Should You Buy Air Canada Stock Right Now?

Description

Air Canada (TSX:AC) took a beating through the pandemic, but the stock price is moving higher as investors search for undervalued reopening picks. Is Air Canada stock a buy today?

Air Canada valuation

Air Canada traded for more than $50 per share in early 2020 before the pandemic. The stock had enjoyed a nice surge amid industry optimism about the prospects for 2020 and beyond. Business travel was booming and fuel prices remained at levels that allowed Air Canada to generate strong profits and invest in new planes.

Today, the stock is down roughly 50% from that level, but Air Canada is a much smaller company and the travel world has been turned on its head. Restrictions on international flights remain in place as several countries continue to battle with new waves of COVID-19 infections. Vaccination numbers in developed economies are getting better, which will lead to some reopening, but it will be months before governments allow a free flow of international air travel, possibly 2022.

With a cash burn rate of $14 million per day in Q1 2021 and similar losses anticipated in Q2, the stock appears a bit expensive at the current price of around $27 per share.

Strings attached to government aid

Air Canada recently agreed to financial aid terms from the government that could put its recovery at risk. The airline has to maintain staff levels that were in place as of April 1, 2021, potentially impacting management's ability to further restructure operations. In addition, Air Canada borrowed cash at a low-interest rate to provide refunds for cancelled flights.

In addition, Air Canada must follow through on new plane orders it cancelled last fall. It's possible the airline won't get back to the size required to use the assets profitably, putting additional pressure on costs. In the near term, Air Canada has to restart domestic routes to smaller cities and communities. If the planes are empty, the company could see a spike in cash burn that might force it to access more of the expensive loans offered by the government than it would otherwise need to tap.

Business travel

Over the past year, businesses discovered that they can do deals without in-person visits. flights, hotels, and other travel costs are significant, and many large global companies have already slashed their future travel budgets.

Business seats are the most profitable for an airline and a permanent drop in business travel is a possibility investors need to consider when evaluating the stock.

Jet fuel costs

West Texas Intermediate (WTI) oil now trades around US$68 per barrel and Brent oil is at US$71. Refineries that make jet fuel will pass on the increased feedstock costs to customers on the finished product. Analysts broadly expect WTI to hit US$75 this year and potentially soar to US$100 by 2025 due to reduced investment across the global oil industry.

Fuel costs make up 15-20% of an airline’s expenses. In the past, the airline industry was able to add fuel surcharges to ticket prices. Travellers who are already facing rising ticket prices might simply decide to stay home.

Is Air Canada stock a buy today?

While Air Canada’s share price could certainly pop above $30 in the near term on improved reopening optimism, new investors should be careful chasing the stock for a buy-and-hold portfolio. The headwinds to a return to profitability are significant and the medium-term risks might not be priced into the shares at this point.

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