Is WestJet Airlines Ltd. a Smart Buy?

Description

Investing in airline stocks is investing in a cyclical market. Like car companies, there are very good times for airlines companies, but also very bad times. As investors, we're trying to find the good times and avoid the bad. But with an airline such as **WestJet Airlines Ltd.** (TSX:WJA), it can be difficult to truly time that entrance and exit.

Part of the cyclical nature of the airline has to do with how closely it tracks the overall economy. If people are earning good money and have expendable income, the economy is likely strong and, therefore, people are going to fly to places. If, on the other hand, the economy is weak, people might opt to stay local or spend more time traveling in the car.

And, as you might expect, earnings are down for WestJet. Last year the company had net earnings of $61.5 million in the second quarter. Fast forward a year and net earnings were only $36.6 million–down a little over 40%. According to management, the primary cause for a drop in earnings was the "severe economic downturn in the energy sector," which forced overall guest revenue to decrease. Its operating margin was only 6.5%–down from 10.7% in the same period last year.

You might be thinking that a weak energy sector might actually help WestJet because jet fuel prices would drop. And you'd be right to an extent. Last year its fuel cost per litre was 69 cents. This year its fuel cost per litre was only 53 cents–a drop of 23.2%. The problem is that it had to fly more flights and burned an additional 30 million litres of fuel. The cost per litre went down, but the amount it needed went up.

Then there's the fact that its realized revenue per available seat mile was down 5.8% from 14.16 cents in the previous year, while its realized cost per available seat mile, excluding fuel and employee profit share, was up 7% to 9.93 cents. Decreased revenue and increased costs … I think you get the picture.

So with all of this, you must think my advice is to avoid WestJet.

It's not so cut and dry. While profitability was certainly lower, this is the 45th consecutive quarter that WestJet has been profitable. It has been incredibly difficult for airlines to stay profitable even during the good times, and WestJet has been profitable for over 11 years. That's impressive and shows management takes the company very seriously.

Then, of course, there's the fact that WestJet returns as much money as it can to its investors. Over the last year WestJet has bought back five million shares. And it pays a 2.4% dividend, or $0.14 per share, which is quite secure because its cash flow increased. Between increasing investors' stakes in the company and paying income, it's hard to turn away from WestJet.

So my recommendation is to buy WestJet so long as you can handle the cyclical nature of the company. It's expanding into international markets (which have higher margins), and it excels at keeping costs low. Unless the company breaks its trend of profitability, I think this airline stock might be worth considering.

CATEGORY

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