

## Air Canada (AC-T) Direct Flight Higher

June 22, 2015

**George Trapkov, CFA**

Analyst - (416) 364-5148

[gtrapkov@beaconsecurities.ca](mailto:gtrapkov@beaconsecurities.ca)

**Ahmad Shaath, MBA**

Associate - (416)-507-3964

[ashaath@beaconsecurities.ca](mailto:ashaath@beaconsecurities.ca)

**We are initiating coverage of Air Canada ("AC" or The Company) with a Buy rating and a 12-month target price of \$20.00.** In summary, our recommendation is based on the following:

- Management has done an excellent job over the past 6 years resurrecting Canada's largest airline. It is actively pursuing a plan to increase RASM while reducing CASM, thus driving EBITDAR higher.
- **RASM Growth:** Air Canada rouge ("rouge") is the company's lower-cost, leisure airline operating aircraft at significantly lower cost (~30% for B767) compared to the main airline. We believe it gives Air Canada a competitive edge enabling it to add more niche routes at a lower cost. This, we believe, could potentially provide a meaningful boost to the Company's profitability (EBITDAR/EPS). We also expect a growing contribution of high margin ancillary/non-ticket revenues to drive RASM.
- **CASM Reduction:** AC announced plans to lower 2012 CASM level by 21% by 2018. This will be achieved through the densification of 5 B777, introduction of 37 B787 and expansion of rouge into additional leisure destinations.
- **CASM Reduction - Capacity Purchase Agreement:** The new CPA agreement with Jazz Aviation LP is expected to result in \$550 million in savings, coming primarily from increased pilot mobility, a modernized fleet and a new "fixed-fee" compensation structure.
- **Pension Liability Opt-out - A Potential \$1.1 billion War Chest:** In May 2015, AC reported a pension surplus, essentially freeing up \$1.1 billion of capital. We believe the capital could be deployed to revenue generating opportunities such as investing in ancillary services, growing international-to-international traffic and acquiring complementary businesses.
- The impact of improving RASM and reducing CASM should drive EBITDAR significantly higher. We are modelling FY15 and FY16 EBITDAR of \$2.4 billion and \$2.6 billion, respectively.
- **Very Attractive Valuation:** Air Canada currently trades at 3.8x 2015E EBITDAR compared to world-leading airlines trading at ~5x EBITDAR. We believe Air Canada deserves at least such a multiple and we apply a 4.9x EBITDAR multiple to arrive at our \$20.00 target price. **BUY!**

### Initiating Coverage

**BUY**

**\$20.00**

Price (C\$)	\$13.28
12-month Target Price (C\$)	\$20.00
Potential Return	51%
52 Week Price Range (C\$)	\$6.52 - \$15.09

### Estimates

YE: Dec 31	FY14	FY15E	FY16E
Revenue (\$MM)	13,272	14,037	14,760
EBITDAR (\$MM)	1,671	2,377	2,577
FD EPS	1.81	3.78	4.14

### Valuation

	FY14	FY15E	FY16E
EV/Sales	0.7x	0.6x	0.6x
EV/EBITDAR	5.4x	3.8x	3.5x
P/E	7.3x	3.5x	3.2x

### Stock Data

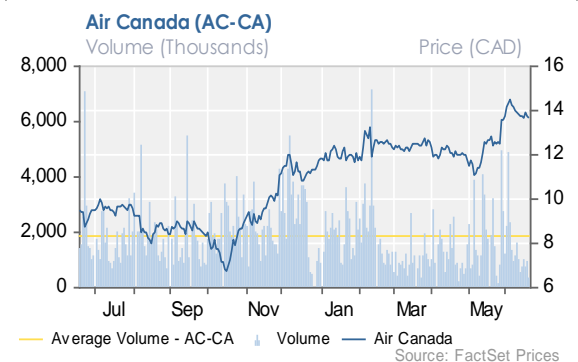
Shares Outstanding (MM)	
Basic	287
FD	287
Market Cap (\$MM)	
Basic	\$3,811
FD	\$3,811
Adj. Net Debt (M)	\$5,197
EV (MM)	\$9,008

### About the Company

Air Canada is Canada's largest airline and the largest provider of scheduled passenger services in the Canadian market, the Canada-U.S. transborder market and in the international market to and from Canada. Air Canada is among the 20 largest airlines in the world and employs 27,000 people. Its corporate headquarters are located in Montreal.

