



Air Canada (TSX:AC): Should You Be Buying Today?

Description

Thousands of investors have patiently followed the **Air Canada** ([TSX:AC](#))(TSX.AC.B) saga hoping to pick up shares at an unbelievably compelling valuation. The plan would be to hold the stock for a short time, or however long it takes for travel to recover to normal levels. The stock — which would inevitably be much higher at this point — would then be sold for a large profit.

Without a doubt, Air Canada has been the most popular stock I've been asked about. Many retail investors were interested in picking up shares.

Now that the stock has more than doubled off its lows, some investors aren't quite as interested, but many still see serious upside potential. After all, the stock is currently right around \$20, and it peaked at \$52 as recently as January.

The more I think about Air Canada, the more I'm afraid I come to an inevitable conclusion: I don't think the airline sector is a good place to put capital.

Here's why I'll likely be avoiding carriers like Air Canada for the rest of my investing career.

Heed Warren Buffett's warning

One of the reasons why it was so surprising when Warren Buffett announced big investments in several U.S. airlines is because Buffett has told investors to avoid the sector for most of his career.

The reasoning is simple: Airlines are a crummy business, even at the best of times.

Airlines use a lot of cash, both in capital to buy planes (or the cost to lease them) and in employee costs. Staff know the business is crummy, so they unionize to ensure they get protection during the inevitable lean times. Most routes lose money unless the plane is full, meaning that the sector is sensitive to even small economic shocks.

And despite customers' relentless complaints about quality, their habits show the only thing that really

matters is price. The industry will always be a relentless march to the bottom.

But the biggest risks come from things airlines can't even try to control. Three big events that severely impacted airlines over the last 20 years included 9/11, the economic meltdown of 2008-09, and today's coronavirus pandemic. Each of these events brought the whole sector to its knees, with major players going bankrupt.

Investors should also note Buffett has been recently [selling airline stocks](#). He's seen the error of his ways.

In fact, we may look back at today and see the only thing that really saved Air Canada were various government bailouts. We haven't seen any direct bailouts for the company, but it is taking advantage of payroll assistance programs to avoid laying off more staff.

The risk of bailouts

The bailout thesis has long been predicted by many investors. They think there's no way the federal government would let Air Canada fall to zero, so they feel safe about investing.

But these folks must remember one thing: There's no guarantee existing shareholders will be made whole in a bailout. You might remember the auto industry bailout in 2009 — an event that wiped out existing shareholders. An Air Canada bailout might end up exactly the same way.

That's the issue here. We don't know the details of this potential last-ditch effort to save the company.

It also makes some sense to let existing shareholders lose in such a scenario. There's a certain amount of risk of holding shares in any stock. Investors accept this every time we hit the buy button. It's also be much more popular politically to save jobs and investment in Canada rather than saving shareholders.

The bottom line

There's simply too much uncertainty surrounding an Air Canada bailout today. We don't have any idea when travel will return to normal, or even how long we'll be in a state of lockdown. We could be back to normal in weeks, or it might take years.

If we're in this new reality for a longer than a month or two, the only thing that will save Air Canada would be a government bailout. But what will that look like?

Until we have some of those answers, investors should stay away from Air Canada — even if the investment comes with compelling [upside potential](#).

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Author

nelsonpsmith

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