Air Canada Stock: Time to Buy?

Description

Air Canada (TSX:AC) stock plunged last month, as investors worried that high fuel prices, route cancellations, and travel chaos through Canadian airports will delay the company's return to profitability. Bargain hunters are now wondering if AC stock is now undervalued.

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Travel outlook

Travel demand is soaring after two years of lockdowns kept people in Canada and around the globe stuck at home. A strong desire to take holidays or travel to visit family in other countries is driving a major surge in seat bookings. This should be positive for Air Canada, as it can command high prices for its seats and is able to run full flights.

Unfortunately, a combination of ongoing COVID-19 restrictions on international travelers, a lack of border staff, and a shortage of airline and airport workers is making travel a nightmare for passengers. Air Canada recently announced route cuts to help it get through the busy summer season, but problems are expected to persist until the fall.

This poses risks for investors. First, the Canadian airlines are supposed to provide financial compensation of up to $1,000 per person when flights are delayed beyond specific time limits and passengers don't get to their destinations as scheduled. With thousands of people missing connections or being held up for hours every day, the payouts could be enormous in the coming months. This could drive up costs and extend losses.

Staff shortages will also increase expenses. High overtime payments to existing staff and expensive recruiting and training costs will eat into the bottom line. Competition for pilots and other experienced airline staff remains fierce and is pushing up core payroll costs. In fact, major airlines in the United States recently announced double-digit salary increases for pilots.

On top of all of the operational challenges, Air Canada has to deal with soaring fuel costs. Jet fuel accounts for 15-20% of an airline's expenses. Oil prices are expected to stay near current levels for the rest of this year and possibly through 2023. Fuel hedges will eventually run out and drive up fuel costs.

Airlines will try to raise ticket prices to compensate, but there is a point where people will simply decide to stay home.

An economic downturn and soaring inflation might also force potential travelers to change their holiday plans.

Is Air Canada stock a buy?

Air Canada trades near $16 per share at the time of writing. That's down from $27 a year ago and now at the lowest price since the fall of 2020. Traders could be tempted to jump in at this point hoping to make some money on a quick bounce. Buy-and-hold investors, however, might want to wait for the Q2 results to come out before taking the plunge.

Air Canada reported a net loss of $974 million in Q1. The second-quarter results should be much better on the revenue side, but the Q2 expenses and guidance for the second half of the year will be key drivers of the market reaction to the numbers.

The industry will eventually get through the current challenges, but Air Canada's return to profitability might take longer than expected. With this in mind, I would probably look for other opportunities today.

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