Air Canada (TSX:AC) Stock: Should You Buy at $20?

Description

Air Canada (TSX:AC) has been on a downward trend since March of this year. The share price recently dipped back below $20, and investors with a contrarian strategy are wondering if AC stock is now undervalued and a good buy for 2022.

Air Canada stock price

Air Canada traded for more than $50 per share before the pandemic. At the time, demand for global business and holiday travel looked robust and the price of oil price remained at a reasonable level. The company generated decent profits, and the balance sheet was healthy.

For the first time in many years, analysts and investors thought the good times were set to continue. The airlines had figured out a way to get people to pay extra for perks like choosing seats and checking extra baggage. These fees drove up margins and profits.

The arrival of the pandemic, however, ruined the party. Global travel restrictions forced Air Canada cut staff by 50% as the airline reduced capacity by more than 90%. The share price plunged, as the world went into lockdown, falling below $13 per share in March 2020. The stock was still under $15 at the end of October last year before a rally kicked into gear that saw Air Canada soar as high as $31 on vaccine-driven optimism.

High cash burn removed some of the investor confidence through most of the past nine months. Air Canada continued to lose money at significant rate, even as it started ramping up capacity. Things were getting better but at a slower pace than the market might have anticipated.

The recent surge in new cases caused by the new Omicron COVID-19 variant is hitting Air Canada just as it looked like it was on track to have a decent 2022.

At the time of writing, the stock trades near $21 per share. That’s up more than a dollar from the previous day’s close below $20 but still about 30% off the 12-month high.

Air travel outlook

New restrictions on non-resident travelers and extensive and expensive COVID-19 testing requirements will likely put a big dent in travel demand in the coming weeks, as the world braces for the worst of the Omicron wave. Once the latest surge has passed, holiday travelers will likely start booking trips again, but it could be months before people are completely comfortable getting on planes for big trips.

The larger concern is the prospects for business travel. The premium seats at the front of the plane are expensive and traditionally generate a good chunk of the profits for airlines. Analysts throughout the pandemic have tried to figure out if business travel will ever return to its glory days. Companies managed to negotiate deals and conduct large meetings using online platforms over the past two years, and it is likely that trend will continue for many situations.

In-person contact is certainly preferred, but executives and salespeople will still travel less than before, as companies look to keep travel costs at reasonable levels.

In the event business travel doesn't return to previous demand, investors will have to rethink the multiples they are willing to pay for airline stocks. Replacing the lost business-class revenue might be difficult.

At the same time, fuel costs have soared in 2021, and high oil prices could be around for the next few years. Fuel expenses account for 15-20% of an airline's expenses. Even if planes fill up again with passengers, margins might be tight if airlines can't pass the higher fuel costs through to passengers.

In the case of Air Canada, it might be difficult to bump up ticket prices. A number of new low-cost competitors have emerged as a result of the availability of cheap planes and unemployed pilots. An abundance of new alternatives for Canadian travelers could force Air Canada to keep ticket prices low.

Is Air Canada stock a good buy now?

The 6% bounce in the share price at the time of writing shows there is appetite in the market for Air Canada stock. Bargain hunters who think the Omicron restrictions will be short-lived might want to consider nibbling near $20 per share. There is a possibility that speculators will drive the stock price sharply higher.

That being said, I would keep any new position small. Air Canada faces COVID-19, competition, and expense headwinds in the coming year, and the stock could easily retest the $15 mark if things go the wrong way in the next few weeks.

There are other cheap stocks in the **TSX Index** that might be better bets right now.

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aswalker