3 Reasons I'm Avoiding Air Canada (TSX:AC) Stock

Description

Air Canada (TSX:AC) stock is starting to look cheap these days. At $23, it is much cheaper than it has been for the past year. For most of 2021, AC was trading between $25 and $29. Concerns about the Delta variant and broader market turbulence caused it to slide in August and September. September witnessed a significant market selloff that took most equities lower. Air Canada was no exception.

There is a case to be made for buying AC stock today. Trading at just 1.4 times sales, it's arguably a value play. However, I'm avoiding the stock for the time being. Here's why.

Ongoing COVID-19 risk

COVID-19 was the event that caused Air Canada stock to sell off in 2020. In March, travel bans forced the company to cancel countless international flights. Later, demand for domestic travel cratered as well, as provinces started implementing quarantines for travelers.

These days, COVID-19 seems to be on its way out. Today, 72% of Canadians are fully vaccinated, and 77% have received at least one dose. Cases are dropping. However, there is one remaining COVID-19 risk that lingers: new variants.

New COVID-19 variants like Delta and Lambda are more contagious than the original. Additionally, some are thought to be vaccine resistant. If a major outbreak of these new variants occurs, then governments may implement new lockdowns. Air Canada's revenue will once again crater.

Heavy debt

Another problem with Air Canada stock is its heavy amount of debt. Airlines are capital-intensive businesses in the best of times. Usually it's not a problem, because they bring in more than enough revenue to cover interest and other expenses. However, in 2021, Air Canada's revenue is still depressed. It has recovered from the worst quarters of 2020 but still is nowhere near the typical 2019 quarter. So, that big pile of debt and $162 million in quarterly interest expenses are real problems.

They make it hard for the company to turn profits while revenue remains low.

Foolish takeaway

Air Canada is in a tough spot these days.

The company's revenue is beginning to recover but is still nowhere near pre-COVID levels.

Since hitting a 2020 low of $12.40, AC stock has recovered significantly. But further gains from this point on will be harder.

When Air Canada was trading at $50 at the beginning of 2020, its revenue was more than double what it is now. On top of that, the company was also profitable in most quarters. Today, the kinds of fundamentals needed to support a much higher valuation just aren't there. And the company doesn't expect revenue to recover to 2019 levels until 2023. So, I'm staying away from this stock for the time being. It looks to me like it's likely to trade sideways for the foreseeable future.

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