All prices in C\$ unless otherwise stated

### Stock Performance



## Table of Contents

Investment Thesis .....	3
Short History of Air Canada .....	3
The Turnaround .....	4
Boosting the Top Line.....	4
Reducing Costs.....	6
Valuation: What's It Worth? .....	8
↑RASM – ↓CASM = ↑EBITDAR → Higher Multiple → Higher Stock Price.....	9
Market Comparables .....	10
Financials – Air Canada Balance Sheet.....	11
Financials – Air Canada Income Statement.....	12

## Investment Thesis

Airlines are our preferred method to travel to our favorite vacation destinations. On an inflation-adjusted basis, flying has never been cheaper and has resulted in ~3.3 billion seats sold per year. While it has been fun to discredit airlines as an investment (note that Warren Buffett once said that "If a capitalist had been present at Kitty Hawk, he should have shot Orville Wright"), the fact is that the US airline Index (XAL – N) has been one of the best performing investments over the last couple of years. In particular, over the last few years, airlines have made significant improvements to their business models which have led to record profits, perhaps most importantly, through the growing contribution of high margin ancillary/non-ticket revenues. The International Air Transport Association (IATA) estimates that in 2015, returns on capital invested for global airlines will exceed the average cost of that capital for the first time in the industry's history.

Air Canada was incorporated in 1937 and has a long history of providing air transportation to Canadians. It went through a near death experience in 2009 but has since managed to overcome these difficulties and made significant operational improvements. In our opinion, the icing on the cake for AC was the \$5.4 billion improvement in its pension solvency position over the last three years – which has freed-up \$1.1 billion for deployment in other revenue generating opportunities.

As a result of its improved financial position, we believe that Air Canada is in the process of being rerated as a favorable investment choice in the transportation sector and we expect its trading multiple to gravitate towards its industry-leading peers' average. The world leading airlines trade at ~5x EBITDAR and we believe Air Canada deserves at least such a multiple, which could lead to a stock price in excess of \$20.00.

## Short History of Air Canada

Air Canada is Canada's largest airline. It provides scheduled flights to over 190 direct destinations on five continents and it operates over 1,500 daily flights. AC's main hubs are Toronto, Vancouver, Montreal and Calgary. Certain domestic and transborder flights are operated by third parties, mainly Jazz Aviation, Sky Regional, Air Georgian Ltd and Exploits Valley Air Services. Air Canada is a founding partner of Star Alliance, through which its 27 member partners are able to offer access to over 190 countries.

Air Canada's predecessor Trans-Canada Air Lines started flying in 1937 and was run as a crown corporation. AC was privatized in 1989. In 2000, Air Canada acquired Canadian Airlines, the second largest Canadian carrier. Following the attacks of September 11, 2001, Air Canada and many world airlines were facing financial difficulties. AC filed for creditor protection in 2003 and in 2005 emerged under the umbrella of ACE Aviation. In November 2006, ACE Aviation and Air Canada completed initial and secondary public offerings. Air Canada, like all other Canadian airlines, is subject to foreign ownership restrictions such that non-Canadians cannot have more than 25% voting control.

During the most recent financial crisis in 2008, traffic and revenues declined. The airline did not have the right cost structure to compete in a falling revenue environment and it needed change. In April 2009, Calin Rovinescu was appointed President and Chief Executive Officer of Air Canada and embarked on a transformational journey for the airline which has resulted in a very successful turnaround of the company.

## The Turnaround

The profitability of any airline is essentially defined as “Revenue per Available Seat” Mile (RASM) – “Costs per Available Seat Mile” (CASM). Mr. Rovinescu’s turnaround plan incorporates drivers for each of these levers.

### Boosting the Top Line

Air Canada has a number of initiatives to grow RASM. We believe the following are the most significant:

#### a) New Rouge Routes to Drive ASMs

Rouge started flying mid-2013 on select leisure routes. By increasing seat density, lowering wage costs and offering a no-frills service, rouge allows Air Canada to compete effectively with other low cost providers such as Transat (Buy rated, \$14.00 TP), Sunwing (private), and Westjet (not rated, not covered).

