Air Canada (TSX:AC) Is Burning $15 Million Cash Daily: Why Should You Care?

Description

Air Canada (TSX:AC) has been in the news for many reasons. Thousands of travelers tweeted when AC gave them vouchers instead of cash refunds for their canceled flights. Then worker unions lobbied the government to nationalize AC, as the airline couldn't maintain its workforce and slashed 20,000 jobs in June 2020 and 1,700 jobs in January. AC even retired 33% of its fleet and suspended routes to save cash.

Despite all these efforts, AC has continued to burn $15 billion cash daily in the six of the last 12 months.

Air Canada is losing $15 million cash daily

Look at AC's plight. All the money it earned over the years is draining away for no fault of its own. It has already exhausted its money and is now taking a loan at the rate of 9% to continue losing money. On top of this, the government is delaying a bailout and imposing conditions.

If this is not enough, the government even tightened the travel restrictions further by making it mandatory for travelers to show a negative COVID test result. If AC passes on all these costs to travelers, ticket prices could soar. But AC has to bring competitive prices when travel reopens.

AC is in such a situation where it has no other way but to abide by all conditions to stay afloat. Then what can it do to minimize losses and reduce cash burn?

What can Air Canada do to reduce cash burn?

It takes airlines a lot of money to buy and maintain those planes. This fixed cost is what is burning a hole in airlines' pockets. AC burnt $15 billion daily in the fourth quarter, as the Justin Trudeau government reinstated stricter travel restrictions. And this time, there is an added cost of the COVID-19 test.

In the first quarter, AC expects a higher daily cash burn of $15-17 million because of higher capital expenditures. And later in the year, it will probably be because of repayment of short-term debt.

There are only two ways AC can reduce cash burn, either by increasing revenue or reducing cost. As passenger revenue is not in AC's hands because of the travel restrictions, it is converting some of its planes to cargo freighters to increase revenue.

It has canceled orders for 22 planes and delayed the delivery of new planes to 2023. In the first quarter, it will see an increase in capital spending if regulators approve its **Transat A.T.** acquisition. AC is seeking more opportunities to reduce costs. Hence, it suspended more routes and slashed more jobs in January. It has also suspended operations of its leisure-based subsidiary Air Canada Rouge.

AC is seeking a government bailout under the new leadership of Michael Rousseau. Unlike Calin Rovinescu, who has been more stern on the government bailout conditions, Rousseau is open and flexible to them. At present, AC needs money, and a CEO with a finance background comes as welcome news. A bailout could be close.

Why is Air Canada desperate for a bailout?

AC's net debt touched $5 billion in 2020. This figure will rise further in 2021, as its cash burn won't end even if the air travel demand returns. In the first few weeks of regular flying, AC will only make losses, as it may not be able to transfer the high cost of reinstating the business to travelers. The airline has $8 billion in liquidity that will fund the cash burn.

Things will only get tougher for AC, as it can't raise low-interest debt with a BB- credit rating. A bailout will give AC a long-term, low-interest-rate loan. But it will come with conditions like reinstating suspended routes, giving ticket refunds of canceled flights, and maintaining reasonable ticket prices.

These conditions go opposite to AC's cost-reduction efforts. This means a bailout will increase its cash burn and delay its profits by five or more years.

Foolish takeaway

As AC's cash burn will increase, retail investors are not looking for long-term value but short-term momentum. Once restrictions are lifted, hopefully by September, you will see AC stock touch $30 price, but not above that.

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