Don’t Buy Air Canada (TSX:AC), Buy This TSX Stock Instead

Description

The **TSX Composite Index** made a comeback toward the end of January after a month-long correction. That was a great time to bag some fundamentally strong stocks at the dip. But let me tell you, not all stocks are worth buying on the dip. A good example of such a stock is **Air Canada** (TSX:AC). If you plan to keep buying the dip and reduce your average cost on this stock, there is a possibility you could be compounding your losses.

Remember, the price is just the amount you pay. What you should look for is value. Is the stock worth the price that it is trading for? Now, how do you determine the value? You look at the fundamentals that can alter the company’s functioning and make it vulnerable to crisis. Let’s look at the fundamentals of two companies, both from completely different sectors and determine which one has value in the current environment.

Air Canada stock

As an airline, Air Canada operates on a wafer-thin margin and has a leveraged balance sheet. Its only plus point is to operate optimally, with more seats filled per flight. The pandemic hit the thin rope on which Air Canada was walking. It grounded the planes and slashed 90% of travel demand, pushing all airlines into their worst nightmare. Air Canada stock lost 75% of its value. There was hope the government would come forward to help due to the strategic importance of Air Canada to the economy. Hence, I was bullish on the stock in 2021.

But AC’s stock price rally was range-bound ($20-$28) given the $7.2 billion net debt sitting in its balance sheet. This net debt will widen if AC uses the bailout money, which is parked in its $14.4 billion liquidity. The Omicron wave and the sky-high fuel prices did just that. The possible losses from renewed travel restrictions could force Air Canada to use the bailout money. Hence, I changed my stance to sell. It’s better to exit the stock at $24-$26 as this is the farthest AC stock can go with such leverage.

Even if the airline returns to positive cash flows, it will take years for it to post net income because of the high-interest expense on its pile of debt.

An alternative to Air Canada

Instead of holding on to Air Canada, I'd exit the stock and buy **Suncor Energy** (TSX:SU)(NYSE:SU). This oil giant has many odds in its favour.

- Firstly, the world is suffering from oil and gas shortage as many countries slowed their investment in oil and gas in favour of renewable.
- Secondly, the tension between Ukraine and Russia is keeping oil prices high. Europe is looking for alternate suppliers. Although Canada may not be an option given the distance, high oil prices could benefit Suncor.
- Thirdly, the pent-up travel demand and reopening of industries could drive oil demand. Many economists expect oil prices to surge to US$100/barrel.

All the above factors work in favour of Suncor and are driving its adjusted operating cash flow, which surged 157% year over year in the fourth quarter. Hence, the company doubled its dividend in 2021. I expect significant dividend growth this year, as the company targets a 25% dividend compounded annual growth rate (CAGR) between 2021 and 2025.

However, a secular trend from oil to renewable could slow the growth in the long term. But, the oil will continue to exist as there are many applications like jet fuel for which there is no renewable alternative. I expect more consolidation in the sector in the long term.

Final takeaway

Air Canada has high leverage, multiple-year losses, and is operating in an environment where there is demand uncertainty and oversupply. The stock has a higher possibility of a downside than upside. Even if the stock price surges significantly, it doesn't have the fundamental support to sustain the price. Hence, Suncor is a better bet in the current market.

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