- AC announced that 55% of the added capacity in 2015 will be through Air Canada rouge. Rouge is expected to have ~36 aircraft by the end of 2015, up from 24 aircraft at the end of 2014.
- The addition of 6 wide-body, long range B767-300ER in 2015 will allow rouge to compete on international routes more aggressively.
- By flying to new leisure destinations and replacing mainline airline on certain routes, rouge will increase system-wide traffic and consequently revenue.

#### b) Ancillary Revenues – Growing and Delivering Sizeable Margins

Ancillary revenues are generated through ticket changes, baggage, seat selection, upgrades and preferred seating. A study by IdeaWorksCompany (airline consultancy on ancillary revenue) estimates that airline ancillary revenue will reach ~US\$50 billion worldwide in 2014. In an earlier study from the same company (2012), it estimated that United Airlines (not covered, not rated) generates as much as ~US\$41.00 per passenger in ancillary revenue.

- Air Canada's ancillary services revenue grew 10% yoy in 2014 and 15% yoy in Q1/FY15. Fees on first checked bag, introduced in late 2014, are expected to continue to be a large driver of ancillary revenue growth in 2015.
- We expect additional growth in ancillary services to come from enhanced offerings such as food services, duty free shopping, in-flight entertainment and onboard Wi-Fi as they are rolled out across the fleet.

- In 2014, Air Canada carried 38.5 million passengers. Every additional dollar of ancillary revenue per passenger would equate to an additional \$38 million in revenue and ~\$10 million EBITDAR given margins on ancillary revenue are likely well in excess of ticket margins. For example, the recently introduced baggage fee brings additional revenue with no additional expenses leading to margins close to 100%.

### **c) International to International Traffic**

Sixth freedom traffic - passengers flying in and out of the US to another international destination via a Canadian airport.

- Additional sixth freedom traffic is highly profitable as it does not require any capital expenditures and helps drive traffic and ancillary services.
- In 2014, AC's sixth freedom traffic increased by 23% yoy; it grew 25% system wide and 30% in Toronto alone in Q1/FY15.
- Despite this impressive growth, AC's 0.8% share of the market is still well below the 1.5% level which the company believes to be its fair share. We believe this could bring an additional \$600 million of revenue.

### **d) Acquisitions**

Air Canada could use over a billion dollars of excess liquidity that it currently has to acquire complementary businesses or competitors. Given that many countries impose foreign ownership restrictions on airlines hence a more logical choice would be to acquire within Canada.

We believe the combination of Air Canada and Transat could create value for both sets of shareholders.

- Assume Air Canada pays \$14/share (a ~86% premium over current price) for a total value of ~\$540 million. Air Canada gets:
  - \$192 million - cash
  - \$100 million – value of hotel JV
  - A tour operator business generating an EBITDA of ~\$113 million at a price tag of \$248 million.
- Transat has operating expenses of ~\$3.4 billion and we would expect Air Canada to achieve at least 2-3% of synergies. At 2% of synergies (\$68 million), 2016 EBITDA could grow to \$181 million and the payback would be less than 2 years.

## Reducing Costs

In addition to streamlining the flight attendant-to-passenger ratio, there are 6 primary cost cutting initiatives the company is pursuing:

### a) CASM Improvement

- In June 2013, AC announced plans to lower its CASM by 15% over the next 5 years (2018) through a combination of densification of 5 B777, introduction of 37 B787 and growth of rouge.
- During the investor day in June 2015, AC revised its CASM guidance to a decline of 21% by 2018. AC is well on track to achieve the savings.
- Air Canada estimates that CASM cost savings from rouge compared to mainline operating A319 (20 in service) and B767 (8 in service) are 23% and 30%, respectively.

### b) Fleet Alignment and Modernization

Air Canada has been making changes to its fleet to improve efficiencies.

- In 2014, AC took delivery of 6 of 37 B787 aircraft on order and announced plans to reconfigure 12 B777-300ER and 6 B777-200LR into a more cost competitive configuration – at a cost of \$300M with an estimated payback of less than three years.
- Beginning in 2017, AC will start taking delivery of B737 MAX to replace the Airbus narrow body aircraft which it expects to deliver over 20% in per seat savings.
- AC is replacing 20 EMBRAER E190s with 5 larger Airbus narrow-body and 5 Boeing 767s with expected CASM reduction of 10%.

### c) CPA with Jazz

In February 2015, Air Canada announced an amended CPA with Chorus Aviation (CHR/B-TSX, not rated, not covered) – parent of Jazz Aviation LP (“Jazz”) for an additional 5 years (now expires at Dec 31, 2025).

