

# Air Canada

52-Week Range: \$9.26 - \$52.71

Current Price: \$17.05

Date of Price: 05/08/2020

Market Cap (M): \$4,453.5

Shares O/S (M): 261.2

YTD Return: -69.86%

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## Air Canada

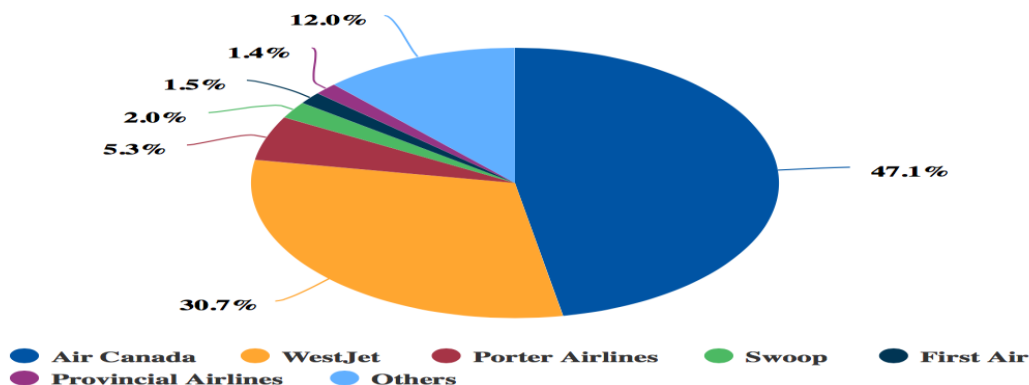
*Air Canada is Canada's largest airline that provides domestic and international travelling services. These services not only include flights but also include vacation travel packages and cruise packages across different parts of the world such as North America and Europe. In addition to travelling, Air Canada also partakes in cargo delivery around the world.*

## Growth Strategy

Air Canada's way of pursuing growth for the most part involves multicultural marketing and market expansion. In 2019, Air Canada hired Sandra Oh for its marketing campaigns in an attempt to bring brand awareness to the international market. In the past, the airline made efforts to campaign in London and India, however, the campaign involving Sandra Oh is planned to have the most impact so far as it targets leisure and business travellers in North America, Europe, Asia and Australia. An example of the airline's market expansion was in 2019 where Air Canada bought out Transat AT Inc. for \$520 million. The acquisition of Transat will help Air Canada's performance in the leisure sector especially up against fellow competitor WestJet who was recently bought by Onex. Furthermore, Air Canada also expects to increase their international presence by tapping into sixth-freedom traffic. Sixth-freedom traffic is essentially the way a traveller goes from one country to another country through the airline's country of origin. In addition to cultural enhancement and market expansion, the airline is also focusing on expanding their margins by managing their debt and costs while increasing revenue at the same time. Additionally, Air Canada will be improving their customer services through a partnership with Amadeus, a travel company that provides technological solutions. On top of excellent customer service, the airline is also an extremely reputable employer as they have been recognized as Canada's Top 100 Employers and they plan to maintain this title as part of their growth strategy.

## Competitive Advantage

Air Canada's most notable advantage is its domestic market size. In Canada, Air Canada occupies an enormous 47% of the Canadian market while the next closest competitor, WestJet only occupies 31%.



This large market size was achieved by the airline being the first airline to include innovative features that made travelling more enjoyable and convenient. Some of these features include 2D barcode scanning, seatback entertainment systems and having a plentiful and sufficient oxygen system. Other than an eminent market size, Air Canada has been included in Canada's Top 100 Employers for 7 years in a row. Since Air Canada treats its employees well, it will lead to a more productive and efficient workforce which will lead to quality results being produced that leads to efficient operations. Another advantage that Air Canada has is its diversity. In 2019, Air Canada won the inaugural award for Diversity in Leadership. By being vested in a diverse workforce and diverse market, it opens the airline up for greater chances and more opportunities of attracting and obtaining a strong human capital as well as being able to serve more and more travellers. Although Air Canada's domestic economic moat is wide, its international position pales in comparison to American airline giants such as Delta or United, however, with Air Canada's strategic growth and relentless hunger to become larger, it has the potential to become comparable to the American airlines in the future.

## **Management**

Air Canada's management consists of extremely talented and skilled individuals. It is because of these individuals' combined efforts that Air Canada has become such a dominant airline in Canada. Through the guidance of its management, the company displays potential to reach new heights in the future.

The CEO and President of Air Canada is Calin Rovinescu. Rovinescu carries decades of experience and talent with him. He was the Vice President of Corporate Development and Strategy from 2000 to 2004, afterwards, he founded an investment bank called Genuity Capital Markets. Before 2000, Rovinescu practiced law for over 20 years. While being the CEO of Air Canada he also became the chair of Star Alliance from 2012 to 2016 and the Chair of the International Air Transport Association from 2014-2015. Furthermore, Rovinsecu was acknowledged as Canada's Outstanding CEO of the Year award twice, once by Financial Post Magazine in 2016 and another time by Globe and Mail's Business Magazine in 2019. Calin Rovinescu proves to be an extremely competent CEO as he carries experiences from an array of prestigious fields such as law and finance.

Michael Rousseau is the Deputy CEO and CFO of Air Canada. Rousseau has over a decade of experience as the CFO which reflects his competence in financial management, reporting and allocation. Before Air Canada, Rousseau was the President, and before becoming the president, was a Vice-President and CFO of retail giant Hudson's Bay Company. Other than Hudson Bay, he also served as an executive in other large companies such as Moore Corporation and Silcorp Limited. In 2017, Rousseau was elected as Canada's CFO of the Year by Financial Executives International Canada, PwC Canada, and Robert Half. Rousseau is a perfect fit for the CFO position at Air Canada given his numerous experiences in various executive positions.

