



Air Canada (TSX:AC) Stock Just Soared 25% Post Earnings

Description

Air Canada ([TSX:AC](#)) stock just soared 25% as its third-quarter earnings gave a positive surprise. But there is more to AC's stock rally. Airline stocks have surged by the double digits as **Pfizer** and **BioNTech** announced that their COVID-19 vaccine is more than 90% effective, according to [Reuters](#). I will keep the vaccine discussion for later. Now, I will discuss AC's earnings.

While its U.S. counterparts reported higher losses, AC contained its net loss to just \$690 million — a remarkable feat for an airline that operated at just 20% capacity in the third quarter. It also maintained \$8.2 billion in liquidity despite the strictest traveled restrictions. This liquidity instilled confidence among investors that AC can avert bankruptcy.

Three key takeaways from Air Canada's earnings

I have been pessimistic on AC as its American counterparts accumulated losses despite a 70%-100% sequential revenue growth. And the constant extending of international travel restriction until November 21 didn't help. Moreover, aviation data firm Cirium showed that AC cancelled more than 70% of its flights scheduled for November.

Hence, AC's third-quarter revenue surged only 44% sequentially to \$757 million as Canada restricted foreign nationals from entering Canada and also imposed interprovincial travel restrictions.

At a time when world airlines are burning cash, the first step is to control costs. AC management's efficiency to cut costs and adjust to the significantly low demand helped it control losses. The airline reduced its operating expenses 26% sequentially to \$1.54 billion as it executed the \$1.5 billion cost-cutting program. The airline also cut 20,000 jobs in June and took Canada Emergency Wage Subsidy (CEWS), which the government has extended till June 2021.

AC is yet to realize the cost savings that will come from retiring 79 older aircraft, or 33% of its fleet. It has also reduced its projected capital expenditure by \$3 billion for the next three years by canceling orders for 22 aircraft and deferring deliveries of 34 aircraft over the 2021-2023 period. It also [slashed its bid price](#) for **Transat A.T.** by 74% to \$190 million.

These significant cost controls helped AC slow its daily cash burn to \$9 million from \$15-\$17 million in the previous quarter. Its third-quarter loss reduced to \$685 million from \$1.75 billion in the previous quarter. Note that the slowdown in daily cash burn is also because AC did not refund the money on canceled flights. By giving vouchers instead of a cash refund, the airline has deferred its losses over the next few months.

What's in store for Air Canada in the fourth quarter?

The fourth-quarter revenue could be similar to the third quarter as Prime Minister Justin Trudeau has stated that it won't open the U.S. borders until its neighbouring country controls COVID-19 spread. With the resurgence of COVID-19 cases, the borders might remain closed to non-essential travel for the rest of the year. However, AC will continue to cut costs and reduce its cash burn.

In the first nine months, AC's revenue declined 66% year-over-year (YoY) to \$5 billion. Its net loss widened to \$3.5 billion. It is on track to report a net loss of \$4 billion this year, which will wipe out its last three years of profits.

Should you buy the Canadian airline stock?

By slowing its cash burn by almost 50%, AC proved its potential to avert bankruptcy for two years. Even if Pfizer's COVID-19 vaccine is approved and distributed worldwide, it will take another year. Until then, air travel demand will remain tight, with business travel unlikely to return to the pre-pandemic level for the next three years. But AC's capacity will also not be the same as the pre-pandemic level.

AC's management is well positioned to recoup the pandemic losses and avert bankruptcy. But it will take the stock several years to return to the pre-pandemic level of \$50. Don't rush to buy the stock close to \$20 as the price may not be sustainable. Wait for some time. The stock price will correct, and then buy it below \$18.

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Date

2025/08/30

Date Created

2020/11/09

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