How Air Canada (TSX:AC) Stock Is Placed After a Nasty Q1

Description

The first quarter of 2020 was indeed an unpleasant one for market participants. The coronavirus outbreak ravaged almost all financial markets globally. The **TSX Composite Index** tumbled more than 25%, while **Air Canada** (TSX:AC)(TSX:AC.B) stock, one of the top losers, fell almost 50% in the first quarter.

While Air Canada stock has exhibited a sharp jump from close to $9 levels recently, the stock certainly does not look strong. We still have to wait for almost a month for its first-quarter earnings. The stock might witness renewed downward pressure later this month due to its expected weak numbers for the quarter.

Air Canada stock might continue to trade weak

No doubt cost reduction has become the top priority for the biggest airline in the country. Early this week, Air Canada announced that it will reduce its capacity by 85-90% in the second quarter of 2020 compared to the same period last year. It has also temporarily laid off 16,500 employees starting April. That's a staggering 45% of the total of its workforce.

The reduced capacity will significantly dent Q2 revenues. But on the positive side, lower jet fuel prices and cost-cutting initiatives could offset that to some extent. Its Q1 numbers will make the picture clearer on how deep the wound is. It will also be interesting to see how the management deals with the situation amid such challenging times.

If the COVID-19 pandemic continues, it will surely be painful for companies such as Air Canada. Longer-than-expected lockdowns might make it difficult for it to make it through the crisis on its own. In that case, government support will play a key role in keeping the airline company operative.

Strong balance sheet

However, Air Canada has got a strong cash position to survive challenging times. It has more than $6 billion of cash and short-term investments, which will come in handy when it is not operating.

Investors should note that Air Canada stock was weak mainly because of its grounded flights. It remains a high-quality business with a leadership position in the industry. Its significant market share and a large scale will likely help weather these tough periods as well.

In terms of valuation, Air Canada stock is currently trading at a price-to-earnings valuation of three times. That's substantially cheap compared to its historical average valuation. Although there is uncertainty about its earnings in the next few quarters, the stock looks discounted after falling more than 70% from its recent highs in January 2020.

Will Air Canada emerge stronger?

In my view, the virus outbreak and lockdowns will continue to dominate business activities in the second quarter, too. There will be a gradual recovery in the second half of the year. However, a couple of loss-making quarters will dominate the year 2020 for Air Canada. Its solid cash position will help it pass through this crisis.

Additionally, lower jet fuel prices and higher-than-usual demand after the lockdowns will likely support of Air Canada and will make up for the lost time.

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Date
2025/08/17
Date Created
2020/04/02
Author

vinitkularni20