Air Canada (TSX:AC) Stock: Is the Dip Over?

Description

Air Canada (TSX:AC) stock kept rallying all through February and then plateaued in March. You must be wondering if the dip over. Has the stock stabilized? Hold on! Don't jump to conclusions. Short-term stock volatility is an emotion (fear and greed), but long-term stock price growth is fundamental. A hollowed stock cannot stay overvalued for long and will dip on any instance of negative news that evokes fear.

Why is Air Canada stock rallying in early April?

On the one side, Germany and France have imposed fresh lockdowns, and other nations are on the verge of following suit. On the other side, the United Kingdom has eased the lockdown, and Canadians are hoping to see some easing in air travel in May. But May is still 30 days away, and coronavirus can change many things in 30 days.

Nevertheless, AC is a momentum stock, and these are Robinhood investors who believe in living in the moment. The stock surged 2% today after the airline called off its deal to acquire international tour operator **Transat A.T**. Just a few months back, investors were bullish on the deal, and now they are happy that AC called off the deal. What's the deal with these wavering feelings?

Air Canada is better off without Transat

In October 2020, AC's former CEO Calin Rovinescu slashed the bid price for Transat by 72% to $190 million. At that time, the deal still made sense as there was hope that leisure travel will return in full swing. And the vaccine news further strengthened these hopes. But the second wave of the pandemic in December burned these hopes in thin air, and no sign of bailout left AC pressed for cash.

Even though AC had $8 billion in liquidity at the end of 2020, every penny counts as time is not in favour of airlines. The travel restrictions are unlikely to ease before 2022. AC was hanging on to the hope of a successful vaccine rollout by September. But the rising cases of the mutant virus, delays in vaccine deliveries, and people's reluctance to get vaccinated are slowing the vaccine rollout.

Canada has no domestic production capacity for making vaccines. Hence, it is relying on imports. On the world stage, Canada is around 40th on the list of vaccine priority. This means AC better preserve cash to burn in the cold winters as air travel demand may not return soon.

In the current situation, Transat seems more like a burden than an asset. Hence, when European regulators delayed their approval due to concerns of higher prices and reduced choices for travelers, AC got a reason to walk away. It had no economic moat to fight for the deal. A $12.5 million termination fee looked like a sweeter deal than a $190 million acquisition. This move has Air Canada's new CEO Michael Rousseau written all over it as he is trying every bit to cut costs and get a bailout.

Air Canada stock is not immune to dip

The Transat deal news gives AC a better chance to survive but does not make it immune to dip. Think of it this way. When you are flying with only one engine, throwing away heavy objects helps you stay in the air longer. But it doesn't avoid the risk of a crash. AC stock can dip if:

- There is a third wave of the pandemic,
- The Canadian government doesn't give a sizeable bailout,
- The vaccine rollout is delayed significantly.

AC is burning $15-$17 million cash per day. As time passes, it is becoming more difficult for the airline to raise capital, and its $8 billion liquidity will keep it afloat for 12 to 15 months with no revenue. This means AC stock still has a high risk to dip to $20 or even $0.

Final thoughts

I would suggest not to buy the airline stock at a price above $24 as that will reduce your chances of making any money from the stock's volatility. There is a transaction cost attached to every trade, and the stock's rally doesn't last long. Instead of stressing over AC, invest in long-term stocks with better growth potential.

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Date
2025/09/04
Date Created
2021/04/05
Author
pujatayal