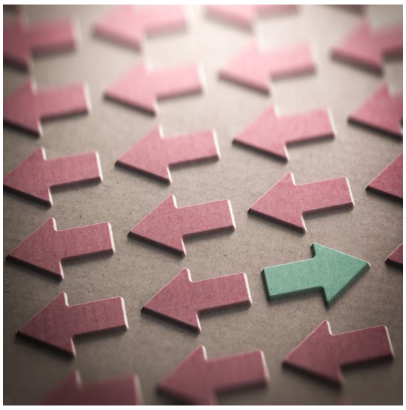

Could This Airline Stock Be the Contrarian Bet of the Decade?

Description

The airline industry has been at the epicentre of the ongoing crisis. Flights across the world have virtually stopped. Air traffic fell off a cliff when most countries implemented stay-at-home policies in March. Airline stocks followed the nosedive.

Top airline stocks such as **Air Canada** have lost nearly two-thirds of their market value year to date. With demand suppressed and debt costs rising, these major airlines could be squeezed further. Some major airlines in other parts of the world have already declared bankruptcy, and even Warren Buffett seems to have abandoned the industry.

Things look as bleak as they could possibly be. This could create an opportunity for a keen contrarian investor looking for a distressed asset. Here's one Canadian airline stock I believe investors could add to their "distressed" watch list for 2020.

Chorus Aviation

Much like the rest of the airline industry, **Chorus Aviation** (TSX:CHR) has lost value this year. The stock is down over 64.8% year to date. Investors seem justifiably pessimistic.

However, Chorus isn't a traditional airline company. The business model is based on regional routes and chartered flights. In other words, the company operates within Canadian borders. It also doesn't sell tickets but leases aircrafts out to bigger carriers.

It's biggest customer, of course, is Air Canada. Air Canada has signed a long-term multi-year deal to lease the company's aircrafts. These smaller planes fly between Canadian cities and provinces under the Jazz and Air Canada Express brands.

As you can imagine, the outlook for regional flights is better than international flights. Due to the pandemic, I believe travellers will more likely travel domestically rather than risk going abroad for the next year or so. That fact means Chorus's business could be at the forefront of the recovery for the airline industry.

Meanwhile, 90% of the company's sales are secured by long-term contracts with major airlines. This puts Chorus in a great position to weather the ongoing storm.

Valuation

Since the stock has lost two-thirds of its value, the valuation seems ludicrously attractive. The company's market value is just $452.5 million at the moment. That's 25% less than book value and only 33% of annual sales.

A recovery to book value alone could deliver double-digit returns for investors. If it rebounds to its previous valuation, the stock could be a multi-bagger. However, as with any valuation this attractive, there are caveats.

Caveats

Chorus has a sizable debt burden. Long-term debt is worth *triple* the underlying equity. Servicing that debt is about to get more difficult. Rating agencies have been downgrading corporate debt across the world.

To service the debt and stay afloat, Chorus might have to make some uncomfortable decisions. It's already cut staff and executive salaries in an effort to save costs. The 17% dividend yield has already been suspended to shore up cash. It might also have to issue shares and dilute existing shareholders to sustain itself during this crisis.

Investors should be aware of these risks.

Foolish takeaway

Chorus Aviation could be the ultimate contrarian play. It's a regional aircraft lessee, so the business could bounce back sooner than the rest of the airline industry. However, the debt burden could squeeze the business and its investors in the short term.

It's a high-risk, potentially high-reward bet for speculative investors.

CATEGORY

1. Coronavirus
2. Investing

TICKERS GLOBAL

1. TSX:CHR (Chorus Aviation Inc.)

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