Will Air Canada (TSX:AC) Stock Go to $0?

Description

Air Canada (TSX:AC) stock has become incredibly popular with value investors — and it's not hard to see why. Despite delivering 1,000% returns over the previous decade, the stock has been hammered as a result of the COVID-19 pandemic.

The risks are clear. Air traffic has fallen off a cliff. Cash burn rates are outrageously high. Government bailouts are all but certain.

Yet the current stock prices discount could more than make up for those risks. This stock rarely goes on sale, but this could be your chance.

Air Canada is a wonderful stock

Before the pandemic began, Air Canada was crushing the market. In just eight years, the stock rose *60 times* in value. A $10,000 investment became $600,000. Sales and profits were rising year after year. In 2019, the company controlled roughly half of the Canadian domestic air market.

Then, COVID-19 hit. Air traffic plummeted. With a large fixed-cost asset base, even a small decrease in revenue has an outsized effect on profits. With demand down by more than 50%, losses are piling up quickly.

Just take a look at **Delta Air Lines**. Last year, Warren Buffett was one of its largest shareholders. Like Air Canada, its stock price was shooting through the roof. Today, the airline is burning more than US$50 million in cash per day just to stay afloat.

Delta is roughly three times larger than Air Canada. If the cash burn rates are similar, Air Canada could be losing more than US$15 million *every day*.

Here's the good news: Air Canada had US$4.5 billion in cash and cash equivalents on its balance sheet last quarter. This is one of the highest cash levels in the industry when compared to its market size. That will allow it to survive for months with almost zero revenue.

Is now the time to buy?

There's no doubt that the current downturn in air travel is painful. Even worse, depressed airline demand will almost certainly persist for months. Some analysts aren't expecting a return to normalcy until *at least* 2021, and that's assuming we don't have a resurgence of COVID-19 next winter season.

But air travel isn't going away. In fact, the latest bear market, no matter how painful, could eventually help financially strong operators like Air Canada.

For decades, betting on airlines was a losing proposition. Battles for market share evaporated any chance of long-term profit. But then things changed. A few years ago, Warren Buffett invested billions into the industry, despite avoiding it for his entire investing career.

What caused the change? Consolidation.

In previous decades, dozens of companies competed on every major route. Today, only a handful of companies dominate the market. Almost 80% of the U.S. market is now controlled by four companies; approximately 70% of the Canadian market is controlled by just two companies. WestJet has a 34% market share, while Air Canada has a 46% share.

In this downturn smaller competitors with restricted access to capital will exit the market. Carriers like Air Canada and WestJet will fill the void. And if there's anything we've learned about the airline industry in recent years, it's that consolidation brings higher profits.

The coming year will be volatile for airline stocks, but those that survive will realize a future brighter than ever before. Based on its financial strength, Air Canada looks like it will be one of the few survivors. Patient investors could be heavily rewarded.

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