



Air Canada (TSX:AC) Is a Better Buy Than Delta Airlines

Description

The coronavirus is crushing travel, tourism, and airlines. Since the World Health Organization (WHO) declared a pandemic in mid-March, airline stocks have collapsed. Among the hardest hit are **Delta Airlines** ([NYSE:DAL](#)) and **Air Canada** ([TSX:AC](#)), which are down 63% since the start of 2020.

Poor results

Delta's latest results indicate that there is [worse ahead](#) for airlines, including national flag carrier Air Canada. In early April, Delta's CEO released a memorandum stating the airline was burning through US\$60 million a day. That equates to over US\$1.8 billion a month. It is no surprise when it is considered that Delta has reduced domestic capacity by 80% and international flights by 90%.

This can be blamed on the coronavirus pandemic. Governments across the world have enacted travel restrictions and closed their borders to international visitors. Some countries anticipate that they will be closed to international travel for up to six more months or more.

Some governments have even banned internal travel as a means of preventing the spread of the virus. Even with less than one month of the coronavirus impacting its operations Delta reported a stunning first-quarter 2020 net loss of US\$534 million.

The numbers for the second and third quarters can only get worse as the full impact of the economic fallout from the coronavirus deepens. The only saving grace for airlines is that operational costs will fall substantially.

Growing debt

To bolster its ability to survive the coronavirus pandemic, Delta has boosted its liquidity. It did this by raising US\$5.4 billion in debt capital and drawing down US\$3 billion from credit facilities. Delta also announced that it was making another debt offering for US\$1.5 billion and moved to secure an additional US\$1.5 billion loan.

The massive injection of debt, while setting Delta up to survive the sharp decline in air travel, will weigh upon its financial performance for the foreseeable future. A shortage of cash flow and repeated losses will weigh further on Delta's financial position.

There is growing speculation that the pandemic's impact on air travel could last for up to three years. That doesn't bode well for airline earnings or those airlines in precarious financial positions or that are burning large amounts of cash, especially with little to no revenue being generated.

Buy Air Canada instead

It will be those airlines with considerable financial resources, a strong balance sheet, and the ability to dial down expenses, which will make it out the other side. In that sense, Air Canada is a [superior investment](#). As the national flag carrier, it has a wider economic moat than Delta and operates in a less-competitive market, helping to protect earnings.

Air Canada has a sounder foundation. Its first-quarter adjusted net loss was \$392 million, which was significantly lower than Delta's loss. Air Canada finished the period with cash and short-term investments totalling \$6.1 billion.

Meanwhile, long-term debt and pension liabilities only grew 11% year over year to \$12.2 billion. After deducting cash and short-term investments, Air Canada's net debt, including pension liabilities, is \$6 billion. That is a modest 33% of the airlines trailing 12-month revenue, indicating it is manageable.

In order to survive the coronavirus crisis, Air Canada has slashed capacity by 85-90% and suspended a large proportion of its employees. That coupled with sharply lower oil prices will see a significant reduction in costs over the course of 2020.

Looking ahead

The poor outlook for international travel means it will be some time before Air Canada's earnings return to something approaching pre-coronavirus normal. The airline has, however, battened down the hatches and appears capable of surviving the economic fallout from the pandemic. That means there is every likelihood that Air Canada's stock will soar once travel and tourism rebound.

Nevertheless, it is a speculative contrarian play for those investors with a high tolerance to risk and volatility.

CATEGORY

1. Coronavirus
2. Investing

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1. NYSE:DAL (Delta Air Lines, Inc.)
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