Ditch Air Canada (TSX:AC) for the Airline Stock of the Future

Description

Air Canada (TSX:AC) stock is a popular investment right now. Shares are up more than 60% since their 2020 lows. Just don't pile into this stock yet.

When most people think of Canadian airlines, they think of Air Canada. But there's one carrier that represents the *future* of flying, and I bet you've never been on one of its planes.

Don't get stuck in the past

For most of recent history, demand for air travel grew on an annual basis. That meant more and more planes getting put into service. If you think airlines benefited, think again. From 2006 to 2012, Air Canada stock lost more than 95% of its value.

Why the mismatch?

Counterintuitively, the problem for airlines stocks was revenue growth. No one explains this better than Warren Buffett. In 2007, he stressed that airline investors were "attracted by growth when they should have been repelled by it."

"Airlines have huge upfront costs to buy airplanes and build networks, then they compete fiercely on price, which pushes profit margins down to a level that can't support those capital investments, especially through economic downturns when demand for air travel dips," explained one *Intelligencer* piece on Buffett's feelings about airlines.

We saw this play out in real time with Air Canada. Sales kept growing, but profits proved ephemeral.

"Investors kept putting money into airlines through the decades anyway, perhaps partly due to the romance of air travel, driven by the belief that next time would be different. Buffett's 2007 warning was about not getting caught up in this belief," the piece concluded.

If you want to bet on airline stocks, you need to get creative.

This stock crushes Air Canada

Something amazing happened in 2020. Air Canada stock fell by 50%, but shares of **Cargojet** (TSX:CJT) surged to new highs. What's so special about Cargojet?

Instead of flying passengers, this company flies packages. It's the largest airline in Canada focusing on rapid shipments. People stopped traveling in 2020 due to the coronavirus, but they didn't stop spending. And because they couldn't go to shopping centres, consumers took their spending dollars online. Those purchases require shipping, directly benefiting Cargojet.

Last year, I was so confident in this stock that I suggested Air Canada shareholders flip their bets over to Cargojet.

"Passenger airline traffic will be impaired for years. And that's a best case scenario. If you're holding airline stocks like Air Canada, don't anticipate a quick turnaround," I explained. "Cargojet, meanwhile, is seeing a surge of demand. Digital retail penetration in Canada still lags the U.S., so the company has multiple tailwinds of growth behind it."

Bottom line

The vaccine rollout has pushed many investors to reconsider airline stocks. Air Canada shares are already off their pandemic lows. But remember that airlines have always struggled with overcapacity issues. And right now, we have enough planes for a 2019 world, but only enough demand to fill 25% of those seats.

Cargojet, meanwhile, is surfing a multi-year growth tailwind that will only *accelerate* if the COVID-19 situation persists into 2022. This stock is on the right side of our current reality.

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