



Why I Like This Airline Stock Over Westjet Airlines Ltd. and Air Canada

Description

In an industry that's been filled with booms and busts, right now is actually a pretty good time for Canada's two major airlines.

The big tailwind right now is the price of fuel. Somewhat ironically, both **Air Canada** ([TSX:AC](#)) and **Westjet Airlines Ltd.** (TSX:WJA) are only now feeling the effects of that, since both companies hedge their fuel costs. This is being partially offset by a lower Canadian dollar, but fuel costs are still considerably lower than they were a year ago.

Planes are also staying full. Air Canada recently reported a record load factor of 83.7% for March, which was its highest level for the month ever. Westjet came in at 81.3%, which was a little light of analysts' expectations, but is still a solid number. While the economy is still somewhat tepid, both airlines have come up with solutions to keeping planes full, while not resorting to price wars. Both have settled into a duopoly, content to offer about the same service for about the same price.

For consumers, this isn't the best news, but investors should be cheering it. Duopolies are good for business.

But the airlines are still facing issues, especially Westjet. It remains to be seen just how badly the company will be affected by the slowdown in the energy sector. Sure, management has expanded significantly from its Albertan roots, but it is still viewed as having a great deal of exposure to the west.

Air Canada, meanwhile, just can't get any respect from the market. Seven out of eight analysts that follow the company rate it a buy, with an average earnings target of \$2.33 per share. That puts shares currently at less than six times forward earnings, which might be the lowest multiple on the TSX. Sure, shares have rallied since October, but it's obvious that investors just aren't as bullish on the company as analysts are.

While both are solid operators, I think **Transat AT Inc.** (TSX:TRZ.B) offers the best opportunity in the space.

Why Transat?

While the decline in the loonie has been an annoyance for Air Canada and Westjet, it's been practically a disaster for Transat.

That's because Transat doesn't get the majority of its revenue from domestic flights. It primarily flies to sun belt destinations, places like Mexico, Cuba, and the Dominican Republic. As a result, most of its expenses are tied to the U.S. dollar, while most of its revenues are in Canadian. That's not going to help the bottom line.

Profits in 2013 were \$1.59 per share. By the time 2014 was over, profits had declined significantly to \$0.59 per share. And the currency issues have only gotten worse since.

The company is also struggling with increased competition. Westjet has increased the number of flights it offers to tropical destinations, hoping to loosen Transat's grip on the all-inclusive winter vacation market. Air Canada has used its new Dreamliner planes to increase service to Europe, which is Transat's other big market.

The combination of all these factors have sent Transat shares reeling, closing on Tuesday at just \$6.12 each. That's close to a 10-year low and a far cry from the \$40 each they temporarily commanded back in 2007.

But if you're a believer that the currency swing will eventually right itself, Transat shares could be a screaming buy at these levels. Earnings over the last five years have fluctuated from a loss of \$0.44 per share in 2012 to a profit of \$1.74 in 2010. It has a history of recovering even when things look pretty bleak, like they do now. Average earnings over the period are \$0.62.

The company also has the balance sheet strength to make it through this latest rough patch. It has \$1.65 per share in cash, no long-term debt (but it does lease its fleet of planes), and a book value of \$11.98 per share.

Like Air Canada, Transat will likely return to a point where it has great current earnings and only trades for a single-digit multiple. It might take years, but airlines are notoriously cyclical. The time to buy is when everyone hates the stock. It sure looks like that time is now with Transat.

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1. Investing

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1. Editor's Choice

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1. TSX:AC (Air Canada)

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