



Is CAE Inc. a Better Buy Than Air Canada?

Description

Billionaire investor Warren Buffett is no fan of airlines.

Even though **Berkshire Hathaway** has invested in the sector before (even making money in the process, although not without a little scare first), Buffett has come out on record as being against airlines. He once said, “How do you become a millionaire? Make a billion dollars and then buy an airline.”

That's not exactly a glowing recommendation of the sector.

But many smart investors do successfully invest in airlines. Sure, bankruptcies have been common in the sector in the past, but there have been a lot of success stories as well. Both **Southwest** and **WestJet Airlines** have been consistently profitable for years without the slightest financial problem. Even troubled airlines have made for good investments.

But perhaps the best way for investors to play the sector is through a company that serves the airline industry, but without all the risk of fuel prices and economic slowdowns. There's really only one option in Canada, **CAE Inc.** ([TSX:CAE](#))([NYSE:CAE](#)), which is the maker of flight simulation systems to train new pilots.

Is CAE a good choice? Or should investors stick with the leading airline in the country, **Air Canada** ([TSX:AC](#))? Let's take a closer look at each.

The case for Air Canada

With crude oil depressed and mergers south of the border creating an oligarchy-type situation, now is a pretty good time to be an airline.

Analysts are pretty bullish on Air Canada specifically. Estimates are that the company is set to earn \$3.28 per share in 2015, and \$3.02 in 2016. That puts the shares at just 3.8 times 2015's estimates and 4.1 times 2016's best guess. Air Canada might have the lowest forward price-to-earnings ratio on the entire TSX.

Not surprisingly, analysts are suggesting that investors buy the stock. Out of the eight analysts who cover the name, seven have given it a strong buy rating, with one lone analyst calling it a hold. Target prices are anywhere between \$28 and \$10 per share, with an average of nearly \$19. That represents some attractive upside from current levels, right around \$12.50.

Demand doesn't look to be subsiding either. The company recently reported a record load factor, with nearly 85% of seats filled. Demand is particularly strong to areas like Asia, which combined with newer and more fuel efficient planes, makes these routes very profitable.

Plus, now that WestJet has established itself, neither airline has much incentive to be aggressive with pricing. If you need evidence of that, try taking a domestic flight. Prices between the two carriers are close to identical. That's bad for consumers, but good for business.

The only big risk I can see is a large geopolitical event, like another terrorist attack.

The case for CAE

Many of the things that are good for Air Canada are also good for CAE. If the industry is doing well, more pilots are hired who need more simulators. The company's other big customer is the U.S. military, which shows no signs of slowing down.

CAE is the undisputed leader in its field. More than 120,000 flight personnel train on its simulators annually, with a presence in dozens of major centres around the world. Its customers are the who's who of the airline world, including United, Emirates, Lufthansa, and Japan Airlines, just to name a few. Customer loyalty in the simulator business is much better than in the airline business.

Because of its strong competitive position, the stock is trading at a much higher multiple than Air Canada. CAE is projected to earn \$0.76 per share in 2015, following it up with \$0.88 in 2016. That puts shares at 19.4 times and 16.8 times forward earnings, respectively. That's not terribly expensive compared with the rest of the market, but it certainly is compared with Air Canada.

Analysts are a little less excited about CAE's shares, ranking them, on average, as a moderate buy. The average price target is about 10% higher than where shares trade now.

While I like the moat in the aircraft simulator business, Air Canada's shares are just too cheap to ignore. Perhaps it'll get itself back into trouble again, but for the next little while, it looks to be clear skies ahead for Air Canada—at least when compared with CAE.

CATEGORY

1. Investing

TICKERS GLOBAL

1. NYSE:CAE (CAE Inc.)
2. TSX:AC (Air Canada)
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Date

2025/08/26

Date Created

2015/04/14

Author

nelsonpsmith

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