Air Canada (TSX:AC) Stock Slumps to Around $20: Should You Buy?

Description

Air Canada (TSX:AC) stock fell almost 6% on Monday after the new U.S. president Joe Biden imposed travel restrictions similar to Canada's. It seems like airlines are back to where they were in March 2020. The second wave of the pandemic is spreading faster. The mutant coronavirus is more contagious and could reduce the impact of the vaccine. In the light of the new developments, countries worldwide are reinstating the March 2020 air travel restrictions.

The United States reinstates air travel restrictions

Effective today, any person above two years of age traveling to the United States from another country will have to do a COVID test 72 hours before travel and show a negative result. The above rule also applies to those who took the vaccine.

Even after people are tested negative, they have to quarantine themselves. Now, it is not clear how many days of quarantine is mandatory. But the Centers for Disease Control and Prevention (CDC) has reduced the quarantine requirement to 10 days.

The Justin Trudeau government has implemented similar rules since January 7. At that time, AC announced additional 1,700 job cuts and several route suspensions, as it saw a slurry of close-in booking cancelation. While Canada's restrictions were not enough, AC's second-largest market, America (22% revenue in 2019), has also imposed travel restrictions.

Air Canada under a 12-month quarantine

While people have been in quarantine for 14 days and recovered, AC is now heading to the 11th month of quarantine, and it could easily extend to the 12th month. While AC managed to slip by 2020 with just 30% revenue, it might not be able to handle the pressure for another full year without a government bailout.

At the end of the third quarter, AC had $8 billion in liquidity and expected more than $1 billion cash burn in the fourth quarter. In January, the airline implemented a fresh round of capital raising ($850 million in equity capital) and cost cutting. This shows that times are tough. Hence, AC stock fell to about $20. This is the lower side of the $20-$26 price range I'd suggested to those who wanted to make short-term gains.

But I will suggest you wait a little longer before buying the stock at $20. It could fall further when the airline releases its fourth-quarter earnings on February 12. This is also the time when CEO Calin Rovinescu retires and CFO Michael Rousseau takes charge. You will also see the fate of AC's acquisition of **Transat A.T.** Either the stock could fall to $18 or rise to $22, depending on which side the earnings point the needle.

Is Air Canada stock a buy at $20?

Although the future looks bleak at the moment, AC stock has the potential to revive to $26-$30 by the end of 2021. If you want to invest around $500 in AC, buy $170 (a third) worth of AC stock at the $20 price. Wait for earnings and buy another $250 worth of stock if the price falls to $18. Keep the remaining money handy to tap any sudden dip.

This way, you can leverage the downside and benefit from the upside. What is the possibility of upside?

The most pressing issue for AC is cash burn and expensive liquidity. The airline is taking loans at 9% interest. The Justin Trudeau government has been in bailout talks with AC since November 2020. Even if there is a bailout, it could go both ways. If the government provides low-interest, long-term loans to AC, the stock could surge. But if the government nationalizes AC, it could send the stock down.

The next issue is travel restrictions. Once these restrictions ease, AC will see pent-up demand for leisure travel. That will be the turning point for investors, and the stock could jump more than 20% in one day. But the biggest question is, will AC withstand to see that day?

With the rate at which it is reducing its fleet size and suspending routes, it might not survive beyond 2021. All the moving elements make AC a short-term, risky bet you can play in the $20-$26 range.

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