



Will This New Airline Ground WestJet Airlines Ltd.'s and Air Canada's Stock Prices?

Description

It hasn't been an easy journey for NewLeaf Travel, Canada's newest budget airline.

The company hit the market with a bang back in January, selling low-cost tickets to and from secondary markets like Abbotsford, Halifax, Hamilton, and Winnipeg. Flying from these markets would allow the company to offer much lower fares, undercutting the two incumbents that virtually own Canada's domestic market, **WestJet Airlines Ltd.** (TSX:WJA) and **Air Canada** ([TSX:AC](#)).

Right as consumers were really starting to get excited about the project, New Leaf suspended operations. The problem was with the company's business model. It had a charter arrangement with Kelowna-based Flair Airlines, with Flair doing the actual flying and New Leaf just selling tickets.

When NewLeaf launched, the Canadian Transportation Agency was reviewing whether a company like NewLeaf should have to hold a license of its own or not. Under the rules at the time, NewLeaf was good to go. But the company still decided it would rather be safe than sorry and temporarily delayed its launch.

This all seemed like ancient history until Thursday morning. NewLeaf is back, and this time it's better than ever. It announced flights would finally start (for real this time) on July 25 from an expanded network of 12 cities. Additions included markets like Edmonton, Victoria, and Kamloops, and it was announced that fares would be as low as \$79 for a one-way ticket.

Shares of Canada's existing airlines shrugged off the news. Air Canada shares were down just a couple of pennies during Thursday morning trading, while WestJet shares posted a small gain.

Should investors worry about this new competitor, or is it much ado about nothing?

The airline business today

The domestic market is much better for the incumbents than the international market, where competition eats into profits.

Take one of Canada's most popular routes: Calgary to Toronto. Over the next few months fares for this popular route are between \$600 and \$700, including taxes and other incidentals. Yet routes to international destinations of similar distance can be had for anywhere from \$450 to \$600 depending on the popularity.

It's pretty obvious NewLeaf is trying to hit the incumbents where it hurts.

But at the same time, there's one major problem. I can't fly Calgary to Toronto on NewLeaf. The best the company can do is a direct Edmonton to Hamilton flight, which currently looks to be about \$200 less than the Calgary to Toronto flight.

That's a nice cost savings, but is it really worth the hassle of having to add hours onto your travel time?

Both Air Canada and WestJet have done a nice job making money from things that aren't butts in seats. Both have a \$25 charge for checking a bag. Both are equipping their fleets with WiFi. And both have a variety of overpriced snacks that can be bought if a flyer is feeling peckish.

NewLeaf will operate under a similar business model, trying to make up for low ticket sales by selling extras. But they don't have the luxury of being able to do this over routes with a ton of demand.

Which airline will emerge as the winner?

If I were an investor worried about this, I'd be more likely to choose WestJet as an investment over Air Canada.

The main reason is as simple as it is powerful. Because WestJet doesn't have unions or bloated legacy commitments, it can operate with costs of about 25% less than Air Canada. That's a good thing to have in a world that could get much more competitive.

WestJet also has a history of consistent profitability, recently posting its 44th consecutive quarter in the black. It also has a terrific balance sheet with just \$85 million in net debt. Air Canada has more than \$3.5 billion in net debt. A good rule of thumb is that the company with less debt is better prepared to endure a price war.

I don't think Air Canada or WestJet shareholders have much to worry about. At this point, NewLeaf is just a distraction. But if the company really catches on with travelers, I'd be more worried as an Air Canada shareholder than a WestJet one.

CATEGORY

1. Investing

TICKERS GLOBAL

1. TSX:AC (Air Canada)

Category

1. Investing

Date

2025/09/11

Date Created

2016/06/23

Author

nelsonpsmith

default watermark

default watermark