- The new agreement changes the payment terms from “cost plus” mark-up to a fixed fee compensation structure.
- Jazz pilots will have access to pilot vacancies at Air Canada – lowering cost for both Air Canada and Jazz.
- Jazz’s fleet will be modernized and simplified with the addition of 23 Bombardier Q400 Aircraft.
- Air Canada estimates the new agreement will result in ~\$550 million in financial value over the next six years with an immediate positive impact on net income of \$50 million in 2015.

### d) Billy Bishop Toronto City Airport (“Island Airport”) Operations Review

Sky Regional, on behalf of AC, flies up to 30 flights a day from the Billy Bishop Toronto City Airport to Montreal. In early 2015, AC announced that it is considering terminating its operations at the airport. Montreal-Toronto is already served by Air Canada from Toronto Pearson Airport. We believe that it makes financial sense for Air Canada to terminate its operations at the Island Airport.

- With the introduction of the of Union Pearson Express, it will take 25 minutes for travelers to reach Toronto Pearson from downtown Toronto for less than \$20.00 (with Presto). The trip duration to Pearson will be very competitive with a trip to the Island Airport.
- We believe that the flights to Montreal from the Island Airport are likely not very profitable if at all (our experience is that load factors are very light) and shifting the passengers to Pearson Airport will increase load factors and generate some additional savings.
- AC has negotiated better rates with Toronto Pearson Airport in regards to international connecting traffic.

**e) Pension Solvency Surplus:**

Air Canada has managed to turn a pension solvency deficit of \$4.2 billion to an estimated surplus of \$1.2 billion (as of May 20, 2015) in just 3 years.

- As a result, on May 26<sup>th</sup>, 2015, AC elected to opt-out of the government-mandated pension contributions. Now, Air Canada will have to contribute \$90 million in 2015 and \$0 in 2016, resulting in immediate savings of \$110 million and \$200 million in 2015 and 2016, respectively.
- Air Canada is taking additional steps to immunize the pension liabilities. Currently, ~75% of the pension liabilities are matched with fixed income securities to minimize risk.
- The pension surplus frees up \$1.1 billion of capital for revenue generating opportunities, as discussed previously.

**f) Controlling Fuel and FX Impact**

- Fuel: In 2014, Air Canada purchased more than 4.2 billion litres of fuel. AC uses call options to hedge some of its exposure and as of June 2, 2015 ~24% of 2015 fuel purchases were hedged. AC estimates that US\$1/barrel increase in price of jet fuel decreases operating income by \$29 million. Nevertheless, with oil down significantly yoy, we expect fuel costs to be down materially.
- FX: Air Canada reports in Canadian dollars however it incurs expenses in a number of different currencies with the majority of foreign expenditures in US dollars. Also, the company has debt denominated in US dollars. AC targets to hedge 65% of the net U.S. dollar outflows on a rolling 18-month basis. As of December 31, 2014, Air Canada estimates that \$0.01 cent increase in the CAD/USD exchange (i.e. weakening C\$) rate has a negative impact of \$45 million on pre-tax income.



## Valuation: What's It Worth?

From a valuation prospective, we believe the shares of Air Canada are undervalued. Air Canada currently trades at a forward EV/EBITDAR (for the period ending Dec 31, 2015) multiple of 3.8x. As a result of its improved financial position, we believe that Air Canada is in the process of being re-rated as a favorable investment choice in the transportation sector and we expect its trading multiple to gravitate towards its industry-leading peers. The world leading airlines trade at ~5x EBITDAR and we believe Air Canada deserves at least such a multiple which could lead to a stock price in excess of \$20.00.

