



How to Play Air Canada and WestJet Airlines Ltd. on Lower Oil Prices

Description

Everyone is talking about the staggering drop in oil prices. But whether it is positive or negative depends on which side of the fence you are sitting on. For energy companies, the drop is posing a challenge to control costs, but for companies like **Air Canada** ([TSX: AC](#)) and **WestJet Airlines Ltd.** (TSX: WJA), this slump seems welcomed.

This is because lower oil prices could result in lower jet fuel prices. Fuel makes up roughly 30% of Air Canada's costs and about 32% of WestJet's. But what investors should understand is that jet fuel imitates Brent prices more than WTI prices. The huge percentage decline in oil prices everyone is talking about is for WTI. Although Brent crude is also falling sharply, declining about 39% since June 2014. In that time, jet fuel prices have fallen about 26%.

Currently, there are two broad factors working in favour of airlines – lower crude prices and strong air travel demand (especially given the holiday season). But there are also a few reasons to be cautious. Here's why:

Increase in competition

Lower jet fuel prices would potentially accelerate plans of new entrants into the market. Word on the street is two new Canadian start-up airlines are looking to introduce ultra low-cost carriers by the middle of next year. The companies are Jet Naked (backed by Enerjet) and Jetlines (backed by Inovent Capital Inc.). While this may not be an immediate threat to Air Canada or WestJet in the short term, in the long run it could be impactful. For now, WestJet is trying to increase sales by cutting fares by 15% on certain routes.

Exposure

Both airlines, Air Canada and WestJet are pretty sensitive to macro issues and industry catalysts, which include oil price changes, foreign exchange volatility, etc. However, Air Canada seems to be more exposed than WestJet, given its large operations and financial leverage.

Playing the space

So what should investors do to whether this storm (or silver lining on a dark cloud)? I reckon holding on to the stocks if you already own them. If you are looking to buy into this space, I'd suggest waiting a few since both stocks are trading near their 52-weeks highs. I prefer waiting for stock prices to go south before making an entry. It's usually easier said than done.

CATEGORY

1. Investing

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Author

sandram

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