Why Buffett Holds Suncor Energy (TSX:SU) and Not Air Canada (TSX:AC)

Description

When the COVID-19 outbreak took the form of a pandemic, it spelled doom for the airline industry. International travel was the major cause of the virus spreading worldwide. The billionaire investor Warren Buffett wasted no time and sold $6 billion worth of airline stocks of **Air Canada's** (TSX:AC) peers.

It was not just the airlines but also the oil industry that was bruised by the pandemic. Yet Buffett retained its holdings in **Suncor Energy** (TSX:SU)(NYSE:SU). He purchased additional five million shares of the oil giant.

Both Suncor and AC stocks have lost 60%-68% of their value as they fight the pandemic. Neither of them can do anything about the demand. Hence, they are cutting costs, restructuring, reducing capital expenditures, and increasing liquidity to withstand the demand crisis. Then why is it that Buffett is invested in Suncor and not AC?

Why is Buffett invested in Suncor?

The one thing Buffett likes about Suncor is its long-lived assets — oilfields, which have an average life of 26 years. Suncor has an upper hand with stable cash flows and high dividends. It has been paying dividends since 1992 and steadily increasing them since 2008.

Although many analysts say that oil companies' heydays are over and renewable energy will replace oil, that won't happen for the next two decades. Till that time, it will continue to pay dividends.

Suncor has cut dividends by 55%, but investors have penalized the stock for it. The stock is down 30% from the date dividend cuts were announced, thereby increasing its dividend yield above 5%.

The oil demand will return when people start traveling again and factories start production in full swing. In the best-case scenario, Suncor would continue to pay the current dividend per share, and its stock would return to the pre-pandemic level in five years. It will give you $62,725 ($12,725 individends and $50,000 in capital appreciation) income on a $50,000 investment.

In the worst-case scenario, Suncor would acquire smaller oil companies or get acquired by a bigger fish. In both cases, investors would stand to win.

Why is Buffett not investing in Air Canada?

AC's asset is its aircraft fleet, which has become a liability amid the multi-year weakness in travel demand. The airline is reducing its liability by retiring one-third of its fleet. The airline already operated at wafer-thin margins of less than 10% before the pandemic, which left it with little bandwidth to avert a short-term crisis without falling into the red. The pandemic is a long-term crisis with airline bosses not expecting business travel to return to the pre-pandemic level before 10 years.

Buffett also said that the world has changed for airlines. AC has already wiped away its three-year profits and is likely to post another two to five years of losses. The airline also faces the risk of bankruptcy or a government bailout. Both of these events are not good for investors.

Even if Buffett invests $50,000 in AC, there would be no dividends and a risk of this money becoming $0. If AC averts bankruptcy, it would be another 10 years before his investment even shows a profit.

Investor takeaway

Following in Buffett's footsteps, Suncor is a better bet than AC in the pandemic. A safer investment than Suncor is the pipeline operator **Enbridge** (TSX:ENB)(NYSE:ENB). It doesn't have exposure to oil prices, which makes it more stable. It has exposure to natural gas and renewable energy. Its assets are pipelines, which again have a longer life and a higher return on investment.

Enbridge's "toll-like" business model ensures regular cash inflow. The more pipelines it builds, the more cash it earns and increases its dividends every year. This high capacity doesn't lead to cash burning in the event of weak demand.

In a normal scenario, Enbridge would continue to pay the current dividend without increasing it, and its stock would return to the pre-pandemic level in five years. It will give you over $46,000 ($21,325 in dividends and $25,000 in capital appreciation) income on $50,000 investment.

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