Is Crashing Oil a Buy or Sell Signal for WestJet Airlines Ltd. Stock?

Description

On the surface, low oil prices are a positive for **WestJet Airlines Ltd.** (TSX:WJA). With fuel a major cost for the airline, the decrease in the price of fuel means that the company can save a great deal of money. But oil has fallen far enough that it could end up being a negative, not a positive for WestJet Airlines.

How low is too low?

Low oil prices are generally a good thing for the economy because when oil becomes cheaper, consumers spend less money on energy and lower energy costs trickle through the economy, lowering the cost of many goods, saving consumers even more money. But these benefits disappear when oil falls to the point where it starts to hurt oil companies' bottom lines. When the oil companies start to suffer, cost cuts become a necessity and one of the ways companies reduce costs is through layoffs.

With Canada's economy so focused on energy, layoffs in the energy sector can have a large impact on any consumer stock. With fewer people in the workforce, less money will be spent on consumables, and when this starts to happen the benefits of low gasoline prices quickly evaporate.

What does this all mean for WestJet?

Oil prices have already fallen to a price where they are a negative for the economy, so what is in store for WestJet? I think the company's position measn that the positive factors will outweigh the negative factors as long as oil prices don't stay too low for two long.

The major positive WestJet has going for it is that it is in a healthy financial position, and could use the drop in fuel costs to cut fares. In fact, even before oil plunged, the airline's chief said that the company was open to decreasing fares to drive demand.

There is a portion of airline demand that is flexible, such as vacation travel, and a portion that is not, such as business travel. As low oil prices persist, I see things getting more competitive for WestJet Airlines, but I also see the airline as the most competitively fit among its peers.

WestJet is in the position where it can lower fares to encourage demand, with the fall in fuel costs giving the company even more wiggle room to make these changes. In the near term, WestJet could survive by poaching essential travel customers away from its peers, even if non-essential travel demand starts to decrease. However, if oil stays really low for a consistent length of time, the decline in demand will overshadow any fuel cost savings.

CATEGORY

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