Is Air Canada (TSX:AC) a Must-Buy at $15?

Description

Air Canada (TSX:AC)(TSX:AC.B) and airlines around the globe have taken a massive hit to the chin amid the coronavirus (COVID-19) pandemic. At the time of writing, Air Canada stock is down a whopping 70% from its all-time high after the last month and a half of selling hell.

There's no question that the stock has endured a painful decline, but it's still sitting above its three-year low. So, if you're looking to buy the dip in the battered airline, you've got to be ready for more turbulent times over the coming quarter and realize that just because the stock got cut in half twice during its 75% peak-to-trough drop doesn't mean it can't happen again.

A severely undervalued play that's not for the faint of heart

Now that a "bottom" has formed in the broader markets, many investors are probably wondering if it's safe to jump aboard Air Canada again to maximize its upside potential in what could be a historic rebound rally heading into year-end.

While the stock market may be calming down after a handful of circuit-breaking down days in March, investors should remain cautious, as the coronavirus is continuing its exponential spread across North America, with no "flattened curve" in sight.

While treatments for COVID-19 could come earlier than expected, investors should resist the urge to try to predict when the virus will die out and when the large number of grounded planes will take to the skies again.

Instead, focus on the risk/reward trade-off that exists today and initiate a position if you're comfortable with enduring turbulent times that are likely ahead. More important, have a plan to average down your cost basis should this pandemic drag on longer than expected and bring Air Canada shares back to single-digit territory.

Air Canada: Get ready for some hideous numbers

The first- and second-quarter numbers are going to be ugly. They're going to drag down the full-year numbers and could offset any meaningful rebound in the second half should the pandemic subside in the summer. Air Canada temporarily laid off 16,500 and has been raising liquidity to prepare for the hurricane that lies ahead.

Given Air Canada's high fixed costs, operating leverage is likely to be deep in the red while most other fundamental metrics look to crumble like a paper bag.

The airlines are incredibly cyclical in nature, so such rapid decay in numbers shouldn't come as a surprise during a downturn, even with the profound operational improvements that have been made in the years following the Financial Crisis.

There's no question that the airlines were better prepared to ride out a cyclical downturn this time around. Most of them, including Air Canada, are far better businesses than they were prior to 2008. Unfortunately, the airlines were probably prepared for anything but a pandemic-induced downturn.

Air Canada: The good news

Air Canada is less leveraged relative to some of the U.S.-based airlines, some of which are guilty of "wasting" cash on share buybacks over the years.

With around $7.1 billion in liquidity at the time of writing, I see Air Canada surviving the coming onslaught with a minimal chance of insolvency.

While this pandemic will surely cause steep operating losses, Air Canada looks more than liquid enough to cover the cash bleed and regain control after another few quarters of turbulence.

The stock has a terrific risk/reward at this juncture, and if I had to bet, I'd say the stock will be a heck of a lot higher in two years from now. Of course, you'll need to endure short-term pain for the shot at long-term gain.

Shares of AC trade at a mere 1.7 times enterprise value/EBITDA, which is absurdly cheap. While the stock is by no means timely, it makes sense to nibble away at the name gradually over the coming months.

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