# WestJet Airlines Ltd.: If You Don't Buy Now, You'll Be Kicking Yourself Later

## Description

There are many investors who won't go near airline stocks.

They've got plenty of reasons. The industry is littered with nightmarish tales of bankruptcy and price wars. Huge fixed costs have a way of hitting an operator right at the wrong time of the cycle. Returns on capital for the industry's history have been abysmal. There are very few ways for an airline to differentiate itself from its competitors, which turns the industry into one that essentially offers a commodity.

default watermark

All of these factors add up to what's traditionally been a crummy investment. No wonder billionaire investor Warren Buffett has sworn off the sector completely.

I'm not sure things are quite that bleak, however. With Canada's airlines trading at excessively cheap valuations, it seems like these concerns are more than priced into the two main operators in the business, **Air Canada** (TSX:AC)(TSX:AC.B) and **WestJet Airlines Ltd.** (TSX:WJA).

The good news about both of these stocks being so cheap is that investors can choose the best while still getting a good value. Here's why I think WestJet will end up being the better buy in five to 10 years.

### A great balance sheet

When investing in an airline, the balance sheet is incredibly important. Airlines can go from successful to struggling remarkably quickly, since operating leverage is so high. That means they need financial flexibility.

WestJet's balance sheet is in fine shape. The company does have nearly $1.5 billion in total debt, but that's offset by more than $1.4 billion in cash and short-term investments. So in reality, WestJet only owes less than $100 million–a pittance for a company with a market cap of $2.7 billion.

It should be able to continue adding cash to its reserves. Revenue was down a little over 4% in the most recent quarter because of weakness in Alberta, its home market. But profitability was still there with earnings hitting $0.71 per share. The most recent quarter marked WestJet's 44th consecutive quarter of profitability, a period which includes the Great Recession.

WestJet has also been able to pay investors a consistently rising dividend. The yield currently stands at 2.6%.

**Growth potential**

Even during this storm, WestJet has still been expanding.

Regional routes have been an important expansion opportunity. Since WestJet’s costs per mile flown are approximately 25% less than Air Canada’s, it has been able to create demand on routes Air Canada previously had to itself.

Here’s how it works.

WestJet announces it’s starting a new route. It runs this route at breakeven prices for a few months to generate demand and to convert former Air Canada customers. It then sets a regular price cheaper than what was being charged before. This new, lower price entices people who used to drive these routes to fly. The extra demand created is absorbed by capacity, which makes these routes quite profitable.

default watermark

WestJet also has further opportunities to expand in North America, further into Europe, and eventually, Asia. But in the meantime, the company has done a nice job getting some of these foreign customers by entering into codeshare agreements with some 40 different worldwide airlines.

**Ancillary revenues**

WestJet is doing a great job getting high-margin revenue from things that aren’t airplane tickets.

Checked baggage fees are a big contributor, even though many travelers are choosing to avoid them by packing light. WiFi is now available on most WestJet flights, and it seems like every time I fly, I see at least a few people buy the overpriced snacks. The company’s branded credit card is also doing well. These are all good things–at least, for investors.

In 2015 WestJet generated $16.62 per guest in ancillary revenue per guest, and that was before it rolled out its WiFi service in a big way, and 2016 looks to be even better from that perspective.

WestJet is a great operator in a business many investors hate. It has good financials, a great management team, and growth potential in both new routes and ancillary revenue. Perhaps investors should get in while sentiment is still somewhat negative. Or else it might be too late.

**CATEGORY**

1. Dividend Stocks
2. Investing

**POST TAG**

1. Editor's Choice

**TICKERS GLOBAL**

1. TSX:AC (Air Canada)

**Category**

1. Dividend Stocks
2. Investing

**Tags**

1. Editor's Choice

**Date**
2025/09/11
**Date Created**
2016/05/16
**Author**
nelsonpsmith

default watermark

default watermark