Is Air Canada Stock a Buy in September?

Description

The outlook for global airline stocks, including **Air Canada** (TSX:AC), remained densely clouded in August. However, there was a small glimmer of hope in another industry news piece during the past week.

The International Air Transport Association (IATA), which represents 290 airlines comprising 82% of global air traffic, warned on July 28 that global passenger numbers could return to pre-pandemic levels by 2024, a year later than previously projected. The news dented airline stock investors' spirits — more so when it was pointed out that international travel, which comprises about two-thirds of global aviation revenue, remains at just 2-4% of pre-pandemic levels.

However, domestic travel is picking up some recovery pace — more so in China, where domestic arrivals at Chinese airports reportedly reached 86% of 2019 levels in August. More flights were re-instated during the second quarter of this year, as coronavirus cases declined in the Asian country. Even more encouraging, domestic flight bookings in China are reportedly back to 98% of 2019 levels and could fully recover by early September this year.

The truth is, China's recovery is happening within just six months after planes were grounded and blanket travel bans were put in place across the country in efforts to contain the spread of COVID-19.

A Chinese recovery and the global airline industry

If domestic markets could recover as fast as the Chinese one post-lockdowns, airline cash flow bleeds could be reduced by small margins. And some jobs could be saved across the aviation industry, including at Air Canada.

That said, the bulk of the air travel business is from servicing international routes. But cross-border travel bans remain in place, and international travel remains severely subdued between 2% to 4% of pre-COVID-19 levels. If IATA's 2024 prediction comes to pass, a good number of airlines will require government bailouts to avoid bankruptcy.

Is Air Canada stock a buy right now?

Air Canada stock was badly hit by the COVID-19 market crash in April. Its share price remains 63% down year to date. Revenue took an 89% hit last quarter, but there are small signs of business recovery this quarter.

The Canadian airline plans to increase its planned weekly flights in September by just over 24% from August levels. Its serviced routes increased from 58 in June to 91 by month-end of August.

The majority of operated flights remain domestic ones. Encouragingly, weekly flights to Europe, the Middle East, and India could increase from about 69 in August to 90 in October as more routes re-open. International flights to South America could recover from just three per week in September to 12 a week in October. Traffic to Asia is picking pace with flights increasing from around 16 in August to about 22 in October.

Recoveries, however small and slow, are critical to the survival of the company right now. If the Canadian market follows the Chinese one, the nation’s flagship career could recover up to a third of its historical revenue run rate within a few more months.

The challenge is, even if the domestic and U.S. traffic fully recovers, both markets made up about 52.4% of total pre-crisis revenue annually. The company still needs more international traffic to return. This could take years to happen.

Even worse, deep fare discounts aided China’s recovery. A discounted full recovery in North American traffic won’t really produce the same cash flow as pre-pandemic invoices.

High operating costs and low-profit margins mean some painful years of negative free cash flow ahead. The reality is, AC stock could need further dilutive equity raises and a government bailout a few quarters from now.

Foolish bottom line

Investors should expect the high volatility on the beaten-down airline stock to persist for longer.

That said, if I were to choose between buying a new iPhone and investing in Air Canada stock again today, I would still bet on the country’s flagship airline surviving this perfect storm. Shares could more than double to afford one more than two iPhones over the next few years. The position remains flat, but the smartphone would already have depreciated.

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