Why Air Canada (TSX:AC) Stock Has Significant Upside Potential

Description

Shares of **Air Canada** (TSX:AC)(TSX:AC.B) have been on a tear in the last few years. The stock has gained close to 500% in the last five years and is up 66% year to date, easily outperforming peers and broader indices.

So, do investors need to buy the stock after its stupendous performance since 2014? Let's have a look at the company's business segments, revenue growth, valuation, risk factors, and more.

Air Canada provides primarily provides scheduled passenger services in the Canadian and international markets. It has around 170 aircraft and a 28-member airline network. The company offers flights to over 1,300 destinations across 190 countries.

Air Canada's passenger business segments account for close to 90% of total sales, and Canada accounted for 27.6% of revenue in 2018.

Revenue and earnings growth

What has driven Air Canada's stock higher in the last few years? The company has managed to grow sales from $14.67 billion in 2016 to $18.06 billion in 2018. Analysts expect this revenue growth to continue in the near future.

Analysts estimate Air Canada sales to grow by 6.8% to $19.3 billion in 2019, 6.9% to $20.6 billion in 2020, and by 4% to $21.4 billion in 2021. Comparatively, Air Canada's earnings are estimated to rise by a robust 48.2% in 2019 and 33.1% in 2020. Analysts expect earnings to grow at an annual rate of 19% over the next five years.

Air Canada stock is trading at a forward price-to-earnings multiple of just 8.9, which means it has solid upside potential if you look at the company's long-term earnings growth. The company is valued at $11.6 billion, or 0.6 times 2019 sales, which, again, indicates that the stock is undervalued.

What might drive Air Canada stock lower?

While Air Canada's growth story is far from over, investors will be concerned over the upcoming recession. Travel companies are hit hard in a downturn, as consumers cut spending on vacations and delay their travel plans. This makes Air Canada vulnerable to negative investor sentiment.

Airline companies are also impacted by rising fuel prices that drive down profit margins lower. In the last few years, oil prices have been far from volatile benefiting Air Canada and peers.

Air Canada is also not a highly sought-after airline in terms of customer service. But its low-cost prices give it an edge over competitors and might stem the revenue decline in a recessionary economy.

Air Canada is focused on sustainable growth

One of Air Canada's primary goals is to become a sustainable and profitable global airline. Further, it wants to continually improve the customer's flying experience and employee engagement, and create value for shareholders.

It aims to achieve strategic goals by identifying and implementing cost-reduction initiatives. Air Canada has stated it is looking to "pursue profitable international growth opportunities and leverage its competitive attributes to expand margins, in large part by increasing connecting traffic through its strategic international gateways in Toronto, Vancouver, and Montréal, and grow and compete effectively in both the business and leisure markets to and from Canada."

There are both risks and opportunities while investing in an airline stock. These companies are most vulnerable to economic activity and global scenarios. But how often do investors get an opportunity to buy a growth stock that is still trading at a cheap valuation, despite its impressive run in the last five years?

Analysts tracking Air Canada have a 12-month average target price of $53.35 on the stock, indicating upside potential of 24.4% from the current price.

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