Why Air Canada Stock Is a Risky Buy Today

Description

Air Canada (TSX:AC) stock soared on positive vaccine news in recent months, but investors wonder if the rally in Air Canada's share price might have gone too far.

Vaccine optimism impact on Air Canada stock

Air Canada traded near $15 per share in early November. A month later, speculators drove the share price to $27. Positive trial results on key COVID vaccines created new investor enthusiasm for Air Canada and other airline stocks. The approvals of two vaccines by the United States, the U.K., Canada, and Europe and subsequent vaccine rollouts helped keep the stock elevated, although the share price pulled back to $22 by the end of December as traders booked profits.

Vaccines are the key to a recovery in the airline industry. However, it will likely be the end of the summer in 2021 before the general public has access to the shots. This means travel restrictions could remain in place for several months.

The stock market is always forward-looking. Airlines should see countries open up their borders in the second half of the year. Travellers eager to visit relatives or go on vacation could drive a surge in bookings. This would give Air Canada a nice boost in revenue to stem the cash burn.

With that in mind, some upside from the November low could be warranted in the stock price, but it might be too soon to buy.

COVID surge threatens recovery

The second COVID wave is forcing new lockdowns in most developed economies. The U.K. just announced a national lockdown to battle the spread of a new COVID variant. Researchers recently voiced concerns that another variant that originated in South Africa might not respond to current vaccines.

Mainland Europe and the United States continue to see rising COVID cases. Japan closed its border to foreign nationals in the past week. Several of Canada's provinces are under strict lockdown measures, and the government now requires all travellers to present a negative COVID test result before boarding a plane headed to the country. The two-week quarantine upon arrival remains in place.

This means Air Canada and the broader airline industry face a challenging winter.

Oil price impact on Air Canada stock

Fuel costs represent 15-20% of an airline's expenses. As a result, rising oil prices can put a big dent in margins. Brent oil now trades at US$53 per barrel and WTI hit the US$50 mark for the first time since last February. In the event oil prices continue to recover through 2021, the price of jet fuel could soar.

This would put Air Canada in a tough spot. The company might need to raise ticket prices to account for the extra fuel expense. Travellers in Canada already consider the tickets to be expensive. The result could be lower demand.

Will business travel ever recover?

Beyond the pandemic, the airline industry might see a permanent drop in business travel. Executives and sales people who traditionally fly around the globe to visit clients had to conduct meetings across online platforms in 2020. The success and effectiveness of virtual meetings caught many people by surprise, and analysts wonder if business travel will ever fully recover.

The expensive seats in the front of the plane generate big margins for Air Canada and other airlines with international routes. If business travel doesn't recover, investors should brace for slimmer profits when capacity eventually rebounds.

The bottom line on Air Canada stock?

Air Canada stock trades near $23 per share at the time of writing. That's down about 50% from the start of January last year. This might seem cheap, but the company has gone from being very profitable to burning through about $1 billion in net cash per quarter. Management cut more than 50% of the staff in 2020 and scrapped dozens of planes.

Capacity isn't expected to recover for at least three years. In the meantime, Air Canada is trying to negotiate a favourable bailout from the government.

With all the near-term headwinds and uncertain market conditions, the stock appears expensive. Other opportunities in the market might be better bets right now.

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aswalker