The Chief Commercial Officer (CCO) of Air Canada is Lucie Guillemette. Being an airline, the way Air Canada promotes and brands itself is essential towards the business' growth. Guillemette has been part of Air Canada's executive team since 2008 and has been with Air Canada since 1987 when she was a Customer Service and Sales Agent. In 2017, Guillemette was named as one of Canada's 100 Most Powerful women in Business in the Corporate Executive Category by the Women's Executive Network. With a long history at the company and an ample amount of experience in the marketing field, Guillemette will be able to enhance and grow Air Canada's international presence to a new level as the CCO.

## External Analysis

Currently, the airline industry is facing immense risk due to the COVID-19 pandemic. After the pandemic started spreading across the world, the majority of the world has halted air travel. This puts airlines at an extremely disadvantageous position as the reduction of travel ceases every airline's revenue stream.

### Airline revenues set to decline

Bars show the estimated loss in passenger revenue in 2020 compared to 2019



SOURCE: International Air Transport Association (April 14, 2020)

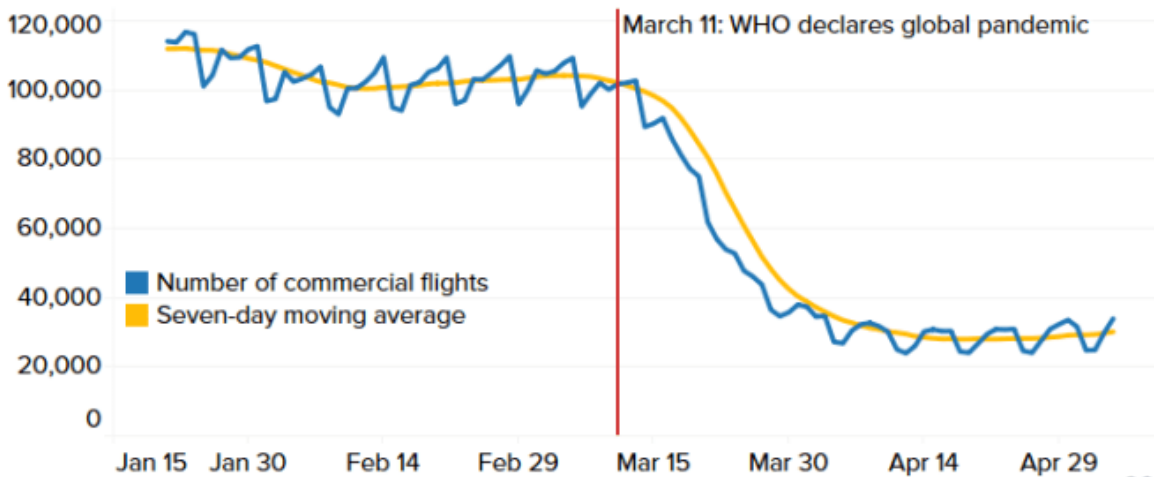


Without a stable or constant revenue stream, airlines will have trouble sustaining their operations. Considering the huge amounts of debt that airlines carry, it will not be long until they burn all their cash. Looking at the situation that airlines face, it is very likely that the airline industry will require government funding in order to survive the pandemic. Furthermore, after the pandemic, it would take years for the airlines to fully recover. There are several factors that are responsible for the slow recovery. This pandemic leaves millions of people unemployed which results in a drastic decrease in overall disposable income. Since the disposable income is lower, it means that consumers are less likely to purchase plane tickets and travel as plane tickets

can get quite costly. Another point is that after witnessing the eruption of COVID-19 on an international scale, governments will most likely lift travel bans in a slow and cautious manner. Speaking of travelling, people will also become more cautious and may travel less in order to keep themselves safe for an extended period of time after the pandemic is over.

## Coronavirus pandemic hit global travel

The number of commercial flights has been falling since the start of 2020



SOURCE: Flightradar24. Data as of May 5, 2020



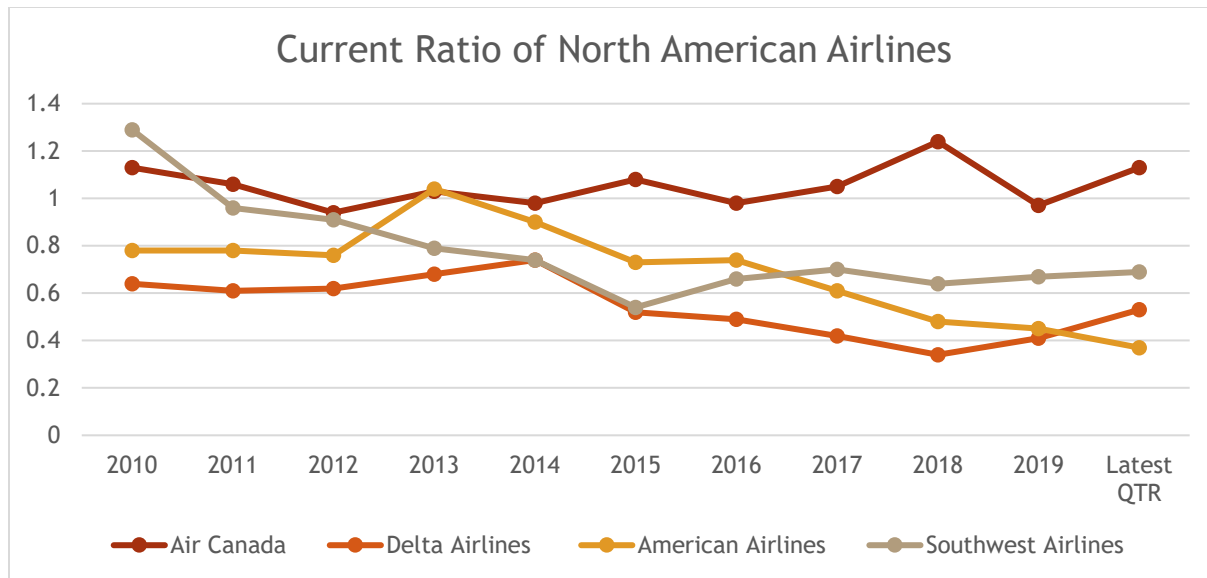
Despite the pessimistic outlook on the airline economy, Air Canada remains to be a different case than most airlines mainly due to its domestic position and the management's risk reducing strategies. Air Canada currently laid off 20,000/38,000 employees and plans to use the government's 75% wage subsidy program to help cover the salaries for the majority of those employees. Moreover, management is also planning on cutting \$1 billion in costs and eliminating 79 planes from its fleet. A portion of those 79 planes will be replaced, a portion will be permanently removed, and a portion will be offered for employee buyouts. Another advantage the airline has is that they are the nation's flagship air carrier. Since they are Canada's most dominant airline, it means that the country needs the airline as well since it plays an important role in Canada's economy. Additionally, Air Canada also has very little domestic competition which means that it will be easier for them to recover after the pandemic passes considering how domestic travelling routes will be available first.

