



Air Canada Reports Healthy Results but the Stock Gets Hit

Description

Air Canada ([TSX:AC](#))(TSX:AC.B) reported 2015 results Wednesday morning that were in line with expectations and pretty good. The stock, however, was down over 12%. Why?

Let's first take a look at the results, which were a reflection of strong demand and good cost control.

Strong demand, increasing returns

Operating revenue increased 4.5% in the year as traffic growth was 9.6%. In fact, in January the company reported a traffic increase of 7.1%, so demand continues to be strong. Return on invested capital (ROIC) came in at 18.3% in 2015 compared to 12.1% in 2014. This is evidence of the success of management's strategy thus far, which has been to focus on and invest in fleet modernization, international expansion, network diversification, and the roll out of its leisure carrier Rouge.

Let's look more closely at two of the company's focus areas.

Redeploy capacity to healthier markets

With increasing diversification and markets at Air Canada's disposal, the airliner has the ability to pull out of markets that are less profitable and redeploy the capacity in healthier markets. Air Canada launched many new international routes this year, and this has increased diversification and the ability to redeploy capacity.

The company has reduced its exposure to western Canada's woes as Canada currently represents one-third of total revenues with international representing two-thirds.

Fleet modernization: CSeries order

Air Canada also announced the intent to order 75 (45 firm and 30 options) of **Bombardier, Inc.**'s ([TSX:BBD.B](#)) new CSeries, the CS300, which is a 135 seat plane. It's good news for Bombardier as the CSeries jet has caused big problems for the company. The CSeries program has been plagued with cost overruns, delays, technical issues and a lacklustre order book.

How will this purchase benefit the Air Canada? While capex spending is high at this time (this order at list price is equal to \$3.8 billion) and this may be a worry that investors have on their minds, a normalized level of capital spending would be roughly \$1 billion per year, according to management. And the fleet modernization will give Air Canada a 10% cost advantage when compared to the aircraft it will replace, which has a 20% fuel-burn advantage, and the aircraft will be significantly quieter.

Management is focused on the long term

Management has set long-term targets for ROIC of 13-16% for a leverage ratio of 2.2 or less by 2018, continued margin expansion, and sustained profitability.

Going forward, the company will be reporting traffic and capacity on a quarterly basis rather than a monthly basis, and this probably did not help the stock either, but it is more in line with the company's long-term view, and from that perspective, it is at least consistent.

CATEGORY

1. Investing

TICKERS GLOBAL

1. TSX:AC (Air Canada)
2. TSX:BBD.B (Bombardier)

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