



Air Canada (TSX:AC) Stock: Is Warren Buffett Right?

Description

Warren Buffett's company sold all of its airline holdings last year. **Air Canada** ([TSX:AC](#)) stock wasn't part of the portfolio, but investors wonder if Warren Buffett made a mistake regarding the airline industry.

Outlook for air travel in the next year

Airlines had been on a role leading up to the pandemic. The industry benefitted from growing demand by both business and holiday travellers. A crash in [oil prices](#) in 2014 led to cheaper fuel costs. WTI oil fell from US\$100 per barrel in 2014 and never fully recovered.

Airlines also figured out that they could boost margins by charging customers for a wide array of add-ons. Additional fees on extra bags, seat preferences, and ticket flexibility all help the bottom line.

Investors with a bullish view on the airline industry see a return to the pre-pandemic glory days on the horizon. That might be the case with COVID-19 vaccinations rolling out at a faster pace. The U.S. recently said all adult Americans could have access to the vaccine by the end of May. As the rest of the developed economies catch up, restrictions on air travel should start to ease in the coming months.

Global herd immunity could happen some time in 2022, according to [Melinda Gates](#), the co-chair of the Bill and Melinda Gates Foundation.

That's great news for Air Canada and the airline industry.

Risks for Air Canada stock

In his 2020 shareholder meeting, Warren Buffett said, "The world has changed for the airlines."

A year later, that statement rings true. New restrictions put in place by the Canadian government in early 2021 forced the cancellation of more Air Canada flights. This current situation is the worst it has

been for the airline during the entire pandemic.

Air Canada continues to discuss financial aid options with the Canadian government. Talks began last November, and the result could have a meaningful impact on Air Canada investors. The government has said the deal must include refunds for cancelled flights. The restart of flights to regional centres is also expected to be part of the terms.

Air Canada is burning through more than \$1 billion in net cash per quarter. The bailout requirements could put added pressure on the balance sheet and expand cash burn until demand increases for flights to smaller cities. Flying empty planes isn't good for business.

Rising oil prices threaten the recovery as well. WTI oil trades near US\$65 per barrel. Analysts predict a run to US\$75 this year and talk of a potential surge to [US\\$100 in 2022](#) or 2023 is becoming more common.

Fuel costs typically represent 15-20% of expenses. If jet fuel prices rise significantly, Air Canada will have to increase ticket prices to offset the hit. Travellers might simply decide to stay home.

Business travel is another wild card. The pandemic forced executives and salespeople to conduct business via online meetings over the past year. The success of the virtual meeting caught many people by surprise. This trend is likely to continue. Business class seats are very profitable for Air Canada and its peers. If business travel never recovers, airlines could struggle to return to previous levels of profitability.

Should you follow Warren Buffett's lead on airline stocks?

Air Canada will survive, and people will start to travel again once the pandemic ends. However, there is significant uncertainty regarding the path to profitability.

Given the strong rally in Air Canada's stock price over the past few months, investors might want to book some profits and search for other opportunities in the market.

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