Another factor that contributes to how Air Canada performs in its industry along with its competitors is the implementation of technology to promote innovation and safety amongst crew members and passengers. Last year, Air Canada started to implement artificial intelligence into their carriers so that they can anticipate when maintenance or repair is required. Moreover, big data is also used in their loyalty programs to enhance customer relations and retention. Air Canada aims high with its use of new technologies as it hopes to become Canada's AI employer of choice in only 3 years. Aside from artificial intelligence and big data, airlines around the

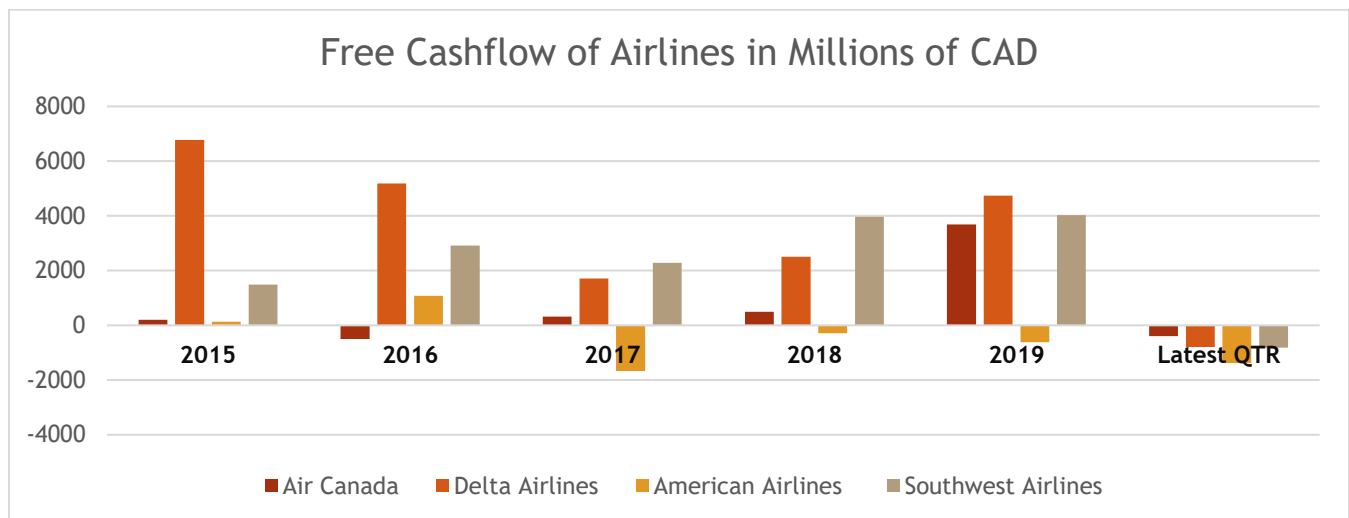
world will most likely be implementing new safety precautions in their screening systems to prevent another pandemic like the current one from occurring again. It is expected that COVID-19 will push airlines to implement new screening measures that detect vital signs to ensure that every passenger is healthy and to reduce the risk of a virus like COVID-19 from spreading internationally again.

## **Quantitative Analysis**

The airline industry has suffered a significant amount of financial damage from the COVID-19 outbreak. Given this, it is expected that the price of any airline is extremely low, Air Canada included. Currently, Air Canada is trading at \$17.05 in comparison to its price of \$44.33 before the pandemic. For the latest quarter, growth rates in revenue, operating income and earnings are down 16.42%, 440.94% and 417.46% respectively which explains the \$1-billion loss that the carrier is facing. Continuing on, its ROA fell from 6.29% to 0.3%, ROE fell from 35.01% to 2.17% and ROIC fell from 14.30% to 1.91% which reflects how the company's returns are drastically diminishing as well. Aside from the discouraging growth rates and returns, an important quantitative aspect to watch right now is the company's financial health. Despite the company's desperate efforts to cut expenses and raise cash, such as cutting their fleet by 31% and reducing their total operating expenses by 85%-90% while raising approximately \$1.6 billion from credit facilities, Air Canada still finds itself in a very limited cash position in comparison to its debt and liabilities. Furthermore, the company has a debt/equity ratio of 2.26 in comparison to last year's ratio of 1.82 which shows a significant increase in the debt the company is taking on. The company is also expected to take on more debt in the future because they must increase their borrowings to finance their operations. Although the quantitative outlook for Air Canada is disappointing, it is important to keep in mind that the sudden decrease in numbers is due to the pandemic. The pandemic is the main reason keeping the vast majority of the world's population from travelling thus reducing earnings and revenue drastically. On a more positive note, Air Canada is in a better financial position than some of its peers such as Delta Airlines (DAL), American Airlines (AAL), and Southwest Airlines (LUV). Air Canada still boasts a current and quick ratio above 1 meaning that it still has enough assets to cover its liabilities. On the other hand, its competitors are currently displaying current and quick ratios under 1 which means that either they are already having trouble covering their liabilities or will have trouble in the very near future.



