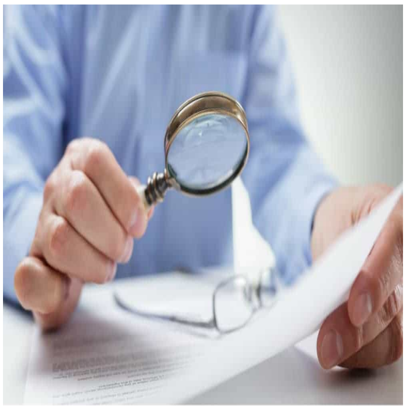

Air Canada (TSX:AC) Gains 24%: Here's What to Do With its Stock

Description

Shares of **Air Canada** (TSX:AC) rose over 24% in one month, igniting hopes of recovery. Despite the recovery, shares of the beleaguered airline company are still down about 62% year to date, as travel restrictions amid the pandemic weighed heavily on its financials.

Nevertheless, easing of lockdown measures, the restart of domestic flights, and an expected medical breakthrough for the treatment of the virus brings some respite for Air Canada. Moreover, the stock is available at a significant discount, making it a top recovery play.

However, investors should be cautious, as deep capacity reductions, absence of international flights, cash burn, and high debt could continue to restrict the upside in Air Canada stock in the short term. Increasing COVID-19 infections could further play spoilsport.

The most crucial factor that will fuel the recovery for the passenger airline companies is customer demand. Though the customer demand is likely to improve gradually, it could take airline companies a couple of years or even more in reaching the pre-pandemic levels.

However, Air Canada is a market leader, and with strong liquidity, it is in a better position to bounce back from the lows than its smaller competitors once the demand recovers.

Cash burn to go down?

Air Canada reported a net cash burn of $19 million per day, or about $1.72 billion in the second quarter, which is alarming for a company not generating enough cash flows. Net cash burn is the amount of money required to run operations, pay debts, and meet current obligations.

Air Canada expects the number to improve gradually, as passenger demand rises. For the third quarter, Air Canada projects net cash burn between $1.35 billion to $1.60 billion, anticipating improvements in the passenger volumes and opening of the international borders.

As international borders are still sealed and could lead to higher-than-guided net cash burn, expected improvement in passenger volumes could provide some cushion.

Quarterly numbers could improve

Air Canada reported 89% drop in its revenues during the most recent quarter, reflecting a 96% decline in total passenger volumes and lower capacity. Meanwhile, its operating and net loss of $1.6 billion and $1.8 billion, respectively, widened sequentially.

While the numbers are scary, most of this decline was due to the grounding of its flights amid government's mandatory travel restrictions. While Air Canada could continue to report a loss in the upcoming quarters, the easing of travel restrictions could help the company to improve its top line and reduce losses on a sequential basis. Though the company's capacity could remain low, it's likely to be better than the second quarter.

Also, increased cargo capacity, cost-reduction measures, and preservation of cash bode well for recovery.

Bottom line

The massive decline in Air Canada stock and an expected improvement in passenger volumes make it an attractive bet. However, investors need to show patience with Air Canada stock as tons of uncertainty and continued challenges could remain a drag.

Long-term investors are likely to win big, as Air Canada could double or even triple in the next three to four years.

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