain for Air Canada than its current stock price suggests.

The first major indication comes from what the airline is expecting in Q3.

There will still be 75% fewer flights than normal in Q3

Currently, Air Canada is operating 85-90% fewer flights than it normally does. This is due to a number of factors, including travel restrictions and reduced passenger demand. Obviously, such depressed levels of activity will result in lower revenue. It's one of the reasons why AC stock started falling in the first place. However, the stock doesn't seem to be priced for *prolonged* lost revenue.

That may be a mistake. In its first-quarter report, Air Canada said it still expected to be operating 75% below normal in Q3. In other words, it expects some of the cancelled routes to be re-opened, but not most of them. That would tend to suggest that AC will still be losing money in the third quarter. If that happens, then an even bigger problem could be looming on the horizon.

The airline could run into long-term financial problems

Airlines are capital-intensive businesses. They have enormous expenses, including aircraft purchases, maintenance, fuel, and payroll. For this reason, they typically have large amounts of debt. In 2019, AC had about $8 billion worth of debt and leases, and $515 million in interest expense.

That interest will be hard to service with 90% less revenue than normal. If the problem persists for a long time, then the airline may need to either refinance or accept a bailout. If Air Canada has to issue equity as part of a bailout deal, then existing shareholders will see their value diluted.

Foolish takeaway

Over the years, Air Canada has been one of the best-performing TSX stocks. After recovering from bankruptcy, its shares soared through the 2010s. Now, however, the company is facing a challenge it may not be up to. The COVID-19 pandemic and the travel restrictions that have come with it have been devastating for airlines. In Air Canada’s case, it’s already manifesting in massive losses. Quite possibly, the company’s revenue will be down for years — not months — to come. If that scenario plays out, then the stock price may have further yet to fall.

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