



Air Canada Grounds Rouge: What's Next for AC Stock Investors?

Description

Air Canada ([TSX:AC](#)) faces tough challenges through the rest of the winter. Investors now wonder if Air Canada stock can survive the pandemic storm.

Tighter government restrictions

Canada recently implemented a ban on all flights to Mexico and the Caribbean. The move comes as part of a ramped-up effort to keep new COVID-19 variants out of the country amid delayed vaccination deliveries from key suppliers.

Air Canada and its peers had found some success in recent months flying Canadians to warm destinations. A [CBC report](#) in mid-January showed 1,500 flights that had gone between Canada and 18 holiday destinations since October 1.

The article highlighted the challenge the government faces in getting people to respect the directive to avoid non-essential travel. Whether or not the story pushed the government to enact the new restrictions is unknown, but a window of rare revenue opportunity for Air Canada and its peers that fly to vacation destinations is now closed.

As a result, Air Canada announced it will ground all Rouge flights. The subsidiary serves the sun and fun locations. Air Canada will lay off an additional 80 people, although it says the move is temporary. Rouge remains part of the long-term growth strategy.

In early January, Canada imposed new rules that required people flying to Canada to present proof of a negative COVID-19 test within the past three days before boarding the plane. The measure had the desired impact on bookings, but a pilot COVID test program at Toronto's Pearson International Airport showed that some arriving passengers still tested positive.

In response, Canada [announced](#) January 29 that anyone arriving by air to the country must take a test on arrival and stay in a designated hotel at their own expense for three days until the test results are confirmed. People then have to complete the required 14-day quarantine at their planned destination.

Impact on Air Canada stock

Despite all the added bad news, Air Canada stock trades near \$22 per share, unchanged from where it was a month ago. Some pundits say the shares are a great [buy](#) at this level. Others think it should be closer to \$10.

Why are investors still optimistic?

Air Canada continues to negotiate aid terms with the government. The process began in November and investors hope a bailout will ensure the company cruises through the lockdowns. Global airlines received at least US\$160 billion in government aid in 2020 according to the IATA. Financial assistance for Air Canada and its peers will eventually arrive.

However, investors need to pay attention to the details of any package. Restrictive and expensive terms could impede a return to profitability. The government claims it wants refunds paid to ticket holders who had their flights cancelled. Guarantees to maintain routes to smaller cities is also a demand. Pundits suggest the government could require Air Canada to take delivery of cancelled plane orders for aircraft made in Canada. Commitments on carbon emission initiatives might be part of a deal as well.

All these measures would have an impact on the balance sheet, cash flow, and profitability.

Should you buy Air Canada stock now?

A year ago, Air Canada was in great shape. Profitability remained high amid strong demand for expensive seats. The stock traded for \$45, which made sense with all indicators pointing to positive 2020 growth.

Today, Air Canada is a much smaller entity. The company is burning through about \$1 billion in net cash per quarter. Business travel might never return to previous levels. Airline executives say overall capacity won't reach 2019 levels for at least three years.

To make matters worse, oil prices are now at 12-month highs. That's great for Canadian [oil producers](#) but bad news for airlines.

Given the risks in both the coming months and the next few years, the current valuation appears a bit stretched. Air Canada's stock price could certainly jump on news of a bailout, but I would search for other opportunities in the market today.

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