Our financial forecasts are:

	<b>FY15E</b>	<b>FY16E</b>
Revenue (MM)	\$14,037	\$14,760
EBITDAR (MM)	\$2,377	\$2,577

**Our \$20.00 target price is derived by applying a 4.9x multiple on our 2015 EBITDAR estimate of \$2.38 billion. We believe the company shares deserve a premium valuation given the higher than average growth and significant opportunities for organic growth.**

<b>EV/EBITDAR Sensitivity</b>	<b>Share Price</b>	<b>2015E</b>	<b>2016E</b>
<b>EBITDAR Estimate (\$MM)</b>		<b>2,377</b>	<b>2,577</b>
Current Price	\$13.28	4.1x	3.7x
	\$14.00	4.1x	3.8x
	\$15.00	4.3x	3.9x
	\$16.00	4.4x	4.0x
	\$17.00	4.5x	4.2x
	\$18.00	4.6x	4.3x
	\$19.00	4.7x	4.4x
<b>Target Price</b>	<b>\$20.00</b>	<b>4.9x</b>	<b>4.5x</b>
	\$21.00	5.0x	4.6x
	\$22.00	5.1x	4.7x
	\$23.00	5.2x	4.8x
	\$23.50	5.3x	4.9x
	\$24.00	5.3x	4.9x

Note: Using forward estimate of net debt to arrive at 1YR forward EV estimate



**↑RASM – ↓CASM = ↑EBITDAR → Higher Multiple → Higher Stock Price.**

We are initiating coverage of Air Canada with a **BUY rating** and a **\$20.00 target price**, representing a projected total return of 51%. In summary, our recommendation is based on the following:

- a) Over the last 6 years, Calin Rovinescu and his management team have successfully executed a remarkable remake of Air Canada. Since Mr. Rovinescu has taken over, he managed to expand EBITDAR margins by over 550 bps to a current level of 12.6% (FY2014). As a result, we believe the current goal of 15-18% margin by 2018 is achievable. We expect higher margins will lead to a multiple expansion and meaningfully higher share price.
- b) With the introduction of the lower-cost rouge, Air Canada is adding new destinations where it was not previously competitive.
- c) AC plans to achieve 21% CASM savings by 2018. This will be achieved through the densification of 5 B777, introduction of 37 B787 and expansion of rouge into additional leisure destinations.
- d) We expect ancillary revenues to continue to grow at a fast pace. We believe these revenues come at very attractive margins and will provide an additional boost to profitability.
- e) In May 2015, AC reported a pension surplus, essentially freeing up \$1.1 billion of capital. We believe the capital could be deployed to revenue generating opportunities such as investing in ancillary services, growing international to international traffic and acquiring complementary businesses.
- f) Management has expressed its confidence in the business through the announcement of a 10 million share buy-back program.

Given the strong revenue growth and cost savings opportunities, we believe AC should trade at the high-end of the valuation range. Consequently, we are initiating coverage with a Buy rating and a target price of C\$20.00.

