Air Canada Stock: How Low Could It Go?

Description

Air Canada (TSX:AC) continues to lose altitude after the stock soared earlier this year on hope the company would stage a major recovery in 2021.

Investors who missed the big rally are now wondering how low the AC stock price will go before it becomes safe to buy for a Tax-Free Savings Account (TFSA) or RRSP portfolio.

Turbulent recovery

The spring wave of the pandemic delayed reopening plans and the spread of the Delta variant around the globe in recent months threatens to keep potential travellers at home longer than expected. Air Canada cut capacity by more than 90% compared to 2019 levels when government travel restrictions took effect.

Vaccinated U.S. and international visitors are now allowed to fly to Canada, so seat sales should continue to rebound, but that doesn't mean Air Canada is on the fast track to renewed profitability.

In the Q2 2021 financial report, Air Canada said it had a net cash burn of $745 million in the quarter or about $8 million per day. The business reported an operating loss of $1.133 billion compared to an operating loss of $1.55 billion in the same period last year. Things are better, but that doesn't mean the situation is good.

The Q3 results should show improvement. Air Canada predicted cash burn would be about half as bad in the third quarter of 2021. It's possible that the airline will see positive cash flow by the end of the year, especially now that people can receive international visits from family and friends.

What about business class?

Business people are still working from home and the new wave of COVID-19 infections caused by the Delta variant is forcing companies to extend the work-from-home mandates to at least the first part of next year.

As a result, salespeople and executives are still using online meetings to conduct business. Corporate travel is expected to eventually pick up, but analysts have varied opinions on whether business travel will ever fully recover to 2019 levels.

This is a concern for airlines and their investors. The first-class seats with tasty meals and other perks are very expensive and drive a good chunk of the profits airlines. In the event business travel doesn’t bounce back, investors might need to reset their profit expectations for Air Canada and other airlines.

Expenses

Fuel costs could also hinder the return to profitability. Jet fuel was relatively cheap from 2015 to 2020 due to low oil prices. This was a big contributor to the fat profits generated by the airline industry, along with all the little add-on charges for bags, seat selection, and optional meals.

West Texas Intermediate (WTI) oil is currently US$72 per barrel. That’s already above the pre-pandemic price. Oil bulls see WTI hitting US$80 next year and potentially taking a run at US$100 again by 2025. In that scenario, Air Canada would likely have to impose added fuel charges to ticket prices. It is uncertain whether travellers will be willing to pay.

The bottom line

Air Canada has arguably turned the corner and capacity will gradually increase, but the airline still has a long road to recovery. The stock trades near $22.50 at the time of writing, down from the 2021 closing high around $30. Despite the pullback, it still looks expensive given the challenging outlook.

A bounce off this level is certainly possible, by I would probably stay on the sidelines for a while. It wouldn’t be a surprise to see Air Canada’s stock price fall back to $15 before it stabilizes.

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