Air Canada (TSX:AC) Stock Soared 40% This Week: Time to Buy?

Description

There was some respite for **Air Canada** (TSX:AC)(TSX:AC.B) investors this week after the stock showed a sharp recovery. The stock has soared approximately 40% so far this week after falling below $10 — almost its five-year-low levels.

The surge was in line with the TSX Composite after the Canadian Government announced the stimulus package to combat COVID-19. However, questions remain: Will this recovery last? And what should Air Canada investors do now?

Air Canada and the virus outbreak

Air Canada stock has tumbled more than 75% since mid-February till early this week. It will likely continue to be volatile in short to medium term. Interestingly, when the COVID-19 pandemic starts to wane, it will likely bounce back even faster.

Some were afraid Canada's flag carrier would go bankrupt, and some thought the stock will fall to $0. However, Air Canada will likely emerge stronger from these challenging times. It has a healthy balance sheet and a strong cash position that will help it traverse through these tough times.

It had $6 billion in cash and short-term investments at the end of Q4 2019. This will likely be enough to fund its short-term liabilities when it is not generating any significant cash from operations. The company has already been working on retaining cash and trimming costs through temporary lay-offs.

Valuation

Let's take a look at the valuation of Air Canada stock. In 2019, the airline company reported earnings of $3.37 per share. Last month, the management estimated a marginal increase in its earnings for 2020, which is now unworkable because of the epidemic.

Thus, let's assume its earnings will take a hit by around 50% and Air Canada still earns close to $1.70

per share. Based on these estimates, Air Canada stock is currently trading at a forward price-to-earnings multiple of 10.5.

This seems reasonable and even indicates room for further growth. However, these earnings estimates could get revised downwards if the virus impact gets extended in the second half of 2020.

The recent surge in Air Canada stock should not be perceived as a signal to a long-term recovery just yet. Short-term gyrations will occur as we continue to deal with uncertainties.

Foolish takeaway

The picture will get a lot clearer when the airline releases its Q1 earnings in early May. We will then get to know how deep the wound is and how long will it take to recover. Till then, Air Canada stock could remain weak, as the pandemic dominates and flights remain grounded.

Importantly, weak performance in one or two quarters should not bother long-term investors. Investors should note that lower oil prices will lower jet fuel prices as well, which forms a large part of airlines' expenses. Thus, if oil prices remain lower longer than the virus outbreak, it will be favourable for Air Canada.

Air Canada remains a solid play. It's delivered a 4,000% return in the last decade. It holds more than 50% of share in Canada's airline market. At the moment, Canadian heavyweight Air Canada, with such an attractive valuation, is indeed a solid investment proposition, even after its recent surge.

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Author
vinitkularni20