# Market Comparables

Airlines Comparables																							
		Sales							EBITDAR			EPS (FD)			EV/EBITDAR			P/E					
Company	Ticker	Currency	Year End	Last Price	Market Cap. (MM)	Adjusted Net Debt (MM)	EV (MM)	Adj. Net Debt/Capitalization	2014A	2015E	2016E	2014A	2015E	2016E	2014A	2015E	2016E	2014A	2015E	2016E	2014A	2015E	2016E
<b>Air Canada</b>	<b>AC-CA</b>	<b>CAD</b>	<b>Dec</b>	<b>13.28</b>	<b>3,811</b>	<b>5,197</b>	<b>9,008</b>	<b>136%</b>	<b>13,272</b>	<b>14,037</b>	<b>14,760</b>	<b>1,671</b>	<b>2,377</b>	<b>2,577</b>	<b>1.81</b>	<b>3.78</b>	<b>4.14</b>	<b>5.4x</b>	<b>3.8x</b>	<b>3.5x</b>	<b>7.3x</b>	<b>3.5x</b>	<b>3.2x</b>
<b>Legacy Carriers</b>																							
Air France-KLM SA	AF-PAR	EUR	Dec	6.34	1,878	13,334	15,251	710%	24,912	25,427	25,521	2,269	2,972	3,363	(0.67)	(0.35)	1.25	6.7x	5.1x	4.5x	-	-	5.1x
Alaska Air Group, Inc.	ALK-US	USD	Dec	64.65	8,337	212	8,549	3%	5,368	5,623	6,012	1,378	1,690	1,714	4.42	5.95	6.16	6.2x	5.1x	5.0x	14.6x	10.9x	10.5x
American Airlines Group, Inc.	AAL-US	USD	Dec	41.56	28,793	18,059	46,852	63%	42,650	42,112	43,638	7,819	10,014	9,795	3.93	8.96	6.81	6.0x	4.7x	4.8x	10.6x	4.6x	6.1x
Cathay Pacific Airways Limited	293-HK	HKD	Dec	19.66	77,339	47,295	124,765	61%	105,991	108,960	115,288	17,250	N/A	N/A	0.80	1.81	2.04	7.2x	-	-	24.5x	10.9x	9.6x
Delta Air Lines, Inc.	DAL-US	USD	Dec	41.99	34,276	6,116	40,392	18%	40,204	40,998	42,492	6,768	8,508	8,998	0.78	4.45	5.29	6.0x	4.7x	4.5x	53.8x	9.4x	7.9x
Deutsche Lufthansa AG	LHA-DE	EUR	Dec	11.76	5,440	2,390	7,901	44%	30,011	31,095	31,614	2,410	2,896	3,163	0.12	2.01	2.25	3.3x	2.7x	2.5x	98.0x	5.9x	5.2x
International Consolidated Airlines Group SA	IAG-GB	GBP	Dec	5.22	10,643	4,280	15,163	40%	16,249	15,772	16,294	3,158	4,168	4,562	0.37	0.53	0.63	4.8x	3.6x	3.3x	14.0x	9.9x	8.3x
Qantas Airways Limited	QAN-AU	AUD	Jun	3.19	7,006	4,631	11,644	66%	15,352	15,752	16,151	1,483	2,835	3,506	(1.29)	0.29	0.49	7.9x	4.1x	3.3x	-	10.9x	6.5x
Singapore Airlines Ltd.	C6L-SG	SGD	Mar	10.52	12,302	2,157	14,925	18%	15,566	15,469	15,949	3,352	N/A	N/A	0.31	0.68	0.82	4.5x	-	-	33.7x	15.5x	12.8x
Transat A.T. Inc. Class B	TRZ.B-CA	CAD	Oct	7.53	291	519	810	178%	3,752	3,587	3,572	179	161	203	0.85	0.44	1.23	4.5x	5.0x	4.0x	8.8x	17.1x	6.1x
United Continental Holdings, Inc.	UAL-US	USD	Dec	53.25	20,342	12,300	32,642	60%	38,901	38,481	39,560	5,326	7,640	7,445	2.93	10.42	8.67	6.1x	4.3x	4.4x	18.2x	5.1x	6.1x
<b>Average</b>								<b>115%</b>										<b>5.7x</b>	<b>4.4x</b>	<b>4.0x</b>	<b>30.7x</b>	<b>10.0x</b>	<b>7.7x</b>
<b>Average Excluding Outliers</b>								<b>55%</b>										<b>5.7x</b>	<b>4.6x</b>	<b>4.0x</b>	<b>22.3x</b>	<b>10.0x</b>	<b>7.1x</b>
<b>Low Cost Carriers</b>																							
Allegiant Travel Company	ALGT-US	USD	Dec	179.43	3,077	254	3,333	8%	1,137	1,255	1,412	300	442	448	4.86	11.65	11.74	11.1x	7.5x	7.4x	36.9x	15.4x	15.3x
easyJet plc	EZJ-GB	GBP	Sep	15.91	6,320	253	6,573	4%	4,527	4,670	4,899	823	908	982	1.13	1.28	1.41	8.0x	7.2x	6.7x	14.1x	12.4x	11.3x
JetBlue Airways Corporation	JBLU-US	USD	Dec	20.23	6,337	2,535	8,872	40%	5,817	6,433	7,054	982	1,633	1,750	1.19	1.77	1.96	9.0x	5.4x	5.1x	17.0x	11.4x	10.3x
Ryanair Holdings Plc	RY4B-IE	EUR	Mar	11.96	16,470	(336)	16,134	-2%	5,654	6,159	6,421	1,530	1,713	1,943	0.62	0.73	0.87	10.5x	9.4x	8.3x	19.1x	16.4x	13.7x
Southwest Airlines Co.	LUV-US	USD	Dec	34.22	22,869	1,167	24,036	5%	18,605	19,482	20,717	3,572	5,090	4,996	1.64	3.36	3.40	6.7x	4.7x	4.8x	20.9x	10.2x	10.1x
Virgin America, Inc.	VA-US	USD	Dec	29.17	1,260	1,006	2,266	80%	1,490	1,521	1,739	306	406	444	7.13	4.13	3.67	7.4x	5.6x	5.1x	4.1x	7.1x	8.0x
WestJet	WJA-CA	CAD	Dec	26.95	3,402	1,042	4,444	31%	3,977	4,119	4,419	875	1,076	1,143	2.20	3.31	3.35	5.1x	4.1x	3.9x	12.3x	8.1x	8.0x
<b>Average</b>								<b>24%</b>										<b>7.1x</b>	<b>5.5x</b>	<b>5.1x</b>	<b>19.8x</b>	<b>11.5x</b>	<b>9.5x</b>
<b>Average Excluding Outliers</b>								<b>14%</b>										<b>8.3x</b>	<b>6.3x</b>	<b>5.9x</b>	<b>14.6x</b>	<b>11.6x</b>	<b>10.9x</b>
<b>Global Average</b>								<b>79%</b>										<b>6.7x</b>	<b>5.2x</b>	<b>4.9x</b>	<b>25.0x</b>	<b>10.7x</b>	<b>8.9x</b>
<b>Global Average Excluding Outliers</b>								<b>42%</b>										<b>6.5x</b>	<b>4.9x</b>	<b>4.6x</b>	<b>20.2x</b>	<b>10.7x</b>	<b>8.6x</b>

