



Is Air Canada (TSX:AC) Stock on the \$30 Trajectory?

Description

On Friday, **Air Canada** ([TSX:AC](#)) stock surged 5%, not because of its earnings, but because Transport Canada approved its takeover of **Transat A.T** (TSX:TRZ). Transat stock surged 13%. AC is downsizing, canceling flights, suspending routes, and retiring aircraft. Capacity has become a curse more than a gift for AC in the COVID-19 economy. So, why are investors happy with this acquisition?

What does the Air Canada–Transat deal mean to investors?

The airline industry has undergone significant consolidation over the years, as its high fixed costs makes it vulnerable during a crisis. Most of the airlines worldwide have gone bankrupt at some point in time. As the airline industry faces its biggest crisis to date, a consolidation comes as welcome news.

I have reiterated time and again that the air travel recovery hinges on the pent-up demand from leisure travelers. They are not flying because the Justin Trudeau government has put blanket restrictions on non-essential travel.

Towards the end of 2021, airlines expect to see some of these restrictions ease. At that time, AC will use tour operator Transat. The consolidation of the two biggest airlines connecting Canada to Europe could give AC a kind of monopoly in some routes. When the restrictions ease, AC will use its Aeroplan loyalty program and Transat customers to make the most of the pent-up demand from leisure travel.

Transat is more desperate than AC, as it is stuck with \$600 million of customers' deposits and less than \$680 million in cash. In an analyst's call, Transat's chief financial officer Denis Petrin said, "We are signaling that there might be a question mark on our ability to continue as a going concern, considering that additional financing will be necessary if there is no transaction." Hence, the government approval will save Transat from bankruptcy.

However, the battle is only half won. Even the European Commission has to approve the deal. That approval could trigger another 4-5% rally in AC stock price.

Will Air Canada stock touch the \$30 mark?

The Transat deal is just one of the elements that can push AC stock to \$30. But the success of its plans depends on the status of the pandemic-induced restrictions. The airline has prepared itself for another 12 months of losses.

AC released its 2020 [annual earnings](#). It ended the year with a \$4.65 billion net loss, \$5 billion net debt, and \$8 billion liquidity. The airline has made all arrangements to reduce its losses in 2021. It has reduced its capacity by 67% in 2020, cut costs and capital requirements by \$1.7 billion, and is looking for more cost-cutting opportunities. The rising net debt is building pressure on the need for a low-interest-rate, long-term loan in the form of a bailout.

If AC stock surges to \$30, it will not be because of fundamentals. It will be because of hopes of the return of pent-up demand and a bailout. Air Canada stock's 5% surge post-earnings will fade if the European Commission rejects the Transat deal and the Canadian government remains silent on the airline-specific bailout.

If the government doesn't give a bailout before June, AC stock could fall below \$20. This is because the Canada Emergency Wage Subsidy, which is bearing AC's 20% operating expense, ends in June.

How to make money from airline stocks

AC's earnings don't make me bullish. And I will not suggest using up a good portion of your portfolio on AC unless Redditors target it for a [short squeeze](#). You can probably invest 5% of your portfolio in AC. A good price point to buy the stock is \$20, as the stock is likely to hover in the \$20-\$30 price range in 2021, even if travel restrictions ease.

There are better growth stocks with strong fundamentals.

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