Air Canada Stock: Are Investors Too Optimistic?

Description

Air Canada (TSX:AC) is up 80% in the past month. Investors who'd bought Air Canada stock at the start of November are wondering if they should book profits or hold on for more gains.

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Vaccine impact on Air Canada stock

A wave of positive vaccine trial results in recent weeks led to much of the rise in Air Canada's stock price. The shares sat at $15 in early November and currently trade close to $27.

Investors see light at the end of the pandemic tunnel. The U.K. already approved one vaccine for distribution. Health Canada is expected to give the first one the thumbs up in the next few weeks. Rollouts to the provinces should begin by January and will continue through 2021.

While all this is good news for the airline industry, investors should be careful about getting too excited. Travel restrictions remain in place, and that situation probably won't change until vaccines are widely available to the general public. The United States is battling a second COVID wave that appears out of control in some regions. A number of Canadian provinces have implemented lockdowns similar to the initial response at the start of the pandemic.

Globally, COVID continues to spread. Developing nations won't have the infrastructure in place to roll out vaccinations at the same speed as developed countries. Even in Canada, it will likely be the second half of 2021 before the average person has access to a COVID vaccine.

The market appears somewhat oblivious to the logistical challenges.

Risks for Air Canada investors

At $27 per share, Air Canada stock is back to where it was in early 2019, but the company is much smaller than it was two years ago, and its prospects appear less certain.

Air Canada cut 20,000 jobs in June, representing more than half its workforce. The carrier permanently scrapped dozens of planes and cut routes in recent months to try to minimize cash burn.

On the positive side, once vaccines are widely available and travel restrictions end, people will start to take holidays again and go to visit relatives.

Business travel, however, is a wildcard. The fancy seats at the front of the plane sell at a premium, and business travel typically accounts for a good chunk of airline profits. During the pandemic, executives and sales people who would normally jet-set around the country or across the globe stayed home and used online video conferencing platforms to conduct meetings. Companies managed very well without spending thousands of dollars on flights and hotels to do business. Analysts say the virtual meeting is here to stay and that business travel might never return to previous levels.

If that turns out to be the case, the airlines might see smaller profit margins per flight in the future.

Another concern is oil prices. Jet fuel remains the largest expense for airlines. Low oil prices helped drive profits higher in recent years. The near-term outlook calls for oil to stay below US$50 per barrel, but some pundits see a surge back towards US$100 in the next few years. Massive investment cuts across the oil industry could result in tight supplies once the global economy is back on track.

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Should you buy or sell now?

Air Canada rallied as high as $52 in early 2020, before the pandemic. Investors shouldn’t use that price as a target for the current recovery. Air Canada will be a much smaller business for several years and a number of headwinds remain. At this point, the stock appears expensive.

If you’d bought Air Canada stock a month ago, it might be a good idea to book some profits. Investors who missed the rally should be careful starting new positions at this level. There are other cheap stocks in the market right now that might offer better upside.

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