ALERT: Air Canada (TSX:AC) Stock Has 31% Immediate Downside

Description

Air Canada (TSX:AC) stock has 31% downside. It's not hard to do the math.

At the start of November, shares were priced at $15. Then a sudden surge occurred, buoyed by several positive vaccine developments.

If Air Canada stock returned to its pre-November price point, there would be 31% downside. Let's look at why another plunge is a strong possibility.

This story is far from over

In March, everything changed for airlines.

"We're now living through the darkest period ever in the history of commercial aviation, significantly worse than the aftermath of 9/11, SARS, or the 2008 global financial crisis," Air Canada's CEO said when COVID-19 first hit. "There is little doubt that we are not yet out of the trough."

Air traffic quickly fell by 95%. This halted the first golden age of airline stocks, in which many carriers saw their share prices balloon in value.

"For Air Canada, the pandemic and government-imposed lockdowns and travel restrictions the world over have ended a run of 27 consecutive quarters of year-over-year revenue growth," the CEO concluded.

We received some great vaccine news recently, and it seems like there's light at the end of the tunnel. But for airlines, and maybe the world as a whole, we're still far from the finish line.

Is Air Canada really in trouble?

When Warren Buffett invested in airline stocks in 2017, he stressed that supply and demand were at the heart of his purchases.

“The hope is they will keep orders in reasonable relationship to potential demand,” he explained.

For years, airlines rushed to buy new planes as demand rose. That increased sales, but capital intensity made long-term profits difficult to come by. In 2017, as Air Canada stock was taking off, Warren Buffett saw a bright future ahead.

No one could have predicted the COVID-19 crisis, at least with any specificity. For airlines, it was a crushing short-term blow. But in regards to Buffett’s supply-demand thesis, airlines could be in trouble for years to come.

“You’ve got too many planes,” Buffett explained in May, shortly after selling his entire airline portfolio.

Just look at Air Canada, which is losing millions of dollars per day. The carrier has enough planes for a 2019 world, but demand is 90% lower. One airline CEO thinks demand will remain lower *permanently*.

Bottom line

Buffett hits the nail on the head when he says there are simply too many planes. We know what happens to airline profits when there’s too much supply. We have nearly a century of data.

Just pull up some price charts of airlines during the 1990s and early 2000s. Air Canada shares, for example, lost 90% of their value in fewer than five years. Too much supply created too much competition, eviscerating any hopes of profit.

The problem is that these planes won’t go away anytime soon. They’re considered long-lived assets. Next year, they’ll still exist. Many will still operate a decade from now. What happens to demand, meanwhile, is anybody’s guess.

There are plenty of stocks worth buying right now. Don’t expect Buffett to touch Air Canada.

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