



# Copa Holdings, S.A. (CPA)

Updated September 27<sup>th</sup>, 2018 by Josh Arnold

## Key Metrics

<b>Current Price:</b> \$80	<b>5 Year CAGR Estimate:</b> 14.3%	<b>Volatility Percentile:</b> 93.6%
<b>Fair Value Price:</b> \$107	<b>5 Year Growth Estimate:</b> 4.0%	<b>Momentum Percentile:</b> 2.5%
<b>% Fair Value:</b> 75%	<b>5 Year Valuation Multiple Estimate:</b> 5.8%	<b>Valuation Percentile:</b> 92.0%
<b>Dividend Yield:</b> 4.5%	<b>5 Year Price Target:</b> \$129	<b>Total Return Percentile:</b> 88.0%

## Overview & Current Events

Copa Holdings was founded in 1947 in Panama City. The company was originally called the National Airline of Panama and since its humble beginning with just three flights, it has grown to an international airline with more than 300 daily flights to more than 30 countries. The company produces about \$3 billion in revenue annually and has a market capitalization of \$3.3 billion. As Copa is a Panamanian company, dividends are subject to a 10% tax to foreign investors.

Copa reported second quarter earnings on 8/8/2018 and results were somewhat mixed. The number of passengers carried rose 13% year-over-year while capacity grew 11.2%, resulting in a load factor of 83.5%, which compares favorably to last year's Q2 load factor of 82.2%. Total revenue was up 10.5% in Q2, but sharply higher fuel costs meant that yield fell and so did operating income, which declined 27%. Earnings-per-share declined almost 15% to \$1.18 despite cost saving efforts. Operationally, Copa had a very strong Q2, continuing its run of higher load factors and increasing capacity. However, fuel costs are a significant wildcard and in Q2, it struggled to keep up.

## Growth on a Per-Share Basis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
<b>EPS</b>	\$2.73	\$5.47	\$5.48	\$6.98	\$7.35	\$9.63	\$8.15	\$5.13	\$7.90	\$8.72	<b>\$9.65</b>	<b>\$11.75</b>
<b>DPS</b>	\$0.37	\$0.37	\$1.09	\$1.64	\$4.35	\$1.46	\$3.84	\$3.36	\$2.04	\$2.52	<b>\$3.48</b>	<b>\$4.25</b>
<b>Shares</b>	43.2	43.4	43.6	43.9	44.0	44.1	44.0	44.4	42.1	44.7	<b>42.4</b>	<b>42.5</b>

Copa's earnings-per-share history has been quite volatile, as one would expect for an airline. Copa seems to be on a more stable footing today, however. Looking forward, we expect 4% earnings-per-share growth annually.

Copa will achieve this by continuing to increase capacity as well as its passenger miles flown. The company continues to buy more and more capacity as it is now over 100 aircraft, and given its very high load factors, we expect it has a significant runway to acquire more capacity in the coming years. Passenger miles flown continue to increase but with the company's load factor near 84%, which is extremely high, we see more limited upside from increased utilization. Part of the reason the company's earnings have grown so significantly in the past few years is due to increased load factors, but the best airlines in the world operate in the mid-80% range in terms of load factor. Thus, upside from here would seem limited. In addition, fuel pricing is a huge wildcard for Copa, as we saw in Q2's results. We cannot predict how fuel prices will fluctuate in the coming years, but it is likely to have a meaningful impact on Copa's earnings.

The dividend is back up to \$3.48 per share and we expect it will grow with earnings, hitting \$4.25 per share over the next five years. Copa already has a high yield and hasn't shown a willingness to pay a majority of earnings in dividends. Thus, we see its strategy remaining stable as Copa uses cash to buy additional capacity, not significantly boosting the dividend.

## Valuation Analysis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Now	2023
<b>Avg. P/E</b>	12.1	7.0	9.6	8.8	11.0	13.7	15.9	10.8	8.8	13.5	<b>8.3</b>	<b>11.0</b>
<b>Avg. Yld.</b>	1.1%	1.0%	2.1%	2.7%	5.4%	1.1%	3.0%	4.2%	2.9%	2.1%	<b>4.5%</b>	<b>3.3%</b>

The company's price-to-earnings multiple has moved around a lot over the years, which is typical of airline stocks given that they are very cyclical. Periods of very low valuations have eventually given way to much higher ones, and today, we

*Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.*

are firmly in the former category. Shares trade for just 8.3 times our estimates for this year, which compares quite favorably to a longer-term average of 11. Therefore, we see a meaningful 5.8% tailwind to total returns as the stock sees higher valuations over time. In addition, the current yield of 4.5% is quite high and we expect it will fall to 3.3% by 2023.

## Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
<b>Load Fctr</b>	--	--	76.9%	76.4%	75.4%	76.7%	76.7%	75.3%	80.4%	83.2%	<b>83.8%</b>	<b>84.5%</b>
<b>Debt/A</b>	68%	58%	57%	55%	56%	52%	49%	57%	52%	50%	<b>50%</b>	<b>50%</b>
<b>Int. Cov.</b>	6.1	13.4	11.5	14.6	18.9	29.6	37.3	(22.1)	17.1	26.2	<b>30.0</b>	<b>35.0</b>
<b>Payout</b>	14%	7%	20%	23%	59%	15%	47%	65%	26%	29%	<b>36%</b>	<b>36%</b>
<b>Std. Dev.</b>	66%	43%	30%	30%	20%	19%	33%	52%	49%	19%	<b>30%</b>	<b>36%</b>

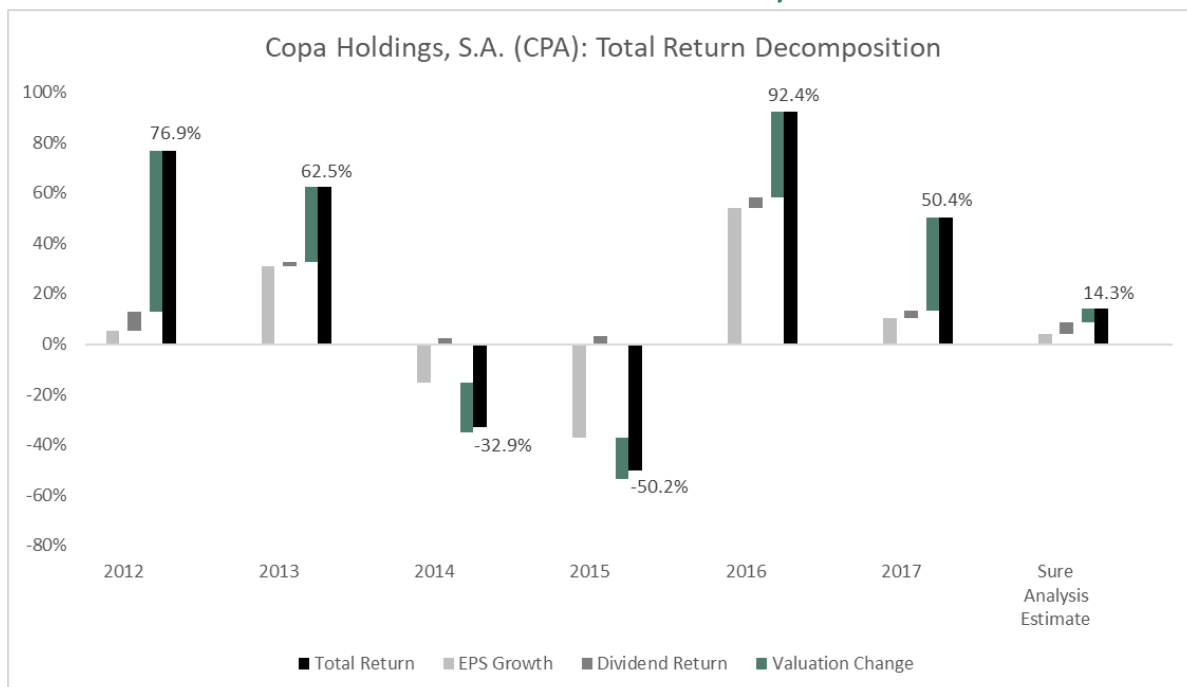
Copa's operating metrics have improved significantly in recent years, led by higher load factors. Copa used to be an average airline in the mid-70% range but in the past couple of years, it has seen its efficiency improve tremendously. That has helped earnings grow as well as for the company to reduce its reliance upon debt, which encumbers just half of its total assets today. Interest coverage is superb, and the payout ratio is around one-third of earnings, so Copa's balance sheet and financing situation is outstanding. We do not see a lot of improvements to these metrics moving forward but given how good Copa already is, that is certainly not a problem.

Copa's competitive advantage is in its strong financial situation, which allows it to acquire profitable growth. It will suffer during the next recession, however, as all airline stocks will, so that is something for investors to consider.

## Final Thoughts & Recommendation

In total, we see 14.3% annual total returns for Copa. This stock tends to have boom and bust cycles, as seen below, and 2018 has certainly been a bust. Shares have fallen by more than 40% and are cheap once again. Copa also has strong fundamentals, and we see total returns comprised of 4% earnings growth, the 4.5% yield and a 5.8% tailwind from a higher valuation. Copa would not be appropriate for growth investors, but it certainly has a high yield and cheap valuation, so we rate it a buy. Airline stocks are not without their risks, but Copa looks very well positioned after the recent decline.

## Total Return Breakdown by Year



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