Could Air Canada Be a Big Winner in 2023?

Description

When the pandemic initially hit, there was fear and uncertainty in almost every sector about how they would be impacted. And while most businesses and industries eventually found ways to cope with the pandemic and minimize its impact on operations, there's no question that some of the hardest impacted stocks were airlines such as **Air Canada** (TSX:AC).

It wasn't until last year that we really began to see the airline industry and travel in general recover. It was clear that as soon as restrictions were eased, the pent-up demand from travelers would help these airlines recover quickly.

Unfortunately, there were a lot of growing pains, both from the airlines' point of view and at airports. And since many of these issues are now being addressed, and the problems caused by a tight labour force have begun to ease, there is potential for stocks like Air Canada to be big winners in 2023.

Let's look at what Air Canada's potential is this year as well as going forward. In addition, it's important to understand the potential risks it faces on its way to a complete recovery.

Is Air Canada stock undervalued in today's environment?

A quick look at Air Canada's stock chart will show that the stock continues to trade more than 50% below where it was before the pandemic hit. However, although its share price is down significantly, it's not as clear if Air Canada stock is still undervalued.

For one, there is much more risk in this environment. The economy is facing major headwinds this year, and it's possible that airlines could be impacted, especially since vacationing is a discretionary service for many Canadians.

Furthermore, it's also important to remember that Air Canada stock had to take on a lot of debt during the pandemic in addition to diluting shareholders. Therefore, looking at the stock price and its historical chart could be misleading.

The most important thing to watch as Air Canada's operations continue to return to normal is its profitability.

Already we've seen its revenue rebound sharply, especially in the second half of 2022. But with higher interest expenses due to all its increased debt (as well as higher interest rates), and volatile fuel prices, it's crucial to ensure Air Canada can continue to improve its profitability if you're hoping for its share price to recover.

As of Monday's close, Air Canada stock was trading at a forward enterprise value (EV) to earnings before interest, taxes, depreciation, and amortization (EBITDA) ratio of just six times. That's much cheaper than it traded over the last 12 months, as its expected EBITDA continues to increase as its operations recover.

In fact, the stock now has a positive forward price-to-earnings (P/E) ratio for the first time since the pandemic hit. It's worth noting, though, that both its forward P/E ratio and its forward EV/EBITDA ratio are both much higher than they were in the years leading up to the pandemic.

Although Air Canada is on the right track with its recovery, the stock doesn't appear to offer as much value as one might think.

Can the airliner be a big winner in 2023?

Despite the fact that Air Canada doesn't offer a tonne of value at this price, the stock could still be a big winner in 2023 if it can continue to grow its margins and, ultimately, its profitability.

What will be a major help to the stock is if it can continue to see strong demand from travelers, which has been crucial to offsetting cost increases from inflation.

If the slowing economy does impact travel and consumer spending, Air Canada could have a tough time growing its profitability this year and paying down some of the debt it took on through the pandemic.

However, if we continue to see strong demand, and airlines continue to have the pricing power to pass cost increases along to consumers, Air Canada could end up recovering faster than many expect it to.

Although there's a tonne of uncertainty right now, especially about a potential recession on the horizon, one thing's for sure: long-term investors willing to buy now and hold until its recovery could see an impressive return on their investment.

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