Will This New Airline Spell Trouble for WestJet Airlines Ltd. and Air Canada?

Description

Finally, after years of competing on price, Canada's airlines have gotten smart.

On domestic routes, there's rarely ever a difference on price from **WestJet Airlines Ltd.** (TSX:WJA) or **Air Canada** (TSX:AC). They both know there's going to be a certain demand from market to market, and with little in the way of competition, have no incentive to undercut prices. This policy might be bad for Canadian travelers, but it's good for business.

That might be changing, however. NewLeaf Travel Company announced on Wednesday that it was now accepting bookings for flights scheduled to begin in February. NewLeaf's business model is simple and one that's currently popular in Europe with Ryanair and in the U.S. with **Spirit Airlines**.

In an attempt to keep prices low, NewLeaf's ticket price only includes a seat. Everything from carry-on bags to beverages on the plane will cost extra. NewLeaf will also keep costs down by focusing on secondary airports like Halifax, Hamilton, Abbotsford, and Winnipeg.

Canadian consumers look to be embracing NewLeaf's business model. Its website crashed shortly after the company announced it was now selling tickets because it was slammed with traffic. Many intrepid travelers I chatted with were also very excited about the low prices.

As investors, we're more concerned with how much this new airline will affect the incumbents. Do WestJet and Air Canada have anything to fear from NewLeaf? Let's take a closer look.

A tough sector

NewLeaf is the newest entrant in a sector that hasn't been kind to new players.

In 2001, Jetsgo Corporation was founded in the Montreal area. At its peak it served 19 destinations in Canada, 10 in the United States, and was active in the Caribbean. By 2005 it had ceased operations, entering bankruptcy protection, and leaving thousands of travelers stranded on their way to March break vacations.

Canjet was founded in 1999, merging with struggling Canada 3000 shortly before Canada 3000 declared bankruptcy. It came out of bankruptcy in 2002 with just six planes and service to 37 different destinations. It focused operations on eastern Canada and had a few flights to Europe before announcing on September 1, 2015 that it was shutting down.

The only successful Canadian airline start-up in the last 15 years has been Porter Airlines, and it has exclusive access to Toronto's Island Airport. That's a huge advantage over the incumbents.

So needless to say, if I'm Air Canada or WestJet, I'm hardly shaking in my boots. In fact, WestJet is the only real success story in Canadian aviation history. Remember, Air Canada was government owned for decades and declared bankruptcy in 2004. It narrowly averted bankruptcy in 2009 and 2012 as well.

One thing a true discount carrier will do is create demand. Business travelers aren't price sensitive at all, and neither are many tourists. Travel has become increasingly important for many people, and they have the disposable income to pay for it. A company like NewLeaf takes market share away from driving and the bus, but not so much from other airlines.

The other thing to consider is the ability of the incumbents to put a new player out of business. WestJet already has a low-cost business model. And because it has grown so much, it can easily drop the prices to match NewLeaf's offerings on select routes, making it up in profit everywhere else. Without full planes, it's going to be tough for NewLeaf.

WestJet easily has the balance sheet strength to endure competition from even a well-funded start-up. It's currently sitting on more than $1.4 billion in cash and is riding a streak of 42 consecutive profitable quarters.

NewLeaf might be an interesting option for consumers, but at this point it's a non-issue for Canadian airline investors. Both Air Canada and WestJet have far bigger problems to worry about.

CATEGORY

1. Investing

TICKERS GLOBAL

1. TSX:AC (Air Canada)

Category

1. Investing

Date
2025/07/08
Date Created
2016/01/07
Author
nelsonpsmith