

Air Travel Is Back: Why Isn't Air Canada (TSX:AC)?

Description

The Canadian government has reopened the country's borders. Air travel is back, with people "revenge spending" on holidays they couldn't take over the past year. This boom in air travel doesn't seem to be reflected in **Air Canada** ([TSX:AC](#)) stock.

Year-to-date, Air Canada stock is up only 16.8%. Meanwhile, the **TSX 60 Index** is up 24.7% over the same period. The company's latest earnings report has once again affirmed that its recovery is on track and that it could bounce back to profitability soon. So why is its stock underperforming the rest of the stock market?

Here are some possible explanations.

Overlooked fundamentals

In the third quarter, Air Canada's air traffic was up by over 200% compared to the third quarter of last year. Heading into year-end, air traffic should improve significantly on the reopening of international borders. Pent-up demand in the air travel industry heading into the holiday season could present an opportunity to trim some of the losses accrued over the past year.

Improving air travel allowed the airline to half its operating loss to [\\$364 million](#) in the third quarter. Additionally, the downsizing and the cost-cutting that went into play during the pandemic has started bearing fruit.

The airline is yet to touch a \$5.9 billion government bailout. The improving underlying fundamentals means the airline could forgo the package all together all but averting the possibility of the government taking up a 5% stake worth over [\\$500 million](#).

Investors may have possibly overlooked all these green flags in the company's recent earnings results.

One of the biggest operational costs of running an airline is fuel. Fuel costs, of course, have been climbing steadily higher over the past year. A barrel of crude oil now costs US\$80 – more than double the price from last year. Some believe the price could exceed \$100 soon, which would be detrimental to Air Canada's profit margins.

However, investors may be forgetting that aircraft are more efficient now and Air Canada has already experienced much higher fuel costs. A barrel of oil cost \$100 on average throughout 2011 to 2014. Air Canada stock was up 900% over that same period. So the airline can certainly handle higher fuel costs in the near future.

Air Canada's stock is mispriced

Air Canada is well-positioned to bottom out and generate significant value if there is no further pandemic wave and travel restrictions. At \$25 a share, the stock is arguably undervalued. It's trading at a price-to-earnings multiple of eight.

Fundraising efforts in the third quarter of this year put a whopping \$7.1 billion in gross proceeds on the company's book. Meanwhile, management has extended the airline's debt maturities by several years. Combined with the rebound in sales, Air Canada's debt issues should be resolved in the near future.

Bottom line

The rebound in travel and international borders reopening should have boosted Air Canada much higher. However, the stock has underperformed the rest of the market this year. That could be because investors have overlooked fundamentals and are too pessimistic. Keep an eye on this potential opportunity.

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