



Copa Holdings, S.A. (CPA)

Updated November 16th, 2018 by Josh Arnold

Key Metrics

Current Price:	\$84	5 Year CAGR Estimate:	7.8%	Volatility Percentile:	92.0%
Fair Value Price:	\$83	5 Year Growth Estimate:	4.0%	Momentum Percentile:	3.0%
% Fair Value:	102%	5 Year Valuation Multiple Estimate:	-0.3%	Growth Percentile:	20.3%
Dividend Yield:	4.1%	5 Year Price Target	\$100	Valuation Percentile:	50.6%
Dividend Risk Score:	F	Retirement Suitability Score:	D	Total Return Percentile:	41.5%

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 \$2.7 billion in revenue annually and has a market capitalization of \$3.6 billion. As Copa is a Panamanian company, dividends are subject to a 10% tax to foreign investors. Copa reported Q3 earnings on 11/14/18 and results were weaker than expected. Total revenue rose 2.1% as cargo and mail revenue increased 17% and passenger revenue rose 1.4%. Revenue passenger miles were up 4.8%. Revenue passengers carried increased 2.9%, but available seat miles increased 6.6% as Copa continues to build out its capacity. This led to a lower load factor during the quarter as it fell 140bps year-over-year to 84.3%. To be clear, a load factor in the mid-80s is a strong number, but Copa's metrics were so good last year that the slight pullback has spooked investors. On the margin front, fuel prices continue to be a tremendous headwind. Fuel gallons used rose 5.3%, roughly in line with passenger miles, but the average price per gallon soared 31% during Q3. This is a problem all airlines are facing and Copa was particularly susceptible to it in Q3. As a result, operating margin plummeted 730bps to 11% in Q3 from the year-ago period that enjoyed much lower fuel prices. Adjusted earnings-per-share fell 44% to \$1.36 during the quarter. As a result of capacity growth outpacing passenger miles and much higher fuel prices, we've substantially lowered our 2018 estimate of earnings-per-share to \$7.50. This reduction reflects the fundamental situation Copa finds itself in with what amounts to excess capacity and potentially declining load factors. Coupled with higher fuel prices, Copa stands to produce meaningfully lower earnings this year than last year.

Growth on a Per-Share Basis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
EPS	\$2.73	\$5.47	\$5.48	\$6.98	\$7.35	\$9.63	\$8.15	\$5.13	\$7.90	\$8.72	\$7.50	\$9.12
DPS	\$0.37	\$0.37	\$1.09	\$1.64	\$4.35	\$1.46	\$3.84	\$3.36	\$2.04	\$2.52	\$3.48	\$4.25
Shares	43.2	43.4	43.6	43.9	44.0	44.1	44.0	44.4	42.1	44.7	42.4	42.5

Copa's earnings-per-share history has been quite volatile, as one would expect for an airline. Looking forward, we expect 4% earnings-per-share growth annually, reflecting the uncertain environment airlines are operating in today.

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. Indeed the company recently purchased two Boeing 737 MAX 9 aircraft while it is divesting a handful of older craft, helping to modernize its fleet. Passenger miles flown continue to increase but with the company's load factor near 84%, we see limited upside from increased utilization. In addition, fuel pricing is a wildcard for Copa, as we saw in Q3'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 but is not willing to distribute a majority of earnings as dividends. Thus, we see its strategy remaining stable as Copa uses cash to buy additional capacity, not significantly boosting the dividend.

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.



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Valuation Analysis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Now	2023
Avg. P/E	12.1	7.0	9.6	8.8	11.0	13.7	15.9	10.8	8.8	13.5	11.2	11.0
Avg. Yld.	1.1%	1.0%	2.1%	2.7%	5.4%	1.1%	3.0%	4.2%	2.9%	2.1%	4.1%	4.3%

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. Today, the stock trades for 11.2 times our earnings estimate for this year, which is in-line with our fair value estimate. Therefore, we see essentially no impact on total returns from the valuation. In addition, the current yield of 4.1% is quite high, but we expect it to remain in the low-4% range for the foreseeable future.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
Load Fctr	--	--	76.9%	76.4%	75.4%	76.7%	76.7%	75.3%	80.4%	83.2%	84.0%	84.5%
Debt/A	68%	58%	57%	55%	56%	52%	49%	57%	52%	50%	50%	50%
Int. Cov.	6.1	13.4	11.5	14.6	18.9	29.6	37.3	(22.1)	17.1	26.2	30.0	35.0
Payout	14%	7%	20%	23%	59%	15%	47%	65%	26%	29%	46%	47%
Std. Dev.	66%	43%	30%	30%	20%	19%	33%	52%	49%	19%	30%	36%

