WAIT! Consider These 5 Risks Before Buying Air Canada (TSX:AC) Stock

Description

Air Canada (TSX:AC) has been making news headlines with its voluntary COVID-19 testing booths at the Toronto Pearson airport and with the revamped Aeroplan loyalty program. Its stock surged 15% in the last two weeks of August before falling 4.7% in the recent market dip. Are you considering buying AC stock? Then you should know the five major risks AC stock is exposed to.

Can Air Canada survive a second wave of the pandemic?

Air Canada was one of the hardest hit by the COVID-19 pandemic, as the lockdown halted air travel. The pandemic grounded 92% of AC planes. The airline shifted from moving passengers to moving cargo to earn revenue. It lost $2.8 billion in the first half of the year.

The return of domestic travel in the third quarter has brought some respite. But AC faces a major risk of the second wave of the pandemic. It has secured $9.1 billion in liquidity, which can help it survive low demand for the next year or two. But another complete lockdown will accelerate its losses and wipe away the cash faster than expected.

A slow recovery in international travel

Even if there is no second wave of the pandemic, survival will be tough for AC, as it depends on international travel for 70% of its revenue. The Justin Trudeau government has restricted international travel for the last six months. This means 70% of its revenue has been lost.

AC expects the international travel to return to the pre-pandemic level in three years, assuming that travel demand starts recovering in the second half of 2020 and through 2021. But the extension of the travel restriction to September 30 has just cost AC three months of the recovery period. The airline is getting desperate. It is urging the government to ease the 14-day quarantine requirement.

Even if the government eases border restrictions, leisure travel would recover first and business travel would recover last. A study by Climate Group stated that increasing the efficiency of remote working could reduce international business travel by a third in the long term. Such an outcome will have a permanent impact on international air carriers like AC.

Oil prices

Assuming that air travel demand starts to pick up, AC will still be making losses per flight, as it cannot fill all passenger seats due to social-distancing rules. Fuel is the biggest cost for airlines.

The pandemic significantly reduced oil demand. Oil producers struggled to store their production, which dropped the oil price to less than $20. They will continue to remain low for a year or two, giving AC a breather in fuel costs. However, the airline faces the risk of rising oil prices, which will increase fuel costs. If air travel demand continues to remain subdued even when oil prices surge, AC will lose money per flight.

Air Canada’s high cost of capital

Since its airplanes were grounded, AC has been burning $20 million cash every day. To withstand the travel restrictions, it has withdrawn all its revolving credit facility and raised new debt at 9% and 10.5%. It is funding its losses at a 10% interest rate.

Fitch Ratings has downgraded AC’s long-term debt to BB- from BB. This rating means AC will not be able to raise capital at a lower cost, even though the central bank has reduced the interest rate to 0.25%.

Moreover, AC is looking to raise more secured debt using its aircraft as collateral. But demand for international air travel and the launch of **Boeing’s** 777X could reduce the future value of AC’s collateral.

Air Canada’s unmanageable debt

Lastly, the biggest risk for AC is its rising debt. In the first half, it increased its long-term debt by $4.4 billion. Higher and expensive debt will bring in higher interest expenses. If it is unable to generate sufficient cash inflows to manage this debt, it could face a risk of bankruptcy.

When a company goes bankrupt, shareholders stand to lose their invested amount. The next three years are crucial for AC.

CATEGORY

1. Coronavirus
2. Investing

TICKERS GLOBAL

1. TSX:AC (Air Canada)

PARTNER-FEEDS

1. Business Insider
2. Koyfin
3. Msn
4. Newscred
5. Sharewise
6. Yahoo CA

Category

1. Coronavirus
2. Investing

Date
2025/08/17
Date Created
2020/09/14
Author
pujatayal