Air Canada: How Fast and How Far Can You Run?

Description

Over the past year, shares of **Air Canada** (TSX:AC)(TSX:AC.B) have performed exceedingly well. The price increase over the past 52 weeks is over 120% with no dividends paid during this time.

The good news for investors is that the company is trading at a very reasonable 7.5 times trailing earnings in spite of hitting a 52-week high this past Friday at $19.82. Shares closed the week at $19.75. The challenge currently faced by investors and the company is how to get the market to recognize the value that shares are offering. Given the current situation, it is clear that the market is either missing something, or the market is telling investors something.

The nature of the airline business is cyclical, so it is important to realize that when earnings are growing, it is often at the end of a business cycle. For those not in the know, the end of a business cycle is most often characterized by higher than average spending by both companies and individuals. Typically, everyone wanting to work has employment.

In considering shares of Air Canada, investors need to be very careful for a number of reasons. Given the incredible returns over the past five years, many investors will feel much more comfortable when acquiring shares in this airline. Company management, however, has trimmed their positions; executive Greg Landry sold 12,989 shares in early June. For long-term shareholders, it may be time to lock in profits.

Although things have gone very well for the industry over the past few years, investors need to remember that capacity does not necessarily lead to profitability. Instead, it is only in an economic downturn that we can judge whether company management is disciplined or not. Given that the past economic downturn was during the major recession of 2008 and 2009, it is more likely that investors will have another opportunity to make this judgement for themselves in the relatively near future. On average, recessions happen every seven years or so.

In evaluating the company's financial statements, one of the most important metrics is top-line revenues. For the past fiscal year, it is important to note that revenues increased by 5.8% from one year earlier, but not equally throughout each quarter. Given the higher than average summer travel season, the third quarter ending September 30 accounted for approximately 30% of revenues, while the bottom line of the same quarter accounted for almost 75% of profits. The company lost money in both the fourth quarter of fiscal 2016 and the first quarter of fiscal 2017.

With second-quarter results set to be released on August 1, investors may want to reconsider just how much of an allocation of this stock is appropriate given the cyclical nature of the business. Although the momentum has clearly been on the side of the company, investors must remain cautious as these things can turn very quickly.

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