Air Canada Stock: 3 Threats Investors Need to Watch in 2021

Description

Air Canada (TSX:AC) enjoyed a huge rally in recent weeks. In fact, the share price is up 75% since the end of October. Additional upside could be on the way, but investors should consider the risks before buying Air Canada stock at these levels.

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COVID vaccine rollouts

Positive COVID vaccine news drove most of the recent gains in Air Canada's stock price. The first vaccines are now being distributed to front-line healthcare workers and high-risk citizens. As more people get the COVID vaccine, demand for air travel should improve in domestic markets.

In addition, international travel should pick up once governments lift restrictions. The vaccine news is certainly a positive for Air Canada, but the surge in the stock price might be too optimistic.

Why?

Vaccine rollouts to the broader public will take time. Most people in Canada won't get the vaccine until the back half of 2021.

In the meantime, a second COVID wave has forced new lockdowns in major economies. Europe, Canada, and the United States are all struggling to get the pandemic under control. Demand for air travel remains weak and might take longer than anticipated to rebound in 2021.

Oil price threat to Air Canada stock

Jet fuel represents 15-20% of total expenses for airlines. Low oil prices in recent years helped drive rising profit margins for Air Canada and its peers. At the time of writing, WTI oil is back above US$47 per barrel. Brent oil just topped US$50. Demand recovery in China and India along with bullish sentiment on the economic recovery could sustain the upward trend in oil prices next year.

Over the medium term, some analysts see a potential spike toward US$100 per barrel. They think global oil demand will return stronger than anticipated and the massive cuts to investment by producers in 2020 will eventually lead to tight market conditions.

If oil moves back into the US$70-80 range, jet fuel costs will skyrocket. This would be negative for Air Canada stock, as we saw when oil soared after the Great Recession. Air Canada already has rising expenses to deal with as a response to COVID. A significant surge in jet fuel costs might force the airline to raise seat prices to a point where people will delay a return to air travel.

Business travel uncertainty

Once the pandemic ends and travel restrictions disappear, the airline industry hopes for a surge in capacity. Returning to 2019 levels might take two or three years, according to most industry leaders. Air Canada permanently scrapped dozens of planes and eliminated more than half of its workforce this year. It will take time for the market to recover.

Vacationers will likely return quickly. Business travel, however, is a wildcard. The expensive seats in the front of the plane generate a large chunk of the profits for Air Canada and other international airlines. COVID forced executives and sales people to conduct meetings and negotiations virtually over digital platforms. The success of the online meetings has exceeded expectations for most people. Now that everyone is comfortable with the process, there is a risk that business travel will never return to previous demand.

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That would be bad for airline profits, and the market could adjust the multiple on Air Canada stock as a result.

Should you buy Air Canada stock now?

Airlines continue to burn through cash and cut routes. The Q4 2020 results will be ugly, so investors should brace for some near-term volatility in Air Canada stock.

Heading into 2021, we could see a major correction in the broader stock market. This would likely hit Air Canada hard. Beyond that, rising fuel prices, extended travel restrictions, and the uncertain future of business demand for expensive seats all threaten Air Canada's recovery.

The stock appears overbought right now at $27 per share. Investors who got in around the $15 mark should consider taking some profits. Those who missed the rally might want to look for other opportunities.

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