



## Warren Buffett's Vision for Air Canada (TSX:AC)

### Description

**Air Canada** ([TSX:AC](#)) stock is like a wild card. It can go both ways, and no one can tell when. If it goes down, your loss is limited to your investment. And if it goes up, the \$22 stock could more than double to \$50. Its rally will not be backed by strong fundamentals but investor sentiment. The problem with such a rally is it is not sustainable. In such a clouded future, what do Warren Buffett's experienced eyes see for AC?

The year 2021 will be another volatile year for AC. This is the year that will determine whether AC will get through the pandemic or face bankruptcy. Bankruptcy seems unlikely at present, given AC's \$8 billion liquidity and its effort to raise more money. But I won't rule out the possibility of bankruptcy. Let's see what Buffett has to say about the future of the airline.

### What does Buffett think about airlines?

Buffett has always criticized airlines after burning his hands in **U.S. Air** preferred stock in 1989. He barely escaped and made a profit on the investment. Since then, he called investing in airlines is like funding their losses. He says these businesses require "significant capital to engender the growth." Even in its glory year in [2019](#), it increased its net profit by \$1.4 billion on \$3.7 billion capital expenditure.

Back in 2017, airlines were earning good cash flows, and air travel was rising significantly. And it was because of this reason, Buffett went against his ideologies and invested in airlines. He was cautious with his investment and said, "The hope is they will keep orders in reasonable relationship to potential demand." He implied that as long as airlines buy planes in line with the demand, things will be good for the sector.

But in March 2020, the pandemic struck — and Buffett's hopes shattered. He knew the world has changed for airlines. He said, "It turned out I was wrong about that business because of something that was not in any way the fault of four excellent CEOs. Believe me. No joy of being a CEO of an airline." No matter how efficiently the management runs their airlines, there is nothing they can do to stop the losses.

Pandemic-driven travel restrictions created a huge gap in demand and supply. Buffett said, "You've got too many planes." This oversupply pushed AC into a \$4 billion net loss and over \$5 billion in net debt in 2020.

## Buffett's vision for Air Canada

Looking at the future of air travel, Buffett said, "I don't know that three, four years from now people will fly as many passenger miles as they did last year." Buffett doesn't expect air travel to return to the pre-pandemic level in three to four years. It has been almost a year, and air travel has not picked up primarily because of travel restrictions and flight cancellations.

But there is one theory. Once the vaccine rollout succeeds and the travel restrictions ease, there will be pent up demand. There are hopes that the government will lift travel restrictions completely by September once the vaccine has done its job. If there is a sudden surge in air travel demand, it will be mainly from leisure travelers who are sensitive to prices.

For AC, the demand surge will likely be from customers to whom it gave travel vouchers as refunds for canceled flights. Even if the revenue doubles or triples, it will take AC at least five years to break even. The airline spent 91% of its revenue on operating expenses in its glory years. Even if I take into consideration AC's [downsizing and cost-cutting](#), its operating expenses will reduce. But its non-operating expenses will increase as the debt that is piling up on its balance sheet will increase its interest expense.

## Air Canada 2021: Bankruptcy or bailout?

AC has been asking the government for a bailout in the form of low-interest, long-term loans. A bailout can help AC reduce its interest burden and return to profits faster. The year 2021 will determine whether AC will get a bailout or whether its liquidity will dry up, propelling toward bankruptcy.

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