Extended Travel Restrictions Could Tank Air Canada (TSX:AC) Stock More

Description

AC earns 22% of its passenger revenue from the U.S. transborder. With the border closed for six months, it had to reduce the capacity of U.S. flights by 97.7% in the second quarter. It will see similar capacity reductions in the third quarter as well.

Air Canada's mounting losses

In my previous article on AC, I was bearish on the stock, because the airline is likely to operate at just a fraction of its capacity for the entire year. The airline is burning $20 million cash every day, which has vanished almost 80% of its last three years' combined profit of $3.55 billion. It has already lost $2.8 billion in the first six months and could lose another $1.5 billion in the next six months.

AC is doing almost everything to save cash. It has adopted a three-step approach to cut $1.3 billion in costs and delay bankruptcy:

- It has slashed 50% of its workforce in June, which would halve its second-biggest expense after fuel.
- The airline is retiring 75 aircraft, which equates to more than 30% of its overall fleet. It is also willing to cancel orders for new aircraft if needed. I believe this need will soon arise.
- It is raising cash from every possible source, such as stocks, debt, loans against aircraft, and credit facility. In the second quarter, it raised $5.5 billion in the capital, thereby increasing its liquidity to $9.12 billion.

The rocky runway to recovery

While its three-step approach will help AC reduce its cash burn, the recovery will only begin when its planes take off from the runaway. The airline saw some demand for domestic travel and cargo. But that is not enough to begin the recovery. It needs international long-distance flights because they make most of the profits.

Any recovery in international travel will most likely begin in 2021. AC expects international travel to return to the pre-pandemic by 2023. Many analysts find three years to be an overly optimistic estimate. But even if we go by this estimate, AC will take seven to 10 years to see any profit.

A decade of losses for Air Canada

Assuming that international travel returns to the pre-pandemic level by 2023 means it will start operating in full capacity. By that time, it will have a large debt on its balance sheet, and this debt will have a huge interest bill. This is because its long-term debt credit rating is “BB,” which indicates a risk of default in adverse economic conditions.

When AC was hit by the backlash of the SARS epidemic in 2002-2003, it lost $1.9 billion and reported bankruptcy. The company took 10 years to return to profit, and its stock only started to grow after it reported profits.

If I go by history, AC is up for another decade of losses. It is too early to say if another bankruptcy is in the cards, as the airline had strengthened its balance sheet for a crisis during its growth years. The $9 billion liquidity and significant downsizing can help it survive until next year. But if international travel doesn’t increase significantly by 2022, AC could file for bankruptcy.

Forget Air Canada: There are better investments that can double your money

Instead of putting your money in AC on hopes of a recovery in three to five years, buy **Cargojet** (TSX:CJT). This air cargo company is minting money on the back of huge

Cargojet stock rose 72% year to date and 53% last year. If you had invested $1,000 in Cargojet in January 2019, your money would have grown to $2,600.

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