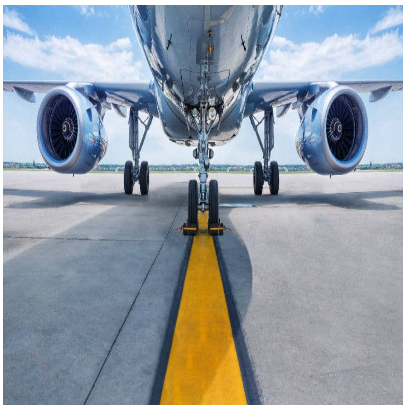

Bear Market Sell-off: Can Air Canada Stock Recover by the End of 2022?

Description

Prior to the pandemic, Canada's premier airline, **Air Canada** (TSX:AC), was among the top-performing companies on the **TSX**. Between the financial crash of 2008 and COVID-19, Air Canada's stock price surged over 3,600%, creating massive wealth for shareholders. But investors who bought the stock at all-time highs would have seen a 65% decline in share prices.

Despite the massive plunge, Air Canada stock is up close to 1,500% since September 2012. Let's see if AC's stock price can stage a comeback in the last quarter of 2022.

Air Canada's stock price is tied to revenue and profit margins

The onset of COVID-19 wreaked havoc on Air Canada's financials. In 2019, Air Canada reported record sales of $19.13 billion with an operating income of $1.65 billion. Three years back, Air Canada and its peers enjoyed a period of economic expansion, low interest rates, and sustainable fuel prices.

In 2020, Air Canada reported revenue of $5.83 billion and an operating loss of $3.46 billion. The airline industry is capital intensive, and the company had to take on massive debt to keep operations running. Despite the reopening of economies, Air Canada's operating loss in the last 12 months stood at $1.5 billion, compared to revenue of $11.38 billion.

The double whammy of rising interest rates and higher fuel prices will continue to act as a major headwind for Air Canada stock in the near term. Further, the prospect of an upcoming recession might also weigh heavily on Air Canada's financials, dragging its stock lower in the process.

Can Air Canada stock move higher in Q4?

There is no doubt that Air Canada is on the road to recovery. In Q3 of 2022, Air Canada's sales will be around 94% of pre-COVID-19 levels, compared to 88% in Q2 and just 60% in Q1. In fact, analysts expect the company to more than double sales to $15.8 billion in 2022. Further, the top-line is forecast to increase by 19.4% to $18.9 billion in 2023.

But investors also need to analyze profit margins that are under pressure. With more than $16.5 billion in debt, Air Canada needs to improve cash flows significantly to service its interest obligations. In the last four quarters, its interest expense stood at $811 million, compared to less than $300 million in 2018.

Given its revenue estimates, Air Canada stock is priced at just 0.35 times 2023 sales which is quite cheap. Further, analysts expect the company to improve adjusted earnings to $0.87 per share in 2023, compared to a loss of $9.66 per share in 2021. So, AC stock is priced at 21 times forward earnings which is reasonable.

However, Air Canada is trading at a lower multiple as it remains a high-risk bet for investors amid a challenging macro-environment.

Improving financials remain critical

In the June quarter, Air Canada's sales stood at $3.98 billion, compared to $837 million in the year-ago period. It reported an adjusted EBITDA (earnings before interest, tax, depreciation, and amortization) of $154 million compared to a loss of $656 million in Q2 of 2021. Its free cash flow also surged to $441 million compared to a negative $1.63 billion in this period.

Due to these improving financial trends, Bay Street remains bullish on Air Canada stock and expects it to surge by almost 40% in the next 12 months.

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