



WestJet Airlines Ltd. Still Has Massive Upside Potential

Description

The first six weeks of 2016 were not good for Canadian stock markets.

The big culprit was the price of oil. As crude sank below \$30 per barrel, investors rightfully got nervous about the whole Canadian economy. Companies with an attachment to Alberta got slammed especially hard.

Like any good value investor, I was busy buying Alberta-based companies on the news. I wanted to get exposure to oil's inevitable recovery, but I wanted a safer way to do it than through a risky, leveraged oil producer. The market was filled with beaten-up companies that have managed to stay profitable even during the darkest times.

One company that was on my watch list that I didn't buy was **WestJet Airlines Ltd.** (TSX:WJA). Shares of Canada's second-largest airline temporarily fell to \$15 each on fears that travel from the company's Calgary hub would grind to a halt. The company also released fourth-quarter results that were pretty lacklustre.

Before I had a chance to buy, shares jumped upwards. Just a month later, the company's stock is bumping up against \$20, and I'm cursing myself for not buying.

But perhaps I'm looking at it the wrong way. Here's why WestJet is still a good buy at \$20 per share.

A great operator

Many of the best investors will say to focus on the quality of a company's operations rather than its valuation. Or, as Warren Buffett likes to say, it's better to buy a great company at a fair price than a fair company at a great price.

There's a lot to like about WestJet's operations. The company has spent a lot of time realizing there are two things that can differentiate it in a crowded airline market: price and service.

WestJet takes care of price by having low-cost operations. It doesn't have unions—a move made after

seeing how difficult it has been for **Air Canada** to deal with its excessive legacy costs. WestJet also keeps its fleet simple, only using three different kinds of planes to save on repair costs. All-in, WestJet has costs of about 25% per mile traveled less than Air Canada, yet it commands very similar prices, especially on domestic routes.

WestJet's service is famously top notch, too. Stories consistently float around social media of WestJetters going above and beyond to give excellent customer service. There are thousands of people who will gladly pay more to take a WestJet flight over a competitor's because they're treated so well, myself included.

Limited competition

Allow me to make a bold prediction. I don't believe there will ever be a meaningful domestic competitor going up against Air Canada or WestJet ever again.

It's just too tough for a new operator to get going. Investors don't like the sector to begin with, and it's doubly hard when a carrier is just starting out. The only way a new entrant in the sector can compete is on price, a move that's met aggressively by incumbents matching. So much for that advantage.

The other thing holding back a new Canadian airline is foreign ownership restrictions. Any new carrier has to be majority owned by Canadian interests if it wants to fly domestic routes.

Great valuation

WestJet is well prepared to weather even a prolonged crummy economy in Canada.

Let's start with the balance sheet. The company is sitting on more than \$1.2 billion in cash, which is enough to offset its entire debt load. WestJet has been making other moves to solidify its balance sheet too, like returning some leased planes.

On an earnings basis, shares are ridiculously cheap. The company earned \$367 million in net profit in 2015, good enough for \$2.92 per share. That puts shares at less than seven times trailing earnings, which is a substantial discount compared with the valuation enjoyed by the company over the last five years. And WestJet pays investors a 2.8% dividend while they wait for the valuation to return to normal.

Shares of WestJet are up 33% compared to recent lows. It's easy for someone to think they've missed out after watching such a move, but there's still plenty of potential upside once shares get back to a more normal valuation.

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1. Dividend Stocks
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nelsonpsmith

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