Is it Safe to Buy WestJet Airlines Ltd.?

Description

The beginning of February was not a good time for **WestJet Airlines Ltd.** (TSX:WJA), Canada's second-largest airline. It announced earnings that did not come close to meeting analyst expectations, sending the stock plummeting. For a few days, it hit about $15 a share. If you picked it up at this price, I'm applauding you.

All told, analysts had been expecting adjusted EPS of $0.63 on revenue of $973.85 million. Instead, WestJet was only able to deliver $0.51 per share on revenue of $958.72 million. While missing expectations is never good, it's disheartening to see that earnings were so much lower than they were in the fourth quarter of 2014 when the company delivered an EPS of $0.77.

One of the primary reasons why the company saw a drop in earnings was because of the oil glut in Canada. Despite diversifying away from Calgary and Edmonton, the reality remains that when oil prices are low, the company has a hard time generating sufficient revenue from its customers.

Does that mean that investors should avoid this stock?

On the contrary, I believe that WestJet is actually a really great buy at this price. And there are a few reasons why I believe that.

The first has to do with the fact that this stock is incredibly undervalued. Presently, it trades at less than seven times its trailing earnings. While the P/E should never be the only data point an investor should look at, this can fill us in on some important information regarding the company. Specifically, airlines are very cyclical. They ebb and flow. Therefore, with the stock being very undervalued, it's quite possible that we're close to the bottom of the cycle.

Another reason why I believe this is a great time to buy the stock is because, despite missing its earnings, the company announced that the dividend is safe and it intends to increase its share-buyback program.

Therefore, the $0.14 per share that it pays out will continue to flow. That 2.86% yield should leave investors happy while they wait for the stock price to appreciate again. To help encourage that stock appreciation, management increased the number of shares it would buy back from four million to six million. This is 4.75% of the total pool.

But it’s not just about the price and dividend. WestJet also happens to be an incredible operator that has limited competition. How much money would it take to launch a competitive airline? Hundreds of millions–if not billions–of dollars. Therefore, I don’t expect that other companies will launch a new airline in Canada.

Further, WestJet does a good job of keeping its customers happy while keeping its costs down. Because it doesn’t deal with unions, only has three types of plane models in its fleet, and is so focused on customer service, it is able to charge similar rates to its primary competitor, **Air Canada**. The big difference is that WestJet spends 25% less per mile traveled than its competitor, giving it a greater margin for profit generation.

All told, airlines can be tricky stocks. However, I believe that WestJet is still a worthy contender for your portfolio. With such a low valuation per earnings, I believe this stock has a lot of room to grow over the next few years. Buying now and holding should provide a significant return on investment.

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1. Investing

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