

Flying High or Grounded? Market Valuation of Air Canada through Financial Ratios and Stock Analysis

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Abstract. This paper investigates how Air Canada's financial ratios and stock performance from 2022 to 2024 reflect investor confidence during the airline's post-pandemic recovery. It focuses on key metrics such as the price-to-earnings (P/E) ratio, market-to-book ratio, and operating data. While financial performance improved significantly in 2023, valuation metrics in 2024 suggest renewed investor caution, possibly due to fuel cost volatility and international demand weakness. This paper uses comparative analysis with WestJet and incorporates CAPM to assess investor sentiment and valuation accuracy. Additional insights are incorporated through a profitability, liquidity, and solvency analysis for the 2020–2023 period to contextualize financial health during Air Canada's recovery.

Keywords: Air Canada, financial ratios, stock performance, market valuation.

1. Introduction

The COVID-19 pandemic brought the global airline industry to a near halt, and Air Canada was no exception. With international border closures, fleet reductions, and revenue plunges, the airline faced historic losses in 2020 and 2021. By 2023, Air Canada posted record operating revenues and a return to profitability. However, as financial recovery emerged, valuation ratios remained subdued, suggesting a potential disconnect between market sentiment and firm fundamentals. This paper seeks to answer how do financial ratios and stock performance reflect investor sentiment in Air Canada's recovery period? We evaluate market valuation through financial indicators, investor responses, and external risks impacting stock perception.

2. Literature Review

Academic studies have long debated how efficiently financial ratios reflect investor behavior. In capital-intensive sectors like aviation, investors scrutinize indicators such as the P/E ratio, adjusted EBITDA, and leverage. Undervaluation post-crisis is often driven by perceived risk rather than actual financial weakness [1]. In uncertain economic climates, market prices often deviate from intrinsic values due to noise trading and speculative behavior [2]. Behavioral finance models suggest that investor overreaction or cautious sentiment can distort valuation even during operational recovery [3]. The airline industry's sensitivity to fuel prices, regulation, and macroeconomic conditions compounds these effects.

Aviation sector valuation is uniquely susceptible to systemic shocks. IATA reported that while global passenger demand rebounded in 2022 and 2023, investor confidence did not mirror this rebound evenly across markets [4]. Airline-specific risk factors such as fleet management, labor disputes, and international route exposure remain key differentiators in how investors assign value. The CAPM model remains a core theoretical tool in understanding how systematic risk affects expected returns in such volatile industries.

3. Theoretical Framework and Methodology

3.1. Theoretical Framework

This study applies three core financial theories:

3.1.1. Price-to-Earnings (P/E) ratio

The Price-to-Earnings (P/E) ratio is a financial metric that measures a company's current share price relative to its earnings per share, which can be expressed as:

$$\text{P/E Ratio} = \frac{\text{Market Price per Share}}{\text{Earnings per Share (EPS)}}$$

A low P/E may indicate undervaluation or reflect investor concern over future earnings.

3.1.2. Market-to-Book (M/B) Ratio

the Market-to-Book (M/B) Ratio is a financial metric used to compare a company's current market value to its book value of equity, which can be expressed as:

$$\text{M/B Ratio} = \frac{\text{Market Cap}}{\text{Book Value of Equity}}$$

The Market-to-Book (M/B) Ratio ratio below 1 implies the market undervalues the firm relative to its assets.

3.1.3. CAPM Model

Thirdly, the Capital Asset Pricing Model (CAPM) is a financial model that describes the relationship between the expected return of an asset and its systematic risk. It states that the expected return on an investment is equal to the risk-free rate plus a risk premium, which is determined by the asset's beta (a measure of its volatility relative to the market). The formula for CAPM is:

$$\text{Expected Return} = \text{Risk-Free Rate} + \text{Beta} \times (\text{Market Return} - \text{Risk-Free Rate})$$

We use this model to assess whether a stock's return compensates for its risk level.

3.2. Methodology

This research draws on data from Air Canada's 2023 and 2024 annual reports [5], financial databases, and WestJet's financial disclosures [6,7]. Valuation metrics, operating statistics, and profitability ratios are examined over the 2022-2024 period. The CAPM model is applied using an estimated beta of 1.55 and a 5% equity market premium. The analysis also incorporates external factors including tariff impacts, exchange rate fluctuations, and competition from WestJet and Porter Airlines.

4. Results

From a liquidity standpoint, Air Canada's short-term financial health also improved over the period. The current ratio increased from 0.76 in 2020 to 1.12 in 2023, and the quick ratio rose from 0.65 to 0.98. These indicators suggest a strengthened ability to meet short-term obligations, although they still fall short of ideal industry benchmarks of 1.3 and above. In 2024, liquidity showed modest resilience despite increased costs, aided by careful cash flow management and strong forward booking trends.

