



2 Reasons WestJet Airlines Ltd. May Be Your Turnaround Stock

Description

No matter what kind of investor you are, you don't want to overpay for your investments because doing so will reduce your returns whether in terms of yield or capital gain. That's why I like buying companies when they're priced below their intrinsic value.

In the past week, **WestJet Airlines Ltd.** (TSX:WJA) set a new 52-week low. Because of Westjet's cyclical nature, it only makes sense to consider an investment in it when it's priced significantly below its intrinsic value. I believe now is the time to get in on its discounted shares. Here's why.

1. Discounted valuation

With a S&P credit rating of BBB-, I don't consider Westjet as a core holding in my portfolio, but I do think it's a plausible investment right now given its discounted valuation.

At \$22 per share, Westjet is priced at below a price-to-earnings ratio (P/E) of 8, while it has traded above a P/E of 13 multiple times in the past. As a result, I think it's fair to assign a P/E of 11 to 13, expecting the price to eventually hit those levels again.

This would imply a price of \$34.80 to \$41 by 2017. This is a return of 62-90% or an annualized return of 22-30% including the dividend.

Based on the price-to-book ratio (P/B), Westjet is selling at the same valuation, 0.7, as in 2008 and 2009. For comparison purposes, in the past 10 years, its P/B ranged between 0.6 and 1.4.

Based on the price-to-cash-flow ratio (P/CFL), Westjet is selling at the same valuation, 3.7, as in 2008 and 2012. For comparison purposes, in the past 10 years, its P/CFL ranged between 3.2 and 7.3.

2. Shareholder-friendly with higher dividends

A lower share price implies a higher yield. With a yield of 2.5% at \$22, Westjet is sitting at its highest yield in history. What's more to like about Westjet's dividend is that it has been increasing for five years in a row.

The safest dividend is the one that was just raised. Westjet increased it last at the start of this year with a growth rate of 16.7%. The payout ratio is sustainable at 19% and has a cushion of safety, so I expect Westjet to continue growing its dividend in 2016.

Looking back over four years, WestJet increased its dividend at a compound annual growth rate of 29%; that is a smoothed-out increase of 29% per year.

At the same time Westjet is growing the payout, it is also reducing the pool of outstanding shares. From 2010 to 2014, the shares reduced by 11%. The less outstanding shares, the less Westjet has to pay in dividends, which indicates a safer dividend for existing shareholders.

In conclusion

I bought Westjet as a trade within a three-year time frame. My target sell price is between \$34.80 and \$41. However, if a core company becomes priced attractively, I'm willing to sell Westjet for a lower profit to exchange for higher quality. That said, I think Westjet is a reasonable investment for today and I like it for its discounted valuation and dividend growth history.

CATEGORY

1. Dividend Stocks
2. Investing

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