



Beware of Air Canada (TSX:AC): Buy This Thriving Airline Instead

Description

As the coronavirus crisis gradually became a reality in North America, [airline stocks](#), like **Air Canada** ([TSX:AC](#))(TSX:AC.B) crashed nearly 60%. Considering Air Canada's 90% gain in 2019, many investors are looking at this name as a good rebound opportunity. This may seem like an attractive investment plan, but investors looking at Air Canada should beware.

Beware of Air Canada

First, no one knows when worldwide travel restrictions will be fully lifted. It is one thing to be allowed to travel again, it is quite another thing for people to be brave enough to travel on a tightly packed plane. At the very least, it is going to take months (maybe years) for regular air traffic volumes to resume. Unfortunately, this puts Air Canada in a very uncertain environment to operate.

Second, as with most airlines, Air Canada has significant fixed costs related to its operations. Airplanes are expensive pieces of equipment. Most airlines are heavily leveraged to finance these pricey assets. Air Canada had over \$8 billion of long term debt and annual interest expenses of \$500 million (as of last year).

Despite significantly lower passenger volumes, the company still must pay for regional carrier contracts, aircraft maintenance, gate/ground package costs, and debt service.

Simply, Air Canada can't afford to have planes sitting on the tarmac for long. Air Canada is going to be under significant financial and operational stress until the world normalizes — and who knows when that might happen?

For now, I would just avoid Air Canada. Wait-and-see and hope for the best, but don't invest here yet.

Check out freight airlines

If you like the aviation industry, but don't want the same type of operational risks, then **Cargojet** ([TSX:CJT](#))

) is an interesting company. This is not an airline that carries passengers; it's an airline for freight and goods.

Cargojet is Canada's largest logistics and cargo airline. As opposed to Air Canada, Cargojet has remained very busy through the crisis. With Canadians taking social distancing measures seriously, just-in-time delivery demand has increased.

Cargojet represents 90% of Canada's domestic overnight cargo delivery market. It provides valuable delivery of time-sensitive supplies for consumers, businesses, and right now, notably, medical service providers.

Cargojet has a well-established business model. 75% of its domestic revenue is under long-term contracts. These contracts have guaranteed minimum volumes and include variable cost reimbursements/surcharges. This ensures a predictable stream of cash flow and clarity regarding fixed operating costs.

Since 2016, it has averaged revenues and adjusted EBITDA growth by, respectively, 12% and 17% every year. That type of growth and returns is pretty exceptional for a "boring" logistics business.

An e-commerce airline

Cargojet is particularly exciting because of its exposure to the rapidly expanding e-commerce industry. Last August, **Amazon** affirmed this by partnering with Cargojet and [agreeing to purchase a 9.9% stake](#) (plus options to purchase an additional 5%) in the business.

Next-day delivery will soon be the norm for e-commerce delivery. Cargojet's overnight shipping expertise positions it well to grow with this trend. Its routes already cover about 90% of Canada's populations, so it has established the requisite infrastructure to expand.

Presently, e-commerce makes up just 5% of retail sales in Canada. Yet, many analysts are predicting that this could rise to 20% in a few years. The current stay-at-home economy we live in could further accelerate this trend. Cargojet's strong domestic and growing international network should benefit long term from this trend.

The Foolish takeaway

Cargojet is not a cheap stock. It is trading with an EV/EBITDA of 14 times. Since the market crash, it quickly bounced back near to its February highs. Yet, Cargojet has operational clarity and even the potential to grow this year.

Its valuation is likely justified. I would rather invest in Cargojet, which has a clear "runway" to growth, rather than speculate on a turnaround with Air Canada.

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