



Will Air Canada (TSX:AC) Stock Survive 2020?

Description

Air Canada ([TSX:AC](#)) stock surged last week, as positive coronavirus vaccine data made the rounds. The bullish case was simple: an effective vaccine could restore global air traffic demand.

That may ultimately prove true, but it doesn't mean airline stocks are a buy. There are two main reasons why you shouldn't make a bet on this flailing industry.

There are way too many planes

Previous to the COVID-19 pandemic, airline demand was on a straight line upward. For decades, more and more people took their first plane ride. In 2019, there were nearly five billion passengers aboard commercial airplanes.

Rising demand didn't always result in higher profits. Whenever demand rose, carriers rushed to add more capacity. This increased industry supply, pressuring prices. Competition was so fierce that few companies turned a profit. From 2006 to 2012, Air Canada stock lost 95% of its value.

For decades, Warren Buffett famously refused to invest in airlines for this exact reason.

"The airline industry's demand for capital ever since that first flight has been insatiable," Buffett [explained](#) many years ago. "Investors have poured money into a bottomless pit, attracted by growth when they should have been repelled by it."

That final point is key. Revenue growth looked appealing, but discerning investors understood that profits wouldn't necessarily follow.

Right now, the industry's supply-demand balance is at record highs. We have enough planes for a 2019 world even though passenger demand is 90% lower. Even worse, Air Canada executives don't think demand will recover for another couple years.

All of this will result in horrible operating environments — perhaps the worst we've ever seen. A

vaccine may boost demand, but it won't erase the huge overhang of planes sitting on the sidelines. As soon as any profits appear, these dormant planes will jump into action, adding a constant stream of competition.

The future may be dim, but trouble is already at the gates.

Air Canada is burning cash

Here's a great example of what will happen to airlines over the next year.

This quarter, Air Canada [burned](#) more than \$1 billion in cash. In the previous two quarters, it also posted billion-dollar losses. This ship is sinking fast. That's what happens when you own enough planes to carry 20 times the number of passengers you're currently flying.

If passenger traffic quadrupled from today's levels, Air Canada would still be operating at less than 40% of its potential capacity. That's still loss-making territory.

Even if passenger traffic magically returned to 2019 levels by the end of the year — a future that no one is predicting — pricing would still be weak, as carriers have taken delivery of hundreds of additional planes in 2020.

There's just no way out for airlines right now. All of them are burning huge amounts of cash. They're ticking time bombs. Even as conditions improve, profits won't appear for several years.

There are only two outcomes here for Air Canada. Either it raises billions of dollars in additional financing, massively diluting its current shareholders, or it goes bankrupt. I don't want to be on the ride down.

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