3 Signs That the Airlines Industry Is Still Ultra-High-Risk

Description

Air Canada (TSX:AC) has recently been making headlines with COVID-19 testing booths at the Toronto Pearson airport and the new and improved Aeroplan loyalty program. The airline stock showed some positive movement by surging 15% towards the end of August. However, it has fallen 16.27% between September 17 and October 1, 2020.

Are you considering buying the Air Canada stock? You should know about a few signs that the airline industry is still ultra-high-risk as an investment for your capital.

A second wave of infections

The pandemic devastated most sectors across the economy — apart from the housing sector. The airline sector was one of the hardest-hit industries by COVID-19 as the lockdowns completely halted all airline operations. Air Canada took the brunt of the impact, with more than 90% of its planes being grounded.

The airline made efforts to shift its focus on transporting cargo to generate revenue. Despite offsetting some of the losses, Air Canada ended up losing $2.8 billion in the first half of 2020.

The resumption of domestic air travel has revamped its revenue in the third quarter. Still, AC faces a significant risk if there is a second wave of infections. The airline managed to secure $9.1 billion in liquidity to stay afloat for at least a year. However, another complete lockdown can spell horrible news for the airline by wiping out the cash faster than anticipated.

A high cash burn rate

AC has been burning more than $20 million in cash every day since its planes were grounded. The airline withdrew its revolving credit facility and raised new debt to cover its funding losses. While Air Canada did manage to secure cash in the second quarter, it can't achieve the same liquidity going forward so easily.

Fitch Ratings downgraded the airline's long-term debt from BB to BB-. The change in rating means that the airline cannot raise capital at a lower cost until the rating improves, despite the central bank's reduction of interest rate to 0.25%.

Rising oil prices

Suppose the air travel demand picks up for both domestic and international flights. Air Canada could still mark major losses for each flight since the airline cannot entirely fill its flights due to social distancing requirements. Fuel is the highest cost for airlines.

Decreased oil demand also reduced oil prices. Energy sector operators were struggling to store the commodity adequately, and the oil prices went quite low earlier in the year. If oil prices remain low, Air Canada can enjoy a respite in its operational costs. However, normalizing oil prices can increase its operating costs.

The risk is prevalent across the airline industry, and Air Canada would see the brunt of the losses due to being the largest airline operator in the country.

Foolish takeaway

Air Canada might seem like an attractive option for investors at its current share price of $15.95 per share. There is massive upside potential in the stock for investors when the pandemic subsides. However, there is still a lot of risk with investing your capital in a company that keeps burning cash faster than it can earn revenue.

I would advise being cautious while investing in the airline and consider focusing on safer investments.

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Date
2025/09/14
Date Created
2020/10/05
Author
adamothman