Furthermore, Air Canada went into 2020 with a steady cash position near Delta and Southwest and is salvaging more cash than its competitors in this quarter throughout the economic crisis as well.



Overall, the current economic situation has inflicted severe damage on Air Canada's financials, however, with low domestic competition and strategic managerial decisions, the airline will be able to fly again in the future.

## Investment Thesis

Currently, the price accurately reflects the financial position the company is at. With a travel ban that results in the loss of basically all customers, Air Canada's price crashed as well. However, to assess the company fairly, the qualitative and economic circumstances must be accounted for as well. The temporary economic situation is also a major contributor as to why the company is priced at only \$17.05. Since the economic slump is only temporary, it also means

that the travel bans are also temporary. Once the travel bans are lifted, Air Canada's qualitative advantages will put the company in a good position to grow along with the industry in general. A hold recommendation is made for the company at a price of \$17.05 as the price may keep going down in the short-term, however, when looking at the next 5-10 years, Air Canada will be to provide its investors with attractive gains.

### **Canada's Flagship Airline**

When people think about Canada and their airlines, the first thing that will occur in their minds is Air Canada. Air Canada has positioned themselves as the brand that represents Canadian flight, travel, and tourism. As mentioned before Air Canada takes up 46% of the market. Due to the influence that this airline has on the country's economy and the world's travel and tourism industry, it would be safe to say that one way or another, the airline will be able to survive this pandemic. The government is highly likely to provide funding for the company and the recovery is expected to be swift as well since it does not need to overcome many competitors in a domestic perspective. Internationally speaking, the competition will also be reduced as it is guaranteed that there will be some airlines that are not going to survive the pandemic. Overall, Air Canada's position in the market and especially in Canada grants the company security from the effects of the pandemic and a runway for growth after the pandemic passes.

### **Competent Management**

Another trait that puts Air Canada ahead of its competitors and a company that can still grow is its management. The CEO, Calin Rovinescu is an extremely successful person with a broad range of knowledge in a variety of industries that have an integral impact on an airline's success such as legal factors and finance. Rovinescu had significant impact and takes credit for preventing the airline from going bankrupt as well as commencing sustainable operations and improved employee relationships. Furthermore, he was responsible for setting record revenues, profits and passengers through international expansion as Air Canada is now capable of travelling to all 6 continents all the while the share price appreciated an enormous 4000% since 2009. Other key members of management include Michael Rousseau (CFO) and Lucie Guillemette (CCO). Rousseau plays a key role in the company as he controls the financial position of the company. With his experience, and strategic capital allocation, Air Canada's survival is assured. Guillemette is responsible for Air Canada's commercial tactics. The value she puts on sustainable profits and her industry knowledge that is comprised of 33 years at Air Canada makes her a reliable figure that will be responsible for paving the airline's runway when it recovers and takes off for future growth.



# Comparable Companies Analysis

Operating Statistics:		Capitalization													Projected		Projected		Source: Company Filings	
Company Name	Ticker	Share Price	Diluted Shares	Equity Value	Enterprise Value	LTM	Revenue			EBITDA			Net Income			Revenue Growth	EBITDA Growth	LTM	EBITDA Margin	
							FY20	FY21	LTM	FY20	FY21	LTM	FY20	FY21				FY20	FY21	
Southwest Airlines Co.	LUV	\$ 38.29	589.4	\$ 22,568.1	\$ 23,794.9	\$ 30,285.8	\$ 15,596.7	\$ 25,860.1	\$ 4,771.0	\$ (2,832.9)	\$ 4,944.3	\$ 3,241.7	\$ (3,479.9)	\$ 2,294.5	65.8%	274.5%	15.8%	(18.2%)	19.1%	
Delta Air Lines, Inc.	DAL	31.98	635.2	20,313.7	45,801.8	63,529.3	30,976.3	50,477.2	10,737.2	(3,276.9)	9,302.2	6,765.2	(6,205.7)	4,022.5	63.0%	383.9%	16.9%	(10.6%)	18.4%	
American Airlines Group Inc.	AAL	14.27	422.9	6,034.8	48,970.2	61,519.0	29,717.7	48,698.5	6,351.9	(6,218.4)	6,942.8	2,376.3	(10,235.2)	1,093.7	63.9%	211.7%	10.3%	(20.9%)	14.3%	
JetBlue Airways Corporation	JBLU	12.80	269.7	3,452.2	6,573.9	10,996.2	5,472.8	9,021.7	1,523.2	(844.3)	1,303.7	802.0	(1,532.0)	167.7	64.8%	254.4%	13.9%	(15.4%)	14.5%	
United Airlines Holdings, Inc.	UAL	35.79	290.4	10,393.4	36,026.5	58,633.0	27,947.5	47,955.7	7,606.3	(6,122.5)	4,840.0	4,241.0	(8,387.5)	952.8	71.6%	179.1%	13.0%	(21.9%)	10.1%	
Maximum		\$ 38.29		\$ 22,568.1	\$ 48,970.2	\$ 63,529.3	\$ 30,976.3	\$ 50,477.2	\$ 10,737.2	\$ (844.3)	\$ 9,302.2	\$ 6,765.2	\$ (1,532.0)	\$ 4,022.5	71.6%	383.9%	16.9%	(10.6%)	19.1%	
75th Percentile		35.79		20,313.7	45,801.8	61,519.0	29,717.7	48,698.5	7,606.3	(2,832.9)	6,942.8	4,241.0	(3,479.9)	2,294.5	65.8%	274.5%	15.8%	(15.4%)	18.4%	
Median		\$ 31.98		\$ 10,393.4	\$ 36,026.5	\$ 58,633.0	\$ 27,947.5	\$ 47,955.7	\$ 6,351.9	\$ (3,276.9)	\$ 4,944.3	\$ 3,241.7	\$ (6,205.7)	\$ 1,093.7	64.8%	254.4%	13.9%	(18.2%)	14.5%	
25th Percentile		14.27		6,034.8	23,794.9	30,285.8	15,596.7	25,860.1	4,771.0	(6,122.5)	4,840.0	2,376.3	(8,387.5)	952.8	63.9%	211.7%	13.0%	(20.9%)	14.3%	
Minimum		12.80		3,452.2	6,573.9	10,996.2	5,472.8	9,021.7	1,523.2	(6,218.4)	1,303.7	802.0	(10,235.2)	167.7	63.0%	179.1%	10.3%	(21.9%)	10.1%	

