Why Air Canada (TSX:AC) Stock Isn't Cheap Enough!

Description

Air Canada (TSX:AC) stock has been heavily discussed and speculated on in 2020, and perhaps rightly so. For the past 10 years, Air Canada was one of Canada's best-performing stocks. However, today it trades almost as volatile as some penny stocks.

Air Canada's stock is cheap, but not cheap enough

Many Canadian investors believe that because Air Canada's stock is so cheap today, it could have a massive turnaround like it did from 2010 to 2020. Yet investors need to beware that Air Canada's business, financial, and operational model has been severely damaged from the COVID-19 pandemic crisis.

Airlines are cost- and debt-intensive businesses. During good times, they can recover many of those costs through fares and high volumes. The leverage helps amplify their spread on margins when passenger volumes are stable and growing. However, when passengers are afraid of or restricted from national and international travel, it challenges their entire business model.

Air Canada's earnings growth could be challenged for years

Consequently, airlines like Air Canada have had to raise more debt, equity, and sale-leaseback capital (around $6 billion) just to cover its approximate $15 million daily cash burn. Unfortunately, it could take much longer for Air Canada's stock to recover and accrete the same type of earnings growth as it did in the last decade.

Air Canada could manage its business operations perfectly and still not come out of the pandemic whole. The longer the pandemic persists, the greater the damage. Perhaps it will get bailed out by the Canadian government. Yet, if that's the case, you don't want to be a shareholder. Frankly, I would not touch the stock until there is greater certainty around the pandemic and a recovery in travel volumes.

This TSX stock will likely outperform Air Canada

One top **TSX** stock that I would bet my hard-earned capital on today is **Constellation Software** (TSX:CSU). Like Air Canada, this stock is one of the best performers on the TSX over the past decade. Since 2010, it's earned shareholders a whopping 4,082% return! The good news is, I still believe this stock has lots of opportunity.

Constellation is a serial compounder of capital. It acquires good, niche software-as-a-service (SaaS) businesses, injects capital and resources, and makes them great cash-flowing machines. As a result, the company produces a significant amount of free cash flow (a 3.5% free cash flow yield).

Since the company is able to reinvest its free cash flow into new businesses, it has a very cheap cost of capital. It is almost completely self-funding. Right now, the company has a very solid balance sheet and is sitting with over $100 million of net cash.

As opposed to Air Canada, this stock is relatively resilient in any economic environment. It has a diversified mix of software businesses that should accrete fairly consistent revenue and earnings growth in any environment.

In fact, this economic crisis could be beneficial to a serial business acquirer like Constellation. Small niche software businesses could see their valuations decline. That could create some long-term consolidation opportunities over the next few years.

The Foolish takeaway

Compared to other SaaS stocks, Constellation is relatively cheap with a forward EV/EBITDA ratio of 21 times as compared to its peer average of 31 times. Likewise, its forward price-to-earnings ratio is 31 times versus a peer average of 50 times. While Constellation stock is not "cheap" like Air Canada, it offers visible opportunity for value. Forget Air Canada stock for now and buy Constellation's business model, which has proven resilient in any environment!

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