



Why WestJet Airlines Ltd. Continues to Soar ... for Now

Description

WestJet Airlines Ltd. (TSX:WJA) has seen fantastic top- and bottom-line results from its recent Q3 2016 financials release. The company has outperformed on a number of key metrics, including revenue and earnings growth, load factor, and passengers flown. The company's stock price has improved significantly since its recent dip in February, but it's still down approximately 16% from its 52-week peak this past summer.

I will be looking at what factors the long-term investor will need to consider as indicators of profitability in the coming quarters.

The good news

Looking at some of the key fundamentals, WestJet appears to be in relatively decent shape. The carrier flew more passengers year over year, seeing a 7% increase in passengers flown (approximately 5.9 million passengers) with revenues increasing by a similar margin (7.6%) to \$1.12 billion.

The company has also been able to increase net income by 14% partially due to a drop in jet fuel expense, which declined by 0.3% since last year. The company is projecting that costs will continue to drop in 2017, forecasting a drop of 1-2% in the company's cost per available seat mile (CASM), although WestJet's 2016 adjusted CASM came in 0.3% higher in the Q3 2016.

The company has also indicated that expanding some of the long-range flights from Canada abroad may be in the long-term playbook. Investors will look to WestJet's long-haul flight results in the coming quarters to assess if this market segment is one that can be profitable in the short term and if long-term expansion remains feasible.

The bad news

WestJet's revenue per available seat mile (RASM), one of the fundamental gauges investors use to assess an airline's relative productivity, has decreased for seven straight quarters, including Q3 2016. The most recent RASM decrease of 2.7% is less than the company's Q4 2016 forecasted loss, which

is projected to come in between 4% and 6%.

The company's load factor is anticipated to be affected by the addition of more long-haul flights and other external factors, which investors will need to monitor carefully. Of primary importance is future fluctuations in the price of jet fuel, which I will look at next

The ugly

The bottom line for most major airline carriers is that profitability and future free cash flows are very closely correlated with jet fuel prices. As such, most major airlines hedge at least a portion of their jet fuel exposure.

WestJet has eliminated its jet fuel hedging portfolio.

The company clearly stated in its Q3 2016 financial statements that "as of September 30, 2016 we have no fuel derivative contracts outstanding. We will continue to monitor and adjust to movements in fuel prices and may re-visit our hedging strategy as changing markets and competitive conditions warrant."

The company may indeed be able to re-incorporate a hedging strategy in a relatively short amount of time, but it remains woefully exposed to a large oil-price shock.

Many analysts have pointed to the significant potential for a continued oil-price rebound. Such a situation would prove to be a massive risk for any potential airline investor, but more so for an investor looking at an unhedged option in a slew of partially or fully hedged stocks

WestJet has been able to "ride the wave" of low oil prices via an unhedged strategy for now, but it remains to be seen how the market for jet fuel will impact the company in the long term.

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