



Why Air Canada Is Flying Higher Than Ever Before

Description

Airlines are currently enjoying one of the best periods of growth in well over a decade.

Air Canada ([TSX:AC](#))(TSX:AC.B) had a terrific end to 2016, finishing the year with the stock appreciating by an incredible 33%. In terms of airline peers, most other airlines had a great year too, but none finished off the year as well as Air Canada did.

So, why did Air Canada fare so well, and can we expect the same this year from Canada's largest carrier?

It's the industry — not just Air Canada

Airline stocks are notorious for going through cycles of growth and contraction. The two extremes have defined the industry for years, and, most of the time, an airline breaking even is considered a victory.

Think about the business of running an airline for a moment. You have an \$80-100 million cost for each plane in the fleet which requires highly specialized crews and equipment to maintain, and they need to be in both the port of origin as well as the port of arrival. Then you have fuel costs, airport landing fees, airport improvement fees, and countless other considerations. I'm not even mentioning the fact that most of those workers — from the pilot to the gate agent — are also unionized.

Additionally, keep in mind that airlines are very receptive to the overall health of the economy. When a downturn occurs, the spillover into the airline industry can be quick and brutal. An example of this was the slowdown in Alberta attributed to the weak energy market, which caused both **Air Canada** and **WestJet Airlines Ltd.** (TSX:WJA) to cancel, reroute, and modify routes.

This delicate pendulum-style, little-growth business model was best described over a decade ago by none other than the Oracle of Omaha himself — Warren Buffet — who stated, "The worst sort of business is one that grows rapidly, requires significant capital to engender the growth, and then earns little or no money. Think airlines."

Ouch.

If airlines are not perceived as good investments, then why did Air Canada and other airline stocks finish 2016 on such highs? And why did **Berkshire Hathaway** also make a significant investment in several large airlines?

There are two reasons for this.

First, we are in one of those rapid-growth periods, and the pendulum hasn't fully decided to turn around just yet. This makes the current climate a great one for investors and airlines alike.

The second reason (and why I believe is why the airline business will finally become more stable) is, for the first time, airlines are undergoing modest, steady growth during this cycle, as opposed to the big splash made in previous cycles. This allows for airlines to continue to grow while keeping costs in line to prepare for the inevitable downturn.

Where does Air Canada go from here?

Air Canada's actions in 2016 strengthened the company on a variety fronts. Among the accomplishments made in the past year, Air Canada launched 15 new international routes and effectively joined an elite club of airlines that fly to six continents.

The airline also created 1,500 new jobs and took delivery of nine new Dreamliner 787 jets with a further nine Dreamliners to be delivered in 2017. Air Canada also reconfigured the fleet of **Boeing 777** aircraft with a new cabin configuration and inflight entertainment systems.

In my opinion, the actions that Air Canada undertook during 2016 have strengthened the airline moving into 2017, and while the airline industry may eventually cycle into a phase of contraction, Air Canada remains a great investment option.

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