Air Canada (TSX:AC) Stock: Are You a Buyer?

Description

Air Canada (TSX:AC) stock has doubled from a March 2020 market crash low of about $12.50 per share. Those lucky few who managed to grab the stock in a flash at below $10 last year and held on until now would be sitting on hefty gains of more than 160%.

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Last year, the airline company ran into a brick wall. Revenue dropped 70% and it booked a huge loss of $4.6 billion. No recovery was insight in the last reported quarter of Q4 2020, in which revenue was down 81% year over year and it booked a loss of more than $1.1 billion.

Yet, none of this was due to poor management. We're experiencing a global pandemic and many of its planes were simply grounded because of travel restrictions and much lower demand for flying for leisure or business purposes.

The stock has recovered to much higher levels with the expectation that the global COVID-19 vaccine rollout will take effect and result in herd immunity hopefully sometime this year.

Air Canada stock still has substantial room for upside. Post-pandemic, over the next couple of years, it could recover to the $40 level for more than 50% price appreciation.

What's Air Canada stock's downside?

To determine if a stock is worth investing in, other than estimating the upside potential, investors should also estimate the downside risk.

In the prior recession about 12 years ago, Air Canada stock fell to below $1 per share. However, the company was much stronger this time around going into the pandemic, as evident by the market giving it a much higher support at approximately $15 per share versus $1 years ago.

If the pandemic drags on for longer than expected, the airline stock could descend to the $15 level again for about 43% downside. That is, that can happen if things get really bad. If there’s mild bad news, the stock could drop to the $20 level for about 24% downside.

At the end of 2020, Air Canada was sitting on net debt of about $5.5 billion with a sky-high debt-to-equity ratio (D/E) of 15.85 times. In comparison, pre-pandemic, its net debt was about $3.3 billion and it had a D/E of 5.3 times. Its interest expense essentially doubled in Q4 2020 versus Q4 2019.

There’s no doubt that Air Canada’s balance sheet was severely damaged in this pandemic. However, it was unavoidable given the situation.

It’s going to take perhaps a couple of years of profitable operations to improve the balance sheet meaningfully.

Should you buy Air Canada stock?

If you already hold Air Canada stock from much lower levels, you have the cushion to wait for more upside. Alternatively, if you see better or safer investment opportunities elsewhere, it might make sense to take at least a partial profit.

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If you’re thinking of buying a new position in Air Canada stock, you might want to exercise caution and see if you could capture it on a correction to the $15-20 range.

The key thing is to keep your position correctly sized for the risk that you’re taking. That is, if you do decide to invest in the stock, don’t bet the farm on it. The holding might make up no more than 1% of a diversified portfolio, unlike core holdings that could be 5% of the portfolio.

Air Canada’s Q1 2021 earnings results in early May will be telling. Investors who are on the fence about the idea might wait until then to make a decision.

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