



## The Biggest Loser in More Ways Than 1

### Description

“When something looks too good to be true, it usually is.”

At a current price of almost \$27 per share, **Air Canada** ([TSX:AC](#))(TSX:AC.B) trades at 3.6 times earnings, which may seem like a “[no brainer](#)” to many investors, yet the stock price has not moved upwards in close to half a year. Clearly, the market is being very [cautious](#) with the valuation of this company, as there are a number of risks that could lead it substantially lower.

The most obvious factor is that the cost of oil could increase which would reduce the average amount of disposable income available to consumers in addition to cutting into the margins of the company. In spite of most long investors not taking this risk seriously, it must be noted that state-owned Aramco (in Saudi Arabia) is planning the biggest IPO in history, which will be most lucrative if oil trades at a higher price instead of a lower price. It is in the best interests of Saudi Arabia to maintain a high oil price.

After the high price of oil, the desire of President Trump to re-draft NAFTA may drastically reduce the amount of travel undertaken by business people should the economy slow down. In spite of both Canadians and Americans still needing to purchase the goods and services to which they are accustomed, a new NAFTA could just have a material impact over the short run in addition to reducing the total amount of goods moved between the two countries.

After the isolated risks, Air Canada still needs to be considered through the eyes of Michael Porter’s five forces. As a reminder to readers, Porter uses the airline as the quintessential example of a bad business. The past decade has seen better behaviour from many airlines and a sector that has only gotten better. Once things start to tighten, the natural competitiveness to attract clients and fill planes is only going to seem normal.

Going back to the valuation, the high amount of profit needs to be addressed. Air Canada is trading at a low price-to-earnings multiple (P/E) because of a one-time item (recovery of income taxes), which has temporarily boosted the bottom line. After backing that item out, the more normalized P/E is still no more than 5.7. Clearly, the high [expectations](#) for 2019 (an increase in bottom-line profit by 33%) are much too high for investors. At current prices, the market is pricing in something substantially worse.

The last thing for investors to consider are the technical indicators, which are clearly displaying a price ceiling around the \$28 mark, which will be critical for long and short [investors](#) alike. Although this stock seems like a very difficult short sale, the truth is that investors have seen this story before. It typically ends the same way: with a long trip down!

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## Date

2025/09/17

## Date Created

2018/04/05

## Author

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