



Copa Holdings, S.A. (CPA)

Updated August 20th, 2019 by Josh Arnold

Key Metrics

Current Price:	\$104	5 Year CAGR Estimate:	3.0%	Volatility Percentile:	78.7%
Fair Value Price:	\$87	5 Year Growth Estimate:	4.0%	Momentum Percentile:	88.6%
% Fair Value:	120%	5 Year Valuation Multiple Estimate:	-3.5%	Growth Percentile:	26.2%
Dividend Yield:	2.5%	5 Year Price Target	\$106	Valuation Percentile:	29.6%
Dividend Risk Score:	D	Retirement Suitability Score:	D	Total Return Percentile:	17.0%

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 \$2.7 billion in revenue annually and has a market capitalization of \$4.4 billion. As Copa is a Panamanian company, dividends are subject to a 10% tax to foreign investors.

Copa reported Q2 earnings on 8/7/19 and results were stronger than expected. Revenue was up 1.7% year-over-year as passenger revenue was up 1.5%, and cargo and other revenue rose more quickly. Fuel costs were down 8% year-over-year as Copa reaped some of the benefits of moderating oil prices. Wages and benefits were flat against the year-ago period, helping to send total operating costs 2% lower against last year's Q2.

Revenue passengers carried, which is a measure of volume, rose 3.7%. Revenue passenger miles, however, declined 2.5% in Q2. Copa's load factor rose 160bps to 85.1%, which is outstanding for any airline. Helping to offset some of the decline in revenue passenger miles was better yield, which rose 4.1% and helped drive revenue per available seat mile 6.3% higher in Q2. Operating margin was up 330bps to 12.8% of revenue in Q2 thanks to these factors.

Earnings-per-share rose 2.1% to \$1.20 and we've boosted our earnings-per-share estimate for this year to \$7.90. Copa's Q2 performance was better than expected in a variety of ways. Revenue is performing better than feared, and lower operating expenses are helping to boost margins.

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	\$7.90	\$9.61
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
Shares¹	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 can 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 has over 100 aircraft, and we expect it has a significant runway to acquire more capacity in the coming years. Q2 reversed the recent trend of higher passenger miles flown, but lower load factors, so investors will want to keep an eye on those key metrics in coming periods. In addition, fuel pricing is a wildcard for Copa. 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. With yields rebounding nicely in Q2, as well as materially lower fuel expense, we're much more bullish than we were after Q1 results, which led to our earnings-per-share estimate rising back towards \$8 for this year.

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.

¹ Share count in millions

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	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	---	8.8	13.5	15.8	13.2	11.0
Avg. Yld.	1.0%	2.1%	2.7%	5.4%	1.1%	3.0%	4.2%	2.9%	2.1%	3.4%	2.5%	3.0%

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 13.2 times our earnings estimate for this year, which is moderately in excess of our fair value estimate of 11 times earnings. Therefore, we see a -3.5% headwind to total returns from a declining valuation. That could also help send the yield higher as we see it coming in near 3% again in the future. However, this depends upon Copa's willingness to continue the payout at its current rate or higher.

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%	---	26%	29%	53%	33%	33%

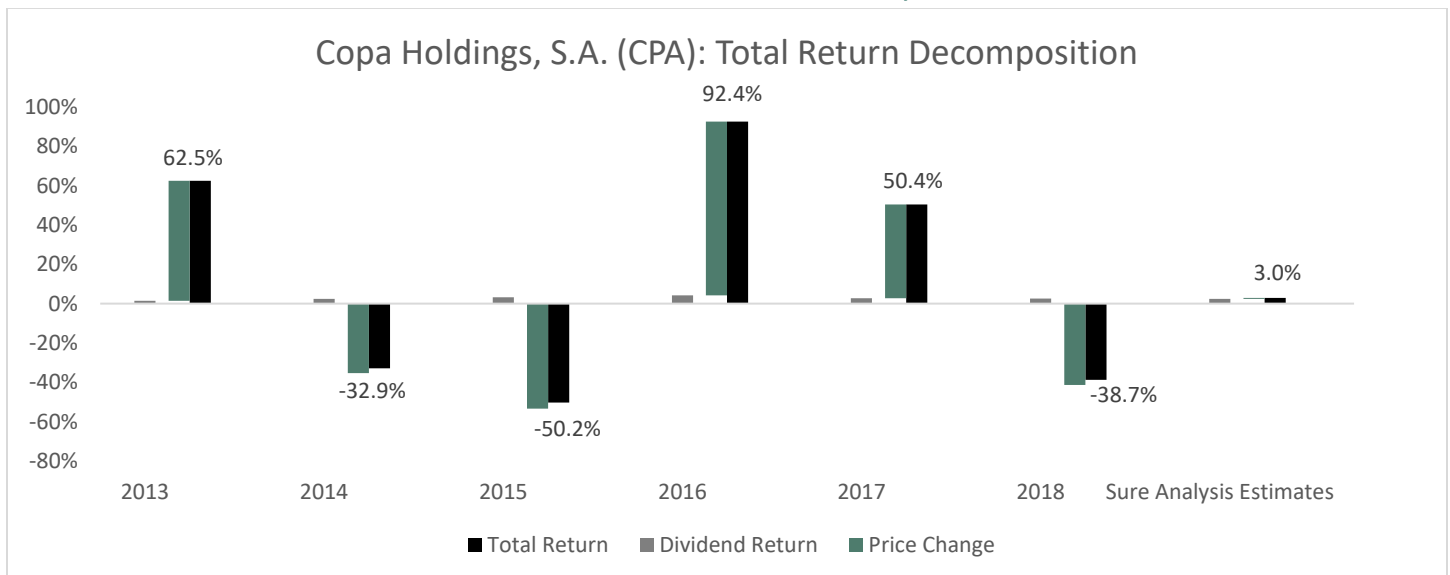
Copa's payout ratio was uncharacteristically high in 2018, but is around one-third of earnings for this year. We expect that is where it will stay in the coming years, particularly if weakness continues to characterize the company's results.

