



Air Canada vs. WestJet Airlines Ltd.: Which Airline Is Best?

Description

Many investors have sworn off the airline industry completely, pointing at all of the negatives of the sector.

That list is huge. Airlines provide a commodity product, making it very difficult to compete on anything but price. In times of economic weakness, it's virtually impossible for airlines to slash expenses to the extent necessary. Fuel, the industry's biggest expense of all, is something that can only marginally be controlled. And finally, there's the risk of terrorism or some horribly tragic accident.

Put all of these factors together, and it's easy to see why people are bearish on the whole industry.

But at the same time, some argue the industry is improving, especially here in Canada. Canada's two largest airlines—**Air Canada** ([TSX:AC](#))(TSX:AC.B) and **WestJet Airlines Ltd.** (TSX:WJA)—enjoy duopoly status at home, low fuel prices that look here to stay at least a little while longer, and both have had some measure of success diversifying revenue away from just butts in seats.

Let's take a closer look at each company and try to determine which is the better buy.

Operations

There are two main differences between the operations of these two companies.

The first is scope. While both airlines do the majority of their flights here in Canada, Air Canada is a true worldwide airline, flying to Europe, Asia, South America, and Australia. WestJet has just begun to start flying to the United Kingdom and Ireland.

The worldwide operations of Air Canada can be seen as a positive or a negative depending on your perspective. On the one hand, it's good to diversify away from domestic routes. On the other hand, many of these routes are highly competitive, especially to Europe. Anybody who flies domestically in Canada know that's where the money is made.

The second big difference between the two is a focus on costs. WestJet does all it can to keep costs

down, like only using a few different plane models and putting a large amount of effort into encouraging its staff to not unionize. Because of its cost-cutting expertise, WestJet has a cost per mile flown that's approximately 25% less than Air Canada's.

In a world where airline costs are so important, many investors prefer the non-unionized WestJet and its commitment to keeping costs down.

Financial safety

Airline investors have to pay close attention to a company's balance sheet. The industry is just too unpredictable.

Air Canada has a reasonable balance sheet. It's currently sitting on more than \$3.1 billion in cash and nearly \$7 billion in debt. Its debt-to-assets ratio is approximately 50%, which seems to be about where management wants that ratio to be.

Like Air Canada, WestJet is also sitting on a mountain of cash. It has \$1.7 billion in cash and short-term investments compared to just over \$2 billion in total debt. Its debt-to-assets ratio is much lower than Air Canada's, only recently surpassing 25%.

From a balance sheet perspective, WestJet is the better choice.

Valuation

Air Canada is one of the cheapest stocks in the world, trading at just four times earnings.

No, that's not a typo.

Analysts think the party will continue for at least a little while longer with 2016's earnings projected to come in at \$3.61 per share and 2017's bottom line to be \$3.22 per share. That puts shares at 2.5 and 2.8 times earnings, respectively.

Obviously, the market doesn't have much confidence in Air Canada hitting those numbers.

WestJet's valuation is not nearly as cheap as Air Canada's, but it isn't exactly expensive, either. Shares currently trade at 10 times trailing earnings. Earnings expectations for 2016 and 2017 are \$2.43 and \$2.48 per share, respectively, giving shares a forward earnings multiple pretty close to the trailing multiple.

WestJet also pays investors a 2.4% dividend. Both companies are buying back what they view as undervalued shares. WestJet eliminated some five million shares over the last year, and Air Canada got rid of 12 million.

Which should you pick?

For me, WestJet is the clear winner. It has a solid balance sheet, growth potential, low costs, and, perhaps most importantly, some very fierce customer loyalty. However, Air Canada does have a lot going for it as well, and you can't beat that valuation.

CATEGORY

1. Dividend Stocks
2. Investing

TICKERS GLOBAL

1. TSX:AC (Air Canada)

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