



Can Air Canada Stock Fly High Again?

Description

This stock is perhaps one of the greatest [rebound stories](#) on the TSX from previous financial crises.

Air Canada's ([TSX:AC](#)) shares have taken investors on a very bumpy ride in recent decades. The airline sector is one with inherently higher levels of market risk today. This factor will not go away overnight. This stock now seems like a high conviction trade today given current events. The coronavirus pandemic continues to challenge investor fortitude with respect to holding onto risk assets such as Air Canada shares.

Economic shocks are different but the same

Whether we consider the terrorist attacks in 2001, the global financial crisis of '08/'09, or the recent coronavirus pandemic, the past two decades have been turbulent (excuse the pun) to say the least for this sector. The underlying business models of airlines are inherently difficult for investors. These are companies with extremely high fixed costs, razor-thin margins, and pro-cyclical economic sensitivities. These factors make these equities naturally some of the best stocks to own in well-functioning macroeconomic environments. These stocks are also among the worst stocks to hold during financial crises.

When passengers stop flying either out of fear or other market-related reasons, airlines take a hit. When passengers are mandated to either avoid air travel altogether or fly with onerous government-mandated restrictions, airlines are impacted. Thus, it is easy to see why airlines perform poorly in times of crisis.

The business models of most airlines require planes to fly at or near capacity to earn a profit. Years of engineering prowess have resulted in the airline industry becoming what Warren Buffett previously noted as a “train-like” business — that is, one in which planes have become a rail-like business in the sky. The only difference is humans are transported as cargo rather than commodities. Cramming more cattle into a rail car is the name of the game for railroad operators. The same analogy is awkwardly (and unfortunately) applicable to airlines today.

Structural changes are not good or bad, except for airlines

Of course, as the pandemic rages on, investors in Air Canada must begin to consider the longer-term ramifications of this virus — for instance, how will passengers choose to fly in the future, and at what frequency. This pandemic has brought on new ways of connecting individuals separated by long distances. New technologies that may not have been as readily or quickly adopted without such a terrible catalyst are now mainstream. The need for consultants to fly coast to coast for a business meeting for one day may not be as great long term. Attendance at conferences in another city or country for a day require commuter flights, which may come under similar pressure.

These structural changes to how commuters choose to fly has turned out to be great for the environment. These changes have also saved companies and individuals a great deal of money. Work-from-home programs and other work-life balance initiatives have increased worker productivity according to some studies. This reality makes these structural shifts a potential net benefit for society. That said, airlines and other hospitality-related businesses are likely to continue to feel the brunt of these shifts. Air Canada, therefore, could struggle over the medium to long term as a result.

Bottom line

Air Canada has been successful at raising money of late and does have one of the best balance sheets of its North American peers. This allows the company greater wiggle room to withstand the stress put on this sector from this pandemic. That said, I think airlines in general have become too risky to own with this pandemic overhang. I would therefore encourage investors looking for risk asses to therefore explore other companies in other sectors with better potential long-term, risk-adjusted returns.

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