3 Reasons Investors Should Prefer WestJet Airlines Ltd. Over Air Canada

Description

There are a number of problems with the airline sector that have caused some of the world's top investors–including billionaire Warren Buffett–to swear off the sector completely.

The big issue is high fixed costs. There aren't much difference in expenses if an airplane flies empty or full. The airline still has to acquire the plane in the first place and fill it with fuel. It still needs flight attendants, ground staff, and mechanics. Yet revenue can fluctuate wildly as the number of butts in seats either goes up or down.

This problem isn't quite as pronounced in Canada. Government regulations state that an airline has to be majority-owned by Canadians before it can start flying domestic routes. Our domestic skies have evolved into a comfortable oligarchy, with two companies dominating 90% of the market: **WestJet Airlines Ltd.** (TSX:WJA) and **Air Canada** (TSX:AC)(TSX:AC.B).

Many investors are willing to overlook the industry's massive operating leverage and invest in one of Canada's airlines, content in knowing that domestic routes provide predictable profits. Anyone who has ever flown from Calgary to Toronto knows there are no price wars inside Canada; there haven't been for a long time. The airlines are getting much smarter at predicting demand.

Which airline should investors choose? Here's why I'd choose WestJet over Air Canada.

Focus on costs

WestJet knows keeping costs under control is a huge advantage. Management has dedicated a lot of time and energy to do so.

One of the big ways it has done so is by avoiding unions. It seems like every few years Air Canada gets into a nasty battle with its unions with a deal hastily agreed to hours before a deadline. WestJet doesn't have this problem.

WestJet has also kept costs down by sticking with only a few airplane models. It has traditionally only used Boeing 737s, but recent expansion into regional and European routes have caused it to acquire two different model aircraft. Still, the strategy is a proven winner and should continue to be going forward. Air Canada, on the other hand, flies numerous models.

WestJet has made focusing on costs a company-wide quest, and it has had terrific results. Its overall costs are approximately 25% less per mile flown than Air Canada's–a huge advantage in any industry, but especially airlines.

Growth potential

WestJet is smaller than Air Canada. The latter has a market cap of $3.6 billion, while the former has a value of $2.7 billion.

Domestically, there isn't much difference. WestJet has a solid hold on its share of flights within Canada, and it's really expanded into regional flights in the last few years. Both also have plenty of flights to the United States, Mexico, and Caribbean destinations.

The big difference is Europe and Asia. WestJet has only started going to Europe, introducing flights to the U.K. and Ireland. Air Canada flies to dozens of destinations in Europe, Asia, and the Middle East.

WestJet has its eye on these destinations and will likely expand to continental Europe next. This won't be easy, since European airlines are adding more flights to Canada, but its low costs should help WestJet seize some of the market.

Financial position

WestJet's balance sheet is rock solid.

Total debt has been creeping up, coming in at just over $2 billion thanks to it taking delivery of a number of new aircraft. That debt is largely offset by $1.7 billion in cash. A net debt position of $300 million isn't bad; Air Canada has net debt of $3.8 billion.

WestJet is also consistently profitable–a rarity in the industry. It recently reported its 45th consecutive quarter of profitability, although earnings were down more than 40% versus the same period last year. Analysts are still fairly bullish for the year, predicting the company will still earn $2.45 per share. That puts shares a forward P/E of nine–a very reasonable multiple.

The bottom line

WestJet continues to be my favourite airline stock because it delivers consistent earnings, has a solid balance sheet, keeps costs under control, and has plenty of growth potential. Air Canada just can't compete with all of that.

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1. Investing

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1. Editor's Choice

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1. TSX:AC (Air Canada)

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Date
2025/07/07
Date Created
2016/10/25
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