Air Canada (TSX:AC): At What Price Is This Stock a Buy?

Description

Air Canada (TSX:AC) took a major hit last year during the market crash, but the share price rebounded nicely in recent months and investors wonder if this is a good time to buy or sell Air Canada stock.

Near-term outlook for Air Canada

Air Canada continues to negotiate a financial-aid package with the Canadian government. Talks began last November, so the delay suggests the two sides are having difficulty reaching an agreement. Global aid to airlines was at least US$160 billion in 2020, according to the IATA, so it makes sense that Canada would help its airline industry.

From an investor's perspective, the details make all the difference as to whether a bailout is positive. The government has made public statements saying a deal would require refunds for cancelled flights and the restart of halted routes to small cities across the country.

The refunds would likely be replaced with a loan, adding more debt to the balance sheet. Forcing flights to restart before demand increases could drive up expenses at a time when Air Canada continues to bleed cash. In the Q4 2020 report Air Canada said it expects Q1 2021 net cash burn to be as high as $1.53 billion.

Analysts also wonder if the government will take an equity stake in Air Canada. The markets might not react well to the government becoming a significant shareholder. At the same time, too much debt could also force investors to take a step back.

On the pandemic front, the third COVID-19 wave is now a reality in certain parts of Canada and Europe. This will likely delay the removal of travel restrictions. It is possible that airlines could miss the bulk of another summer travel season. The situation should improve by the fall, but there is much uncertainty as to when capacity will really start to ramp up.

Medium-term outlook for Air Canada

Airline industry executives have said they don't expect capacity to return to 2019 levels until at least 2023. A surge in holiday travel is likely, but the business community remains a wildcard. That's problematic because business seats sell for a lot more money than economy seats and the cosy spots in the front of the plane generate a good chunk of an airline's profits.

The world learned to conduct business through video meetings in the past year. The success and acceptance of the online interactions could mean companies will scale back travel budgets for salespeople and executives.

Fuel prices might also impede a return to profitability for Air Canada and its peers. WTI oil trades near US$60 per barrel at the time of writing. That's up from US$36 last fall. Analysts increased estimates in recent months with some targeting a 2021 high of US$80.

Massive investment cuts across the energy industry could result in a supply squeeze at some point in the next few years. As a result, some analysts suggest oil could spike back to US$100. High oil prices drive up fuel costs and jet fuel represents 15-20% of an airline's expenses.

Should you buy Air Canada stock now or wait?

Air Canada soared from $15 last November to $30 in early March. At the time of writing the share price sits near $26 per share. This might appear undervalued compared to the $50 mark the stock topped before the pandemic, but the world has changed and it could be years before Air Canada is profitable again.

Air Canada stock appears expensive right now, so I would wait for a pullback if you plan to buy. It wouldn't be a surprise to see a correction to $20 or lower in the coming months.

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Date
2025/07/27
Date Created
2021/04/01
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