Source: FactSet, Beacon Research

## Financials – Income Statement

<b>Air Canada Inc.</b>				
<b>Fiscal YE December 31</b>				
<b>(\$MM except per share)</b>				
	<b>2013A</b>	<b>2014A</b>	<b>2015E</b>	<b>2016E</b>
Passenger Revenues	\$11,021	\$11,804	\$12,454	\$13,048
Cargo Revenues	474	502	546	590
Other	887	966	1,037	1,123
<b>Total Revenues</b>	<b>\$12,382</b>	<b>\$13,272</b>	<b>\$14,037</b>	<b>\$14,760</b>
<b>Operating costs</b>	<b>\$10,949</b>	<b>\$11,601</b>	<b>\$11,660</b>	<b>\$12,183</b>
<b>Adj. EBITDAR</b>	<b>\$1,433</b>	<b>\$1,671</b>	<b>\$2,377</b>	<b>\$2,577</b>
<b>Earnings Per Share</b>				
<b>Adjusted</b>	<b>\$1.19</b>	<b>\$1.81</b>	<b>\$3.78</b>	<b>\$4.14</b>
<b>OPERATING STATISTICS</b>				
RPM (MM)	56,791	61,616	67,577	71,944
ASM (MM)	68,573	73,889	80,711	85,666
Load Factor	82.8%	83.4%	83.7%	84.0%
Yield (¢)	19.1	18.9	18.4	18.1
CASM, ex. Fuel (¢)	12.7	12.5	12.3	11.8

Source: Beacon Securities., Company Reports

## Financials – Balance Sheet

<b>Air Canada Inc.</b>				
<b>Fiscal YE December 31</b>				
<b>(\$MM except per share)</b>				
	<b>2013A</b>	<b>2014A</b>	<b>2015E</b>	<b>2016E</b>
<b>ASSETS</b>				
Cash and cash equivalents	750	661	990	384
Short-term investments	1,458	1,614	1,815	1,815
<b>Total Cash &amp; ST Investments</b>	<b>2,208</b>	<b>2,275</b>	<b>2,805</b>	<b>2,199</b>
Restricted cash	92	89	95	102
Accounts receivable	589	656	769	809
Spare parts, materials, and supplies	65	91	93	97
Prepaid expenses and other current assets	263	295	240	240
Prepaid maintenance to ACTS	-	-	-	-
Future income taxes	-	-	-	-
Aircraft fuel inventory	71	72	72	72
<b>Total Current Assets</b>	<b>1,080</b>	<b>1,203</b>	<b>1,269</b>	<b>1,320</b>
Property and equipment	5,073	5,998	6,656	8,294
Intangible and Goodwill	615	616	616	616
Deposits and other assets	494	556	579	579
Other blank 1	-	-	-	-
<b>Total Long Term Assets</b>	<b>6,182</b>	<b>7,170</b>	<b>7,851</b>	<b>9,489</b>
<b>TOTAL ASSETS</b>	<b>9,470</b>	<b>10,648</b>	<b>11,925</b>	<b>13,008</b>
<b>LIABILITIES</b>				
Accounts payable and accrued liabilities	1,129	1,259	1,321	1,389
Advance ticket sales	1,687	1,794	1,912	2,047
Current portion of LT debt & Capital Leases	374	484	555	555
<b>Total Current Liabilities</b>	<b>3,190</b>	<b>3,537</b>	<b>3,789</b>	<b>3,991</b>
LT Debt & Capital Leases	3,959	4,732	5,149	5,024
Pension and other benefit liabilities	2,687	2,403	2,044	1,912
Other long-term liabilities	375	313	308	308
Notes payable to ACE subsidiary	-	-	-	-
Preferred shares	-	-	-	-
Maintenance provisions	656	796	849	849
<b>Total Long Term Liabilities</b>	<b>7,677</b>	<b>8,244</b>	<b>8,350</b>	<b>8,093</b>
<b>Non-controlling interest</b>	<b>63</b>	<b>68</b>	<b>60</b>	<b>60</b>
Share capital	827	835	836	836
Contributed surplus	80	77	76	76
Retained earnings (deficit)	(2,367)	(2,113)	(1,185)	(49)
<b>Total Group Equity</b>	<b>(1,460)</b>	<b>(1,201)</b>	<b>(273)</b>	<b>863</b>
<b>TOTAL LIABILITIES &amp; SHAREHOLDER'S EQUITY</b>	<b>9,470</b>	<b>10,648</b>	<b>11,925</b>	<b>13,008</b>

