



100% Downside!? Air Canada (TSX:AC) Stock Could Be Headed for Disaster

Description

Air Canada ([TSX:AC](#)) stock could be headed for disaster — at least if you do the math in a certain way. If you run the numbers with different assumptions, the stock could survive.

So, which is it?

Air Canada will go bankrupt

Let's run through the bear case first. In this scenario, the entire business goes bankrupt, leaving shareholders with nothing.

The most obvious cause is that the business is running out of cash.

"In the third quarter of 2020, net cash burn of \$818 million (or approximately \$9 million per day, on average) was significantly better than management's net cash burn expectations of between \$1.35 billion and \$1.6 billion (or between \$15 million and \$17 million per day, on average)," Air Canada executives [revealed](#) on the latest conference call.

You can see that they tried to put a positive spin on things, but it's hard to run from the fact that your company burned through \$818 million over the last 90 days. That's especially true given the company posted billion-dollar losses in the two quarters previous.

Air Canada bears have an easy case to make. Right now, the company's market cap is around \$6.4 billion. The problem is that it has \$26 billion in debt. Even when you subtract its \$8.5 billion in current assets, debt is still three times larger than the equity base.

High debt levels are a big problem when you're losing \$1 billion every quarter. The only answer is to add more debt or issue more equity. Air Canada has opted for both this year, leveraging up the balance sheet to extreme levels, all while massively diluting shareholders.

This can only go on for so long. The clock is [ticking](#). If the market senses that profitability won't emerge

in 2021 — a reasonable possibility — it may end its limitless lending to the company.

Once the cash faucets stop running, the clock *really* starts ticking. There's a good chance Air Canada doesn't survive another year.

Maybe things will be okay?

What needs to happen for Air Canada to survive?

The market needs to play nice for another couple quarters while the business stabilizes. But if vaccines are rapidly distributed early next year, and passenger traffic returns quickly, perhaps profits will actually emerge. That's the only way out of this mess.

What are the odds that this future will occur? I wouldn't be so confident.

Even if a vaccine is distributed rapidly around the world, and air demand picks up heavily, there's no guarantee that profits will emerge. It's a simple case of supply and demand.

Right now, we have enough planes for a 2019 world, forcing airlines to operate at just 10% of their capacity. That's why losses are piling up so quickly. In order to turn a profit, demand might need to rise 1,000% next year. That's a tough bet.

Even if that were to occur, profits are *still* not guaranteed. That's because planes takes several years to build. In 2020, the world took delivery of hundreds of new planes that were ordered before the pandemic began. We have enough industry supply for a 2019 world *plus* some growth.

Will Air Canada survive the COVID-19 crisis? It's possible, but I wouldn't bet on it.

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