Air Canada (TSX:AC) Investors: The Most Important Thing to Know

Description

Air Canada (TSX:AC) investors are brave. They're willing to bet on a future that few people can imagine: a world where people fly on planes.

Since March, global passenger traffic has been in a funk. Well, worse than a funk. By most estimates, demand is 95% *lower* than the year before.

But Air Canada investors already know that. They understand this is why the stock is down 70% versus its pre-pandemic highs. What they're betting on is a reversal. Those that buy now can lock-in a deal of a lifetime.

But that's not the end of the story. If you're betting on an airline stock like this, there's one thing you must know.

Here's the deal

Airlines were a tough bet for decades. Warren Buffett famously wrote off the entire industry.

"Investors have poured money into a bottomless pit, attracted by growth when they should have been repelled by it," Buffett wrote in 1992.

Other icons felt the same way.

"If you want to be a millionaire, start with a billion dollars and launch a new airline," Richard Branson once told reporters.

Just look at Air Canada's historical performance. From 2006 to 2009, shares lost 95% of their value. That's an incredible destruction of shareholder value.

But then something changed.

From 2010 to 2019, Air Canada stock rose nearly 4,000%! The secret was that competition finally turned rational. After decades of over-supply, the industry finally figured out how to balance plane orders and customer growth.

This balance allowed airlines to generate sustainable profits for the first time — then the COVID-19 crisis halted that progress completely.

“The past quarter was the first in 27 consecutive quarters that we did not report year-over-year operating revenue growth,” noted Air Canada’s CEO when the pandemic began. “We are now living through the darkest period ever in the history of commercial aviation.”

Everyone knows that times are tough for airlines. But when demand returns to normal, will airline stocks soar?

Trust Air Canada stock?

Right now, Air Canada has around $9 billion in liquidity left. It’s burning roughly $1.5 billion per quarter, so if conditions fail to improve, it only has six quarters of runway left.

If conditions *don’t* improve, bankruptcy is on the table. But if you’re invested in the stock, you likely expect a return-to-normal within the next year or so.

How much upside will Air Canada stock have if we attain a vaccine and mass immunity sometime in 2021? The answer may surprise you.

Nearly every airline believes demand won’t return to baseline for another three years, and one major CEO believes demand will be *permanently* smaller.

Meanwhile, hundreds of planes continue to be built and put into service (you likely sense the problem here).

The industry struggled for decades because over-supply prevented long-term profits. Right now, we’re headed towards a future with far too many planes. Passenger traffic would need to be *above* pre-pandemic highs to ensure reliable profits. That’s an extraordinary bet to make.

While Air traffic will surge once the coronavirus passes, that doesn’t mean Air Canada stock will benefit. It may not even survive.

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