Air Canada (TSX:AC): The Best TSX Stock for September?

Description

TSX stocks are struggling. Since the year began, the **S&P/TSX Composite Index** has lost 2% of its value. What the index doesn't show you, however, is that some stocks have lost significantly more. **Air Canada** (TSX:AC), for example, is lower by nearly 70%.

Airline stocks are a mess right now. Demand remains at rock-bottom levels due to the coronavirus. Travel restrictions are putting a lid on traffic, but even if those were lifted, it's unclear how many business and leisure travelers would return.

With expectations so low, even a small uptick in demand could send these stocks higher.

Right now, Air Canada is operating at just 5% of its usual capacity! It wouldn't take much to send revenues soaring.

Read these details

Let's get the obvious out of the way: Air Canada isn't doing well right now. Last quarter it lost $1.7 billion. The quarter before it lost $1.1 billion. That's a $2.8 billion loss in six months.

"As these numbers indicate, most commercial aviation in our country has been effectively shut down," notes CEO Calin Rovinescu.

The crazy part is that the company's entire market cap right now is just $5.1 billion! By 2021, losses could eat up its entire valuation.

To be fair, Air Canada still has roughly $9 billion in liquidity. While that's more than its market cap, it still represents less than 24 months of runway.

How long do executives believe the crisis will last?

"As we have said previously, we expect the recovery to take at least three years," says Air Canada's

CEO. Manufacturers like **Airbus** and **Boeing** believe the recovery could take up to five years. **Delta Air Lines**‘ CEO thinks the industry will remain *permanently* smaller.

I bet you’re seeing the mismatch here. Air Canada has less than 24 months of financial runway, yet the recovery will take at least three years. How do you square this circle?

Bet on Air Canada stock?

There are two bull cases for this stock right now.

The first is that the coronavirus pandemic will subside quickly, and air traffic will normalize much quicker than the market thinks.

If this occurs in the next 12 months, the stock is clearly a buy, but it’s a tough thesis to stand behind. Even if a vaccine were discovered today, it could take a year to approve, manufacture, and scale. Then travelers would still need to overcome their flying fears.

The second bull case is a long-term bet. If you’re willing to wait out the lean years, you can capitalize once the recovery takes place. This is a reasonable stance, but it has one major flaw: dilution could mitigate all of the upside potential.

Airlines like Air Canada will undoubtedly need to raise massive amounts of capital to survive. That means current shareholders will have to share the benefits, likely to a large degree.

“This capital, though it might save them, will reduce the value of their businesses. Equity issuances would permanently dilute shareholders, as future earnings will be shared with a much-increased shareholder base,” concludes Vitaliy Katsenelson, CIO at Investment Management Associates.

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Date
2025/08/25
Date Created
2020/08/31
Author
rvanzo