Air Canada	AC	\$ 17.05	261.2	\$ 4,453.5	10,387.5	\$ 19,131.0	\$ 9,696.3	\$ 11,979.8	\$ 3,636.0	\$ (1,163.6)	\$ 1,916.8	\$ 1,476.0	\$ (3,470.0)	\$ 457.0	23.6%	264.7%	19.0%	(12.0%)	16.0%
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Valuation Statistics:		Capitalization				Enterprise Value /				Enterprise Value /				P / E Multiple	
Company Name		Equity Value		Enterprise Value	LTM	Revenue FY20	FY21	LTM	EBITDA FY20	FY21	LTM	EBITDA FY20	FY21	FY20	FY21
Southwest Airlines Co.	LUV	\$ 22,568.1		\$ 23,794.9	0.8 x	1.5 x	0.9 x	5.0 x	NM	4.8 x	7.0 x	NM	4.8 x	9.8 x	
Delta Air Lines, Inc.	DAL	20,313.7		45,801.8	0.7 x	1.5 x	0.9 x	4.3 x	NM	4.9 x	3.0 x	NM	4.9 x	5.1 x	
American Airlines Group Inc.	AAL	6,034.8		48,970.2	0.8 x	1.6 x	1.0 x	7.7 x	NM	7.1 x	2.5 x	NM	7.1 x	5.5 x	
JetBlue Airways Corporation	JBLU	3,452.2		6,573.9	0.6 x	1.2 x	0.7 x	4.3 x	NM	5.0 x	4.3 x	NM	5.0 x	20.6 x	
United Airlines Holdings, Inc.	UAL	10,393.4		36,026.5	0.6 x	1.3 x	0.8 x	4.7 x	NM	7.4 x	2.5 x	NM	7.4 x	10.9 x	
Maximum		\$ 22,568.1		\$ 48,970.2	0.8 x	1.6 x	1.0 x	7.7 x	0.0 x	7.4 x	7.0 x	0.0 x	7.4 x	20.6 x	
75th Percentile		20,313.7		45,801.8	0.8 x	1.5 x	0.9 x	5.0 x	N/A	7.1 x	4.3 x	N/A	7.1 x	10.9 x	
Median		\$ 10,393.4		\$ 36,026.5	0.7 x	1.5 x	0.9 x	4.7 x	N/A	5.0 x	3.0 x	N/A	5.0 x	9.8 x	
25th Percentile		6,034.8		23,794.9	0.6 x	1.3 x	0.8 x	4.3 x	N/A	4.9 x	2.5 x	N/A	4.9 x	5.5 x	
Minimum		3,452.2		6,573.9	0.6 x	1.2 x	0.7 x	4.3 x	0.0 x	4.8 x	2.5 x	0.0 x	4.8 x	5.1 x	

Air Canada	AC	\$ 4,453		\$ 10,387	0.5 x	1.1 x	0.9 x	2.9 x	NM	5.4 x	3.0 x	NM	5.4 x	9.7 x	
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## **Comparable Companies Analysis Rationale**

Air Canada is being compared to airlines that share a similar geographic region. Although the market capitalization between the companies are quite different, it would be an appropriate comparison because they share the same customers to an extent. Since Air Canada holds a strong position in the domestic Canadian travel industry, it is reasonable to consider comparing Air Canada to the neighbouring country's airlines.

In FY20, every airline's revenue, EBITDA and net income are expected to be in the negatives. These negative statistics reflect the catastrophic damage that COVID-19 is inflicting on the travel industry. Consensus estimates forecast that these operating statistics will be back up in FY2021. These estimates tend to be optimistic considering how the American government is handling the pandemic and how health experts are currently expecting a second wave of COVID-19 to occur which will extend travel bans thus extending the losses that these airlines must endure.

When analyzing the different airlines, there are several key factors to consider. Air Canada's revenue, EBITDA and net income are consistently below the median which is expected as its competitors are able to yield greater numbers simply due to their sizes, geographic location and history. Air Canada's projected revenue is also much lower than its competitors because its competitors are expected to recover by 2021 and receive a great influx of business at that point. However, Air Canada's CEO, Calin Rovinescu expects the effects of the pandemic to last up to three years. Given this information, Air Canada's revenues are expected to takeoff after FY22 instead of FY21.

Moving on, Air Canada displays potential in its projected EBITDA growth as well as its EBITDA margins all performing above average in comparison to its peers. In terms of valuation, the company's multiples are quite close to the margins indicating that the company is of fair value right now. Once again, this is also because the company's recovery and growth are not expected to take full effect until at least FY22. Since the company is already achieving average multiples when not fully recovered, it shows potential to yield more attractive multiples in the future.

