



Air Canada (TSX:AC) Stock Rose 34%: What Should You Do With This Stock Now?

Description

Air Canada ([TSX:AC](#)) stock soared 34% on the word of the bailout. Although there is no official announcement yet, it could come soon. What happens after the bailout? The golden rule of investing is to buy when others sell and sell when another buy — just swim opposite the tide. Another way to put it is to buy the dip and profit off the rise.

Warren Buffett: “Be fearful when others are greedy”

No matter the stock, the rule applies to all of them. Then why I hesitate in getting rid of AC when it has reached its pandemic high. It is the greed of the stock breaking the \$30 mark that is keeping you from taking profits. I won't deny that possibility. But if you are looking to buy AC at the current price point of \$27.5, you are walking into a value trap.

This value trap has a 16% upside if the stock rises to \$32 and a 20% downside if the stock returns to its average trading price of \$22. The Oracle of Omaha Warren Buffett said, “Be fearful when others are greedy and greedy when others are fearful.” The current momentum of AC stock shows the greed of a bailout. And this is the time to be fearful and cash out your profits, because the bailout is like a tossed coin that can fall on heads or tails.

Why are investors greedy about a bailout for Air Canada?

Airlines worldwide are burning cash, as people stay confined to their towns. Air Canada is [burning](#) \$15-\$17 million cash daily, which means another \$1 billion loss in the first quarter. The airline has \$8 billion in liquidity and \$5 billion in net debt. It is raising more debt at a 9% interest rate to improve liquidity.

If the net debt continues to grow, it will become difficult for AC to return to profits. A bailout will provide temporary relief to AC in terms of net debt. It will give the airline some flexibility to work around the pandemic and squeeze out revenue from its planes and loyalty program.

But this bailout will be fruitful only when its terms are favourable. What will be favourable for AC is when the government gives billions of dollars in low-interest, long-term debt. Stock warrants will dilute shareholders' interests in the long term.

Moreover, the government has laid out the following conditions for a bailout:

- The airline should refund the ticket money to passengers whose flights got canceled.
- It should reopen its suspended routes.
- It should protect Canadians and the public interest, probably by keeping tickets affordable.

These conditions will increase the cost for Air Canada. The amount and mode of the bailout will determine how effective this taxpayer money proves. Maximizing the returns from this bailout money while complying with the above conditions is then the management's efficiency. And shareholders have confidence in Air Canada's management.

Is it too early to hope for Air Canada's profit recovery?

A stock price should reflect a company's future earning potential. But AC has nothing but losses in 2021. Then what is AC's stock price reflecting? It is reflecting traders' technical volatility and investors' hopes that the airline will recover.

When the [airline was hit by the SARS epidemic](#) (2002-2003), it took AC one bankruptcy and seven years before any profits. It was only in 2013 when the true growth story of AC stock began, and it surged 2,000% in seven years.

Although AC is more experienced and in a better position now, it is too early to hope for a recovery in its profits. When the airline fundamentals show progress, a new growth story will begin. Until then, there are better and more profitable stocks that are writing their growth story.

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