



Copa Holdings, S.A. (CPA)

Updated February 14th, 2019 by Josh Arnold

Key Metrics

Current Price:	\$95	5 Year CAGR Estimate:	3.7%	Volatility Percentile:	89.8%
Fair Value Price:	\$81	5 Year Growth Estimate:	4.0%	Momentum Percentile:	9.9%
% Fair Value:	116%	5 Year Valuation Multiple Estimate:	-3.0%	Growth Percentile:	22.3%
Dividend Yield:	2.7%	5 Year Price Target	\$99	Valuation Percentile:	23.8%
Dividend Risk Score:	F	Retirement Suitability Score:	D	Total Return Percentile:	17.1%

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 \$2.8 billion in revenue annually and has a market capitalization of \$4 billion. As Copa is a Panamanian company, dividends are subject to a 10% tax to foreign investors.

Copa reported Q4 earnings on 2/13/19 and results missed expectations on both the top and bottom lines. Total revenue fell 2.7% during Q4 as higher capacity partially offset some weakness in the company's booking strength. Indeed, revenue passenger miles actually rose 4.9% year-over-year as Copa, like other airlines, has continued to boost its capacity. However, its available seat miles rose slightly more quickly at +5.5%, meaning its load factor fell 40bps to 82.8%. Copa is in the middle of the pack in terms of load factor so seeing it decline further is a bit worrying at this point.

Yield fell 7.7% in Q4, which Copa attributed to currency weakness in Brazil and Argentina. This caused revenue per available seat mile to also fall 7.7% year-over-year. From a revenue perspective, Copa had an unfavorable Q4 to be sure.

Operating costs per mile also rose 0.5% in Q4, although excluding fuel costs, it decreased 5.8% year-over-year. This was thanks to Copa's efforts to reduce costs everywhere, including salaries and benefits and maintenance costs.

In total, adjusted earnings-per-share came in at \$1.04 in Q4, which widely missed expectations. That also caused Copa to miss our estimate for 2018, with the actual figure coming in at \$6.52, well short of our \$7.50 estimate. We're out with an initial estimate of \$7.40 for 2019 as revenue should rise again, but fuel prices will once again be a significant wildcard.

In December, competitor Avianca Brasil filed for bankruptcy after some of its creditors sued for possession of its aircraft. This should help tighten industry capacity in the region which is a net positive for Copa.

Subsequent to the end of the quarter, Copa's board declared a 65-cent quarterly dividend for 2019, which is well off from the 87-cent quarterly dividend of 2018. Copa has paid variable dividends in the past, so this is not unusual, but it does amount to a sizable 25% cut in the payout year-over-year.

Growth on a Per-Share Basis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
EPS	\$5.47	\$5.48	\$6.98	\$7.35	\$9.63	\$8.15	\$5.13	\$7.90	\$8.72	\$6.52	\$7.40	\$9.00
DPS	\$0.37	\$1.09	\$1.64	\$4.35	\$1.46	\$3.84	\$3.36	\$2.04	\$2.52	\$3.48	\$2.60	\$3.15
Shares	43.4	43.6	43.9	44.0	44.1	44.0	44.4	42.1	44.7	42.5	42.0	40.0

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 load factors, we expect it has a significant runway to acquire more capacity in the coming years. Passenger miles flown continue to increase but the company's declining load factor is a worry. In addition, fuel pricing is a wildcard for Copa, as we saw again in Q4'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, as it did in Q4 and for the full year of 2018.

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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The dividend is back down to \$2.60 per share and we expect it will grow with earnings, hitting \$3.15 per share over the next five years. Copa already has a nice 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.

Valuation Analysis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	Now	2024
Avg. P/E	7.0	9.6	8.8	11.0	13.7	15.9	10.8	8.8	13.5	15.8	12.8	11.0
Avg. Yld.	1.0%	2.1%	2.7%	5.4%	1.1%	3.0%	4.2%	2.9%	2.1%	3.4%	2.7%	3.2%

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 12.8 times our earnings estimate for this year, which is meaningfully in excess of our fair value estimate. Therefore, we see a 3% headwind to total returns in the coming years from a declining valuation. That should also help send the yield higher as we see it cresting 3% again in the coming years.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
Payout	7%	20%	23%	59%	15%	47%	65%	26%	29%	53%	35%	35%

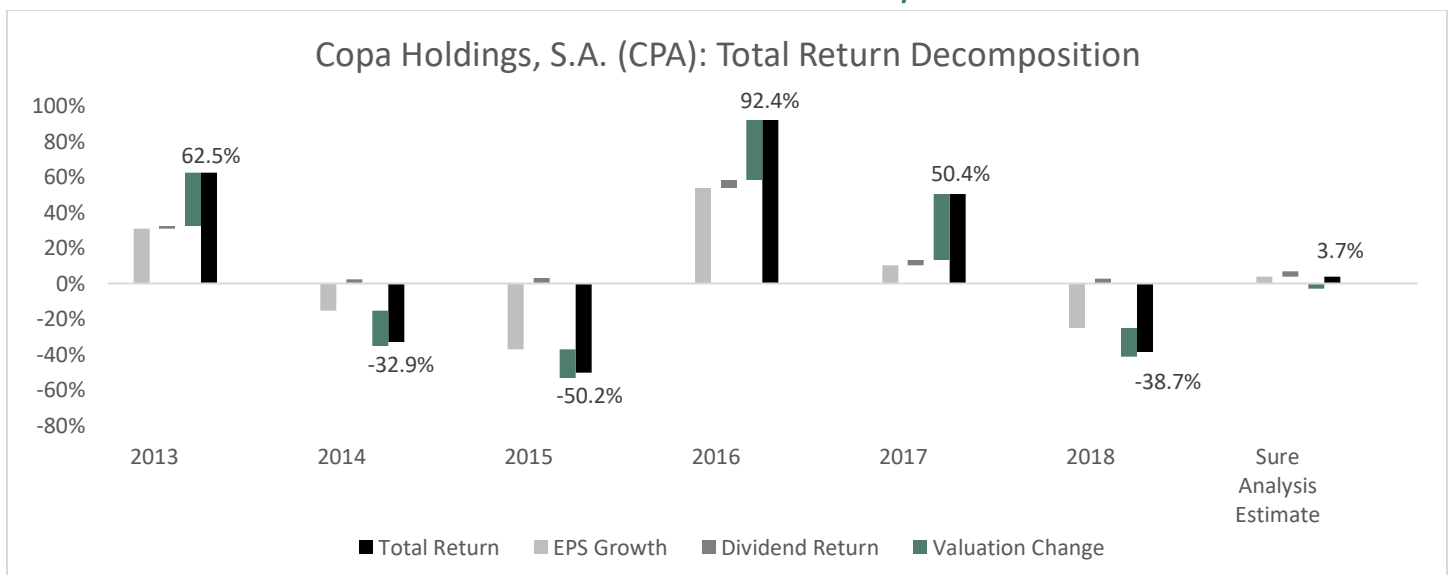
Copa's payout ratio was uncharacteristically high in 2018, but is around one-third of earnings for this year. We expect that is where it will stay in the coming years, particularly if weakness continues to characterize the company's results.

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 just 3.7% annual total returns for Copa. This stock tends to have boom and bust cycles, and given Q4 results, it would appear the company is trending lower at the moment. We see total returns comprised of 4% earnings growth, the 2.7% yield and a 3% headwind from the valuation. Given the risks to the company's fundamentals as well as the yield that has fallen well below 3%, and the stock that is overvalued in our view, we're downgrading Copa from a hold to a sell. The stock is pricing in too much good news today so we think investors should avoid it for the time being.

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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