Air Canada’s Stock Soars Following its Q1 Report: What Should You Do Now?

Description

Air Canada (TSX:AC), Canada’s largest full-service airline, announced its first-quarter earnings results before the market opened on April 29, and its stock has reacted by rising over 10%. Let’s break down the results to determine if a rally of this magnitude is warranted, then decide if we should buy the stock today.

The results that ignited the rally

Here’s a summary of Air Canada’s first-quarter earnings results compared with its results in the same period a year ago.

Metric	Q1 2016	Q1 2015
Adjusted Earnings Per Share	$0.30	$0.41
Operating Revenue	$3.34 billion	$3.25 billion

Source: Air Canada

Air Canada’s adjusted earnings per diluted share decreased 26.8% and its operating revenue increased 2.9% compared with the first quarter of fiscal 2015. Its steep decline in earnings per share can be attributed to its adjusted net income decreasing 30.3% to $85 million, driven by a 4.6% increase in operating expenses, which it noted was due to the impact of its capacity growth and the unfavourable impact of a weaker Canadian dollar.

Its slight revenue growth can be attributed to its total number of revenue passengers carried increasing 5% to 9.96 million, which led to its revenues from passengers increasing 2.8% to $2.86 billion.

Here’s a quick breakdown of 12 other notable statistics from the report compared with the year-ago period:

1. Seats dispatched increased 6.8% to 13.18 million
2. Capacity (available seat miles) increased 8.2% to 19.83 million

3. Traffic (revenue passenger miles) increased 7.7% to 16.09 million
4. Cargo revenue decreased 10.1% to $116 million
5. Other revenues increased 8.7% to $363 million
6. Earnings before interest, taxes, depreciation, amortization, and aircraft rent (EBITDAR) increased 4.1% to a record $460 million
7. EBITDAR margin improved 20 basis points to 13.8%
8. Operating income decreased 23% to $154 million
9. Operating margin contracted 160 basis points to 4.6%
10. Net cash flows from operating activities increased 19.5% to $968 million
11. Reported a cash use of $148 million compared with free cash flow of $385 million in the year-ago period
12. Return on invested capital (ROIC) improved 220 basis points to 17.4%

Is the rally warranted?

It was a good quarter overall for Air Canada, but I did not see anything in the report that would warrant a rally of over 10%. I do, however, think the stock represents a great investment opportunity for the long term, mainly because it trades at incredibly inexpensive valuations, including less than three times fiscal 2016’s estimated earnings per share of $3.30.

With both of these thoughts in mind, I think Foolish investors should wait for the stock to come back down in to the $8 range to begin scaling in to long-term positions.

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