Air Canada (TSX:AC) Stock: Are Shares Going to $0?

Description

Air Canada (TSX:AC) stock could triple in price. Or shares could go all the way to $0. The future depends on who you ask.

There's a good reason why opinions are so split.

From 2012 to 2019, the stock rose 50 times in value! But when the pandemic began, shares quickly fell by 70%. Bullish investors believe the rapid rise will continue once the pandemic eases.

Others are more skeptical. They believe the COVID-19 crisis will rewrite the game for Air Canada. When you crunch the numbers, it's not clear that the company can survive past 2021.

What will the future actually hold? Let's find out.

Air Canada could win

In 2007, Warren Buffett hated airline stocks.

"The airline industry's demand for capital ever since that first flight has been insatiable," he wrote. "Investors have poured money into a bottomless pit, attracted by growth when they should have been repelled by it."

By 2014, he owned millions of shares across four different airlines. What changed? The answer could point to why Air Canada is a great investment at today's levels.

The problem with airlines has always been growth. When industry revenues rise, carriers rush to buy more planes. That adds more capacity, boosting competition, and pressuring prices. Every time demand rises, sales increase, but profits remain ephemeral.

In 2014, Buffett saw that the world was changing. Air Canada stock was beginning to surge, and the reason why was simple.

“They’re like the Chicago Cubs. And they got that bad century out of the way,” Buffett highlighted. “The hope is they will keep orders in reasonable relationship to potential demand.”

There’s only one problem: there are currently *way* too many planes for today’s COVID-19 environment. We have enough planes for a 2019 world, but the 2020 world has 95% fewer aircraft passengers.

This could ultimately benefit Air Canada. Many global carriers have already gone bankrupt. As Canada’s largest airline, Air Canada has more financial runway than any of its competitors. If it can survive, it could see a future with dramatically lower competition.

The trick is that it needs to stay afloat until the competition exits the market.

The math is scary

Air Canada could ultimately benefit from the crisis due to industry consolidation, but the clock is ticking.

By my estimates, the company only has around $8 billion in liquidity left. It’s burning about $1.2 billion every quarter. Some quick math suggests 2021 will be a critical year for the business.

If it looks like demand won’t reach 2019 levels until 2022 or beyond, don’t be surprised to see the market pull funding from Air Canada. After all, losses can only be plugged by new financing for so long.

Even if the company survives, and the stock doesn’t go to zero, there’s no guarantee that early investors will profit.

“The sad reality is that unless airlines raise new capital, they will go bankrupt,” cautions Vitaliy Katsenelson. “This capital, though it might save them, will reduce the value of their businesses. Equity issuances would permanently dilute shareholders, as future earnings will be shared with a much-increased shareholder base.”

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Date
2025/08/26
Date Created
2020/11/16
Author
rvanzo