



How Much Higher Can Air Canada Fly?

Description

Air Canada ([TSX:AC](#))(TSX:AC.B) has been one of the biggest winners on the TSX this year, rewarding shareholders with a ~75% YTD return. Despite surging into the stratosphere, the stock is still ridiculously undervalued with a mere price-to-earnings multiple of just 3.57. That may seem like a typo, but it's not. Air Canada has a huge amount of positive momentum, and there are many reasons to believe the stock can continue to soar over the next year.

Record Q3 2017 results, but shares still slipped

For the third quarter, Air Canada clocked in \$1.39 billion in EBITDAR, beating analyst expectations of \$1.38 billion. Adjusted EPS was recorded at \$3.43 — up 17.1% year over year and beating the street consensus by \$0.06.

On the revenue front, Air Canada clocked in \$4.88 billion in total revenues — up 9.6% compared to the same quarter last year. Cargo revenues and passenger revenues increased by 37.7% and 9.1%, respectively, on a year-over-year basis.

Not everything in the report was positive, as Air Canada saw its operating expenses increase by 9% in Q3 thanks in part to higher fuel prices.

Despite beating on earnings by a fair amount, Air Canada shares continued to [plunge](#) in the days following earnings and are now down ~14% from all-time highs. There's no question that the general public has grown accustomed to exceptional results from the company, but I do not believe the post-earnings sell-off was warranted, especially when you consider that Air Canada is well on its way to hitting the higher end of the fiscal 2017 free cash flow guidance of \$600-900 million.

Valuation

Shares of AC currently trade at a 3.57 price-to-earnings multiple, a 0.4 price-to-sales multiple, and a 2.6 price-to-cash flow multiple versus the company's five-year historical average multiples of 31.2, 0.2, and 2.4, respectively. Shares are still dirt cheap right now, especially considering Air Canada is well positioned to meet its EPS targets in the near term.

Bottom line

Management is improving the business as it continues along with its long-term plan. Although shares have surged exponentially over the year, the stock still offers a huge amount of value, and I believe there's still [much more room to run from here](#).

If you're a medium-term investor looking to ride the cyclical opportunity in the airlines, Air Canada is a fantastic pick. Just make sure you take profits off the table at some point down the road, because airlines are horrible long-term investments, especially once the economy weakens.

Stay smart. Stay hungry. Stay Foolish.

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