Canadians: Avoid This 1 Stock Everyone Is Raving About!

Description

Air Canada (TSX:AC)(TSX:AC.B) is Canada's largest airline with over 1,500 daily flights to 200 destinations. The company generates 94% of its revenue from passenger services, 4% from cargo, and 6% from other.

It currently has a market capitalization of $13.29 billion with a 52-week high of $51.07 and a 52-week low of $23.50. Investors should be wary about investing in Air Canada, given the close ties between revenues and the economy.

An interpretation of the numbers

For the nine months ended September 30, 2019, the company reported a strong balance sheet with positive retained earnings of $3.2 billion. This is a good sign for investors, as it suggests the company has more years of cumulative net income than net loss.

Air Canada reported a $4.8 billion increase in liabilities, driven by the Aeroplan acquisition, which includes $4.3 billion in current and long-term Aeroplan and other deferred revenue.

Overall revenues are up 7% from $13.8 billion to $14.8 billion, driven by Air Canada's passenger division. The company reported operating income of $1.5 billion, up from $1.3 billion the prior year.

Expenses increased marginally but pre-tax income is up significantly due to a $407 million gain in foreign exchange and the absence of a $188 million loss on disposal recorded in 2018. Investors should look closer at operating income as opposed to pre-tax income, as the non-operating expenses can greatly sway the after-tax income/loss.

Air Canada paid down $808 million in this period, which indicates a commitment on management's part to be fiscally responsible. Further, the company reduced its capital-expenditure spending, which could suggest a rough year ahead.

But wait, there's more

The company's notes to its financials indicate a couple of important items.

Firstly, the company received approval to renew its normal course issuer bid (NCIB), which allows it to purchase up to 24,130,551 shares that represent 10% of Air Canada's public float. During the nine months ended September 30, 2019, Air Canada purchased $250 million worth of shares. This is up from $23 million during the same period last year. NCIBs are usually issued by senior management to indicate it believes the share price is undervalued. Despite this, airline companies are notoriously cyclical, which reiterates my long-term bearish sentiment on Air Canada's stock.

Secondly, the company made an offer to acquire all of the issued and outstanding shares of Transat for $13 per share for total consideration of $520 million. After facing pressure, Air Canada upped the offer to $18 per share for an all-cash consideration of $720 million, which received the approval of 95% of Air Transat shareholders. The deal still has to be approved by regulatory bodies, and some say it will face challenges.

Foolish takeaway

Investors looking to diversify their portfolio and purchase shares of an airline company should avoid Air Canada. Despite its solid balance sheet and stellar returns year to date, the company operates in a highly cyclical industry that makes it a poor choice for a long-term buy-and-hold strategy.

I commend the company on its NCIB and acquisition of Air Transat; however, these moves to reassure investors of the company's future growth does not abate my worries that the company will be experiencing rough times in the near future, as we are headed toward a recession.

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