



3 Reasons I am Bullish on Air Canada (TSX:AC) Stock

Description

Air Canada ([TSX:AC](#)) stock keeps falling. Are you losing your patience? Should you sell the stock and book losses? All these thoughts might be boggling your mind, as you see your portfolio turn red. It is all in the numbers, and right now, they are not in Air Canada's favour. But I am still bullish on the stock and expect it to touch or come close to \$40.

Riding the stock market inefficiencies

Famous investor Peter Lynch said, "There's no shame in losing money on a stock. Everybody does it. What is shameful is to hold on to a stock, or worse, to buy more of it when the fundamentals are deteriorating." But what if fundamentals are improving? In an efficient market, the stock price corrects itself to the company's earnings potential in the long term. But the markets are inefficient in the short term. They tend to ignore the fundamentals. These inefficiencies are what hedge funds take advantage of.

Air Canada's latest [earnings report](#) hints at recovery and cash inflow. But the stock market inefficiencies have not priced these positives. The overall market is running a [bearish tone](#), as the government has [slashed](#) the Canada Recovery Benefit (CRB).

What could drive Air Canada stock to \$40?

Air Canada is the country's largest international airline that connects Canada to the world. Its main source of revenue is tickets, and its main expense is buying and maintaining planes and fuel expenses. When any of these three elements are imbalanced, the airline fundamentals take a hit.

Air Canada's decelerating cash burn

During the pandemic, all three elements fell, as the Justin Trudeau government closed international borders for 15 months. There wasn't any cash inflow, and there was significant cash outflow, as it had to maintain planes. The airline's priority was to reduce this cash burn.

AC achieved it in the second quarter, halving its daily cash burn from \$15-\$17 million to \$8 million. Around \$5 million of this cash burn vanished due to cash inflow from advance ticket sales and reduced costs and capital spending.

The government will allow fully vaccinated U.S. citizens to enter Canada for non-essential travel on August 9. And on September 7, the government will open the borders to other foreigners. Banking on these dates, AC expects its average daily cash burn to reduce to \$3-\$5 million in the third quarter. That's the first positive.

Recovery in the airline capacity

In the second quarter, AC resumed service to 50 Canadian cities and communities. It expects to gradually resume services to several regions in the United States and the Atlantic this summer. It is already seeing pent-up demand from Canadian leisure travellers to U.S. destinations. By 2022, AC expects demand to resume to 2019 levels in the U.S. and Atlantic. However, things remain uncertain in the Pacific, as vaccination is happening at different paces across the world.

In the third quarter of 2021, AC expects to return to 35% of its third quarter of 2019 operating capacity. This is more than double the second-quarter capacity recovery of 15% of the 2019 capacity. And for the record, the airline has reduced its overall capacity by retiring 33% of its fleet. This speedy recovery in capacity will bring in more cash flow and help it become profitable in a few years. That's another positive.

Air Canada's debt restructuring

The pandemic cash burn pushed Air Canada into enormous debt. It had a net debt of \$7 billion at the end of the second quarter. The second priority for AC after slowing cash burn is reducing debt, and the airline has already started work on it.

AC is restructuring debt to reduce the interest burden. It has \$4 billion in low-cost government bailout loans, but it is trying not to use them, as that will give the government a 4% equity stake. The government already has a 6% equity stake in the airline from the \$500 million equity financing. AC will evaluate the recovery situation. If the recovery goes as planned, it might opt out of the bailout loans.

Such a decision will instill confidence in investors, and drive AC stock on the path of recovery. These three positives make me bullish on Air Canada's recovery to \$40.

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Date

2025/07/17

Date Created

2021/08/05

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