## Discounted Cash Flow Analysis

Air Canada - FCF Projections:	Units:	Historical			Projected									
		FY17	FY18	FY19	FY20	FY21	FY22	FY23	FY24	FY25	FY26	FY27	FY28	FY29
Operating Income (EBIT):	\$ M	1,364.0	1,496.0	1,650.0	(1,939.3)	1,078.2	2,288.6	1,677.4	1,922.2	2,116.3	2,288.3	2,344.1	2,401.2	2,459.7
Net Operating Profit After Taxes (NOPAT):	\$ M	995.7	1,092.1	1,204.5	(1,415.7)	787.1	1,670.7	1,224.5	1,403.2	1,544.9	1,670.5	1,711.2	1,752.9	1,795.6
Adjustments for Non-Cash Charges:														
(+) Depreciation & Amortization:	\$ M	956.0	1,717.0	1,986.0	775.7	838.6	1,144.3	1,048.4	904.5	470.3	361.3	370.1	379.1	388.4
% Revenue:	%	5.9%	9.5%	10.4%	8.0%	7.0%	6.0%	5.0%	4.0%	2.0%	1.5%	1.5%	1.5%	1.5%
(+/-) Deferred Income Taxes:	\$ M	49.0	52.0	73.0	78.5	(32.0)	(43.3)	(18.1)	(15.6)	(11.4)	(9.3)	(9.5)	(9.7)	(10.0)
% Income Statement Taxes:	%	(6.6%)	27.2%	24.4%	15.0%	11.0%	7.0%	4.0%	3.0%	2.0%	1.5%	1.5%	1.5%	1.5%
Net Change in Working Capital:	\$ M	466.0	(25.0)	663.0	943.5	(342.5)	(354.6)	(151.7)	(131.6)	(72.1)	(45.8)	(47.0)	(48.1)	(49.3)
(-) Capital Expenditures:	\$ M	(2,422.0)	(2,436.0)	(2,025.0)	(2,424.1)	(1,797.0)	(1,525.7)	(1,048.4)	(678.4)	(470.3)	(481.8)	(493.5)	(505.5)	(517.8)
Unlevered Free Cash Flow:	\$ M	\$ 44.7	\$ 400.1	\$ 1,901.5	\$ (2,042.0)	\$ (545.9)	\$ 891.4	\$ 1,054.7	\$ 1,482.1	\$ 1,461.4	\$ 1,494.9	\$ 1,531.4	\$ 1,568.7	\$ 1,606.9
Growth Rate:	%	N/A	794.6%	375.3%	(207.4%)	(73.3%)	263.3%	18.3%	40.5%	(1.4%)	2.3%	2.4%	2.4%	2.4%
Discount Period:	#				1	2	3	4	5	6	7	8	9	10
Discount Rate (WACC):	%				8.32%	8.32%	8.32%	8.32%	8.32%	8.32%	8.32%	8.32%	8.32%	8.32%
Cumulative Discount Factor:	#				0.923	0.852	0.787	0.726	0.670	0.619	0.571	0.528	0.487	0.450
PV of Unlevered FCF:	\$ M				\$ (1,885.1)	\$ (465.2)	\$ 701.3	\$ 766.0	\$ 993.7	\$ 904.6	\$ 854.2	\$ 807.8	\$ 763.9	\$ 722.4
EBITDA:	\$ M	\$ 2,320.0	\$ 3,213.0	\$ 3,636.0	\$ (1,163.6)	\$ 1,916.8	\$ 3,432.9	\$ 2,725.8	\$ 2,826.7	\$ 2,586.6	\$ 2,649.6	\$ 2,714.2	\$ 2,780.4	\$ 2,848.1
Growth Rate:	%	N/A	38.5%	13.2%	(132.0%)	(264.7%)	79.1%	(20.6%)	3.7%	(8.5%)	2.4%	2.4%	2.4%	2.4%

### Terminal Value - Perpetuity Growth Method:

Discount Rate (WACC):	8.32%
Expected Long-Term GDP Growth:	(2.5%)
Baseline Terminal FCF Growth Rate:	(3.0%)
Baseline Terminal Value:	\$ 13,765.6
Implied Terminal EBITDA Multiple:	4.8 x
(+) PV of Terminal Value:	6,188.5
(+) Sum of PV of Free Cash Flows:	4,163.7
Implied Enterprise Value:	\$ 10,352.1
Implied Equity Value:	4,418.1
Diluted Shares Outstanding:	261.200
Implied Share Price from DCF:	\$ 16.91
Premium / (Discount) to Current:	(0.8%)

## **Discounted Cash Flow Analysis Rationale**

The discounted cash flow analysis is a way of measuring the valuation of a company in an intrinsic manner. The company's free cash flow is projected into the future for 10 years and then discounted back to its present value using the weighted average cost of capital. This model is mainly used to show how the market may have mispriced the company thus resulting in an over or undervalued company on the market and hence, explaining why the purposed company, Air Canada, is a good investment.

The airline industry is currently struggling to survive due to the effects of the COVID-19 pandemic. This explains the -3% terminal growth rate. Despite how powerful Air Canada's brand is in Canada, the company will not receive any sort of government funding, rather, only a bridge-loan will be available. From this announcement, the future of Canada's airline industry may now seem uncertain. However, regardless of the impact that the pandemic has on the airline industry across the world, the key reason why Air Canada will survive is because Canada needs the airline to fuel its travel and industry economy. The company's financials were projected into the future in a conservative mindset due to the current economic crisis. These assumptions resulted in an intrinsic price of \$16.91. This shows that the market is accurately pricing the airline due to its current performance, however, as time passes, the growth rate and the intrinsic value may change due to the uncertain circumstances of the pandemic. It is important to keep in mind that although recovery is certain, the price may keep dropping as Air Canada will not be able to achieve significant growth anytime soon.

