



My 5-Year Prediction for Air Canada (TSX:AC) Post Bailout

Description

The \$5.6 billion bailout has extended **Air Canada's** ([TSX:AC](#)) life by five years. After reading the bailout terms, I've removed AC bankruptcy from my five-year prediction for the airline. The bailout amount assures that the airline can survive another year of international travel restrictions. But the bailout comes after the third wave of the pandemic diminished hopes of free skies. How have the recent developments impacted my five-year prediction for AC?

In [February](#), I gave the best and the worst-case scenario for AC. And after two months, only the worst-case scenarios have materialized. The virus mutation has caused the third wave and is infecting younger citizens. There is a high probability that the Canadian government might extend the international travel restrictions, which were supposed to end on April 30.

However, even the third wave could not pull down AC stock below \$24, as investors were still hopeful for a sizeable bailout package. But when the government announced the bailout package, AC stock fell 13.5% in a week, below the \$24 price. Will the bailout reduce AC's volatility, or will it set the stage for a \$32 normal?

The five years of the Air Canada bailout

This is not the first time AC has dealt with a coronavirus. In the last 20 years, it has dealt with two coronavirus variants, Severe Acute Respiratory Syndrome (SARS) in 2002–2003 and the Middle East respiratory syndrome (MERS) in 2012. But these outbreaks did not last for over a year or grounded all the planes. However, the learnings from them did help AC avoid bankruptcy for a year. And now the bailout has given it the support to avoid bankruptcy for another two years.

You may ask then why I keep emphasizing the five-year term. This is because the shortest duration loans under the bailout package are of five years. Moreover, five years is sufficient time for air travel to stabilize and adjust to the new normal of social distancing and air travel demand.

During the SARS epidemic, Air Canada went bankrupt in April 2003 and it took the airline six years to emerge from bankruptcy, get back to the stock market, and report profits. With the bailout, AC can survive the pandemic-like scenario for another two years. If air travel demand begins to recover in these two years, then the bailout will help AC adjust to the new normal in the next three years.

What could be the new normal for the airline industry?

I am highly skeptical air travel demand will return to the pre-pandemic levels in the next five years because the business travel demand could take years to return. **Microsoft** founder Bill Gates even [believes](#) that remote working might take away more than 50% of the business travel forever.

In the pre-pandemic scenario, business travel contributed more than 50% towards the US airlines' revenue while accounting for only 30% of the trips. This means airlines made profits from the business travelers. With a major chunk of the premium gone, airlines have to adjust to the new normal and find ways to make profits. While the pandemic has reduced the opportunity for business travel, it has opened the opportunity for air cargo from the proliferation of e-commerce.

AC looks to monetize on this new opportunity and has created a dedicated subsidiary for air cargo services. With business travelers taking a back seat, it is targeting leisure travelers. When international skies open, Air Canada could see a wave of leisure travel from the pent-up demand of one year. Moreover, the airline is upgrading its fleet by keeping fuel-efficient aircraft and require low maintenance.

The five-year prediction for Air Canada

It took AC six years to return to profit during the SARS epidemic. This time it has a \$5.9 billion bailout and high liquidity. But the pandemic crisis is also equally severe. If air travel begins to return by the end of the year, AC might probably be able to turn profitable by 2026-2027. But it will be too optimistic to say at the moment.

The vaccine has upped AC stock's normal from \$15 to \$23. The airline-specific bailout could boost the stock to \$32 price and make this price the company's new normal until air travel demand returns.

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Date

2025/06/28

Date Created

2021/04/22

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