Sell Air Canada (TSX:AC) Stock: The Math Is Scary

Description

Air Canada (TSX:AC) is a weird stock. Last decade, shares returned *50 times* their original value. A $20,000 investment became $1 million.

Then the coronavirus hit. The challenge proved unprecedented. Shares quickly lost 60% of their value and still haven't recovered.

For many, this is a buying opportunity. A decade from now, we'll still be flying in planes. If previous estimates are correct, more people than ever will travel in the sky. Demand could be *huge*. This seems like a chance to buy into that demand at a deep discount.

Others are more cautious. Air Canada is a terrific company, but it's currently losing billions of dollars. If the industry doesn't recover quickly, even the best won't survive.

What does the future hold? As always, it's critical to crunch some numbers.

Let's do the math

Right now, many investors are looking to the future for airline stocks. That's all fine and dandy, but to reap the rewards of this future, airlines need to make it that far. With high levels of fixed costs and air traffic down 95%, it's unclear how many stocks will survive. Several have already gone bankrupt.

Let's run the numbers.

Right now, Air Canada has a market cap of $5.4 billion. In recent months, the company raised $5.5 billion in new equity, debt, and aircraft financing, giving it roughly $9 billion in liquidity as of June 30, the latest disclosed quarter.

Last quarter, net cash burn was $1.7 billion, approximately $19 million per day. That's an *increase* from the quarter before, when the company posted a $1.1 billion loss.

It’s not hard to see how Air Canada will soon be in trouble. It’s been two months since the latest quarterly results, meaning that $9 billion in liquidity is likely down to around $8 billion. Over the last six months, the company burned through nearly $3 billion.

The airline may only have 12 additional months of financial runway left. This is terrible news given the company’s recovery estimates.

“It is our current expectation that it will take at least three years to recover to 2019 levels of revenue and capacity,” Air Canada’s CEO said earlier this year. The numbers just don’t add up.

Should you sell Air Canada stock?

Of course, Air Canada could continue to raise debt and equity — at least as long as the market supports it. But surviving is very different than thriving.

“The sad reality is that unless airlines raise new capital, they will go bankrupt,” warned Vitaliy Katsenelson, CIO at Investment Management Associates.

Our math above supports this assertion, but even if Air Canada can avoid complete collapse through additional financing, investors may not benefit.

“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,” Katsenelson concluded.

Air Canada is simply stuck between a rock and a hard place. The future ends in bankruptcy or massive equity and debt issuances, which spread the rewards perilously thin.

There are several stocks worth buying *right now*. Air Canada isn’t one of them.

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