



Russia-Ukraine War Changed the World for Airlines: Air Canada Stock Down 16%

Description

Air Canada ([TSX:AC](#)) has slumped 16% in over two weeks since the Russia-Ukraine war broke out. If you think the pandemic changed the world for airlines, see what the war is doing to the industry.

The war has changed the world for airlines

In March 2020, [Warren Buffett](#) said that the world has changed for airlines. But Air Canada survived the biggest crisis the airline industry had yet faced. The war has created new problems, one more expensive than the other, and Air Canada's exposure is unknown.

Airline sanctions on Russia

When the war broke out, Canada, the U.S., the U.K., and the European Union (what I'll call "western countries") cancelled air leases and stopped plane makers, maintenance providers, and airlines from operating Russian flights or flying over Russia. They also banned Russian planes from their airspace. In response, Russia banned foreign aircraft from leaving the country. These sanctions have left [500 foreign planes](#), worth US\$12-US\$15 billion stranded in Russia.

With the SWIFT sanctions, leasing companies can't even take their payments. And with the sanctions extended to insurers and reinsurers, it is unclear whether the companies can get reimbursed for their losses.

Moreover, it is a huge risk to get those planes back. Analysts and industry experts are concerned that the Russian government might nationalize those planes and use them for domestic flights. Or they might use them for spare parts when they fall short. And if the planes are returned in good condition, there would be too many planes once again, which could reduce global plane rental prices. The global aircraft and leasing industry could be up for another write-down.

But this is just the problem with the fleet. These sanctions are also impacting airline operations.

Re-routing North America to Asia

Russia is a strategically important country. Many international flights fly over Russian airspace as the distance is short and have fewer headwinds. But the sanction on Russian airspace means Air Canada has to re-route its flights to many Asian destinations, including India, China, and Japan. AC earns 26%-30% of its revenue from flights to the Atlantic and the Pacific.

The re-routing will increase the distance, flight time, and fuel cost, making it an operational challenge. Airlines will have to crack their brains to get the most feasible routes. All this will increase the operational expense of airlines that are already running at huge losses. In 2021, AC reported a \$3 billion operating loss on \$6.4 billion revenue.

How long can Air Canada sustain over US\$100/barrel oil price?

If things couldn't get worse, the oil price is at its 2014-high of US\$102/barrel. It even reached US\$126/barrel when western countries banned Russian oil. The oil price is rising as Russia is a major exporter of oil and natural gas. These sanctions put further pressure on the already tight oil supply. **JP Morgan** analysts [estimate](#) the oil price could go to US\$175/barrel if the supply uncertainty prevails.

High oil prices will eat up airline profits as fuel is the biggest expense, accounting for 20%-30% of their operating expenses. One good thing during the pandemic crisis was record-low oil prices. But even that benefit is gone. Moreover, air travel demand could also take a hit.

Air travel demand

Western countries are grappling with 30-year high inflation, leaving little disposable income in the hands of consumers to spend on leisure. After the pandemic, it was leisure travellers that were driving travel demand. High inflation could affect the demand for both international and domestic leisure travel.

While domestic flights could still see demand, long-haul international travel could see a dip. In a war situation, travellers might be reluctant to leave Canadian boundaries and take an international trip. One hope (international legal travel) on which AC was hinging its recovery is now in the doldrums. All this could put AC revenue back into decline.

How is the war affecting airlines?

The impact of war is grave on the airline industry, which has not yet recovered from the pandemic fallout. Unlike the pandemic, the industry-level changes would be longer than three to five years. AC is [not a stock to buy](#) at any dip. I would suggest selling the stock while you still can.

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