Should You Buy the Dip in Canadian Airline Stocks?

Description

Airline stocks, which posted impressive returns in 2017 in what was a fantastic year for the industry at large, have struggled to start 2018. Passenger traffic hit records in 2017, and there were no commercial airline fatalities throughout the year, marking the safest year on record for air travel. However, there are a number of challenges facing the industry this year.

Air Canada (TSX:AC)(TSX:AC.B) stock has dropped 4.3% in 2018 as of close on April 13. Shares have still climbed a stunning 88.5% year over year. The company posted record operating revenues of $16.25 billion in 2017, and passenger revenue rose 10.1% to $14.47 billion. This was driven by 11.3% year-over-year traffic growth. Air Canada's cost per available seat mile (CASM) rose 0.1% from 2016, and the company projects adjusted CASM to range between a drop of 0.5% to an increase of 1.5% in 2018.

WestJet Airlines Ltd. (TSX:WJA) has dropped 14.3% in 2018 so far and is now down 1.5% year over year. WestJet saw revenue grow 9.2% from 2016 to $4.50 billion in 2017. Segments guests increased 10% to 24.1 million, and CASM climbed 4.3% from the prior year. The company declared a cash dividend of $0.14 per share, representing a 2.4% dividend yield.

Competition over regional flights has intensified in recent years, and 2018 will prove crucial for both Air Canada and WestJet. Air Canada announced in late 2017 that it would expand routes for its regional Air Canada Rouge flights in an effort to compete with low-cost carriers. WestJet is set to launch its Swoop "ultra-low-cost" carrier in June and will offer 24 flights per week out of the airport in Hamilton, Ontario.

The Canadian dollar has struggled with the broader stock market to start 2018. Canadians are wrestling with record-high household and consumer debt. The low Canadian dollar may eat into their purchasing power and push potential customers away from the airline industry. A recent poll at **Reuters** saw 27 out of 29 economists predict that the Bank of Canada would stand pat on the benchmark rate in the upcoming April meeting.

The airline industry is generally more susceptible to economic downturns than other sectors of the economy, and the Canadian economy saw GDP shrink 0.1% in January. In 2009, five of the nine largest U.S. airlines posted losses that totaled almost $4 billion. Air Canada posted a loss of $400 million in the first quarter of 2009, and its stock price fell below $1 during the worst bouts of the financial crisis.

The Canadian dollar rose 1.4% week over week as of close on April 13. Positive progress in NAFTA should be positive for the dollar going forward, and oil prices rallied in the midst of rising tensions in the Middle East. However, this is a double-edged sword for airliners, as higher oil and gas prices will negatively impact operating costs. The oil crash of 2014 has been a boon for airliners, as fuel costs have plummeted.

Air Canada and WestJet have dealt with headwinds thus far, but an oversold TSX and upcoming first-quarter results may present a buying opportunity for investors. According to the International Transport Association, North American revenue passenger kilometres rose 6.5% year over year in February, but this was supported mainly by strong U.S. traffic.

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