Sell Air Canada (TSX:AC) Stock Right Now!

Description

Air Canada (TSX:AC) stock just fell 4% after rising a whopping 73% in 30 days. The stock crossed the $27 mark in the post-pandemic economy as a positive update on the COVID-19 vaccine floored. Investors poured money in AC, thinking it to be the ultimate value stock. But a surge like this only on hopes cannot sustain for long. The stock fell 4% on December 9 when AC announced more service cuts and station closures in Atlantic Canada provinces effective January 11, 2021. These stations will be closed until further notice.

Should you worry about Air Canada?

AC has already suspended services on 30 routes and closed eight stations from its network for an indefinite period. It made these service cuts as these routes were not feasible for running flights due to low air travel demand. The airline has been burning cash to stay operational. It adopted aggressive cost-cutting measures to reduce its cash burn, and route cuts are one of them.

AC has managed to stay afloat without airline-specific government support. The only support it got from the Canadian government was a wage subsidy program that helped it pay its employees. But the airline is raising expensive debt to keep its planes grounded and fly on routes where there aren't sufficient passengers.

The rising COVID-19 cases have reduced traffic further. To add to the weak demand, Canada has extended its travel restrictions until December 21 for the U.S. border and January 21 for other foreign nationals. The government is neither easing travel restrictions nor providing additional financial support in the form of airline-specific bailout.

The government said that it is working out a bailout. It even laid bailout conditions that AC has to refund ticket money for canceled flights and resume operations on canceled routes. But it was silent on the amount of the bailout and the form of the bailout (grants, loans, or equity stake).

AC's latest route cuts signal that its patience is running out. In a statement to *Global News*, Air Canada said, "This decision was not taken lightly and we regret the impact on our customers and community partners, but it is increasingly difficult to continue to operate in this challenging environment, without specific financial support from the government, with whom continue to wait for negotiations to start."

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Cutting routes for an indefinite period shows that the current cost-cutting plan is not enough. The news that a COVID-19 vaccine has come into the market does raise hopes that the dark tunnel of weak air travel will end in a year or two. These hopes sent AC stock to $27, trading at -9.5 times its next 12 month earnings per share. This means you are paying $27 per stock to fund AC's multi-year losses.

The stock was overbought with a Relative Strength Index (RSI) of 78. An overbought stock has limited room to grow and a lot of room to fall. Hence, AC stock fell 4% on the news around route cuts. It is still in the overbought category, which means more decline could come.

I had warned before that AC stock is unlikely to sustain any rally unless the airline shows signs of profits. Even during the 2009 financial crisis, AC stock was unable to sustain the rally until 2013 when it reported its first profit.

How to profit from airline stocks

AC has a stronger balance sheet than its peers, making its stock range-bound. During the pandemic era, the stock moved in the $14-$22 price range. In the vaccine era, where the airline could hope for a recovery in air travel demand, the stock's price range might increase to $18-$26.

In such range-bound stocks, you can make money by buying in the lower range and selling in the higher range. If you buy AC stock at $18 and sell at $25, you will make a 39% profit. In dollar terms, your $100 could convert to around $140. But this high return comes with risk.

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