Air Canada (TSX:AC) Stock: Buy the Dip or Bail Out?

Description

Air Canada (TSX:AC) gave back some of its big gains in the past two weeks, and investors want to know if the pullback is a good opportunity to buy Air Canada stock.

Third COVID-19 wave risks for Air Canada stock

Profit taking after the huge run is part of the sell-off story, but the emergence of the third wave of the pandemic might also be at play. Europe faces new lockdowns in several countries, as governments try to slow the spread of new COVID-19 variants. The new wave of the virus threatens to delay the reopening of air travel to E.U. countries.

In Canada, several provinces currently face the risk of a third wave or are already dealing with one. Until most adults get vaccinated, quarantine requirements for interprovincial travel could remain in place.

Air Canada recently announced plans to restart travel to Mexico and some other international destinations in May. That's a positive sign, but the road to recovery could be a long one if the world doesn't get the pandemic under control.

Cash burn

Air Canada finished 2020 with roughly $8 billion in unrestricted liquidity. That's a tidy sum, but the business is also burning through cash at a rapid pace. In the Q4 2020 report, Air Canada said it expects Q1 2021 net cash burn to be $1.35-1.53 billion or $15-17 million per day.

Unless there is a surprise lifting of travel restrictions in the next couple of months, the Q2 numbers might not be much better. Air Canada did a good job of raising capital in 2020, and the elevated share price gives management some flexibility to issue new stock to help offset the depletion in funds.

However, each time this happens, existing shareholders get diluted, and there is a point where the market could punish the stock.

Rising fuel costs might also come into play. Oil prices surged in the past few months, and estimates for a move to US$100 per barrel in the next couple of years are starting to hit the headlines.

Government aid impact on Air Canada shareholders

Air Canada and its peers began negotiations for government assistance last November. The fact that no deal has been announced indicates the challenges of the situation. An agreement will likely emerge, but investors might not be winners.

The government has made it known that refunds for cancelled flights and the restart of services to regional centres are key to a deal. These measures could hurt the balance sheet and drive up losses. Other requirements might involve forcing the airline to reverse its cancellation of orders for new planes made in Canada. Commitments on carbon emissions could also be part of the mix.

The government generally isn't on the side of shareholders in these situations, so investors need to be careful if they are buying Air Canada stock on the hopes of a generous bailout.

Is Air Canada stock a buy now?

Air Canada trades below $27 per share at the time of writing. That's down from the March closing high near $30, but it is still up significantly compared to the $15 it fetched last fall, when some analysts saw it as undervalued.

Speculation could certainly push the share price back to $30 in the near term. However, buy-and-hold investors might want to take a pass at this level. Air Canada faces daunting challenges in the next few years and a return to profitability could be a long way off.

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