Should You Buy Air Canada (TSX:AC) Stock After its 33% Drop?

Description

Air Canada (TSX:AC)(TSX:AC.B) shareholders have been in a world of pain, with the shares currently down 33% from its mid-January all-time high amid growing fears over the continued spread of the coronavirus (COVID-19).

In many prior pieces, I've urged investors to sell Air Canada, citing the new slate of ominous risks and a valuation that wasn't at all compelling after the stock's historic multi-bagger run.

There's no doubt that travel stocks have been toxic, with the top airlines taking on a brunt of the damage, but after the recent slide, has Air Canada become oversold amid the panic? Or is the valuation still not good enough given the magnitude of disruption to its business?

It's impossible to predict when the coronavirus correction (or crash) will end and what the implications will be, so if your strategy is to buy and pray, you may want to rethink it, as a nationwide shutdown of international flights could still be in the cards should worse come to worst.

And if such an event happens, Air Canada's recent decline of 33%, though excessive, could prove to be just the tip of the iceberg. As such, investors need to understand the full extent of the risks before jumping in at this juncture, no matter how "cheap" shares become.

How cheap is cheap enough in a panic-driven meltdown like this?

At the time of writing, Air Canada stock has sunk to a level such that many of its valuation metrics are more in line with its historical averages. Shares trade at 0.5 times sales and 3.1 times EV/EBITDA, which are more or less at par with five-year historical average multiples of 0.4 and 4.3, respectively.

From a longer-term perspective, the stock is looking cheap, and the damage is overblown beyond proportion, but that doesn't mean the stock won't continue to lead the downward charge, as the **S&P 500** and **TSX Index** looks to flirt with bear market territory over the coming weeks.

What's an investor to do? Take a raincheck on the name and don't try to trade on the outcome of a global pandemic. It's just too risky to call a bottom, given the high degree of exogenous risk and the likelihood that the stock will continue to amplify the negative moves made in the broader markets.

Moreover, Air Canada's next level of strong support is another 20% decline away at around $27-28. Even if the stock hits this critical support level, you must also consider the fact that the recent such a drop is still relatively small in the grander scheme of things. Air Canada stock could get cut in half from its all-time high and still be above its 2019 lows.

That doesn't sound like much of a deal at all.

Foolish takeaway

Yes, a 33% decline is excessive, but Air Canada stock still hasn't surrendered a full year's worth of gains. And while the valuation is now more reasonable compared to when I was urging investors to sell, I see many other stocks out there today that have a far better risk/reward trade-off.

A cheap stock can always become cheaper, especially if it's at the forefront of what could be one of the worst crises since the financial disaster of 2007-08.

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