



Not Flying High for Long at Air Canada

Description

Looking at the history of the airline industry and its current state, it seems investors have been able to make money only on an exception basis. Long-term investors have lost much more than they have gained. Traditionally a terrible business for capital, some believe it has changed. At the current price of just under \$15, **Air Canada** ([TSX:AC](#))(TSX:AC.B) is anything but a buy.

It was reported some time ago that an investment was made by Warren Buffett's company **Berkshire Hathaway** into a number of U.S. airlines. It would seem the only rationalization is that in an industry with such bad economics, there is a scarcity of capital and potentially some opportunity to make a profit.

Like many investments, however, what looks tantalizing today may actually be more like the black widow spider offering a good time. It seems like a good idea, but at the end of the day, there will be nothing left, and the buyer will regret it an awful lot.

In the case of Air Canada, it is one of two dominant competitors in the Canadian airline industry. The company has a very strong footing in the country and has benefited handsomely over the past several years. The low price of oil has been an incredible blessing for the company.

The obvious benefit from the low price of oil is the low price of fuel, which is obviously one of the company's most important costs. Without having to grow revenues to increase the bottom line, it's been difficult to miss with this investment in the recent past.

The second important factor of lower oil prices is the dislocation of workers in the oil field. Adding a number of one-time flyers, who may not be so price sensitive, has yielded much higher margins for those tickets sold. Frequent business travelers will book further in advance and receive better prices.

Now, close to two years into lower oil prices, what was a net benefit to the company's bottom line has become the standard.

There are a number of potential problems on the horizon.

The potential problems

The airline industry has time and time again been the case study for Michael Porter's five forces. There are just too many potentials for another hand to get stuck in the cookie jar asking for a better deal.

To begin, the customers are always wanting lower prices, which in turn drives down ticket prices and puts pressure on the airlines to compete with one another. Then numerous unions are in a position to ask for better contracts since the company is making more money.

Conclusion

Although investors have done well in the past few years with this stock and Warren Buffett gave a vote of confidence to the airline industry with his recent investment, Buffett has made numerous mistakes in his career. This may be another one. History doesn't necessarily repeat itself, but it rhymes.

CATEGORY

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