Air Canada (TSX:AC): Should You Follow Warren Buffett and Sell Airline Stocks?

Description

Analysts consider Warren Buffett to be one of the greatest investors of all time. He has certainly made long-term **Berkshire Hathaway** shareholders rich.

Sometimes, however, even the Oracle of Omaha takes a hit.

Airline stocks

Buffett recently revealed that Berkshire Hathaway sold all of its shares in the four largest U.S. airlines due to the uncertain future in the travel industry caused by the coronavirus pandemic.

Buffett avoided the sector for a long time but started to buy airline stocks in 2016 with big bets on the industry. Low fuel costs, strong travel demand, and decent profits appeared to be sustainable. His company held stakes of close to 10% in the largest U.S. carriers before exiting the positions.

The arrival of the pandemic changed everything. Countries around the world have closed their borders, and it is unknown when restrictions will be lifted.

The largest American airline companies reported significant losses for Q1 2020, and Q2 will be worse. They have suspended dividends and are taking on new debt. All anticipate slow recoveries that might take two or three years.

Should you own Air Canada stock?

Air Canada just reported a Q1 2020 net loss of $1.05 billion, or $4 per share, compared to earnings of $345 million, or $1.26 per diluted share, in the same period last year.

The company has cut capacity by 90% since the beginning of the pandemic. CEO Calin Rovinceau said the return to 2019 capacity and revenue levels could take at least three years.

The stock traded above $52 per share in January and hit a March closing low near $12. A rebound took the stock briefly as high as $22 last week. At the time of writing, Air Canada trades below $18, falling sharply on the Buffett news from the weekend.

Some contrarian investors see the stock as a buy at this level, while others think Air Canada's share price is headed back to zero. The company restructured under bankruptcy protection in 2003. In the wake of the Great Recession, the share price fell below $1.

Opportunity

Investors hope the re-opening of the global economy will occur relatively quickly and growth will return. China is ahead of most countries in the process. Europe, the United States, and Canada are slowly putting steps in place to get business going again.

In the event the initial re-opening phases go well and rapid testing and efficient tracking of the coronavirus are put in place, countries could start to relax travel restrictions in the coming months. That could result in added air capacity ahead of projections. At the same time, fuel costs are down significantly due to the crash in oil prices. Lower expenses for jet fuel should boost margins.

Risks

Analysts wonder if global travel will ever return to pre-pandemic levels. Business trips could dry up, as companies opt for digital meetings. Holidays might be spent close to home for several years before people once again feel comfortable getting on a plane.

Airlines make money by packing passengers into tight spaces. People used to put up with cramped seating to save a few bucks.

It might be a long time before the public is willing to endure those conditions. In the event airlines are forced to add more space between seats, the old profit model goes up in smoke. They would have to charge significantly more for the flights, but there is a price point where people simply won't travel.

The bottom line

Buffett took a big hit on the sale of the airline positions. He wouldn't have done that if he were of the opinion that a rebound is on the way in a timely manner. Given the near-term uncertainties and the fact that industry executives say they don't see a return to previous demand for years, I would avoid Air Canada today.

The **TSX Index** is home to other attractively priced stocks right now that pay reliable dividends and likely carry less risk than the airlines.

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