## **Risks**

Air Canada's most noticeable risk would be that its business and operations rely heavily on the world's economic health and physical health. As seen from the current COVID-19 pandemic, the widespread disease caused the world's economy to crash as it forced governments to put a pause on most business operations and ban travelling. Air Canada's operations are currently in a standstill due to the current economic conditions. Since most businesses are closed and unemployment has increased significantly, the overall disposable income of travellers has decreased which discourages many people from travelling. Furthermore, in order to prevent the disease from spreading further, most governments around the world have implemented a travel ban which will have a severe impact on any airline around the world. Another economic factor that affects the performance of Air Canada would be oil prices. Lately, oil prices crashed which makes fuel cheaper, thus resulting in the airline being able to cut its expenses, however, if the oil prices were to increase, it would be a threat to the company as it would raise expenses. All of these factors could have adverse affects on Air Canada's performance.

Another key risk that Air Canada faces is technological failure. Airlines own hundreds of airplanes and within each airplane, there is a complex and intricate array of technologies that must function in precise coordination for an airplane to operate. If there was a malfunction in even a minor component, it would drastically affect the flight and most likely ground the plane. This could cause cancellation or extreme delays of flights which would result in a poor reputation and unsatisfied customers. Additionally, Air Canada also has technologies related to customer services, reservations and websites which must be maintained with the utmost quality. If Air Canada fails to maintain its technologies and keep them up to date, its reputation, customer loyalty and overall revenue stream will be drastically affected.

## **Catalysts**

Despite not being able to fly, the airline is finding other ways to serve and keep its customers happy. Air Canada is now allowing Altitude members (premium members that are allowed to receive special benefits) to keep their membership until 2021. Furthermore, Air Canada is making the Altitude membership more accessible to a member's loved ones so that everyone can earn status and Aeroplan miles without travelling. By keeping that connection with customers, Air Canada is preparing itself for a faster future recovery with a great influx of customers coming back to flying with them.

## **Conclusion**

COVID-19 is currently inflicting a severe amount of financial damage to almost all the airlines around the world. Air Canada is being hit just as hard as its southern neighbors. However, the evaluation of a company is not based on how hard they were hit but on if and how they recover from the pandemic. Air Canada's impact towards the travel and tourism economy in Canada is vital and there is no doubt that the industry will come alive again after travel bans are lifted. Not only is Air Canada a key player in Canada's economy, the airline's management consists of extremely talented individuals who have the experience to guide the airline through this storm. The monopolistic domestic airline is also known for its outstanding customer service and employee engagement which promotes an environment and a community that every customer wants to be a part of. The qualitative factors and the quantitative measures that Air Canada is taking will guarantee the airline's survival and ensure that the company will soar to greater heights the future.

## **Disclaimer**

The contents of this report are written with careful research and sound estimates; however, it is only for informative purposes. None of the recommendations, information or numbers should be taken as financial advice or instructions on whether to buy or sell a company. The author makes no promises in terms of any results gained from reading this report. In general, investments should not be derived based off only one source or without the aid of a financial advisor or without one's own research. The author of this report does not claim any liability for any of the results that are achieved from the use of this report. The reader may use the information in this report at their own risk.

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# Appendices

## Revenue and Operations Projections

Revenue and Expense Projections:		Units:	Historical			Projected									
			FY17	FY18	FY19	FY20	FY21	FY22	FY23	FY24	FY25	FY26	FY27	FY28	FY29
Net Sales by Segment:															
Passenger	\$ M	\$ 14,471.0	\$ 16,161.0	\$ 17,232.0	\$ 8,616.0	\$ 10,770.0	\$ 17,232.0	\$ 18,955.2	\$ 20,471.6	\$ 21,290.5	\$ 21,822.7	\$ 22,368.3	\$ 22,927.5	\$ 23,500.7	
Cargo	\$ M	650.0	803.0	717.0	430.2	494.7	766.8	843.5	902.6	947.7	966.6	986.0	1,005.7	1,025.8	
Other Segments:	\$ M	1,131.0	1,039.0	1,182.0	650.1	715.1	1,072.7	1,169.2	1,239.4	1,276.5	1,298.2	1,320.3	1,342.8	1,365.6	
Total Consolidated Sales:	\$ M	\$ 16,252.0	\$ 18,003.0	\$ 19,131.0	\$ 9,696.3	\$ 11,979.8	\$ 19,071.5	\$ 20,967.9	\$ 22,613.5	\$ 23,514.7	\$ 24,087.6	\$ 24,674.6	\$ 25,276.0	\$ 25,892.1	
Annual Growth Rate:	%	10.7%	10.8%	6.3%	(49.3%)	23.6%	59.2%	9.9%	7.8%	4.0%	2.4%	2.4%	2.4%	2.4%	
Growth Rates by Segment:															
Passenger	%	10.1%	11.7%	6.6%	(50.0%)	25.0%	60.0%	10.0%	8.0%	4.0%	2.5%	2.5%	2.5%	2.5%	
Cargo	%	27.0%	23.5%	(10.7%)	(40.0%)	15.0%	55.0%	10.0%	7.0%	5.0%	2.0%	2.0%	2.0%	2.0%	
Other Segments Sales Growth:	%	11.2%	(8.1%)	13.8%	(45.0%)	10.0%	50.0%	9.0%	6.0%	3.0%	1.7%	1.7%	1.7%	1.7%	
Operating Income by Segment:															
Total	\$ M	1,364.0	1,496.0	1,650.0	(1,939.3)	1,078.2	2,288.6	1,677.4	1,922.2	2,116.3	2,288.3	2,344.1	2,401.2	2,459.7	
Operating Margin by Segment:															
Total	%	9.4%	9.3%	9.6%	(20.0%)	9.0%	12.0%	8.0%	8.5%	9.0%	9.5%	9.5%	9.5%	9.5%	