Source: Beacon Securities., Company Reports

## Disclosure Requirements

Does Beacon, or its affiliates or analysts collectively, beneficially own 1% or more of any class of the issuer's equity securities?  Yes  No

Does the analyst who prepared this research report have a position, either long or short, in any of the issuer's securities?  Yes  No

Does Beacon Securities beneficially own more than 1% of equity securities of the issuer?  Yes  No

Has any director, partner, or officer of Beacon Securities, or the analyst involved in the preparation of the research report, received remuneration for any services provided to the securities issuer during the preceding 12 months?  
 Yes  No

Has Beacon Securities performed investment banking services in the past 12 months and received compensation for investment banking services for this issuer in the past 12 months?  Yes  No

Was the analyst who prepared this research report compensated from revenues generated solely by the Beacon Securities Investment Banking Department?  Yes  No

Does any director, officer, or employee of Beacon Securities serve as a director, officer, or in any advisory capacity to the issuer?  Yes  No

Are there any material conflicts of interest with Beacon Securities or the analyst who prepared the report and the issuer?  Yes  No

Is Beacon Securities a market maker in the equity of the issuer?  Yes  No

Has the analyst visited the head office of the issuer and viewed its operations in a limited context?  Yes  No

Did the issuer pay for or reimburse the analyst for the travel expenses?  Yes  No

All information contained herein has been collected and compiled by Beacon Securities Limited, an independently owned and operated member of the Investment Industry Regulatory Organization of Canada (IIROC). All facts and statistical data have been obtained or ascertained from sources, which we believe to be reliable, but are not warranted as accurate or complete.

This report is provided for informational purposes only and does not constitute an offer or solicitation to buy or sell securities discussed herein. Based on their volatility, income structure, or eligibility for sale, the securities mentioned herein may not be suitable or available for all investors in all countries.

As at May 31, 2015 <input type="checkbox"/>	#Stocks	Distribution
Buy	47	65.7%
Speculative Buy	15	20.9%
Hold	3	4.5%
Sell	0	0.0%
Under Review	5	9.0%
Total	70	100.0%

Buy	Total 12-month return expected to be > 15%
Speculative Buy	Potential 12-month return is high (>15%) but given elevated risk, investment could result in a material loss
Hold	Total 12-month return is expected to be between 0% and 15%
Sell	Total 12-month return is expected to be negative
Under Review	Currently undergoing a change of analyst coverage

## Dissemination

Beacon Securities distributes its research products simultaneously, via email, to its authorized client base. All research is then available on [www.beaconsecurities.ca](http://www.beaconsecurities.ca) via login and password.

## Analyst Certification

The Beacon Securities Analyst named on the report hereby certifies that the recommendations and/or opinions expressed herein accurately reflect such research analyst's personal views about the company and securities that are the subject of the report; or any other companies mentioned in the report that are also covered by the named analyst. In addition, no part of the research analyst's compensation is, or will be, directly or indirectly, related to the specific recommendations or views expressed by such research analyst in this report.