Air Canada Stock Could Keep Trading Weak as Challenges Mount

Description

Many Canadian stocks breached their pre-pandemic highs this year amid re-openings. However, shares of **Air Canada** (TSX:AC), the country's biggest passenger airline, are still trading way below those levels. It's been a long time that Air Canada investors have been stuck with average or negative returns.

Some analysts seem quite hopeful of the massive recovery of the flag carrier due to surging demand. However, challenges seem to be too daunting for now, which could hinder its growth going forward.

Record-high inflation and impending recession

Airline stocks are highly susceptible to consumer discretionary spending. During high inflation periods, consumers tend to lower their discretionary spending. This could hold up the pent-up demand trends that we are currently seeing and hamper airline companies' top line in the next few quarters. Plus, insanely high energy prices in Europe and a recession in the U.S. could hit disposable household incomes — a worrying development for airline investors.

Global airline companies have not seen a profound impact on their revenues so far, despite daunting inflation. However, higher inflation for longer should concern them in the short to medium term.

Air Canada saw its revenues jump to $4 billion during the second quarter (Q2) of 2022 — a massive 376% surge compared to Q2 2021. It has been seeing triple-digit revenue growth since the last four quarters. But it continues to burn substantial cash and report losses. It burned $481 million and reported $386 million in a net loss in Q2 2022.

High oil prices

Air Canada's operating expenses in Q2 soared to $4.2 billion from $1.97 billion in the same quarter last year. The surge was mainly driven by a 116% rise in jet fuel prices. Fuel prices form some of the major cost components for airlines. Air Canada spends almost 35% of its revenues on fuel expenses. So, oil prices once again breaching triple-digit levels could mar Air Canada's profitability.

So, although demand is there, Air Canada's bottom line will likely see unceasing pressure for the next few quarters.

It seemed like things were finally falling in place for Air Canada investors with the end of pandemic-related restrictions. However, stable profitability still seems like a distant dream. And now, with economic uncertainties, the recovery appears all the more unclear.

Air Canada strengths

Air Canada had total debt of $16.6 billion as of June 30, 2022. Note that it has a strong liquidity position with $8.7 billion in cash and cash equivalents. A robust liquidity balance makes it stand relatively strong in challenging environments and offers flexibility to absorb short-term shocks.

However, a strong balance sheet with unstable profitability will be unable to create meaningful shareholder returns. So, a longer, more severe recession could significantly delay Air Canada's recovery.

What's next for AC stock?

AC stock plunged below $10 apiece during the pandemic crash. Air Canada is a fundamentally sound company with a leading market share and a strong balance sheet. However, with aggressive rate hikes and unrelenting inflation, AC stock might continue to trade weakly. So, in a nutshell, it seems AC investors might have to wait longer to see the golden days.

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