



How to Win Air Canada (TSX:AC) Stock's \$20-\$30 Game

Description

Air Canada (TSX:AC) stock broke its \$27.5 resistance, as investors look with hopeful eyes to the Justin Trudeau government to announce a [bailout](#). Moreover, the airline is diversifying its revenue streams beyond passenger air travel to include air cargo and the Aeroplan loyalty program. All other news is secondary. The bailout is primary as that will address AC's major issue of debt. But if you are hoping that the airline will see another 80% stock price rally as it did in November, be careful.

Bailout in the cards

The biggest game changer for AC stock was the CEO change. Its retiring CEO Calin Rovinescu came from a law background and preferred to stick by his terms. The new CEO Michael Rousseau comes from a finance background and is more accommodative. He has already scrapped the **Transat A.T.** takeover, which Calin Rovinescu negotiated. What the airline needs the most right now is finance.

Investors are hopeful that Rousseau will materialize this four-month-long bailout talk. It is not like that the Canadian government didn't provide any support. AC was the biggest beneficiary of the Canada Emergency Wage Subsidy (CEWS), receiving \$554 million in 2020.

But as Air Transport Association of Canada president John McKenna pointed out in a [CBC report](#), "the subsidy doesn't pay off airlines' capital debt." The airline needs money to pay for planes, equipment, and other such capital expenditure in an environment where revenue is dry.

An airline-specific bailout will give AC low-interest loans for the long term, helping it reduce its interest burden. At present, the airline is raising debt at 9% interest. The government could also give bailout in return for stock warrants. This money will give AC some breathing space to implement its strategy to make money in the post-pandemic world.

Air Canada's strategy for the post-pandemic economy

I have talked in length about the future of air travel demand. Once the government lifts travel

restrictions, AC could see a huge influx of pent-up demand from leisure travelers and those visiting family and friends. But the potential lies in business travel, and that is unlikely to recover for another four to five years.

AC has accepted the fact that air travel demand will not return to pre-pandemic levels. AC decided that if it couldn't fly passengers, then it would fly cargo. AC has introduced a dedicated subsidiary for air cargo. But instead of purchasing freighters, it is taking out seats of widebody passenger aircraft that it has already retired. Another area where AC sees revenue is in its Aeroplan loyalty program. The airline is partnering with new services like **Uber Eats** and **Starbucks** to hold on to its customers.

Air Canada's \$30-\$20 game

The simple rule of investing is to buy on dips and sell on the rise. Air Canada stock has already surged 38%. At the most, it might surge another 15% to \$32 if the government gives a bailout. But the stock won't be able to sustain a \$32 price. It will fall back to its \$20-\$30 game. Why? Because it is the investors' hope that is fueling this rally. And, as it is with sentiments, they waver on rumour and news. A company with strong fundamentals enjoys investor loyalty.

In the airline world, AC has one of the strongest balance sheets, with \$8 billion in liquidity and \$5 billion in net debt. It may look weak when you see it in isolation, but it is strong compared to **American Airlines** and **Delta Airlines**. Despite a bailout, the U.S.-based airlines' net debt overtakes their liquidity.

Airlines Names	Liquidity in 2020	Net Debt in 2020
Air Canada	\$8 billion	\$5 billion
American Airlines	U\$14.3 billion	U\$25.5 billion
Delta Airlines	U\$16.7 billion	U\$18.8 billion

It is this balance sheet that is keeping AC stock steady at \$20. Hence, the stock did not fall below this point in January when the second wave of the pandemic forced AC to cut jobs and close additional routes.

Now that you know the strengths and weaknesses of AC, you can win the \$20-\$30 game if you play by the rules of buying the dips and selling the rallies.

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