



## Looking to Buy TSX Stocks? Don't Fall Into the Air Canada (TSX:AC) Value Trap

### Description

Are you looking to invest in the stock market? This is a good time, as the **S&P/TSX Composite Index** has dipped 3% in the last two days. But don't fall into the **Air Canada** ([TSX:AC](#))

### The Air Canada value trap

AC stock has surged 16.5% in the last two weeks to \$18.63, which is above its 50-day moving average of \$16.53. This surge is temporary. The stock witnessed a similar rally in [early June](#) when it surged 47% in two weeks to \$23.39, as airlines saw an uptick in domestic travel. At that time, the stock surged above its 50-day moving average. It was overbought with a Relative Strength Index (RSI) of 72.

The RSI measures trading activity. When a stock is overbought, it tends to fall in the next few days if the rally is backed by news and not fundamentals. That is what happened with AC in June. The two-week rally faded, and the stock fell 24% in three days.

You can see a similar pattern now. AC stock has surged above the 50-day moving average and the RSI (64) is entering overbought category. This rally is not backed by fundamentals but by news. AC has started COVID-19 tests of passengers arriving in Toronto. This is its latest attempt to convince the government to adopt a more science-based approach to border restrictions.

### International travel restrictions extended to September 30

Air Canada's efforts are not yielding any results. Canada's minister for Public Safety and Emergency Preparedness, Bill Blair, has been extending the U.S.-Canada travel restriction since March 21. In his latest tweet on August 29, he extended the ban from September 21 to September 30.

The government is extending these restrictions, as international travel was the cause behind COVID-19 becoming a pandemic, spreading from China to the rest of the world in fewer than five months. The flight figures showed that 973 flights that flew into or within Canada between February 4 and August 24 had passengers who tested COVID-19 positive.

The government has introduced some stringent measures that travelers from abroad must comply with. Among them are screening questions, temperature checks, and wearing masks. The most important rule is the 14-day quarantine, which is

AC is trying to achieve a middle ground. It will do a voluntary COVID-19 test trial at the arrival point of Toronto airport. It will collect sufficient data to convince the government to come up with an alternative. For instance, the government could make the 14-day quarantine mandatory only for those tested COVID-19 positive.

## A possible implication of Air Canada's COVID-19 test trial

AC is spending a significant amount of time and money on the COVID-19 test to stop the government from extending the international travel ban beyond September. The airline depends on international travel for 70% of its revenue. The travel restrictions forced it to operate at just 10-20% of its capacity for six months. In three months of operating at 8% capacity, AC raked in a loss of \$1.75 billion. In six months, this loss could surge to \$3 billion, as the airline continues to burn \$15-\$17 million cash daily.

AC has every possible interest to get people flying internationally. If its COVID-19 test trial succeeds, it could increase its capacity to 30-40% or even more, which will help it reduce the cash burn and avoid bankruptcy. Back in June, the airline expected international travel to start in the fall of 2020 and return to the pre-pandemic level by 2023.

The slower the recovery, the closer AC will come to bankruptcy as its \$9.1 billion liquidity exhausts and debt piles up. It has short-term loan maturities coming in 2021. By that time, it needs to earn sufficient revenue to either repay those loans or refinance those loans with longer-term loans. That won't be possible with a [Fitch rating](#) of "BB-."

## Investors beware

Don't get swayed by AC's short-term stock rally, as it is not sustainable. Until there is some concrete positive change, AC stock would only be a value trap.

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