Is Air Canada (TSX:AC) a Must-Buy at $24.83?

Description

Air Canada (TSX:AC) finally started to look like it will go on another major rally. Just when things started to look better for the airline, it began declining. The battered airline stock is trading for $24.83 per share at writing, and it is down 16.68% from March 15.

There is likely a hesitation among investors ahead of its first-quarter earnings release scheduled for May 7. You might be wondering whether Air Canada's earnings will inspire enough confidence in investors and lead the stock past the $30 mark as it did in February after its 2020 earnings.

Let's take a look at what you should consider before you consider its current valuation a steal.

Airline's liquidity and cash burn

The first-quarter earnings are coming up and could set the pace for whether the stock surges or declines. The most pressing concern for any airline today is liquidity and cash burn. While Air Canada's revenue is not in its control due to the restrictions on routes and capacity, it does have control over its operating costs.

The airline managed to successfully reduce its operating expenses by 37% to slow down its cash burn rate. However, it anticipated a massive $15-17 million daily cash burn in the first quarter due to higher capital expenses, which means that the airline could report a significant loss of $1.4 billion, reducing its liquidity to $7 billion in Q1 2021.

A high cash burn rate will likely persist before the bailout in the coming quarters, but a bailout could substantially reduce cash burn.

Operating capacity

Operating capacity is another significant concern. The airline operated at a fifth of its capacity from 2019 levels throughout 2020. The company expected to operate at a higher capacity from 2019 levels during this quarter. However, the third wave of infections has led to further travel bans on some countries like Pakistan and India.

The worsening situation elsewhere in the world could keep the airline's operating capacity limited to 15-20% during the second quarter. The operating capacity will have a significant impact on its revenue.

Capital expenses and net debt

Air Canada's rising net debt is another major factor to consider. The $5.9 billion bailout package will add to the airline's debt because $5.4 billion of the amount is a low-interest and long-term debt. There is a sizable portion of almost $4 billion in unsecured loans, which the airline will not likely be able to repay.

The government also has a second plan for around $2.5 billion unsecured loans. The more in loans that AC withdraws from the bailout package, the more the government will acquire proportional equity warrants. The government can get up to a 10% stake in the industry titan with these equity warrants.

Foolish takeaway

Air Canada is currently under a lot of selling pressure because of the terms of the bailout deal. Suppose the company's management can address investor concerns about its equity dilution and explain why the bailout will be good for the airline. In that case, it could be positive news for the airline.

If Air Canada's earnings report spells better news, the airline could surge past $30. The previous quarterly earnings report led to a 40% rally for the airline. I suggest staying on the sidelines and keeping a close eye on the earnings report on May 7 because it could see another rally or another dip for the airline.

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