Air Canada Price Target of $18 Achievable in 2017

Description

Air Canada (TSX:AC)(TSX:AC.B) is one of North America's few remaining value picks in the airline industry. The company's stock price has skyrocketed 55% over the past three months, largely reflecting the strength shown in the company's most recent financial statements. The airline's fundamentals are solid, and at a price-to-earnings ratio of just over four, value investors will likely continue to scoop up shares in the near term.

Price target of $18

In **Royal Bank of Canada's** (TSX:RY)(NYSE:RY) "Top Global Ideas for 2017" released Thursday, Air Canada was one of seven Canadian stocks chosen in the report. This annual report highlights the top stocks expected to outperform the market in 2017.

RBC's equity strategist Matt Barasch points out in the report that 2017 will be a transitional year for stocks; certain sectors and companies may be better positioned to benefit from the proposed economic policies arising from the incoming Trump administration. Air Canada is one of the companies that is expected to outperform in the airline industry–a sector that is expected to receive a boost from Mr. Trump's proposed policies.

RBC's target price for Air Canada in 2017 is $18, which implies a return of approximately 24% at today's stock price levels.

Strong fundamentals

Air Canada's Q3 financial statements indicate significant earnings growth over the past year as well as improvements in the company's revenue passenger miles and free cash flow. The company's stock has reached its 2015 52-week high just this past week due in part to fundamentals that have outperformed analyst expectations on a year-over-year basis.

It is important to remember that Air Canada was a stock trading below $1 in 2012. A number of issues have plagued the company from union and employment disputes to the company's debt load. It appears that investors now feel that the troubled airline is truly on its way toward sustained long-term profitability. After all, a 1,500% gross five-year return is nothing to sneeze at.

Reasons for caution, long term

That said, the company's debt position remains precarious. The company added on another $1.4 billion in debt in 2016, raising the company's leverage ratio from 2.3 to 2.5. The worry for investors is not so much that the company is illiquid–Air Canada's current ratio remains above one–but that the company is largely financing its cash position and current expenditures with long-term debt. This heavy long-term debt load will eat into the company's future return on assets, which currently sits at 6.5%.

A shifting capital structure toward a higher debt-to-equity ratio generally means higher returns on equity in the short term. For short-term investors looking to capitalize on a 2017 uptick on airlines, Air Canada looks like an interesting pick. For the cautious long-term investor, the jury still seems to be out on Air Canada.

CATEGORY

1. Investing

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2. TSX:AC (Air Canada)
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Date
2025/08/25
Date Created
2016/12/16
Author
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