



Air Canada (TSX:AC) Stock: Will It Touch \$30 or \$0?

Description

Air Canada ([TSX:AC](#)) stock covered the journey from \$15 to \$28 in a month. That's an 80% jump. The stock outperformed the top four U.S. airline stocks, which rose between 20% and 50%, on the back of its strong balance sheet. Heading closer to the \$30 price, AC stock has entered a dangerous terrain. Investors have overpriced the stock. What can you expect from it in the coming few months?

Air Canada stock's 80% jump

Since the end of September, I have been advocating AC for [short-term gains](#). That was the time when most stocks became range-bound as investors had already priced in the pandemic impact. They were waiting for the miracle vaccine that could bring them out of the pandemic.

November 9 marked a historic moment for airline investors when **Pfizer** announced 90% effectiveness of its COVID-19 vaccine. AC stock rose a whopping 28% in just one day. Pfizer's announcement raised hopes that the COVID-19 vaccine could come as early as December instead of the first quarter of 2021. Since November 9, AC stock hasn't turned back.

One could list many reasons for AC's 80% stock price rally. For instance, the airline is downsizing and creating a dedicated air cargo business. Moreover, it is readying its aircraft to transmit the COVID-19 vaccine from countries around the world to Canada.

AC is also expecting a sector-specific bailout from the Canadian government. It is trying to work around a scientific approach to the 14-day quarantine requirement by testing passengers for COVID-19.

AC was making these efforts during the pandemic as well, but it couldn't anchor investors' confidence then, as none of these efforts would have made the airline profitable again until the pandemic is over and travel restrictions are lifted.

But now the tables have turned. Given that the vaccine will ease the pandemic in a year or so, AC's efforts can see the light at the end of the tunnel. Hence, its stock rallied 80%.

Why is net debt so important?

AC entered the pandemic with one of the strongest balance sheets. But the pandemic came as a surprise it wasn't prepared for. AC ended the third quarter with [net debt](#) of \$4.9 billion (debt left after deducting cash and short-term investments).

If you look at AC's net debt figure in isolation, it might spell trouble. But compared to the top four North American airlines, AC has the second-best balance sheet after **Southwest Airlines**, which has a net cash position of \$3.7 billion. **American Airlines** has a net debt of \$24 billion.

The airlines are burning cash as 80% of their capacity remains idle. They are raising liquidity through debt and equity. But who will put money in a company that is doomed to make multi-year losses?

Airline bosses are saying that travel demand won't return to the pre-pandemic level for a minimum of three years. This means the cash-burning will continue for another year or so.

As it is, the airline industry doesn't enjoy high profits. Almost 85%-90% of airlines' revenue goes into covering operating expenses. The debt that airlines are accumulating during the pandemic comes at an interest rate as high as 9%.

The higher the debt higher will be the interest expense, thereby weakening an airline's capacity to service its debt. Hence, Warren Buffett exited airline stocks.

What's next for Air Canada stock?

Airline stocks will grow tenfold when they start recovering. But they are prone to bankruptcy if they can't generate enough revenue to service their debt.

In such a scenario, the trick is to put your money in airlines with the lowest debt as it has lower chances of declaring bankruptcy. Hence, AC stock outperformed its North American counterparts. Now approaching \$30, it is priced for the next five years or so. Investors have overbought the stock with a Relative Strength Index of above 80.

At this juncture, AC stock could see some pullback and adopt a new price range of \$20-\$28, but it is unlikely to dip to \$0. So if you want to profit on AC, buy the stock when it falls below \$22 and sell when it surges past \$26.

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