Will Air Canada (TSX:AC) Stock Hit $30 by This Year's End?

Description

While I am bullish on **Air Canada** (TSX:AC) stock and see it as a top recovery play, the market's lukewarm response to its strong Q3 performance and solid Q4 guidance has kept me worried.

It's worth noting that Air Canada stock has risen only 5% since reporting its Q3 financial results on November 2. This is when Air Canada has reported a stark improvement in operating revenue and significantly reduced losses. Moreover, Air Canada's guidance suggested further improvement in its financial and operating performance.

So what's keeping Air Canada stock from flying high?

Factors hurting investors' sentiment

While Air Canada benefitted from improved traffic, an increase in jet fuel expenses remains a drag. In Q3, Air Canada reported fuel expenses of $472 million, up about $297 million from the prior-year period. While a significant part of this increase ($153 million out of $297 million) was driven by a higher volume of flying, a 39% increase in fuel cost per litre led to a $149 million increase in fuel expenses on a year-over-year basis.

Per the latest data provided by the International Air Transport Association and Platts, jet fuel prices (per metric tonne) have nearly doubled on a year-over-year basis in North America, indicating continued pressure on profitability.

While higher fuel expenses could continue to play spoilsport, its rising debt is a concern. It's worth noting that Air Canada's net debt stood at $7.2 billion at the end of Q3, compared to $2.8 billion at the end of 2019.

Should you worry?

I believe these headwinds are temporary and remain upbeat on Air Canada's long-term prospects.

Further, there are solid reasons to believe that Air Canada stock will deliver stellar returns in the medium to long term.

Air Canada's available seat miles and capacity that could generate revenues improved significantly during Q3. While its capacity compares unfavourably to the pre-pandemic levels, management expects further improvement on a sequential basis.

Air Canada projects a 135% year-over-year increase in the ASM capacity in Q4, implying a further improvement in revenues.

Further, as fuel expenses have risen, Air Canada is managing its operating costs well. Notably, Air Canada's adjusted cost per available seat mile excluding the aircraft fuel expense, special items, and the cost of ground packages at Air Canada Vacations improved during Q3. Simply put, a lower adjusted CASM makes Air Canada competitive against its peers and supports profitability.

Thanks to its solid cost controls, it managed to reduce losses by 50% in Q3, which is encouraging.

Looking ahead, improved bookings, increase in ASM capacity, and cost control measures will likely drive Air Canada stock higher.

Bottom line

I expect the overall improvement in the operating environment, the demand, and reopening of international borders to significantly boost Air Canada's financials, in turn, its stock price. Air Canada stock may surge to $30 by this year's end, it undoubtedly remains well-positioned to benefit from the uptick in corporate demand and its revenue diversification initiatives.

With its stock trading at more than 50% discount from the pre-pandemic levels, Air Canada is a buy at current levels.

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