



Is Air Canada (TSX:AC) Stock Oversold?

Description

Air Canada ([TSX:AC](#)) is getting closer to its 2021 lows. As the share price continues to lose altitude, contrarian investors are wondering if AC stock is [undervalued](#) and a good buy.

Omicron threat to Air Canada

The emergence of the Omicron COVID-19 variant is hitting global equity markets, with travel and hospitality stocks taking a particular hit.

The WHO declared Omicron a variant of concern after a steep rise in cases in South Africa over the past few weeks. Governments around the world are implementing new travel restrictions, ranging from a complete ban on all international visitors to targeted bans on visitors from a handful of African countries. Canada already reported three cases and omicron has also been identified in Europe, Israel, and Hong Kong.

This is bad news for Air Canada. The airline was just starting to get back on its feet, adding new routes and enjoying a strong rebound in bookings for winter destinations in 2022. In the event the new variant proves to be more transmissible, evades existing COVID-19 vaccine protections, or causes more severe illness, airlines could see all their progress over the past six months quickly unravel.

Even if complete travel bans are not imposed, tighter testing and monitoring requirements will likely go into place for travelers. This, along with new fears about traveling, could impact ticket sales, as people decide to stay home or delay holiday trips and family visits.

Air Canada financial situation

Air Canada reported Q3 2021 operating revenue of \$2.1 billion — nearly triple the level from the same period in 2021. The rebound shows people are willing to get back on planes when they feel it is safe.

Despite the strong recovery, Air Canada still reported an operating loss of \$364 million in the quarter.

However, net cash flow moved back into the positive at \$153 million, faster than the company had anticipated.

Air Canada took advantage of the summer momentum to strengthen its liquidity. The company reduced borrowing costs, extended maturities on corporate debt, and raised an additional \$7.1 billion in funds. Air Canada finished Q3 2021 with \$9.5 billion in cash, cash equivalents, and investments.

Air Canada has recalled more than 10,000 employees since the beginning of the year. The company reduced staff by about 20,000 in 2020.

Air Canada recently said it has exited its financial assistance agreement with the Canadian government, dropping \$3.975 billion in credit facilities that it has not utilized.

The decision was announced about a week before the Omicron news. Investors are now wondering if the move was too hasty.

Profitability risks

Even if Omicron turns out to be a short-term disturbance, Air Canada's road to profitability could be a bumpy one. Businesspeople are still working from home, and that is likely to remain the case through the first half of next year.

Even when they are comfortable visiting clients abroad again, there is a good chance executives and sales people will take fewer trips than in the past. The success of online meetings has changed the way people conduct business, and pundits say the future of corporate travel revenue is uncertain for the airline industry.

This poses a big challenge. The expensive seats in the front of the plane historically provided a good chunk of the profits.

High fuel costs are also an issue. Oil prices have recently pulled back from their 2021 highs, but could move higher again in the coming year. Jet fuel represents up to 20% of an airline's expenses, so high oil prices can cut into profits, especially if the airlines are not able to raise ticket prices.

Is Air Canada stock a buy?

Air Canada trades near \$20.50 per share at the time of writing. That's down from the 2021 high of \$31 but still up significantly from the 2020 low around \$12.

Investors might be tempted to buy the current pullback, but I would stay on the sidelines until there is more clarity on whether Omicron will trigger new widespread travel bans.

If things go the wrong way in the coming weeks, this stock could quickly retest the 2020 lows. As such, I would look for other deals in the market today.

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