



## Read This Before Investing in Any Canadian Airline Stock

### Description

There's one major thing that separates Canada's airlines from those in the United States, Europe, or Asia.

There isn't really much domestic competition.

Sure, there are small regional airlines — like Porter Air, Canadian North, and others — but they command a tiny percentage of the market. They serve routes that are just too small for the two main players to get into. In fact, the two giants have a domestic market share of more than 80%.

This creates a duopoly situation, which both companies have exploited to their advantage. As anyone who regularly flies cross country can attest, domestic routes inside Canada are some of the most expensive in the world.

Both **WestJet Airlines Ltd.** (TSX:WJA) and **Air Canada** ([TSX:AC](#))(TSX:AC.B) have no incentive to drop fares either. Why would they? Running an airline is a tough business, one with almost no pricing power. Canada's two main incumbents have finally found themselves in a position where they can dictate terms to the market — not the other way around.

But that looks to be changing, and Canadian investors should pay attention.

### Enter new competition

In 2016, NewLeaf Airlines began operations, touting some incredibly low rates.

NewLeaf's business model is simple. It's an ultra-low-cost carrier which charges low prices for tickets and then attempts to make up for it by selling extras. A NewLeaf customer has to pay for everything from choosing their seat to even having a carry-on bag. It also has kept prices down by sticking to smaller airports that charge less.

It hasn't been a smooth ride for Canada's newest airline, however. It suspended its planned opening in early 2016 because of a licensing issue with the Canadian Transportation Agency. And just a few

weeks ago, it was forced to retreat from its new Calgary/Edmonton to Phoenix routes after WestJet initiated a price war.

NewLeaf isn't the only competition coming into the market. Both Enerjet and Canada Jetlines Ltd. are both planning to launch their own ultra-low-cost carriers sometime in 2017. Thanks to new rules passed by the Federal Government, both of these new carriers will be able to sell up to 49% of their shares to foreign investors versus the 25% maximum that was in place before.

Enerjet has already announced it intends to partner with Phoenix-based Indigo Partners, which is one of the world's largest and most influential airline investors. Remember, Indigo was a big initial investor in **Spirit Airlines**, which introduced the ultra-low-cost model to the United States a decade ago.

The implications for both Air Canada and WestJet are dire. Deep-pocketed competition with experience taking on established incumbents is coming. It's only a matter of time.

### **If that weren't enough...**

Increased competition doesn't just appear to be coming in the domestic market. It also looks like it's coming internationally as well.

Rumours are circulating that **Southwest Airlines Co** ([NYSE:LUV](#)) could be planning an expansion into Canada. It has already expanded to Mexico and several Caribbean nations, and many airline analysts think Canada is next. The company is in the process of changing its antiquated booking software to something much more modern and flexible — a switch that will make it easier to expand.

Further competition could be coming from both Asian and European airlines as well. Carriers such as WOW Airlines and Norwegian Air Shuttle are expected to add further flights to Canada in the next year or two, as are certain Asian airlines. Investors should be less worried about this, however, because of overall capacity growth on overseas routes.

### **The bottom line**

Increased competition is coming to Canada's skies. It's only a matter of time.

It's good to be the incumbent airline in such a scenario. Millions of Canadians collect both Air Canada's and WestJet's frequent flyer points, and both have loyal customers that will think twice about switching.

But at the end of the day, price matters in the airline sector. The two giants should be able to handle the pressure, but price wars are only good for consumers. They're bad news for investors.

### **CATEGORY**

1. Dividend Stocks
2. Investing

### **TICKERS GLOBAL**

1. NYSE:LUV (Southwest Airlines Co.)
2. TSX:AC (Air Canada)

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### **Author**

nelsonpsmith

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