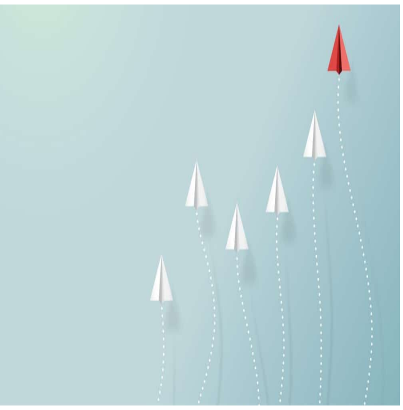

Why Air Canada (TSX:AC) Gained 20% Over the Last Month

Description

The coronavirus pandemic has decimated tourism and air travel. It has hit cruise lines and airlines particularly hard. **Air Canada** (TSX:AC), like its U.S. competitors, has seen its stock tumble, plummeting 62% since the start of 2020.

The largest U.S. carrier by revenue, **Delta Airlines**, is down 61%. **United Airlines** has plummeted by 71%. Unlike the major U.S. carriers, Air Canada has rallied strongly over the last month, gaining 21%. There are a range of reasons why the market is differentiating Canada's flag carrier from its U.S. peers.

Robust fundamentals

Key is the significant lack of domestic competition. When coupled with Air Canada's strong brand and status as the national flag carrier, this provides it with an economic moat. That helps to protect the airline from competition.

More importantly, Air Canada finished 2019 in a solid financial position. It reported record operating revenue of $19 billion. EBITDA expanded by 13% year over year while net income grew by a notable 39 times to almost $1.5 billion. Air Canada finished 2019 with $5.9 billion in cash and short-term investments compared to $14 billion in debt, pensions, and other long-term financial obligations.

Those impressive numbers indicate that Air Canada's performance was comparatively superior to Delta, which is rated as the most profitable U.S. carrier. In fact, Air Canada's net debt, including pension liabilities, was only 26% of 2019 revenue, compared to 30% for Delta.

That demonstrates the strength of Air Canada's financial position at the end of 2019.

Airlines boosting liquidity

Air Canada has been able to avoid burning cash at the same rate as Delta. Earlier this month, Delta's CEO stated that the airline was burning through a whopping US$60 million a day. At that rate, Delta would consume the US$6 billion of cash held at the end of the first quarter 2020 in roughly 100 days.

There is every indication that air travel won't return to anything resembling the pre-coronavirus environment for years.

Delta has taken significant measures to mitigate that and other risks associated with the current crisis. At the end of March, Delta announced it had acquired a US$2.6 billion debt facility and was drawing a further US$3 billion from existing facilities. Last week, the airline announced a US$1.5 billion debt offering and plans to add another US$1.5 billion line of credit once the capital raising closes.

This will leave Delta with a massive debt pile totalling somewhere in the vicinity of US$24 billion once pension liabilities are included. Even once air travel returns to normal this will weigh on Delta's performance for the foreseeable future. For these reasons it is easy to understand Buffett's decision to reduce his stake in Delta by around 13 million shares.

Air Canada preserving its financial position

In stark contrast, Air Canada has only drawn $1 billion from existing lines of credit. This gives the carrier over $6.8 billion in cash and short-term investments. The fact that Air Canada has yet to tap capital markets for additional funds, along with the potential for assistance from Ottawa, provides it with additional levers to manage the crisis should the outlook worsen.

To preserve its solid position, Air Canada has taken measures to significantly reduce costs. These include furloughing or temporarily standing down over 16,000 employees, cutting executive salaries, reducing operating capacity, and deferring capital spending.

Foolish takeaway

For the reasons discussed, Air Canada will emerge from the crisis in better shape than most major North American airlines. After the 2008 Great Recession, which almost bankrupted the airline, it delivered outsized returns for contrarian risk tolerant investors.

Even after allowing for the latest market decline, Air Canada has returned a stunning 648% over the last decade. While past performance is no guarantee of future returns, the risk reward equation for Air Canada is in favour of investors, making now the time to buy.

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