



Why Air Canada Just Became the #1 Canadian Airline for Bullish Investors

Description

Air Canada ([TSX:AC](#))(TSX:AC.B) has a lot going for it right now. Besides a rock-bottom valuation, strong earnings and free cash flow generation, and significant upward momentum “propelling” this stock forward (excuse the pun), the airline now has its largest competitor joining the unionized labour pool, eroding one of the few advantages **WestJet Airlines Ltd.** (TSX:WJA) had over Air Canada for a long time.

Why unionization matters in the airline industry

WestJet has operated without a union since its inception, and on Friday, more than 62% of 1,400 pilots have voted in favour of joining the Air Line Pilots Association, International (ALPA).

Other large airlines, particularly in the United States, have typically seen profits erode in times of Collective Bargaining Agreement (CBA) negotiations between unions and management with each party pushing to advance its interests.

This profitability erosion has been evidenced by increased costs per available seat mile for unionized carriers vs. non-unionized carriers — a key metric which largely determines the future prospects of airlines and helps to gauge the overall operational efficiency of airlines, as compared to its peers.

While the ALPA's webpage lists scheduling as the most important item the union will work on for pilots, it is clear that the negotiating power of pilots just became enhanced with this most recent vote. Planes cannot fly without certified pilots, and a stoppage for any period of time for a mammoth enterprise such as an airline can prove potentially fatal, leading pilots unions to essentially “name their price” in many negotiations and walk away the biggest winners.

What this means for Air Canada moving forward

On a level playing field, I believe the valuation multiples of both Air Canada and WestJet will begin to converge. Currently, Air Canada's price-to-earnings (P/E) ratio is hovering around six, while WestJet's P/E ratio is hovering around 10. Should these two numbers converge, investors in Air Canada will have something to cheer about, while WestJet shareholders will likely wish they had trimmed their positions.

The future is uncertain, but what is certain is that these two companies are no longer representative of the dichotomy they would like you to believe exists in the Canadian aerospace industry.

Canada's airlines have now officially become largely unionized — something that will be important for business school case studies for years to come, and something that's even more prevalent for today's investors looking to trade airlines in a rather uncertain economic environment.

Stay Foolish, my friends.

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