Air Canada (TSX:AC): Is $22/Share Cheap or Expensive?

Description

The TSX Composite Index corrected 2.3% since December 30, 2021, as tech stocks saw a huge selloff over the anticipation of an increase in interest rates. During this time, **Air Canada** (TSX:AC) stock surged almost 4% during this time. Does this short-term outperformance make Air Canada a value stock at around $22/share? To answer this question, you first have to understand what a value stock is.

A cheap value stock

Famous value investor Warren Buffett often quoted his learning from Ben Graham: "Price is what you pay; value is what you get." A tried and tested formula for making money in the stock market is to buy the dip and sell the rally. But the question is, which dip should you buy?

Some stocks dip because they are saturated or are in a long-term decline, struggling to sustain. But some stocks dipped in the market selloff for some recent crisis, but their long-term growth potential is intact. Such stocks can give you value for investing in them during their tough times.

How do you determine whether a value stock is cheap or expensive? You compare a stock's price with its fundamentals to put a number to its future growth potential and then compare it with peers. When a fundamentally strong stock dips for a temporary reason, it is cheap.

Looking at Air Canada stock with a value lens

Air Canada is in its worst nightmare, as the pandemic has reduced its capacity significantly. Just when things started to improve, and the airline reported its first positive net cash flow in 18 months, the Omicron variant shattered investors' hopes. Canada did not announce a nationwide lockdown but increased travel restrictions like quarantine requirements and mandatory Covid testing.

Restrictions have a negative impact on traveler counts. If Air Canada cannot fill those seats, it willmake a loss on every flight, especially with oil prices at their seven-year high. It spends slightly over20% of its revenue on fuel, which comes from Brent crude.

Amid the weak travel environment, the airline is funding its losses with debt to sustain the pandemic. It had $14.4 billion in liquidity at the end of September 2021, which could fund its losses for the next two years. This liquidity includes a bailout that gives the government a 10% equity stake. So, there is volatile revenue and cash burning that is impacting its short-term growth. Then there is equity dilution and leveraged balance sheet that could impact its long-term growth.

Amid all the negatives, there was the hope of pent-up travel demand from leisure travelers. Hanging on to this hope, AC stock surged to as high as $31 last year. There was hope that AC could avoid using bailout money and save itself from equity dilution. But Omicron and BA.2 variants are diming this hope.

AC stock could thrive with the kind of liquidity it has, but its ability to generate growth is limited. I do not expect the stock to go past the $30 price in 2022, making it an expensive stock at $22.

A stock that is cheap

Descartes Systems (TSX:DSG)(NASDAQ:DSGX) is a better investment than Air Canada. Descartes's third-quarter fiscal 2022 revenue and net profit has not only returned to the pre-pandemic levels but also surged from the fiscal 2021 levels. This shows the company has strong fundamentals. Moreover, the pandemic-induced supply chain issues have accelerated growth in the supply chain management industry.

Despite all these positives, Descartes stock dipped almost 24% from its November 2021 high. It is trading at 56 times its forward earnings per share, which is lower than peer **Kinaxis** (trading at 100 times forward price-to-earnings ratio). Moreover, Descartes stock is in a long-term growth trend, surging at an average annual rate of 30%.

The final choice is yours

AC's growth has too many hurdles that pulled its stock down. Instead of buying into a loss-making company, you can buy Descartes to get more value at a cheaper price.

CATEGORY

1. Coronavirus
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2. TSX:AC (Air Canada)
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