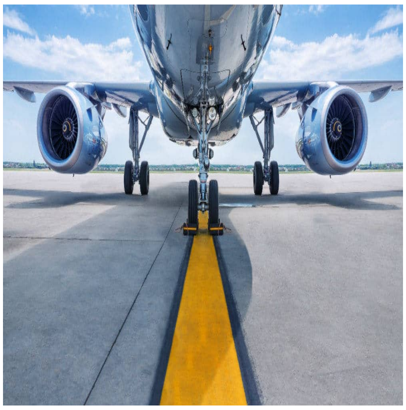

Air Canada (TSX:AC) Ratings Cut: Should You Avoid it?

Description

The accelerated vaccination rollout and improved demand for domestic air travel resulted in **Air Canada** (TSX:AC) finally getting some favourable wind conditions under its wings to help it rise from its pandemic lows. However, the airline stock managed to almost reverse its entire gains this year, as the increasing fears of the fourth wave of infections caused by the Delta variant took its toll on travel demand.

The decrease in demand for air travel and its impact on the airline's recovery is not speculative. RBC Capital Markets downgraded its rating on Air Canada to the equivalent of hold from buy, because it implied that there is a significant risk of the new variants of the novel coronavirus wreaking havoc on its short-term performance.

The downgrade came in earlier in October, and it represents the first time that the bank's analysts have lowered Air Canada stock's rating in eight years. The question is, is Air Canada stock an asset you should avoid right now or an undervalued stock to add to your portfolio?

Let's take a better look at the situation surrounding the beleaguered airline stock to help you make a well-informed decision.

Air travel demand will rise

While bookings are still significantly below pre-pandemic levels, customers are returning to Air Canada. The airline's CFO Mike Rosseau talked about the number of bookings steadily increasing for domestic, transborder, and Atlantic flights. While the resurgence of COVID-19 cases worldwide will likely continue to impact bookings, the demand for air travel is undoubtedly there.

Cargo business revenues are getting better

Air Canada shifted its focus to expand its cargo-only flights due to virtually non-existent passenger flights. The company's cargo business has since improved significantly. Revenues from its cargo business increased by 33% during the second quarter for fiscal 2021, and the numbers are expected to be even higher in the current and coming quarters.

With dedicated freighters providing consistent capacity to meet the growing demands from the booming e-commerce industry, the cargo business could accelerate its revenue growth in the coming years.

Slow recovery due to near-term challenges

The near-term challenges will likely continue playing a role in hampering Air Canada stock's recovery. Cost inflation could also increase the difficulties for the airline. The challenges in the industry may result in a slow recovery for the battered airline.

Foolish takeaway

Air Canada stock is trading for $22.94 per share at writing, reflecting a massive discount of over 55% from its pre-pandemic levels. The near-term challenges still might cause some short-term pain for Air Canada investors. However, the airline stock could be valuable for long-term investors who do not mind waiting for significant capital gains, as global air travel demand recovers.

It is only a matter of time before travel restrictions completely ease up and international borders reopen. Such a development could significantly boost its financials and result in rapid recovery for the stock.

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adamothman