



## Why Air Canada Shares Could Double Over the Next Year

### Description

When looking for double-(or triple-) digit price appreciation, investors don't typically look at airlines, let alone airlines that are nearly 80 years old. This is, however, what several analysts are suggesting for **Air Canada** ([TSX:AC](#)). Currently, analysts at **TD Bank** have a price target of \$21 on the stock (118% above the current price). Analysts at **RBC** don't disagree and see Air Canada reaching \$17 per share (77% above current levels).

The bullish sentiment around Air Canada comes from the fact that it's still in the fairly early stages of a transformation that so far has been quite successful. As Air Canada continues to successfully implement its long-term plan to improve its cost structure, deleverage, and grow revenues/margins, the market should begin to take note and unwind the large discount that Air Canada is currently trading at.

### Air Canada has big transformation plans and is very likely to achieve them

Air Canada was on the verge of bankruptcy only five to six years ago. The current stock price is \$9.80 per share, but in 2012 the price fell below one dollar, turning a 75-year-old international airline into a penny stock. Air Canada went through bankruptcy court in the early 2000s and in 2012 the company was headed towards bankruptcy once again.

The company came off a billion dollar loss in 2008, and the years following saw Air Canada build a pension shortfall that was nearly \$4 billion dollars, its credit downgraded to junk status, and serious labour issues with pilots and ground staff, which saw pilots calling in sick—leading to 75 flight cancellations—after being forced back to work while on strike.

While the years following the recession were difficult for Air Canada, CEO Calvin Rovinescu implemented a turnaround plan focused on reducing costs, deleveraging, increasing liquidity, and growing margins and revenues. The turnaround, though still in its early stages, has been very successful so far. Air Canada grew revenues by 40% over the past six years, increased earnings by 270%, eliminated the pension shortfall (the company currently has a \$1.3 billion surplus), and the result is that shares have appreciated 800% over the time period.

Most importantly, Air Canada set several targets in 2013 (to be achieved by 2018), and the company is

well on track to achieving all of them. This includes profit margins of 15-18% (the company achieved 18.5% margins in 2015, which is up from an average of 11.5% in 2010-2012) and a leverage ratio of 2.2 (the ratio was 2.5 in 2015 down from 3.4 in 2010-2012).

### **The transformation is set to continue**

Air Canada's most important objective is a 21% reduction in CASM (costs per airline seat mile) by 2018. At the recent earnings release, management maintained this objective, and in fact, the company improved its CASM reduction target for 2016 from -0.5 to 0.5% to -1.75 to -2.75%, largely due to the improving outlook for the Canadian dollar.

The company is achieving this through a combination of adding significant low-cost, international capacity through its new Rouge airline as well as through sustainable maintenance cost reductions that come from massive capital expenditures on new aircraft that will result in Air Canada having one of the youngest fleets in the industry.

Air Canada is transitioning to longer-stage international flights with more densely packed aircraft, and this has the effect of driving costs down since longer flights have lower costs per seat, and more densely packed aircraft mean more capacity (which means more revenue) at lower unit cost (since the fixed costs of departure are spread across more seats).

Currently, Air Canada is trading at forward price-to-earnings ratio of 2.7 (based on consensus earnings) compared to its peer group, which is trading at 5.3, excluding outliers. This is far less than Air Canada's long-term average of about 4.5 and, if Air Canada simply traded up to its long-term average, the share price would be \$17.55 per share.

### **CATEGORY**

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1. Editor's Choice

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1. TSX:AC (Air Canada)

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