Why Air Canada (TSX:AC) Stock Is More Solid Than You Think

Description

Airlines are facing massive losses this year. The thesis for owning airline stocks, on the face of it, is riddled with risk. But people are still flying, and passenger numbers will recover in time. While the markets are waiting for a vaccine breakthrough for guidance, the world is about to re-open without one.

At the end of the day, airlines will survive or fail according to their balance sheets. After all, if a business carries liabilities in excess of its assets, that company is essentially worthless. **Air Canada** (TSX:AC) may be down $1 billion in its most recent quarter, but it's certainly not worthless. Far from it. And herein lies one of its greatest strengths. Let's dig into a few numbers.

Air Canada stock is a classic contrarian play

Debt to equity is high with this name. That's no secret. Pundits have been pointing out this flaw in bullish investors' "buy" thesis for some time. Indeed, this ratio underpinned the bear case for Air Canada long before the pandemic tore a hole in the airline's side. However, a debt-to-equity ratio of 162% isn't actually as bad as it seems. The situation is mitigated quite considerably by several positive factors.

First of all, Air Canada's balance sheet is much improved compared with half a decade ago, when its shareholder equity was negative. Second, Air Canada's debt level is adequately covered by cash flows, with 37.4% coverage. Relatedly, interest payments are covered by EBIT 3.4 times over. Third, Air Canada's short-term assets exceed its short-term liabilities, even if they don't exceed its long-term ones.

A stock to pack for the long haul

So, Air Canada technically has what it takes to survive the pandemic without government intervention. But if it needed government intervention, help would be forthcoming. And priced at 92% of its fair value and falling, there may be some more pain on the way — but after that, there is nothing left but upside here. In summary, Air Canada's knife could be about to stop falling. After that, recovery will be slow, but it will bring growth.

Don’t wait for that to happen, though, because a recovery could come sooner than you think. And even if a full return to normalcy isn’t exactly likely any time soon, rallies are likely to keep happening. This means that Air Canada should be bought on deepening moments of weakness. Over time, this approach will lead to a fuller position at less outlay.

The corollary is clear: building on deepening value equals lower capital risk. Wait for the five-day 20% rally to fade before beginning your long-haul trip to stratospheric upside. After all, this is a name that has oscillated between $52 at its peak and $9 at its nadir in the space of 12 months. It could go even lower than that. And it could go as high as $60. Investors should therefore be prepared to keep cash on hand, buy the dips, and carry on holding.

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