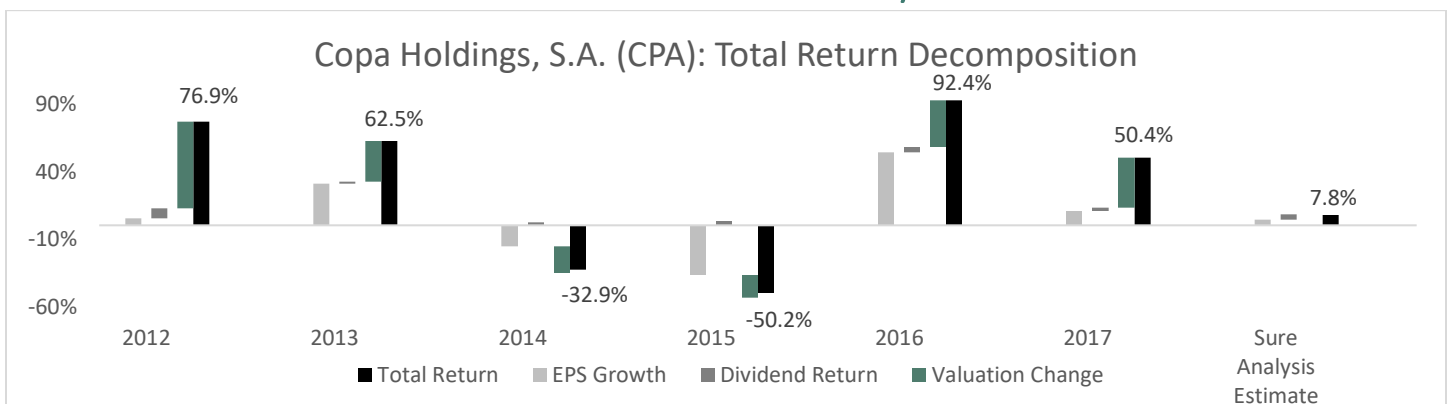
Copa's operating metrics have improved significantly in recent years, led by higher load factors as its efficiency improved tremendously. That has helped earnings grow as well as for the company to reduce its reliance upon debt, which encumbers just half of its total assets today. Interest coverage is superb, and the payout ratio is around one-third of earnings, so Copa's balance sheet and financing situation is outstanding.

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 7.8% 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 almost 40%, but given the reduction in earnings estimates, they are fairly priced in our view. Copa also has strong fundamentals, and we see total returns comprised of 4% earnings growth, the 4.1% yield and a 0.3% headwind from the valuation. Copa would not be appropriate for growth investors, but it certainly has a high yield and reasonable valuation, so we rate it a hold. Airline stocks are not without their risks, and Copa showed that after the Q3 report.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Revenue	1289	1256	1415	1831	2249	2608	2705	2254	2222	2528
Gross Profit	762	689	778	875	991	1219	1216	649	651	838
Gross Margin	59.1%	54.9%	55.0%	47.8%	44.0%	46.7%	45.0%	28.8%	29.3%	33.2%
SG&A Exp.	350	317	295	356	422	480	492	294	286	297
D&A Exp.	43	51	63	76	90	137	115	135	159	164
Operating Profit	310	322	349	443	480	602	609	268	276	440
Operating Margin	24.1%	25.6%	24.7%	24.2%	21.3%	23.1%	22.5%	11.9%	12.4%	17.4%
Net Profit	119	249	241	310	326	427	362	-225	335	370
Net Margin	9.2%	19.8%	17.0%	17.0%	14.5%	16.4%	13.4%	-10.0%	15.1%	14.6%
Free Cash Flow	-18	80	-56	367	360	736	259	216	492	599
Income Tax	17	27	19	36	40	61	37	33	38	48

Balance Sheet Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Total Assets	1954	2161	2556	3066	3480	3953	4080	3715	3846	4253
Cash & Equivalents	221	263	208	244	76	139	221	205	332	239
Accounts Receivable	75	81	89	142	135	118	116	106	114	116
Inventories	18	27	46	42	51	57	60	62	75	82
Goodwill & Int. Ass.	54	66	69	72	87	54	57	69	70	81
Total Liabilities	1322	1250	1446	1676	1943	2051	2005	2128	2004	2141
Accounts Payable	66	51	66	93	105	95	125	95	113	129
Long-Term Debt	916	846	990	1068	1206	1070	1117	1301	1184	1175
Shareholder's Equity	632	911	1110	1390	1537	1902	2075	1587	1842	2111
D/E Ratio	1.45	0.93	0.89	0.77	0.78	0.56	0.54	0.82	0.64	0.56

Profitability & Per Share Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Return on Assets	6.5%	12.1%	10.2%	11.0%	10.0%	11.5%	9.0%	-5.8%	8.8%	9.1%
Return on Equity	20.4%	32.3%	23.9%	24.8%	22.3%	24.9%	18.2%	-12.3%	19.5%	18.7%
ROIC	8.1%	15.1%	12.5%	13.6%	12.6%	15.0%	11.7%	-7.4%	11.3%	11.7%
Shares Out.	43.2	43.4	43.6	43.9	44.0	44.1	44.0	44.4	42.1	44.7
Revenue/Share	29.41	28.61	32.50	41.15	50.66	58.76	60.93	51.37	52.45	59.59
FCF/Share	-0.41	1.82	-1.28	8.26	8.12	16.58	5.83	4.92	11.61	14.11

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.

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