



Why Warren Buffett Should Invest in WestJet Airlines Ltd. Next

Description

Warren Buffett shocked the world on Monday after **Berkshire Hathaway Inc.** announced a very surprising addition to its equity portfolio via its 13F filing.

Berkshire sold its position in **Suncor Energy** and much of its **Wal-Mart Stores** holding in exchange for a number of airline stocks, including **American Airlines**, **United Continental**, and **Delta Air Lines**. CNBC also confirmed that Berkshire also began accumulating shares of **Southwest Airlines** after the 13F cutoff date, September 30.

These aren't small positions, either. In total, 6.27% of Berkshire's portfolio is invested in the sector, excluding the position in Southwest. Or, to put it another way, more than US\$1.5 billion of Berkshire's capital is invested in the sector.

What's interesting about these new positions is Buffett's general distaste for the sector. After a lacklustre investment in US Airways in the 1990s, he told *The Telegraph* newspaper, "if a capitalist had been present at Kitty Hawk back in the early 1900s, he should have shot Orville Wright. He would have saved his progeny money."

So why the change of heart? Most Berkshire observers believe the same thing. It wasn't Buffett who made the decision to put money into the sector. Rather, it was one of his key lieutenants, Ted Weschler or Todd Combs, who made the move.

Not surprisingly, shares of airlines across North America shot higher on the news. Having the backing of Buffett is a big deal to the sector, even if it's just indirectly.

I believe Berkshire got their pick wrong. Here's why I think the company should have invested in **WestJet Airlines Ltd.** (TSX:WJA) instead.

Duopoly status

If you want to fly from Toronto to Calgary or Montreal to Winnipeg, you've really only got two choices. You're climbing aboard a WestJet or an **Air Canada** plane.

Canada's two airline giants know there's little competition, and price their routes accordingly. Price wars don't really exist anymore, and flight comparison websites will often show the exact same cost for comparable flights between the two carriers.

This might be changing, however. New ultra-low-cost carrier New Leaf is planning to expand to major airports, and Transport Canada recently announced it would be lifting foreign ownership limits from 25% to 49% with one shareholder only limited to a 25% ownership stake.

That may prove to be good news for consumers, but starting an airline is tough, especially when you're up against such entrenched competition.

Low cost

WestJet has one big advantage over Air Canada. It has lower costs. WestJet spends about 25% less than Air Canada on a per-mile-flown basis.

There are a couple of reasons WestJet has been able to maintain this advantage. First of all, it has been able to keep its workforce from unionizing. It has also kept its fleet fairly simple, focusing on one kind of plane. This keeps repair and maintenance costs down.

Ancillary revenue

WestJet has also been doing a good job growing revenue from sources that aren't butts in seats, including charging for checked luggage, selling food and beverages while in the sky, and putting WiFi on its planes.

Ancillary revenue hit \$17.82 per guest in the company's most recent quarter versus \$16.44 in the same quarter last year. That's an increase of more than 8%.

Consistent results

WestJet has been able to deliver consistent quarterly profits over the last 46 consecutive quarters, which is as consistent as airline investors are going to get.

These consistent profits have led to nice dividend growth. Five years ago, WestJet paid investors a nickel per share each quarter. These days, the payout is 14 cents. And with a payout ratio of just 22% of trailing earnings, there's plenty of potential for the company to continue giving investors consistent raises.

The bottom line

I've believed WestJet has been in the high class of the North American airline world for a while now. It has great employees, a low-cost business model, duopoly status at home, and it delivers consistent profits. Warren Buffett's interest in the sector is just icing on the cake.

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Author

nelsonpsmith

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