## Financials and Operating Model

Air Canada - FCF Projections:		Units:	Historical			Projected									
			FY17	FY18	FY19	FY20	FY21	FY22	FY23	FY24	FY25	FY26	FY27	FY28	FY29
<b>Revenue:</b>	\$ M		\$ 16,252.0	\$ 18,003.0	\$ 19,131.0	\$ 9,696.3	\$ 11,979.8	\$ 19,071.5	\$ 20,967.9	\$ 22,613.5	\$ 23,514.7	\$ 24,087.6	\$ 24,674.6	\$ 25,276.0	\$ 25,892.1
Revenue Growth Rate:	%		122.9%	10.8%	6.3%	(49.3%)	23.6%	59.2%	9.9%	7.8%	4.0%	2.4%	2.4%	2.4%	2.4%
<b>Operating Income (EBIT):</b>	\$ M		1,364.0	1,496.0	1,650.0	(1,939.3)	1,078.2	2,288.6	1,677.4	1,922.2	2,116.3	2,288.3	2,344.1	2,401.2	2,459.7
Operating Margin:	%		8.4%	8.3%	8.6%	(20.0%)	9.0%	12.0%	8.0%	8.5%	9.0%	9.5%	9.5%	9.5%	9.5%
Growth Rate:	%		248.7%	9.7%	10.3%	(217.5%)	(155.6%)	112.3%	(26.7%)	14.6%	10.1%	8.1%	2.4%	2.4%	2.4%
(-) Taxes, Excluding Effect of Interest:	\$ M		(368.3)	(403.9)	(445.5)	523.6	(291.1)	(617.9)	(452.9)	(519.0)	(571.4)	(617.8)	(632.9)	(648.3)	(664.1)
<b>Net Operating Profit After Taxes (NOPAT):</b>	\$ M		995.7	1,092.1	1,204.5	(1,415.7)	787.1	1,670.7	1,224.5	1,403.2	1,544.9	1,670.5	1,711.2	1,752.9	1,795.6
<b>Adjustments for Non-Cash Charges:</b>															
(+) Depreciation & Amortization:	\$ M		956.0	1,717.0	1,986.0	775.7	838.6	1,144.3	1,048.4	904.5	470.3	361.3	370.1	379.1	388.4
% Revenue:	%		5.9%	9.5%	10.4%	8.0%	7.0%	6.0%	5.0%	4.0%	2.0%	1.5%	1.5%	1.5%	1.5%
(+/-) Deferred Income Taxes:	\$ M		49.0	52.0	73.0	78.5	(32.0)	(43.3)	(18.1)	(15.6)	(11.4)	(9.3)	(9.5)	(9.7)	(10.0)
% Income Statement Taxes:	%		(6.6%)	27.2%	24.4%	15.0%	11.0%	7.0%	4.0%	3.0%	2.0%	1.5%	1.5%	1.5%	1.5%
<b>Net Change in Working Capital:</b>	\$ M		466.0	(25.0)	663.0	943.5	(342.5)	(354.6)	(151.7)	(131.6)	(72.1)	(45.8)	(47.0)	(48.1)	(49.3)
% Change in Revenue:	%		5.2%	(1.4%)	58.8%	(10.0%)	(15.0%)	(5.0%)	(8.0%)	(8.0%)	(8.0%)	(8.0%)	(8.0%)	(8.0%)	(8.0%)
% Revenue:	%		2.9%	(0.1%)	3.5%	9.7%	(2.9%)	(1.9%)	(0.7%)	(0.6%)	(0.3%)	(0.2%)	(0.2%)	(0.2%)	(0.2%)
(-) Capital Expenditures:	\$ M		(2,422.0)	(2,436.0)	(2,025.0)	(2,424.1)	(1,797.0)	(1,525.7)	(1,048.4)	(678.4)	(470.3)	(481.8)	(493.5)	(505.5)	(517.8)
% Revenue:	%		14.9%	13.5%	10.6%	(25.0%)	(15.0%)	(8.0%)	(5.0%)	(3.0%)	(2.0%)	(2.0%)	(2.0%)	(2.0%)	(2.0%)

## Precedent Transactions

Air Canada - Comparable M&A Transactions:								Valuation Multiples		
Acquirer Name	Target Name	Announcement Date	Transaction		LTM		LTM	EV /		
			Enterprise Value		Revenue	EBITDA		Revenue	LTM EBITDA	
Alaska Airlines	Virgin America	2018-04-24	\$	5,600.0	\$	2,158.3	\$	351.3	2.6 x	15.9 x
Lufthansa	Air Berlin	2017-12-21		351.5		(1,103.3)		(1,145.7)	NM	NM
Onex Corp.	WestJet Airlines Ltd.	2019-13-05		7,055.0		6,678.3		800.0	1.1 x	8.8 x
FedEx Corp.	TNT Express	2016-25-05		6,718.5		10,557.2		426.1	0.6 x	15.8 x
	Maximum		\$	7,055.0	\$	10,557.2	\$	800.0	2.6 x	15.9 x
	75th Percentile			6,802.6		7,648.0		519.6	1.8 x	15.9 x
	Median		\$	6,159.3	\$	4,418.3	\$	388.7	1.1 x	15.8 x
	25th Percentile			4,287.9		1,342.9		(22.9)	0.8 x	12.3 x
	Minimum			351.5		(1,103.3)		(1,145.7)	0.6 x	8.8 x