How Investors Can Benefit From Lower Oil Prices

Description

Oil prices continue to fall. With WTI crude oil prices trading below $45 a barrel, and the UAE insisting that no production cut is coming, things are highly uncertain. My thought on this topic is simple. Instead of trying to predict if and/or when oil prices will start to recover, I think investors are better served to focus on companies that stand to benefit from the dramatic fall from grace that oil has experienced.

Let's start with the fact that a drop in energy costs will put more money into the pockets of consumers. And among other things, this higher disposable income will probably mean increased spending on entertainment, food, and clothes over the foreseeable future. So what are some of the companies that we should expect to benefit from this?

Cineplex Inc. (TSX:CGX) is one company that could benefit, as people up their spending on entertainment, and opt to visit the theatre more often. With a dividend yield of 3.35%, strong free cash flow generation (free cash flow yield of 8.2%), 80% of the Canadian box office, and a strong brand name that will help the company with its efforts to diversify into different segments of the entertainment business, this company stands to reap the reward of lower oil prices.

Canadian Tire Corporation Limited's (TSX:CTC.A) goals of annualized sales growth of 3%+ at Canadian Tire, 5%+ at Mark's Work Wearhouse, and 9%+ at FGL Sports, are being helped along by a cooperating oil price environment that is keeping more money in consumers' pockets. And the company is certainly doing its part too. It recently released a three-year growth strategy that includes investing in digital, technology and analytic capabilities, as well as updating product assortments, marketing, and store layouts.

In the latest earnings report, the company reported a healthy 2.8% increase in same-store sales at Canadian Tire stores, an 8.2% increase at FGL Sports, and a 3.2% increase at Mark's Work Wearhouse. EPS increased 11%. So we can see that the company is already doing well, and that this bump in consumer disposable income should feed into this momentum. Based on the thesis that consumers will increasingly have more disposable income, these EPS estimates may be going up in the next while.

Indigo Books and Music Inc. (TSX:IDG) is another stock that is interesting due to the fact that it is in the process of successfully repositioning itself, as the company says: “to provide our customers with the most inspiring retail and digital environments in the world for books and life-enriching products and experiences”, and it is trading below book value. In the latest quarter, comparable sales growth at Indigo and Chapters Superstores increased 9.6%, and sales from the online channel increased 13.4%.

Next, let’s talk about companies where fuel costs are a high percentage of operating costs. Two of the most obvious companies in this category are **Air Canada** (TSX:AC), and **WestJet Airlines Ltd.** (TSX:WJA). Not surprisingly, Air Canada’s stock has a three-month return of 68.8% and WestJet has a three-month return of 19.4%.

At Air Canada, fuel is the single biggest expense. In the company’s latest reported quarter, the second quarter of 2014, aircraft fuel was a whopping 29% of revenue and represents 31% of total operating costs. So it is clear to see how the company will benefit greatly from reduced oil prices.

WestJet Airlines is another beneficiary of a decline in oil prices. For WestJet, fuel makes up 32% of its operating expense. Of the two airliners, WestJet is the better managed company but both will benefit. In the trailing 12-month period, the company showed a profit margin of 7.2%, an ROE of 17%, and a dividend yield of 1.7%. Air Canada, by contrast, reported a profit margin of 1.37%, an ROE that is negligible, and no dividend.

CATEGORY

1. Investing

TICKERS GLOBAL

1. TSX:CGX (Cineplex Inc.)
2. TSX:CTC.A (Canadian Tire Corporation, Limited)
3. TSX:IDG (Indigo Books & Music)

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