WARNING: Air Canada (TSX:AC) Is Headed for a Brutal September!

Description

This summer, airline stocks have been the question hanging over the markets. As we watch tech stocks break new highs and other industries recoup their losses, airlines remain down for the count. It's certainly not for a lack of trying. Airline executives have been lobbying governments to let them re-open international routes for months now with increasing urgency. It apparently hasn't worked. As of August, all of Canada's travel advisories remain in effect, and travelers coming to the country still have to self-isolate for 14 days.

It's in this environment that **Air Canada** (TSX:AC) finds itself. After cancelling 89% of its routes and losing $1.75 billion in the second quarter, the company is still struggling. Heading into September, it is dealing with cancelled routes and sustained cash bleed. Some think the situation will improve. But in all likelihood, it will get worse before it gets better.

Why things are looking bad for September

A few months ago, Air Canada officials reported that they were hoping to see a major ramp up of international travel in the winter. That may or may not come to pass. However, it's definitely not looking like a big increase in flights is coming in September. If you look at the press releases in Air Canada's media centre, there is little mention of routes being re-opened. In fact, the most recent news out of the company on routes was that 30 regional routes were being closed. So, most likely, Air Canada is going to continue losing money in September.

Why this is bad for shareholders

It goes without saying that prolonged revenue loss is bad for any company. However, in Air Canada's case, it's worse than it would be for most companies. There are several reasons why that's the case:

- Air Canada lost approximately $20 million per day last quarter. If routes don't re-open, then, we can expect a similar $1.75 billion loss in Q3.
- Airlines are capital-intensive businesses with lots of debt. Thus, they incur huge expenses — like

interest and pension liabilities — even when they aren't flying.
- Air Canada has already issued new debt to cover its ongoing costs, so its interest expenses will rise.
- The company has also diluted equity, so each share now has a smaller claim on earnings.

When you take all the factors above together, it becomes clear that Air Canada cannot survive another losing quarter. Unfortunately, it looks like it's heading for one.

Bankruptcy ahead?

With another painful month for Air Canada all but certain, the logical next question is, "Will this company go bankrupt?"

As already mentioned, airlines can't survive prolonged revenue loss for long. Their fixed costs are just too high. In Air Canada's case, interest expenses alone are already about a third of revenue. If the company can't ramp up revenue somehow, then it could struggle to service its debt. If that happens, then yes, bankruptcy is a real possibility.

Personally, I'd avoid AC stock in September. It's just facing way too many risk factors now.

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