



## Should Investors Buy WestJet Airlines Ltd.?

### Description

Warren Buffett is adamant about not investing in airline stocks. In his opinion, they're not worth it, they're risky, and people just don't get the returns they need. But Buffett isn't *always* right; he simply had a really bad deal back in the 1980s investing in debt for an airline.

But could Buffett be right about airlines right now? And should investors consider buying **WestJet Airlines Ltd.** (TSX:WJA) in particular?

Airlines are an inherently cyclical business that track the economy rather closely. When times are good, airline stocks are up, and when times are bad, airline stocks are down. And that makes sense because when the economy is weak, the average person doesn't have the money to travel.

And the numbers show it...

Its Q2 2016 net earnings were \$36.65 million, down 40.5% year over year. Its guest revenues were down 1.8% to \$814.4 million. And its operating expenses went up 5.5% to \$887.89 million. The one positive is that it was able to increase its operating cash flow by 11.2% to \$144.67 million.

One of the big reasons why WestJet had a weak quarter was because of oil. A lot of its travel—and really, a lot of Canada's economy—depends on oil. When that weakens, as has been the case over the past couple of years, revenue drops. It's true that jet fuel prices also drop, but the savings are not as great as the loss of earnings from fewer people flying.

Recognizing that this was going to be a problem, WestJet initiated routes to London back in May. This sort of international travel is key for business travel, which has higher margins. But the company is running into serious delays for passengers, which is risky because E.U. regulations mandate that delays over three hours departing London result in compensation for the passengers.

Now, delays are to be expected. It's a new flight path and the company needs to figure things out. The problem is that instead of buying new planes, WestJet decided to acquire old **Boeing** 767s, which are over 20 years old. They're old, not as efficient, and when there are problems, it takes days to get the parts.

I imagine that WestJet will streamline its operation, but these sorts of delays can result in hundreds of thousands of dollars that WestJet has to pay to its customers for the inconvenience.

At this point, I probably wouldn't be all that interested in investing in the airline because the cyclical nature of it could result in it dropping in price. However, there's one really big positive. Because its cash flow increased, its dividend is secure. Management said they would maintaining the \$0.14/share dividend, which will be paid out on September 30.

For all intents and purposes, the 2.4% yield is pretty solid, and it is one of the best characteristics of this stock. So if you're looking for income, it might be a good way to generate it while waiting for the cycle to rebound. Unfortunately, WestJet has a lot ahead of it before it can comfortably say that the rebound has occurred.

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jaycodon

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