Is Air Canada Stock a Buy in January 2023?

Description

While the main TSX Index has breached its pre-pandemic highs long back, **Air Canada** (TSX:AC) stock still currently lingers around those levels. The challenges for Canada's largest passenger airline seem far from over. Its financial recovery looks on track, but macroeconomic woes might hinder its growth in the short to medium term.

What's next for AC stock?

AC stock has gained 12% since the beginning of the year, beating broader markets. However, only time will tell whether this is the start of its much-awaited, long-term recovery. In March 2020, when COVID-19 was raging mayhem, Air Canada management claimed that it will take about three years to fully recover from the pandemic. So, this should possibly be the year when Air Canada investors see their patience coming to fruition.

The flag carrier has been seeing quite an encouraging recovery in its top line since the last few quarters. To be precise, its revenues have jumped by over 250% in the last 12 months compared to the previous comparable period. Air Canada remains a net-loss company at the moment. However, some operational indicators certainly point at its ongoing recovery.

Financial recovery and growth prospects

In the third quarter that ended September 30, 2022, Air Canada's available seat miles more than doubled against the third quarter (Q3) of 2021. It is an important metric in the passenger airline industry and shows an airplane's carrying capacity. It is calculated as the total seats available for revenues multiplied by the distance travelled by aircraft. The trend indeed highlights the revival in the airline sector.

After 10 consecutive quarterly operating losses, Air Canada reported operating profits in Q3 2022. This was quite a feat, especially when the fuel expenses surged exponentially for the quarter. In Q3 2022, Air Canada spent $1.6 billion on fuel expenses, representing a 243% rise year over year.

Jet fuel expenditure is one of the major cost components for an airline and is generally around 30-40% of total costs. How that shapes up in Q4 2022 remains to be seen when it releases its quarterly earnings next month. Revenues might continue to trend higher based on higher demand due to the holiday season.

What's next for AC stock?

Air Canada might see some respite on the fuel expenditure front as well as energy prices relatively weak in Q4 2022. So, an expected revenue growth and margin improvement in upcoming quarters could drive AC stock higher in 2023.

However, it will most likely be an uphill climb. Airline earnings have a positive correlation with broader economic cycles. The recessionary environment could dent discretionary spending, ultimately weighing on its financial recovery. Plus, another COVID-19 variant emerging could also be nightmarish for Air Canada.

AC stock is currently trading at an enterprise value (EV)-to-EBITDA (earnings before interest, tax, depreciation, and amortization) ratio of six, which is lower than its three-year historical average. In comparison, North American peers' average is also around six. That means AC stock does not look overvalued at the moment.

EV-to-EBITDA is a popular valuation metric that considers debt as well as equity value.

Conclusion

AC stock is an attractive bet, given its impending financial turnaround and appealing valuation. However, it seems an apt bet for aggressive investors due to its above-average volatility amid the macroeconomic challenges. Beyond those challenges, its expected slow but steady return to profitability could create decent shareholder value in the long term.

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