

## How Should You Play Air Canada and WestJet Airlines Ltd.?

### Description

It's a smooth ride for Canadian airlines as several factors currently work in favour of the sector. In August, **Air Canada** (TSX: AC.B) posted record load factor — a measure of how full its planes are — in its history. Stocks of **WestJet Airlines Ltd.** (TSX:WJA) have also witnessed a steady climb uphill.

However, analysts at Macquarie Research say they are cautious and have initiated a neutral rating on the sector. This is because they foresee that valuations of Air Canada and WestJet will be compromised due to an anticipated decline in the loonie as well as an increase in oil prices.

### Forex and fuel risks

If the Canadian dollar falls and oil prices rise (a scenario not hard to imagine), these two airlines will be impacted, big-time. Macquarie forecasts a potential fall in the Canadian dollar of about 6%, while Brent goes up by 10%-15%. That's a double whammy for Air Canada and WestJet. But how should investors play these two stocks in such a potentially conflicting environment?

Macquarie recommends going long on WestJet and short on Air Canada. If you ask me, I'd say hold your horses. If you've already bought into any of these stocks, wait it out — since a fall in the loonie and a rise in fuel prices is only a hypothetical scenario cautioning inventors.

### Steady environment

The airlines have a lot going good for them. Air Canada continues to drive costs out of its system and plans to reduce about 15% more in unit costs over the next five years. It is also improving margins and increasing revenue metrics per passenger.

WestJet has shown a strong run-up in valuations recently. Profits are upbeat and the company aims to reduce costs by \$125 million by the end of 2014. It has an impressive balance sheet with potential for a share buyback and an increase in dividend rates. WestJet has also ventured into new, international territories like Dublin.

Macquarie does have a favourite, though, and that is WestJet, since it has lower leverage, or is less sensitive to fuel and forex when compared to Air Canada. They expect WestJet to outperform with approximately 13% implied upside compared to Air Canada's 0.4% upside. However, if their theory on these catalysts is wrong, then Air Canada is a "better bet for risk-on investors."

My suggestion? Be patient and hold on to the two stocks. But be cautious while you're at it.

### CATEGORY

1. Investing

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