Is Air Canada (TSX:AC) Stock About to Drop Like a Rock?

Description

Air Canada (TSX:AC) stock has fallen off a cliff from its 2019 high of about $50 per share due to pandemic disruptions that greatly limited air travelling. Needless to say, Air Canada is not the safest kind of investment out there right now. However, it's understandable if some investors want to buy it with some play money.

For example, during the last recession around 2009, the stock traded below $1 per share. It was a 50-bagger, turning a $1,000 investment into $50,000 in 10 years for total returns of nearly 48% a year! This is the power of a cyclical stock making a comeback!

How's Air Canada doing?

Air Canada last reported quarterly revenues decline of 86% from last year's $5.5 billion to $757 million. Not surprisingly, it reported a net loss in Q2 and Q3 2020, equating cumulative losses of $2.4 billion. Its Q4 and full-year 2020 results will be released early next month, but it likely won't be pretty, as the pandemic has been spreading faster.

In Q2 2020, the airline company beefed up its cash position to about $5 billion, which was more than half of its current assets. The cash position dropped quickly by $1.3 billion in one quarter to about $3.8 billion.

The company's debt-to-capital ratio augmented to 75%. Additionally, its S&P credit rating is B+, which is non-investment grade.

However, any good news from vaccines or against the pandemic could trigger a jump in the volatile stock. AC stock has a recent beta of 2.5, which implies that it'll climb or fall about 2.5% when the market rises or declines by 1%, essentially meaning that it's a bumpier ride than the market.

Should you buy Air Canada stock?

Is it worth it to buy Air Canada stock today when it trades at about $22 per share?

The stock's ebbs and flows in the short term will depend on the direction of the pandemic. For instance, how well will the global vaccine programs execute? How effective will the vaccines be? A declining number of new COVID-19 cases could drive the stock much higher.

Longer term, post-pandemic, as air travel improves and rises, the stock could do much better and trade at least in the $40-per-share level.

Currently, analysts have an average 12-month price target of $26.72 on the stock for 19% near-term upside. The most bearish analyst has a $12 target though, which translates to 46% downside potential in the short run.

The cyclical stock got rejected from a 200-day simple moving average (SMA) at about $27.50 per share and now sits on a declining 50-day SMA. It needs to break above the $27.50 per share level to head higher. Right now, it shows no sign of doing that.

The Foolish takeaway

Here are a few key takeaways you should keep in mind. Air Canada stock is a speculative cyclical investment. It's in bad shape because of the pandemic and restricted air traveling. Its balance sheet is laden with debt. Specifically, it has long-term debt of about $8.4 billion and a non-investment credit rating.

So, if you do decide to take a position in the stock, make the position small. It should not be bigger than 1% of your stock portfolio. It could be an interesting short-term trade if you aim to buy on meaningful dips and sell on pops from positive news. Alternatively, you can buy a small position and aim to hold through the turnaround from the pandemic.

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