



Why Air Canada's Stock Fell Over 4% on Friday

Description

Air Canada ([TSX:AC](#))(TSX:AC.B), the largest airline in Canada and one of the 20 largest airlines in the world, announced its second-quarter earnings results before the market opened on Friday, July 29, and its stock responded by falling over 4% in the day's trading session.

Let's break down the results and the fundamentals of its stock to determine if we should consider using this weakness as a long-term buying opportunity or if we should wait for an even better entry point in the trading sessions ahead.

The results that failed to impress

Here's a summary of the most notable statistics from Air Canada's three-month period ended on June 30, 2016, compared with its results in the same period a year ago.

Metric	Q2 2016	Q2 2015
Operating revenues	\$3.458 billion	\$3.414 billion
Adjusted earnings per share	\$0.72	\$0.85

Source: Air Canada

Air Canada's operating revenues increased 1.3% and its adjusted earnings per share decreased 15.3% compared with the second quarter of fiscal 2015.

Its slight revenue growth can be attributed to its passenger revenues increasing 2% to a record \$3.14 billion, which was driven by its total number of revenue passengers carried increasing 6% to 10.85 million, but this growth was partially offset by its cargo revenues decreasing 9.8% to \$111 million and its other revenues decreasing 2.4% to \$204 million.

Its steep decline in earnings per share can be attributed to its adjusted net income decreasing 18.8% to \$203 million, which was a direct result of its operating expenses increasing 2.9% to \$3.18 billion and its non-operating expenses increasing 237% to \$91 million.

Here's a quick breakdown of 10 other notable statistics from the report compared with the year-ago period:

1. Operating income decreased 14.2% to \$277 million
2. Earnings before interest, taxes, depreciation, amortization, and aircraft rent (EBITDAR) increased 2.4% to a record \$605 million
3. EBITDAR margin (EBITDAR as a percentage of operating revenue) improved 20 basis points to 17.5%
4. Operating cash flow increased 28.3% to \$657 million
5. Revenue passenger miles (RPM) increased 9.3% to 18.42 billion
6. Available seat miles (ASM) increased 11% to 23.34 billion
7. Passenger revenue per RPM (Yield) decreased 7.2% to 16.7 cents
8. Adjusted operating expense per ASM (CASM) decreased 1.1% to 11.2 cents
9. Return on investing capital (ROIC) remained unchanged at 16.2%
10. Total aircraft in its fleet at the end of the quarter increased by nine to 380

What should you do with Air Canada's stock now?

It was a fairly weak quarter overall for Air Canada, so I think the drop in its stock was warranted. However, I still think the stock represents a great investment opportunity for the long term for three primary reasons.

First, it's incredibly cheap. Air Canada's stock now trades at a mere 2.4 times fiscal 2016's estimated earnings per share of \$3.70, which is very inexpensive compared with its long-term average of about 4.5.

Second, in its earnings report Air Canada noted that it remains on track to meet or exceed key financial targets that it set back in 2013. These targets include the following:

- Annual EBITDAR margin of 15-18% over the term of 2016-2018
- Year-over-year ROIC of 13-16% over the term of 2016-2018
- A leverage ratio not exceeding 2.2 by 2018, which is measured by dividing adjusted net debt by normalized EBITDAR

It also noted that it remains committed and on track to reduce its CASM by 21%, excluding the impact of foreign exchange and fuel prices, by the end of 2018 when compared with 2012. These targets seemed quite bold when they were originally made, but I think the company will exceed each of them by 2018, which will position it for significant long-term growth.

Third, it has continued to add routes, including 10 new international routes and 11 new transborder routes in the second quarter, which marked the most intensive period of expansion in Air Canada's history. Adding routes is an easy way for the company to maximize its revenue stream, and this expansion paired with its cost-reduction strategies will likely lead to record earnings in the years ahead.

With all of the information provided above in mind, I think all Foolish investors should strongly consider using the post-earnings weakness in Air Canada's stock to begin scaling in to long-term positions.

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1. Investing

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