Despite earnings growth, Air Canada's valuation metrics declined, possibly due to macroeconomic risk and declining investor confidence (Table 1). Using *Beta* equals 1.55, *Risk-Free Rate* equals 3%, *Market Return* equals 8% and calculating of the CAPM model, we can obtain Air Canada's *Expected Return* equals 10.75%. Air Canada's actual return in 2023 was 8.5%, which underperformed expected return (10.75%), reinforcing market caution. Investor sentiment has remained cautious despite Air Canada's operational turnaround.

This conservatism is rooted in structural risks: intensifying competition, policy-driven cost escalations, and the slow rebound of international travel. Analysts and institutional investors have

expressed concerns over Air Canada's exposure to variables beyond managerial control, such as foreign exchange movements, fuel price shocks, and tariff escalations. These risks contribute to valuation discounts, as evidenced by falling P/E and market- to-book ratios in early 2025. Investors likely view WestJet and Porter as agile competitors capable of reshaping Canada's aviation landscape. Until Air Canada can demonstrate consistent earnings growth, sustainable cost control, and a credible response to market share loss, its stock may continue to trade below intrinsic value. Nonetheless, its strong liquidity position and strategic investments could serve as future catalysts, provided execution risks are managed effectively.

Table 1. Valuation Metrics of Air Canada (from 2022 to 2025)

	2022	2023	2024	2025
P/E Ratio	-4.08	2.94	4.63	1.83
M/B Ratio	-4.48	8.43	3.35	2.26

5. Further Discussion

5.1. Macro-level factors

5.1.1. Economic Environment

Inflationary pressures, higher fuel costs, and tighter monetary policy influenced airline performance throughout 2023 and 2024. Canadian GDP grew by 1.3% in 2023, while tourism GDP rose by 9.5%, suggesting sector recovery [8]. However, exchange rate appreciation and labor costs dampened profitability.

In late 2024, signs of economic deceleration emerged. The national unemployment rate began to climb, reaching levels that impacted consumer confidence and spending behavior [9]. Higher unemployment reduces disposable income, leading to decreased demand for discretionary travel. For Air Canada, this translated into lower booking volumes, especially in the leisure and price-sensitive segments. Additionally, business travel remained suppressed due to corporate cost-cutting and economic uncertainty.

The threat of recession also affected investor sentiment, as macroeconomic instability introduces risk to future earnings streams. Air Canada's exposure to international routes and capital-intensive operations makes it particularly vulnerable during downturns. In response, the airline may need to adopt a more conservative approach to capital expenditure and strengthen liquidity buffers to weather prolonged periods of weak demand [10].

5.1.2. Tariff Policies and Competitive Pressures

Tariffs and environmental regulations continue to weigh heavily on Air Canada's cost base. Airport fees in major Canadian hubs have increased steadily, and carbon taxes, particularly on longer-haul routes, erode margin flexibility. The Clean Fuel Standard mandates rising levels of low-carbon fuel usage, increasing compliance and fuel procurement costs. These costs are particularly burdensome on older aircraft still in service for longer transatlantic or transpacific flights.

While Air Canada has attempted to pass some of these costs to consumers through surcharges, price-sensitive travelers increasingly seek alternatives. Ultra-low-cost carriers and smaller regional airlines operate under leaner models and are less exposed to long-haul taxes. Thus, tariffs not only challenge Air Canada's profitability but also expose it to market share erosion in both domestic and international markets.

5.1.3. Revenue Segments

Air Canada's revenue profile continued to evolve in 2024. Cargo revenue, which surged during the pandemic due to strong demand for medical and e-commerce logistics, declined sharply in 2022 and 2023 as supply chains normalized. However, a modest recovery was noted in 2024, indicating a stabilizing global trade environment. Cargo remains a valuable secondary revenue stream, particularly as long-haul routes ramp up.

On the passenger side, domestic and U.S. revenue increased by 1%, a sign of stable short-haul demand. In contrast, international revenue fell by 2%, reflecting persistent weakness in long-haul travel, particularly in Asia and Europe. Factors include slower visa processing, geopolitical tension, and inflation-related travel budget constraints. This shift toward regional over global travel places additional pressure on Air Canada, whose legacy network was historically reliant on international routes. The company may need to reevaluate its route planning and aircraft utilization to adapt to this evolving landscape.

5.2. Enterprise-level factors

5.2.1. Profitability Analysis

Inflationary pressures, higher fuel costs, and tighter monetary policy influenced airline performance throughout 2023 and 2024. Canadian GDP grew by 1.3% in 2023, while tourism GDP rose by 9.5%, suggesting a meaningful recovery in the travel sector. However, profitability was dampened by the appreciation of the Canadian dollar and rising labor costs. These headwinds persisted into 2024, where fuel price volatility and increased regulatory expenses continued to weigh on financial results.

