How to Make Money From Air Canada’s (TSX:AC) Stock Price Volatility

Description

Air Canada (TSX:AC) stock was one of the most heavily traded stocks on the Toronto Stock Exchange last month. The airline caught the attention of many analysts and investors with its better-than-expected third-quarter earnings. **RBC** analyst Walter Spracklin even said that AC was “better off” than its peers. Hence, when the COVID-19 vaccine euphoria hit, AC stock outperformed its peers, surging more than 80%. I have been cautious around the entire aviation sector because of its high capital requirements and single-digit profit margins.

But if you want to bet on airlines, then AC is the stock. It has the economic moat to survive even without a bailout. Before I jump into how to make money from AC’s stock price volatility, I will highlight the events that will fuel the volatility. That way, you will know what action you need to take on what news.

What is fueling Air Canada’s stock price volatility?

AC’s stock price is moving on investor sentiment than fundamentals. If you look at AC’s losses, cash burn, net debt, and liquidity in isolation, the stock is unlikely to recover for another three years. But when you compare it with its North American peers, it is better off than most airlines.

Nine Months 2020	Air Canada	Southwest Airlines	Am
Revenue	$5 billion	US$6.99 billion	US
Net loss	($3.5 billion)	(US$3.01 billion)	(US
Net cash/(debt)	($4.9 billion)	US$3.8 billion	(US
Bailout	$492 million	US$3.2 billion	US

AC has $8 billion in liquidity that will help it stay afloat for more than a year without a bailout, given its annual loss does not significantly exceed $4 billion. The airline did receive an indirect bailout of $492 million in the form of a wage subsidy, but it is less compared to the billions of dollars **Southwest Airlines** and **American Airlines** received as bailout money.

AC is preserving cash by suspending services to various routes, canceling flights, and giving vouchers instead of cash refunds on non-refundable tickets. At the end of September, it had around $1.5 billion in revenue on hand from non-refundable fares.

Now, AC and the Canadian government are in a tussle over an airline-specific bailout. On the one hand, the government is asking AC to refund ticket money and resume services on suspended routes in return for a bailout. On the other hand, AC says that it will refund the money if the bailout amount is substantial and excludes the government equity stake.

A bailout will give AC access to low-interest loans for the long term, which will significantly reduce the interest expense it is incurring by taking loans at 9% interest. A bailout will also help it become profitable faster.

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The update and decision on the bailout will be the next big news after the vaccine that will fuel AC’s volatility. Last week, AC stock fell 4.3%, as the airline announced a plan to suspend services to some Atlantic provinces until further notice, effective January 11, 2021. This is AC’s way of forcing the government for a bailout.

A $27 stock price is not sustainable for AC, which will not make a profit for another two years. But its strong balance sheet will prevent the stock from falling below its pandemic price of $14. AC is better off than other airlines to survive the pandemic crisis, making it an ideal stock to play on volatility.

Before the COVID-19 vaccine news, AC stock was trading in the $14-$22 price range. This price range was governed around sentiments regarding when AC will fly again. The vaccine gave investors a direction to estimate a rough timeline — six months to a year — around the easing of travel restrictions. This hope has upped the price range to $18-$28. Now, investors are concerned if AC will fly competitively, and for that, it needs a bailout.

Investor takeaway

When trading on a range-bound stock, always keep a margin, as it is rare the stock will hit the bottom or top price. You can buy AC stock when it dips to $20 and sells it when it crosses $26. This range can earn you 30% returns. But invest a small amount in this high-risk stock.

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Date
2025/07/04
Date Created
2020/12/14
Author
pujatayal