Here's Why Air Canada (TSX:AC) May Never Recover

Description

There is no denying that one of the hardest-hit industries, if not *the* hardest hit are airline stocks. **Air Canada** (TSX:AC) is by far the biggest airline in the country. It's also one of the most popular stocks on the **TSX.** However, the company is facing many of the same problems as several other airlines around the world.

This has many investors wondering if the massive 65% discount in its share price is a good deal.

The stock is definitely undervalued, creating a significant opportunity for capital appreciation. However, with so much uncertainty, the stock is extremely high-risk too. And if you think of a worst-case scenario, it's possible Air Canada may never recover.

Air Canada's industry headwinds

The airline business is notorious for being a highly competitive industry. For years airlines have worked to improve cost efficiency and grow sales to improve margins and increase profitability.

Companies use massive amounts of data to drive decision making such as budgets, which routes they are flying, schedules, ticket prices, and more.

Everything was planned around maximizing capacity and improving profitability. So naturally, in any economic downturn, airline stocks can be expected to face significant headwinds.

However, a global pandemic without modern precedent takes the significant issues to a whole new level.

Revenues have been almost completely cut, and volume is down to what would have been an unthinkable degree just 12 months ago.

And with international travel, specifically flying, seemingly being one of the most unsafe things you can do during this pandemic, airlines could suffer major losses.

Air Canada’s stock

The one thing Air Canada has going for it is significant liquidity. For now, the stock can manage the massive declines in revenues it faces each day.

However, one of the biggest factors that will influence Air Canada’s outcome will be the duration of the pandemic.

As I alluded to above, airlines have always been highly competitive, which means that profit margins are naturally narrow. And with Air Canada having high fixed costs, the company needs a lot of revenue to break even.

So as long as travel is being disrupted, Air Canada will continue to suffer.

This is what makes Air Canada’s current liquidity so crucial today. So although duration will be the most critical factor, Air Canada should be able to weather the storm longer than most.

Of the five analysts who have issued a target price for Air Canada since its first-quarter earnings, the average price is just $24.

This assumes roughly a 30% upside in the shares over the next year. However, most analysts expect volumes to start to pick back up later in the year, setting the stage for a recovery in 2021 and 2022.

You could argue that buying the stock is great value for two or three years down the road. However, there is no guarantee that travellers have the confidence to come back. And second, it assumes that when travel does start to return and pick up, Air Canada will still be around.

Bottom line

Long-term investors may see this as a value play, and I can see the appeal. However, in my view, that’s more of a speculative bet on the length of this pandemic rather than an investment based on the quality of Air Canada.

Until there is more certainty, I would avoid Air Canada entirely. The major risk is that if this pandemic lasts longer than expected, or takes a turn for the worse, major airlines could become the next casualties.

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