



Investors: 3 Reasons to Prefer CAE Inc. Over Air Canada or WestJet Airlines Ltd.

Description

These days, it's good to be in the airline business, especially in Canada.

Three big factors are keeping the airlines flying high (sorry, couldn't resist). Both **WestJet Airlines Ltd.** (TSX:WJA) and **Air Canada** ([TSX:AC](#)) have finally figured out that trying to undercut each other on domestic routes is a bad idea, especially since there's no competition. Both have done a nice job increasing revenue from things like charging for checked baggage and upgraded seats. And finally, the low price of fuel has really been a boon to the bottom line.

And yet shares in the two companies haven't been great performers. Thus far in 2015, WestJet is down more than 28%, while Air Canada has declined more than 20% from its peak in June and is barely positive year-to-date.

Earnings for each company are also pretty solid. WestJet has earned \$2.68 per share in the last year, putting it at just 8.9 times earnings. Air Canada trades at 18.2 times trailing earnings, but analysts have high expectations for the rest of the year. Air Canada's forward P/E ratio is just 3.2 based on expected 2015 earnings.

Why are the airlines so cheap? It's simple. Investors have been burned many times in the past by an industry that depends on full planes to be profitable. Even a small decline in total air traffic can have a big effect on an airline's bottom line. And if Canada's economy really starts to sputter, both of our local airlines may be forced to cut prices on domestic routes.

Instead, investors who want exposure to the sector should be taking a good look at **CAE Inc.** ([TSX:CAE](#))([NYSE:CAE](#)), the world's foremost maker of airplane simulators. Here are three reasons why.

A terrific moat

One of the things that can help investors figure out which companies are primed to succeed is by figuring out their sustainable competitive advantage. Warren Buffett calls this a moat.

CAE's moat is pretty obvious. It's the clear leader in making the simulators that train pilots around the

world, with 120,000 pilots using its simulators each year at 67 different training locations.

These machines are expensive, and changing to competing machines requires a big commitment from customers. It's much easier to stay with CAE rather than to try to adapt to a new machine. This kind of customer stickiness is good news for the bottom line.

Consistently profitable

Canada's airlines are prone to wild swings in profit because of their huge operating leverage. CAE's profits are much steadier.

Over the last four years, the company posted net profits of \$0.70, \$0.53, \$0.72, and \$0.76 per share. Meanwhile, Air Canada posted a loss of \$0.92, a loss of \$0.31, a profit of \$0.02, and a profit of \$0.34 per share during the same period. It's obvious which one is more consistent.

Next year looks pretty good for CAE as well. Analysts expect profit to jump nicely, coming in at \$0.86 per share. And 2017 is projected to be even better, with earnings expected to be \$0.94 per share. Those numbers translate into a reasonable forward price-to-earnings ratio of 16.2 and 14.8, respectively.

Growth potential

The rest of the world is rapidly getting wealthier, especially in areas like China and India. Like the rest of us, these people will be interested in traveling, which creates greater demand in the airline space. There are thousands of baby boomer pilots around the world, especially in North America and Europe, who are poised to start retiring.

Both of these trends are good news for CAE. Add in additional revenue growth from militaries around the world and it's easy to envision a scenario where it can grow sales annually for a long time.

The company's most recent results prove just that. Revenue was up nearly 6% year over year, with earnings increasing more than 10% before small restructuring costs.

CAE represents an excellent alternative to the airlines. Investors that are interested in the sector should strongly consider it over the much more volatile Air Canada or WestJet.

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