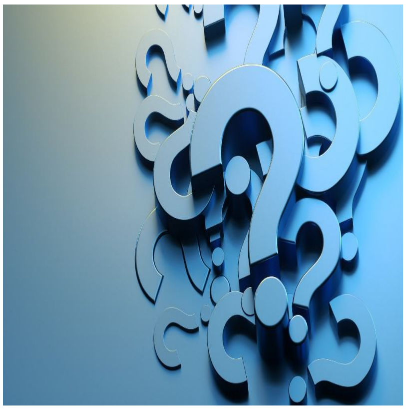

Should You Buy Air Canada (TSX:AC) Stock After the 56% Crash?

Description

Air Canada (TSX:AC)(TSX:AC.B) stock is plunging. In February, the stock was priced at $45. Today, it trades hands at $20. That's a 56% decline in less than 60 days.

There's no doubt that countless value investors are circling the stock. From 2012 to 2019, Air Canada shares rose in value 50 times over. Shares rarely goes on sale, and this could be a limited-time opportunity to buy into a millionaire-maker stock at a steep discount.

But be careful: there are clear danger signs at play.

What you need to know

Let's do away with the obvious: the coronavirus pandemic has dealt a crushing blow to airline stocks. Airplane traffic has truly fallen off a cliff. Across many regions, airline travel is banned entirely, which is terrible news to a business with high fixed costs.

Take **Delta Air Lines** (NYSE:DAL), for example. Reports surfaced last month that the company is burning more than $50 million in cash per day. It costs a lot to park and maintain a global fleet or airplanes, even if they aren't even in service.

This week, Delta had its credit rating downgraded to junk. "Debt raised to sustain liquidity through the pandemic will drive credit metrics outside of a range supportive of investment-grade ratings at least through 2021 and likely into 2022," noted Fitch Ratings.

What about Air Canada? Last quarter, the airline had $6.3 billion in cash and short-term investments — already a good sign. Delta, by comparison, had just $4 billion in cash and short-term investments, despite being *five times* bigger than Air Canada.

Air Canada also has room to bring on additional debt. Its long-term debt stood at $6.3 billion last quarter. Delta's debt, for comparison, was more than $12 billion.

In essence, Air Canada could pay off 100% of its long-term debt simply using cash and liquid investments on hand. Few airlines are capable of this, with Delta serving as a prime example.

Of course, Air Canada has likely taken on significantly more debt since the latest reporting period. But its financial strength in comparison to the industry is clear. If only a few airliners survive the crisis, Air Canada will likely be one of them.

Time to buy Air Canada stock?

While Air Canada stock will eventually be a bargain, how do we know whether or not the time to strike is now? We don’t. Heavy uncertainty plagues the stock, with the range of potential valuations differing wildly.

There’s a case to be made that common stockholders will be completely wiped out through an eventual bankruptcy. But there’s also a case that government assistance will allow conditions to normalize within months, sending the stock price back towards historical highs.

Looking at the financials, Air Canada has more leeway than many of its North American competitors. Make no mistake: The industry will see plenty of bankruptcies, but this company will be one of the last to fall. As long as the government doesn’t allow the entire industry to collapse, Air Canada will have no trouble surviving on emergency government loans.

What will the terms of that emergency financing be? No one knows. That’s a major reason why shares still trade at a big discount. The assistance will almost surely come, however.

If Air Canada can survive, the future competitive environment will be significantly friendlier, with bankrupt competitors leaving room for rapid market share gains.

Whichever airline stocks survive the crisis will have a brighter future ahead of them, and Air Canada looks like it will live to see that future.

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