Why Air Canada Could Be Warren Buffett's Next Investment Target

Description

It's not a far-fetched idea to believe that Warren Buffett's **Berkshire Hathaway Inc.** (NYSE:BRK.A)(NYSE:BRK.B) would venture into Canada to get in on the frenzy which is taking place in the Canadian airline industry after he invested approximately US$10 billion in the American airline industry. After all, **Air Canada** (TSX:AC)(TSX:AC.B) remains severely undervalued when compared to its North American counterparts, and Warren Buffett is no stranger to investing in Canadian companies.

In June, Mr. Buffett ventured once again into Canadian waters, purchasing a 20% stake in the embattled alternative lender **Home Capital Group Inc.** (TSX:HCG) at a severely discounted price of $9.55 per share, with the option to purchase an additional 20% of the company in September at $10.30 per share, pending shareholder approval. Berkshire also agreed to loan Home Capital up to $1.6 billion at a very favourable interest rate (for Berkshire, of course), which would hover between 9% and 9.5% over the next year on the used portion of the facility, while receiving a 1% fee on any undrawn portion.

This recent investment comes on top of previous investments in some of Canada's most prominent companies, such as **Suncor Energy Inc.** (TSX:SU)(NYSE:SU), which Mr. Buffett exited in 2016 after holding the company's equity for three years, as well as a bunch of other investments in Canadian companies since the Oracle of Omaha pulled the trigger on his first Canadian investment more than 50 years ago in Toronto Iron Works.

Air Canada's performance in recent years has far surpassed analyst expectations, and this most recent quarter was no different. Canada's largest airline soared past consensus analyst earnings estimates, resulting in yet another leg up for the airline, which has seen its share price skyrocket more than 2,100% over the past five years, despite continuing to hold some of the best valuation multiples and strongest fundamentals of its peers — fundamentals which appear to continue improving.

In an interview Air Canada CEO Calin Rovinescu gave with *The Globe and Mail*, he spoke to some of the specific numbers which have driven the increase in the company's share price. Among these, he listed the following improvements:

Measure	**2017**	**2009**

Revenue	$15 billion	$9.7 billion
EBITDAR	18.9%	7%
ROIC	14.7%	-1.5%
Leverage Ratio	2.6x	8.3x
Cash on Hand	$4 billion	$1.4 billion
Pension Plans	+$2 billion	-$4 billion

Bottom line

Air Canada remains a solid pick for long-term Buffett-like investors betting on a continued rebound in global air travel. With few headwinds on the horizon, and the sky seemingly the limit for most airline stocks amid improving fundamentals, adding to a position or initiating a new position in Air Canada makes as much sense now as it did three, four, or five years ago. That said, anything is possible, and the potential for the airline industry to experience ad-hoc hardships (terrorist attacks, airplane malfunctions, overbooking scandals) remain a real risk; however, with risk, comes reward.

Stay Foolish, my friends.

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Date
2025/09/17
Date Created
2017/09/01
Author
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