



Should You Buy Air Canada or WestJet Airlines Ltd. Today?

Description

Usually, turnaround investments aren't the highest-quality kind of companies, but they could generate substantial capital gains in a relatively short time frame. That's why I think it's worth it to take a look at **Air Canada** ([TSX:AC](#)) and **WestJet Airlines Ltd.** (TSX:WJA) today.

Which is cheaper?

Air Canada is 13% off from its 52-week high, while WestJet is 28% off from its 52-week high. When looking at the price pullback only, it would seem that WestJet is cheaper. But when looking at the price-to-earnings ratio (P/E), Air Canada is actually priced at a multiple of less than five, while WestJet is priced at a multiple of above eight. The P/E implies Air Canada is cheaper.

Still, the valuation only tells one part of the story. Let's compare the two airlines in multiple facets.

Comparing the airlines

Yield: The higher the yield, the more income shareholders receive today. Air Canada doesn't pay a dividend, while WestJet yields 2.3% at under \$25 per share.

Dividend growth: Other than giving more income back to shareholders, dividend growth also encourages price appreciation of the security. Assuming WestJet continues to pay a \$0.14 per share quarterly dividend, the airline would have to have increased dividends for five years in a row.

Earnings per share (EPS) growth: A healthy dividend is supported by growing earnings. The long-term share price is also driven by earnings growth. From 2005 to 2014 WestJet increased EPS seven times, while Air Canada only increased it five times in the same period. Actually, Air Canada had five years of negative EPS, while WestJet had positive earnings throughout the period.

Payout ratio: The lower the payout ratio, the safer the yield. WestJet's payout ratio is around 20%. So, its dividend is sustainable.

Quality: Air Canada has an S&P credit rating of B+, while WestJet has a rating of BBB-.

Debt: The higher debt level a company has, the more likely it is to default. Air Canada's debt-to-cap ratio is 114% while WestJet's is 34%.

Valuation: As mentioned before, Air Canada is priced at multiple of less than five, while WestJet is priced at a multiple of above eight.

In conclusion

For the safer turnaround opportunity, it's better to go with WestJet, even though it is priced at a higher multiple. First, it has much lower debt levels than Air Canada, so WestJet is much less likely to go bankrupt. Second, WestJet pays a dividend that helps investors to hold on even in a downturn. Its 20% payout ratio implies the dividend is sustainable.

The cautious Foolish investor would hold a turnaround stock in a non-registered account in case a write off is needed.

CATEGORY

1. Dividend Stocks
2. Investing

TICKERS GLOBAL

1. TSX:AC (Air Canada)

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