Could Air Canada (TSX:AC) Be a Millionaire-Maker Stock?

Description

Air Canada (TSX:AC) stock has been a long-term loser amid the market turbulence of 2020. Even in May, after considerable gains for the broader markets, the stock remained down 68% for the year. By contrast, the **TSX** was down just 12.8% for the year as of this writing.

Clearly, investors have lost confidence in Air Canada. With billion-dollar losses and falling revenue, the company is in a hard place. If COVID-19 travel restrictions last the remainder of the year, it may need some form of bailout, which would be bad news. While bailouts can save *companies*, they either add debt or dilute equity, neither of which is good for *investors.*

Still, some investors remain interested in stocks like Air Canada. Badly beaten down, they could be solid distressed plays — that is, assuming they manage to turn things around.

In his recent shareholder meeting, Warren Buffett announced that he had sold his *entire* position in airline stocks, citing long term headwinds. Specifically, he said that he *"wasn't sure"* whether airlines would recover their passenger levels in *"two or three years."* Two or three years is an awfully long time for a company to operate below capacity. For Air Canada, such a period of depressed revenue could cause major financial trouble.

I'll explore why in a minute. First, let's take a look at the bullish case for Air Canada–because the stock *does* have upside in a best case scenario.

Air Canada was a ten-bagger in the 2010s

Before getting into the problems Air Canada is facing, we should take a look at the positive things the company has going for it. One of those is a historical track record of resilience. Air Canada has faced bankruptcy and taken bailouts before and still delivered unbelievable returns to investors.

In 2003, AC entered bankruptcy protection, intentionally “uglifying” itself to ward off a hostile takeover. In 2009, it took $600 million–half from the federal government–to cover its underfunded pension plan. On both of these occasions, it looked like it was game over for Air Canada.

Yet from January 2010 to January 2020, AC shares rose over 3,000%. That’s the kind of return million dollar fortunes are made out of.

It was all thanks to Air Canada’s economic clout. As Canada’s largest airline, Air Canada is vital to the country’s economy. Competitors like WestJet have much slimmer pickings–especially when it comes to international routes–giving AC a role that nobody else can completely fill. As a result, the company is very likely to receive bailout money if it needs it.

The big problem

The problem with Air Canada stock–and the reason it’s not a safe buy–is that it could run into serious financial problems that a bailout won’t save it from. In the company’s most recent quarter, it lost $1.05 billion.

In the same quarter, it had $2.6 billion in cash, and $6.1 billion in cash & marketable securities combined. It would only take a few quarters like Q1 to chew through all of Air Canada’s liquidity.

At that point, the company would likely get a bailout. While that would save the company, it wouldn’t save investors. Bailouts tend to come with a lot of strings attached–typically debt or equity issues.

If Air Canada gets a loan, it will result in a more leveraged balance sheet. If it has to issue new equity, current shareholders will see their ownership diluted.

In either case, the stock will be worth less, all other things the same.

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