Air Canada (TSX:AC): The Pullback Before May 7 Earnings

Description

What is the fate of **Air Canada** (TSX:AC) stock? Some say the stock has the potential to go to $30. But some say that the stock is nothing but doomed. Investors believe a 6% equity stake to the government is too high a price for the $5.9 billion bailout and the conditions that come along. I couldn't agree more. But this is just a short-term view of the bailout. Investors are just getting anxious ahead of the May 7 earnings and the extended travel bans.

The pullback ahead of Air Canada's first-quarter earnings

AC stock has been on a free fall since mid-March as the third wave of the pandemic extended travel bans to sun destinations. This stock price movement reminds me of February 2021 when the airline reported its 2020 earnings.

At that time, AC stock became oversold ahead of earnings as investors priced in bearish sentiments around the airline's fundamentals. And Air Canada did not disappoint. It reported its worst annual earnings to date and an even bleaker outlook of $15-17 million daily cash burn and only 15% capacity in operation.

Coming to the present scenario, AC stock is below its 50-day moving average as the third wave has extended travel bans and investors perceive the bailout negatively. In the upcoming earnings, the airline could report over $1 billion in net loss and a sequential decline in revenue. Moreover, its net debt would increase by $1.4 billion as it withdrew the bailout loan to refund ticket money to travellers whose flights were cancelled because of COVID-19. AC stock could fall further this week.

Is Air Canada stock's pull back a sign of a rally?

Investors are upset with the 6% government ownership and another 4% ownership if AC withdraws a $2.8 billion unsecured bailout loan. Moreover, they are worried that the bailout terms like reopening routes, retaining existing jobs, and buying more planes will restrict Air Canada's flexibility to cut cost.

In Budget 2021, the government extended the Canada Emergency Wage Subsidy (CEWS) till September 25, and AC is most likely to be the key beneficiary. However, the government will reduce the subsidy amount beginning July 4, which will increase AC's salary expense. And if the borders don't open by then, Air Canada's cash burn will only accelerate.

There are many moving pieces, and the exact financial implication of all this is unknown. The upcoming earnings will put a figure to all this and help investors estimate loss from the third wave. Remember, the key cause of a stock price dip is uncertainty. Once this uncertainty is gone, the stock could surge starting next week to a $30 price, a 20% upside.

All eyes on the earnings

In the upcoming earnings, AC will shed some light on how the bailout will strengthen its balance sheet. It will also talk about how the bailout terms will impact its expenses. I don't expect any rosy outlook for AC before July. July is the month when the government will start phasing out its COVID-19 benefits, including the CWS.

Leaving aside the fundamentals, the earnings will see AC stock reach an oversold category, triggering a buy for short-term traders. If you want to make speculative bets, consider buying AC stock when it falls below $24. In the derivatives market, the highest volume call and put option trades have a strike price of $23 and $24, respectively. This means the stock is unlikely to fall below $23.

AC stock might not make a new high within a month like it did in February. But the stock could see a surge to $28-$30 as the skies reopen and the bailout terms sink in. That's a 20-25% return in less than a year. But it comes with the risk of a 17% downside if the stock falls to $20.

You can spend $100-$200 or 2% of your portfolio on Air Canada's stock. This way, a downside will not significantly impact your investment, and you will also get to taste high returns.

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