A Canadian Stock to Sell Immediately!

Description

Air Canada (TSX:AC)(TSX:AC.B) has been one of the best performers over the past few years, with multi-bagger gains rewarded to those who stuck with a name in an industry that faced a profound paradigm shift.

A generational opportunity now in the rear-view mirror

The airlines used to be viewed as a trade, not a long-term investment. But, the airlines are no longer ticking timebombs that could implode in the face of a recession thanks to more fuel-efficient aircraft and operational improvements made possible by new technologies.

Warren Buffett recognized that the situation had changed before the fact, and I urged investors to ride his coattails with Air Canada, a move that would have allowed you to double-up on your investment multiple times over.

Now that the easy profits have been made and the valuation is more aligned with reality (can you believe Air Canada used to have a low-single-digit price-to-earnings multiple?), it's time to start taking profits off the table.

A new slate of risks at a higher multiple

With coronavirus worries continuing to weigh, the demand for air travel, not just international flights to Asia, will wane. Heck, even if a viral outbreak were to subside, the fear of travel stocks could still have the potential to linger on through year-end, and that doesn't bode well for Air Canada.

Airlines may not be as vulnerable to economic weakness as they used to be, but that doesn't mean they won't take a hit to the chin when it happens next. The magnitude of downside may not be +80%, but as cyclical stocks, they'll still take on as much, if not slightly more, damage relative to the broader market indices.

Given economic pressures, Air Canada deserves to trade at a discount to the averages and at today's valuations, I think the discount could stand to widen over the coming months as headwinds continue to weigh.

At the time of writing, Air Canada stock trades at 11.9 times next year's expected earnings, 0.7 times sales, and 3.2 times book. Not an expensive stock, but compared to five-year historical average multiples, the stock doesn't appear to be a great value for your invested dollar given the macro headwinds that could make for a turbulent ride through most of 2020.

Still, Air Canada is a heck of a lot cheaper than some of its U.S. counterparts when you consider the earnings growth and the healthy amount of free cash flow (FCF) generation. Past efforts have finally paid off, and Air Canada is enjoying a higher multiple as a result. Given the incredible run, it'd only be prudent to take a bit of profit off the table with the risks up ahead.

"Personally, I still ascribe to Warren Buffet's prior belief that airlines are not a great investment over the long term. They are susceptible to so many negative shocks, such as oil prices and epidemics, that it's difficult to predict how they'll perform over the long run." said fellow Fool Kris Knutson. "But if you have your heart set on owning an airline, wait and see whether Air Canada continues to pull back in the coming weeks."

I think Knutson is right on the money when it comes to Air Canada.

Foolish takeaway

The risk/reward just isn't as good as it used to be given the new slate of uncertainties. So, fasten your seatbelts because Air Canada stock may soon fall into a tailspin back to $40 (15% downside from current levels).JGG-FRI-A Canadian Stock to Sell Immediately!

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