Air Canada (TSX:AC) Stock: Bull Case versus Bear Case

Description

Aviation has been indeed one of the most hampered sectors amid the COVID-19 pandemic. Things further deteriorated for airline companies in 2021 amid slower vaccinations and mutating viruses. However, Canada's biggest airline **Air Canada** (TSX:AC) stock is up almost 50% so far this year. Analysts and experts are divided about the flag carrier's prospects. Some anticipate bankruptcy for the flag carrier, while the rest foresee an amazing recovery. What should investors do?

Air Canada: Bull case

The year 2020 was a horrid one for almost the entire aviation sector. And Air Canada was no exception. Its revenues plunged 70% last year compared to 2019, which resulted in a $4.6 billion loss.

Despite the deep financial impact, Air Canada seems well placed in the crisis. And that's mainly because of its strong balance sheet. It has $8 billion in cash and equivalents, which should be sufficient to weather the crisis. A government bailout package should further help the airline to survive longer.

Notably, Air Canada was burning $15 million cash daily in the last quarter. Even if the number looks huge in absolute terms, it is less than half of what global peers have burnt. Its prudent spending and disciplined cash management have differentiated it from peers.

Also, the pandemic has forced airlines to come out with unusual cost-cutting practices since last year, which would not have been otherwise possible in the regular course of business. This might lead to operating margin expansion post-pandemic.

Another factor that might drive AC stock higher is Air Canada's gradually resuming operations. The flag carrier is expected to operate with meaningfully higher capacity in the second half of 2021 as against the same period in 2020. It recently announced that it would resume flights to sun destinations from May. The return to normalcy and higher revenue potential could positive for AC stock.

AC stock: Bear case

The pandemic and grounded fleet have substantially damaged Air Canada's financials. Its long-term debt soared beyond $8 billion at the end of Q4 2020, which was a notable increase from $5.1 billion in Q4 2019. The higher debt will increase the debt servicing costs, ultimately hampering its profitability.

Canada's relatively slower vaccinations is a bigger thorn in Air Canada's recovery. Above all, how air travel demand plays out after vaccinations remain to be seen. On similar lines, many expect the entire aviation industry to get smaller post-pandemic.

Another factor that could hinder AC's rally is its valuation. It has soared more than 250% since its last year's lows. It is currently trading at a price-to-book value of five times, which is notably higher than its historical average.

My take

Despite the uncertainties, I think Air Canada is a solid long-term bet. We will probably get closer to the pandemic's end in a couple of quarters, which might bring clarity on air travel demand, too. Though debt and profitability are bigger concerns, Air Canada is way better placed against its peers. Its operational efficiency, leading market share and potential expansion in the leisure space should fuel its post-pandemic recovery.

Although AC stock might correct in the short-term on valuation concerns, bailout prospects and higher capacities in the latter half of 2021 are the two factors that give it an edge. Sentiment around AC stock will likely remain strong going forward, which has been a more significant driver behind its recent rally.

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vinitkularni20