Alert: Airline Stocks Are a Trap

Description

Airline stocks were a play for the economic rebound we were all expecting. These beaten-down corporations were on the verge of bankruptcy last year, but have seen a surge in demand this year. However, these stocks are still value traps despite their modest valuations. Here’s why.

Concerns on the horizon

Airline stocks like **Chorus Aviation** (TSX:CHR) were off to a great start this year. Over the first three months of 2021, Chorus rose 45%. Since then, the stock has come under pressure. This is because oil prices have limited the industry’s margins despite growing sales. Meanwhile, sales haven’t been as great as initially expected anyway.

Another, bigger concern is the new COVID-19 variant that has emerged in South Africa. The B.1.1.529 variant (also known as the Nu variant) is said to be more resistant to vaccines. Some countries are already considering tighter border controls. If the variant spreads, the future could be bleak for the air travel industry.

Chorus underperformance

The stock is down by about 50% from pre-pandemic levels on its core business, coming under pressure. The company offers a variety of aviation services, including aircraft leasing and maintenance services. Before the pandemic, Chorus Aviation grew to become the second-largest regional aircraft lessor in the world.

Fast forward and business prospects have changed significantly in the air travel industry, coming under pressure. While the sector has shown signs of improvement in 2021, uncertainty has been a big problem that appears to have affected Chorus Aviation’s core business.

Solid Q3 results

Amid the uncertainties, Chorus Aviation has shown signs of improvement going by solid Q3 results. Net loss in the quarter narrowed to $14.1 million or $0.08 per basic share, an improvement from a loss of $48.6 million delivered in the second quarter. Adjusted net income also increased $4.4 million quarter-over-quarter to $15.3 million.

During the third quarter, the company carried more than double the number of passengers it did in the first half of the year. Improvement in the regional aviation sector helped the company deliver solid results. However, that doesn’t necessarily mean the stock is a good buy.

Given the underperformance over the past three months and the emerging uncertainties in the air travel industry, now may be the best time to sit out and wait for Chorus Aviation fundamentals to improve. While the stock is trading at a discount with a price-to-earnings multiple of seven, it does not scream a “buy” at current levels.

Bottom line

An ultra-low valuation with rapidly rising sales sounds like the perfect investment opportunity. However, investors need to look ahead to see if there are any risks lurking on the horizon.

For the airline industry, there are plenty of reasons to be concerned. The price of fuel is significantly higher, which cuts margins. Meanwhile, several countries haven’t fully reopened their borders yet.

But the biggest concern is this new variant that has emerged in South Africa. If it spreads as quickly as other variants and is as vaccine-resistant as experts expect, airlines could dip. Stay away from this value trap for now.

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Date
2025/07/02
Date Created
2021/11/26
Author
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