Air Canada (TSX:AC) Stock: Risks vs. Rewards for Investors

Description

Air Canada (TSX:AC) soared from $15 per share last fall to a closing high near $30 on March 15. The stock pulled back a bit in the past two weeks, and investors wonder if this is a good time to buy Air Canada stock or search for other names that might be undervalued today.

Air Canada stock outlook

Air Canada trades near $26.50 at the time of writing. That's about half the value it fetched before the pandemic. Bears say the stock is too high given the uncertainty facing the industry in the next few months. Airline bulls see a strong recovery occurring once COVID-19 vaccines become widely available to the general public.

How long it will take to get to the point where international travel restrictions and quarantine mandates disappear remains the big question.

Risks for Air Canada stock

The third COVID-19 wave has forced new lockdowns in Europe. Several Canadian provinces are also seeing cases rise again. This could keep restrictions in place for several months, meaning Air Canada might miss out on a good chunk of the summer travel season.

Air Canada finished 2020 with $8 billion in unrestricted liquidity. In the Q4 2020 earnings report the company said it expected to see net cash burn of up to $1.53 billion in the first three months of 2021. It is unlikely that travels restrictions will change much before the end of June, so the Q2 results might not be much better. In the event the cash burn situation gets worse, the market might start to worry more about the liquidity of the company and put additional pressure on the stock price.

Aside from the travel restrictions, rising oil prices could drive costs higher and put pressure on margins. Oil bulls see WTI oil hitting US$75 per barrel in 2021 and potentially surging to US$100 in the next couple of years. That's great news for Canadian oil producers but bad for airlines.

On the revenue side, full business seats typically make flights profitable. With the success of virtual meetings over the past year, analysts wonder if business travel will ever recover to previous volumes.

Upside potential for investors

Positive news on a government aid package could send the stock higher. Air Canada and Westjet recently announced the restart of some cancelled international and domestic routes, so a deal could be on the way.

Investors will need to carefully read the details on any potential bailout agreement. Conditions that drive up near-term expenses could impede the pace of Air Canada's return to profitability. An investor-friendly aid package could send the stock soaring.

Once restrictions lift, pent-up demand for holiday travel could give Air Canada a nice boost. It's possible that seats will fill faster than Air Canada can get planes back in the air and people might be willing to pay very high prices to take a vacation. If that turns out to be the case, the share price could pick up a nice tailwind.

The bottom line

Air Canada will survive, but buying the stock today isn't a guaranteed home run. It could be several years before capacity returns to previous levels, and investors should consider the threat of higher fuel costs and reduced business travel in the medium term.

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