



Market Rally: Why Hasn't Air Canada (TSX:AC) Stock Recovered?

Description

Air Canada ([TSX:AC](#)) is a terrific company. In 2012, shares were priced at \$1 apiece. Today, they're worth *20 times* more. And that return factors in the recent decline, which saw shares tumble by 60%. But some investors are worried: why hasn't Air Canada stock recovered during the recent market rally?

The recent recovery has been helpful, but Air Canada stock would still need to *triple* in price to reach its former highs. Some investors are piling into the stock, betting that a long-term view will bring healthy [profits](#). Other investors aren't so sure, noting the limited visibility due to the coronavirus pandemic.

What will the future hold? Will Air Canada stock shoot [higher](#) from the ongoing market rally? Or, will shares remain depressed for months, or even years to come?

First the good news

Here's the good news: whatever becomes of the market rally, Air Canada will likely survive. Its balance sheet had \$6 billion in cash and short-term investments last quarter. Compared to its size, that's more than most airlines, even high-quality names like **Southwest Airlines Co.**

Survival is a big deal. Over the last century, the vast majority of airlines *haven't* survived. The industry earned a terrible reputation.

"If a capitalist had been present at Kitty Hawk back in the early 1900s, he should have shot Orville Wright. He would have saved his progeny money," Warren Buffett quipped in a 2002 interview with *The Telegraph*.

"But seriously, the airline business has been extraordinary. It has eaten up capital over the past century like almost no other business because people seem to keep coming back to it and putting fresh money in," he continued. "You've got huge fixed costs, you've got strong labor unions and you've got commodity pricing. That is not a great recipe for success."

But things have changed, even before the recent market rally. Last year, Buffett was one of the top

shareholders of *four* different airlines. The difference was consolidation. So many companies went bankrupt that pricing and profits improved for those that survived.

“It’s true that the airlines had a bad twentieth century,” Buffett later said “They’re like the Chicago Cubs. And they got that bad century out of the way. The hope is they will keep orders in reasonable relationship to potential demand.”

The current pain will likely force competitors out of the market. If history is any suggestion, this should *increase* Air Canada’s long-term profits.

What about the market rally?

Now, the bad news. You’re likely familiar with this side of the story.

Air traffic has fallen off a cliff. Leisure passengers are afraid to fly, while business travelers are often banned from flying completely. With high fixed costs, airlines are losing millions. **Delta Air Lines**, for example, is reportedly losing more than \$50 million *every day*. A short-term market rally won’t change that reality.

There’s no doubt that Air Canada is also racking up huge daily losses. While its cash pile will stem the tide, it’s growing more likely that it will require a government bailout. Whether that includes low-interest loans or sizable equity stakes is remains to be seen.

Another uncertainty is the return to baseline. Will airline traffic remain depressed for months or years? Competitors will go bankrupt, but their planes will remain operational, just under new ownership. That could ultimately *depress* pricing.

Why haven’t Air Canada shares moved higher with the market rally? Because no one really knows how much the company is worth. Uncertainty is rampant. There’s a future where the company goes bankrupt, but there’s also a possibility that the firm exits the crisis stronger than ever.

This could be the biggest bargain of 2020, but thus far, few investors have been willing to make the leap.

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