Where Will Air Canada (TSX:AC) Stock Go: $0 or $30?

Description

Air Canada (TSX:AC) is one of the most volatile stocks trading on the **Toronto Stock Exchange** with a beta of 2.0. While the stock started the year at an all-time high of over $50, the COVID-19 crisis sent it crashing down to $12-$19. The stock is hanging on to a cliff where it can either rise to $30 or fall to $0. The direction of the stock will go depends on AC's liquidity and the return of international travel demand.

Although past performance does not guarantee future performance, it does lend knowledge that helps prepare for the future.

The past of Air Canada

Back in 2002-2003, the SARS epidemic pushed AC to bankruptcy as it impacted the airline's capacity. It took AC seven years to return to growth. Learning from its experience, the airline improved its cash reserve and reduced debt during its growth years to prepare for another crisis.

At the end of last year, the company had $2.8 billion in net debt and a leverage ratio of 0.8. The leverage ratio shows that the company has sufficient EBITDA to repay its net debt. Moreover, it had over $2 billion in free cash flow and around $6 billion in cash reserve.

All of the above figures are signs of a financially stable company that can withstand a short-term crisis. For 2020, AC planned to expand its international travel by acquiring holiday airline **Transat AT** for a 260% premium. But all this is in the past.

The present of Air Canada

In the present, the global situation has reversed from economic growth to a looming recession. The coronavirus outbreak in March forced world governments to ban travel, both local and international. This is the first time airlines are being banned from flying. AC has around 85-90% of its planes grounded between March 21 and July 21.

The month of March month alone pushed AC into a $1 billion loss in the first quarter — a loss that could double to $2 billion or above in the second quarter as it daily burns $20 million in cash to keep its aircraft in working conditions. AC was not prepared for a crisis of this magnitude. Hence, the stock fell more than 60% in less than a month.

The domestic travel has resumed this month as the pandemic-driven lockdown has eased, but international travel restrictions remain as signs of a second wave of coronavirus looms.

As people gradually start traveling again, AC is putting its aircraft back in the sky. But it is not able to sell many of its seats due to the need for social distancing. Hence, the company is losing money on these flights. But the cash burn will gradually slow as revenue starts pouring in.

The future of Air Canada

The future of air travel is a big mystery. Even if world governments lift travel bans, travellers would be reluctant to fly until researchers find a cure for coronavirus. AC believes that it will take at least three years for international travel to return pre-pandemic levels.

This forecast considers the current scenario, which could change. The situation could worsen if there is a second wave of coronavirus,and travel bans are extended for a longer term.

Moreover, the pandemic could lead to an economic recession as many companies go bankrupt, leaving several people jobless. In times of recession, it becomes difficult to raise money in the capital market. Hence, AC is accumulating cash from all possible sources to prepare for the future crisis.

Investors at a crossroads

The mystery around the magnitude, duration, and impact of the COVID-19 pandemic leaves AC at the crossroads. If the ease in lockdown marks the comeback of the pandemic peak, AC will have a hard time hanging on and could fall off the cliff. A prolonged travel ban could push AC into another bankruptcy, removing the stock from the exchange.

However, if global countries succeed in finding a cure and containing the pandemic, international travel demand could return faster than expected, which could prevent AC from burning more cash and mounting debt.

The airline’s stock could recover to $30 until it returns to profit. Only invest in this stock when there is some clarity around the international travel situation.

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