Can Air Canada (TSX:AC) Continue its Stratospheric Rise?

Description

While the five-year chart on **Air Canada** (TSX:AC)(TSX:AC.B) stock looks very impressive, showing a return of more than 700%, the last year has been less impressive, with the stock remaining range-bound amidst plenty of volatility.

So where do investors go from here? What can we expect going forward?

In my view, the risk on Air Canada stock has become decidedly elevated.

While Air Canada has continued to surpass expectations as the company continues to successfully transform itself into a profitable business through the cycles, I am leery about the future.

The company's focus on return on invested capital, which has hit as high as 15%, has been key to its performance, but we can see that this trend is reversing in this new environment (most recent guidance has come down to 12% from previous guidance of 13% to 16%).

You see, we cannot escape the fact that rising oil prices present a real challenge for the airliner, as fuel is its most significant cost, at more than 30% of total expenses.

And with oil hovering in the $70 range, this is problematic for Air Canada, as we can see in the fact that jet fuel price increased 31% versus last year.

For now, pricing is offsetting increases in fuel prices, as the airliner has been able to raise fares without seeing a hit to traffic. In the second quarter, traffic increased 8.2%, a 13.6% rise from the same period last year.

For now, demand remains quite healthy, and the airliner is still generating ample cash flow.

The company's transformation has only just begun, with a focus on and investment in fleet modernization, international expansion, network diversification, and the rollout of Rouge.

Coming soon is product for premium product for the premium customer that includes lie-flat seats, dining, valet, etc, all of which will drive growth for the airliner.

But let's not forget that although the company has done a fantastic job of transforming itself, it is still a highly cyclical one that will not fare well if consumers tighten up their purse strings and rein in their spending as a result of higher interest rates and heavy consumer debt loads.

And this, coupled with rising fuel prices, will be a strong headwind for the stock.

For **WestJet Airlines Ltd**. (TSX:WJA), 2018 was a year characterized by increased spending, lower returns, and increased system capacity, as the airliner has stepped up its international growth strategy.

WestJet is more heavily indebted, with a net debt to EBITDAR ratio of 3.4 times compared to 2.2 times for Air Canada and trades at higher multiples; it's also in the earlier stages of its transformation strategy, so it's even more risky that Air Canada.

In conclusion, I will say that if I were inclined to invest in an airliner, I would choose Air Canada.

At this time, however, I see no reason to buy either of these stocks, as the macro environment will not be as favourable going forward as it has been in recent years.

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Date
2025/09/17
Date Created
2018/09/19
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