How Long Can Air Canada (TSX:AC) Bleed Cash?

Description

It is no news that **Air Canada** (TSX:AC) is bleeding cash, as most of its planes stay grounded amid the COVID-19 pandemic. The coronavirus spread across the globe because of international travel, and until it is contained, long-haul international flights would mostly stay grounded or fly empty. As the air travel demand has nosedived, aircraft have become more of a liability than an asset.

Airlines are paying from their pocket for aircraft maintenance, employee salaries, airport, and other charges. As their pocket becomes lighter and demand remains subdued, airlines are retiring old aircraft, cutting jobs, and other expenses.

AC has slashed 20,000 jobs and is retiring 79 older aircraft to reduce annual costs by $1 billion. At the same time, it is increasing its liquidity by drawing the revolving credit facility, taking term loans, bridge loans, and raising capital.

How much liquidity does Air Canada need to sustain itself in the pandemic?

At the end of the first quarter, AC had $6.52 billion in liquidity. Then in June, it raised $1.6 billion in capital through stocks and convertible debt. And this week, AC CFO Michael Rousseau said that the airline might need to secure additional financing in the future.

Now, the big question is, how much money does AC need to withstand the pandemic? Nobody knows the answer, because it is difficult to predict the duration and magnitude of the pandemic and its impact on air travel.

A better option for AC is to prepare for the worst with enough liquidity. In its earnings report, AC describes liquidity as the cash needed to meet “financial liabilities, capital commitments, ongoing operations, contractual and other obligations.”

At the end of the first quarter, it had $7.25 billion in current assets, which was sufficient to meet $6.4

billion in current liabilities. But it does not have enough cash to repay its long-term debt of $9.65 billion.

AC is bleeding $20 million in cash every day, which equates to $1.8-$2 billion in net loss after adding interest paid on debt. If it keeps burning cash at this rate, it will be out of money by the end of the year. Domestic travel is recovering, but that won't stop AC's cash burn, as it depends heavily on international travel for revenue.

The airline industry does not expect international travel to resume to the pre-pandemic level before 2023. Hence, AC has to preserve its liquidity for two to three years to withstand the pandemic and its aftermath.

Various financing options available for airlines

AC has adopted a two-pronged approach to address its liquidity issues. The first approach is reducing cash outflow by downsizing its operations, increasing revenue from cargo flights, and renegotiating certain contracts. AC has $2.24 billion in capital commitments and contractual obligations for this year and $4 billion for next year.

The second approach is looking for ways to secure additional funding. In April, AC concluded $1.4 billion in term loan and bridge financing by putting some of its aircraft and spare engines as collateral. It has already raised capital from stocks and convertible bonds. In the second quarter, it has added $3 billion in cash reserves.

For future financing needs, AC has $2.6 billion worth of unencumbered asset pool against which it can take debt. It is also considering using its frequent flyer program Aeroplan as collateral to secure an additional loan.

Prolonged travel restriction could expose Air Canada to solvency issues

AC has strengthened its liquidity at the cost of higher debt and diluted equity. It is channelizing this liquidity towards working capital. The repayment of long-term debt is still a challenge. Hence, Fitch Ratings has downgraded the airline's long-term debt to "BB," indicating a risk of default in adverse economic conditions.

AC can bleed cash for at least two years provided international travel starts recovering this fall and next year. But a more extended global travel restriction could leave the airline with no money and over $12 billion in long-term debt. It could file for bankruptcy to renegotiate its debt and restructure its operations. The next three years are very crucial for AC stock. It can either recover to $30 or fall to $0.

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Date
2025/06/30
Date Created
2020/06/18
Author
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