Air Canada (TSX:AC) Execs Forecast Three Years of Pain: Should you SELL the Stock?

Description

Air Canada (TSX:AC) has been one of the worst-hit stocks in the COVID-19 market fallout. Down 32% since the end of April as of writing, it has tanked while the **TSX** has rallied. Several factors, including Warren Buffett's dramatic airline exit and a disastrous Q1 earnings release, have contributed to the stock's descent.

Amazingly, going by company executives' statements, the worst may be yet to come.

Air Canada's Q1 report contained a number of sour items, including a $1.05 billion loss, a $712 million revenue decline, and a $1.3 billion debt increase. Most of these figures have been well publicized. What has gotten less attention is an alarming prediction Air Canada execs included in the press release.

Quoting a statement by the company's CEO, the release showed that AC expects to take three full years to get back to 2019 performance levels. That's an awfully long time, and there's no telling what could happen while it passes.

In light of this, it's reasonable to consider selling AC stock. Before pulling the trigger on that, though, it helps to know why Air Canada is forecasting such a drawn-out recovery.

Why Air Canada is forecasting such a drawn out recovery

In its Q1 press release, Air Canada said that the recovery from COVID-19 would be long, due to lower customer demand. Specifically, it forecast three full years t*o "…get back to 2019 levels of revenue and capacity."*

This corroborates what Warren Buffett said shortly after selling all of his airline stocks. While COVID-19 lockdowns are likely to end within the next 12 months, that doesn't mean people will start flying like before.

Most likely, individual travellers will remain wary for years to come. For this reason, Buffett said he *"wasn't sure"* air travel levels would recover in *"two or three years."* Air Canada seems to agree.

What it could mean

If it takes Air Canada three years to return to 2019 revenue levels, then its stock price could fall further. Air Canada's stock price at the start of December 2019–$49–reflected what investors thought the company would be worth then. It most likely assumed growth in revenue and earnings.

Theoretically, stocks are valued based on their discounted future earnings. There's no consensus on how many years of future profit is reasonable to forecast. However, most people would agree that 10 years is near the upper limit of what can be predicted.

So let's look at how big of an effect three bad years could have on Air Canada's next decade.

The most obvious impact would be on profitability. Lower revenue means lower earnings, if all other things are the same, and earnings are what stocks are typically valued on.

Imagine that a company projected it would earn $10,000 in 10 years, arising from $1,000 annual profits. Then imagine that three of those years came in at just $500 instead of the expected $1,000. You'd end up with just $8,500–making the 10-year total 15% lower than expected.

Clearly, three years of lower-than-expected earnings can significantly impact a company's long-term value. And actually, my example was fairly generous. I went with three years of *low* earnings, not *negative* earnings.

If Air Canada's earnings end up being negative for three straight years–as they were in Q1–the impact could be even bigger.

Foolish takeaway

Unless you have reason to believe that there's major government support coming for Air Canada, it's probably best to sell the stock now. Several quarters like Q1 would destroy the company's long-term value — and it looks like it's headed for a good few more.

Bankruptcy and equity dilution are also huge concerns. This stock is just way too risky at the moment.

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