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. Copa's fleet is becoming more fuel efficient as new aircraft are purchased, and it is rationalizing its routes. These factors should help soften the blow of the next recession, but airline stocks are very far from being defensive in nature.

Final Thoughts & Recommendation

This business tends to have boom and bust cycles, and the contrast of very strong Q2 results against weak Q1 results shows this once again. We see total returns of just 3.0% for Copa, comprised of 4% earnings growth, the 2.5% yield and a -3.5% headwind from the valuation. Given the risks to the company's fundamentals as well as the yield that has fallen well below 3%, along with a stock that is overvalued in our view, we're reiterating Copa at a sell rating. The stock is pricing in too much good news today.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Revenue	1256	1415	1831	2249	2608	2705	2254	2219	2522	2678
Gross Profit	689	1060	1284	1524	1825	1884	1650	1690	1949	1912
Gross Margin	54.9%	74.9%	70.1%	67.7%	70.0%	69.7%	73.2%	76.2%	77.3%	71.4%
SG&A Exp.	317	324	377	451	516	559	810	795	846	888
D&A Exp.	51	64	76	90	137	115	151	168	167	169
Operating Profit	322	290	385	403	518	521	253	265	424	334
Operating Margin	25.6%	20.5%	21.0%	17.9%	19.8%	19.3%	11.2%	11.9%	16.8%	12.5%
Net Profit	249	241	310	326	427	362	-241	323	364	88
Net Margin	19.8%	17.0%	17.0%	14.5%	16.4%	13.4%	-10.7%	14.6%	14.4%	3.3%
Free Cash Flow	80	101	367	360	736	259	216	492	599	288
Income Tax	27	19	36	40	61	37	33	38	49	35

Balance Sheet Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Total Assets	2161	2556	3066	3480	3953	4080	3519	3641	4045	4087
Cash & Equivalents	263	208	244	76	139	221	205	332	239	156
Accounts Receivable	81	89	130	125	125	117	106	114	116	116
Inventories	27	46	42	51	57	60	62	75	82	87
Goodwill & Int. Ass.	66	69	72	87	54	57	69	70	81	101
Total Liabilities	1250	1446	1676	1943	2051	2005	2128	2004	2150	2247
Accounts Payable	51	66	93	105	95	125	219	104	117	125
Long-Term Debt	846	990	1068	1206	1070	1117	1301	1184	1175	1287
Shareholder's Equity	911	1110	1390	1537	1902	2075	1391	1637	1895	1841
D/E Ratio	0.93	0.89	0.77	0.78	0.56	0.54	0.94	0.72	0.62	0.70

Profitability & Per Share Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Return on Assets	12.1%	10.2%	11.0%	10.0%	11.5%	9.0%	-6.3%	9.0%	9.5%	2.2%
Return on Equity	32.3%	23.9%	24.8%	22.3%	24.9%	18.2%	-13.9%	21.4%	20.6%	4.7%
ROIC	15.1%	12.5%	13.6%	12.6%	15.0%	11.7%	-8.2%	11.7%	12.4%	2.8%
Shares Out.	43.4	43.6	43.9	44.0	44.1	44.0	44.4	42.1	44.7	42.5
Revenue/Share	28.61	32.16	41.15	50.65	58.76	60.93	51.37	52.39	59.45	63.07
FCF/Share	1.82	2.30	8.26	8.12	16.58	5.83	4.92	11.61	14.11	6.77

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

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