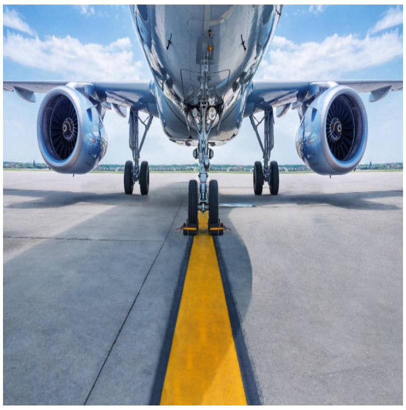

Why Air Canada (TSX:AC) Stock Soared 18% in 6 Days

Description

Air Canada (TSX:AC) stock has soared 18% so far in November on the back of better-than-expected earnings. The stock surged 74% last November when the vaccine news came out. It is difficult to say if the stock will repeat the same rally or report slower growth. But I will try to make an educated guess as to whether the stock can grow and sustain this rally. For that, you first need to know why the stock is soaring.

Why did Air Canada stock soar?

On November 2, Air Canada released its third-quarter earnings. This is the first quarterly earnings after the Canadian government started easing travel restrictions. There were a lot of expectations with the stock, as its price has been trading on a bearish note since the $5.9 billion government bailout. If the airline withdraws the bailout money, the government will get up to a 5% stake in Air Canada. This is over and above the $500 million worth of equity warrants that give the government a 5% stake.

The idea of a 10% government stake didn't bode well with investors, limiting the stock's rally, despite a recovery in air travel demand. Air Canada's management took the bailout money for safe-keeping, given the uncertain nature of the pandemic and the $15 million daily cash burn.

However, in its latest earnings, Air Canada's management gave investors three reasons to rejoice:

- Firstly, Air Canada has not yet touched the $4.4 billion unsecured loans from the bailout program.
- Secondly, the airline has raised $7.1 billion in secured credit facilities, bringing additional liquidity, reducing borrowing costs, and extending debt maturities.
- And lastly, the airline not only stopped cash burn but also reported a positive net cash flow of $153 million.

All three reasons hint that if things keep progressing the same way, it won't be long that Air Canada will return to profits. But if there is another pandemic, that could spell doom for Air Canada, even with total liquidity of more than $14.4 billion. So, there is high risk, but there are also high returns.

Let's take the two extremes and understand what could go wrong and what could go right for Air Canada.

What if Air Canada's recovery continues at the current pace?

In the third quarter, Canada started a phased reopening of the international border, with September 7 marking the day when fully vaccinated foreign nationals could fly to Canada without quarantine. This phased reopening increased Air Canada's traffic by 214.5% compared to the third quarter of 2020. But the air traffic was still 71.7% lower than the third quarter of 2019. This is because of the weak recovery in business travel that accounted for a significant portion of Air Canada's profits.

However, the airline expects to see a significant rebound in business travel in 2022, led by small and medium enterprises. I believe it because Air Canada was realistic and set a three-year time frame for a recovery in air travel. Its estimates have proved right so far. There wasn't any major rebound in air traffic until late this year.

If AC recovers to even 70% capacity of 2019, it could become profitable, as the airline underwent significant restructuring and capacity downsizing. I don't say AC stock will return to the pre-pandemic level, but it can hit the $40 mark as part of the recovery rally, representing a 51% upside.

What if another pandemic wave strikes?

Every coin has two sides. China is seeing a new variant of coronavirus spreading fast. The concern remains that the mutation of the virus could render the vaccine ineffective. If there is another lockdown, AC will return to burning cash. Hence, it is keeping liquidity of $14.4 billion and not letting go of the bailout money. All this can pull AC stock down to $20 or even lower.

Making money from Air Canada stock

AC stock is a double-edged sword. To make money in this stock, buy it below $22-$23 and sell it above $33-$35. If there is no pandemic wave, I would suggest holding the stock till June 2022. At that time, I will revisit the current scenario and guide accordingly.

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