Gross profit margin turned from -8.5% in 2020 to 12.7% in 2023, reflecting stronger cost controls and a resurgence in travel demand. Operating margin similarly improved, rising to 10.4% in 2023 from -25.6% in 2020. The net profit margin transitioned into positive territory, reaching 5.2% in 2023. While 2024 data indicate a sustained revenue base, margin pressures reemerged due to higher input costs, particularly on international routes affected by tariffs and fuel procurement expenses.

5.2.2. Fuel and Currency Impacts

Jet fuel remains one of Air Canada's most significant operating costs, historically comprising 20-30% of total expenses. In 2023, the airline benefited from a 12.4% decline in overall fuel costs, driven by global oil price normalization and improved hedging strategies. However, in 2024, while perlitre consumption figures were not disclosed, the rising USD/CAD exchange rate created new cost pressures. Since jet fuel purchases are denominated in U.S. dollars, a weaker Canadian dollar effectively increases the cost of operations even if global oil prices remain constant.

This exchange rate volatility poses a dual challenge: it reduces operating margins and introduces uncertainty in earnings forecasts, which investors typically penalize with valuation discounts. Furthermore, Air Canada's exposure to international routes makes its fuel strategy more complex than domestic competitors like WestJet. The company's partial reliance on older aircraft with lower fuel efficiency exacerbates this sensitivity to input costs. Thus, while 2023 brought relief, 2024 reintroduced uncertainty, weakening the perceived quality of earnings and potentially reducing investor confidence.

5.2.3. Strategic Fleet Investment

To combat both environmental and operational pressures, Air Canada announced its plan to acquire 18 Boeing 787-10 aircraft and 30 ES-30 electric-hybrid planes. The 787-10s offer 20-25% better fuel efficiency compared to older long-haul aircraft and feature advanced composite materials that reduce maintenance costs. More significantly, the ES-30 aircraft represent a strategic pivot toward energy innovation, aligning with global sustainability mandates and Canada's Clean Fuel Standard.

These investments reflect a forward-looking capital allocation strategy focused on reducing per-seat operating costs and boosting environmental credentials. Over time, this should help stabilize margins, particularly on high-frequency regional routes. However, near-term challenges include capital intensity and execution risk. Deliveries are scheduled to begin in 2026, meaning that any investor optimism will hinge on Air Canada's ability to manage debt levels and maintain liquidity in the interim. Still, the sustainability focus could appeal to ESG-oriented investors, supporting a long-term revaluation of the company's stock.

5.2.4. Domestic Market Competition: WestJet and Porter Airlines

Domestic competition from WestJet and Porter Airlines continues to affect Air Canada's short-haul performance. WestJet's strategic expansion under its "Soaring Together" plan has emphasized strengthening its Western Canada hubs, increasing fleet efficiency, and bolstering regional connectivity [11]. The 2023 acquisition of Sunwing Airlines has further broadened WestJet's footprint in the leisure travel market, giving it access to more vacation destinations and charter routes traditionally served by Air Canada Rouge. This acquisition significantly impacts Air Canada by intensifying competition on sun destinations and seasonal routes, where price sensitivity is high and volume margins are critical. It also allows WestJet to offer vertically integrated vacation packages, increasing its appeal to holiday travelers and reducing Air Canada's competitive edge in this segment [12].

Meanwhile, Porter Airlines, through its "Soaring to New Destinations" initiative, expanded its fleet with fuel-efficient Embraer E195-E2 aircraft and entered key domestic markets such as Vancouver, Calgary, and Edmonton [13]. Porter's differentiated value proposition-offering premium onboard experiences at competitive prices-has drawn business travelers and urban consumers away from Air Canada. The airline's hybrid model positions it between low-cost carriers and full-service competitors, intensifying pressure on Air Canada's mid-market pricing strategy [14].

In response, Air Canada has begun to refine its fare structures, enhance Aeroplan benefits, and invest in operational reliability. However, the dual-pronged challenge posed by WestJet's scale and Porter's market disruption has constrained Air Canada's ability to grow domestic revenue and maintain yields. The evolving competitive dynamics suggest that Air Canada's domestic strategy must balance premium branding with greater agility and pricing flexibility to retain market leadership.

6. Summary

Air Canada's financial trajectory from 2020 to 2024 is steadily regaining financial stability. However, while improving, profitability and liquidity remain vulnerable to macroeconomic shocks, fuel price volatility, and wage pressures. The airline must continue optimizing working capital and managing financial resources efficiently to maintain investor confidence and ensure resilience against future economic disruptions. With aggressive sustain- ability investments and evolving fleet strategy, Air Canada could regain market confidence-but success depends on managing macroeconomic and competitive risks effectively.

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