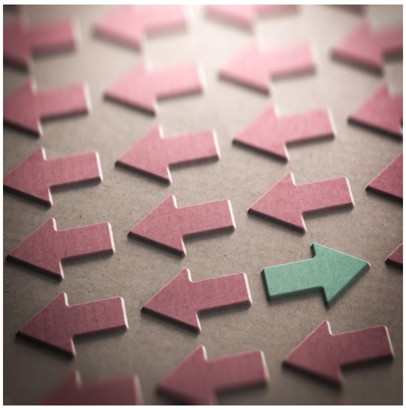

Is Air Canada (TSX:AC) Stock the Best Contrarian Pick for Outsized Gains?

Description

If you're a contrarian investor and on the look-out for shares offering exceptional value, **Air Canada** (TSX:AC) stock might have caught your eye. The stock has been badly battered and is down over 66% year to date. Aircraft grounding and sealing of international borders amid the rapid rise in coronavirus infections hit airline companies hard, including Air Canada.

Although the resumption of domestic flights brings some respite, air travel demand remains subdued. The developments in the domestic market are likely to lead the recovery for airline companies. However, investors should expect a continued contraction in the revenue passenger kilometres in the next several months. The rising COVID-19 cases could continue to discourage passengers from boarding flights, which indicates that the process of recovery is likely to remain challenging.

What's in the offing?

While Air Canada's low stock price attracts, too much uncertainty is a concern. The near-term capacity planning and forecasting demand are likely to remain challenging, as passengers would not purchase tickets well in advance like before. The lack of visibility makes it difficult to forecast the recovery period.

Earlier, Air Canada stated that it would take the airline industry at least three years from now to recover and reach the pre-pandemic levels. However, the uncertain environment and continued growth in infections could lead to a further delay. Investors should note that citing similar concerns, Fitch lowered Air Canada's long-term issuer default rating.

Another big concern for Air Canada is getting international traffic back. International traffic for business and leisure activities has seen a severe and abrupt drop, which is resulting in a drastic decline in earnings and cash from operations.

The company's passenger revenues account for about 86% of its top line, which remains weak. Meanwhile, air cargo, which is witnessing increased demand from e-commerce and pharmaceutical companies, represents only about 4% of its total revenues. To reduce the impact of lower revenues on its bottom line, Air Canada has announced several cost-cutting measures to cushion its margins and stay afloat amid challenges.

The company lowered its employee strength by 50% and plans to generate about $1.1 billion in cost savings from the structural changes. However, its bulging debt and lower operating income is a cause of concern.

Air Canada's total long-term debt stood at $10.7 billion at the end of the most recent quarter. Meanwhile, debt is likely to increase further in the second quarter.

Should you bet on Air Canada stock?

With an uncertain operating environment and the pandemic in the background, Air Canada's problems aren't likely to end soon. The negative passenger sentiment indicates that the company's losses could continue to mount in the near term.

However, the essence of contrarian investing is to be greedy when others are fearful. So, should you buy Air Canada stock now?

The answer is simple. If you have an appetite for risk and the patience to remain invested for at least four to five years, Air Canada stock could generate outsized gains. However, if you are looking for steady returns and avoid volatility, you're better off not investing in it.

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