Would Warren Buffett Be Interested in These Canadian Airline Stocks?

Description

It's no mystery that Warren Buffett has been bullish on the airline sector of late. Consumer spending is steadily increasing, and many airlines have seen a traffic go through the roof. Warren Buffett spread his bets across many U.S. airline stocks late last year, and it's already paid off big.

If Warren Buffett were Canadian, he would probably consider adding **Air Canada** (TSX:AC)(TSX:AC.B) and **WestJet Airlines Ltd.** (TSX:WJA) to his portfolio. But which one would be the better bet at current levels? And is there still more room to run in the airline space?

Warren Buffett is a long-term investor, but his recent purchases of airline stocks are more of a medium-term trade than a typical long-term hold, and the reason is simple. The airlines are dangerously cyclical. If you hold an airline stock during an economic downturn, then you could lose a huge amount of your original investment. If you hold an airline stock during a recession, then it's very likely that the losses will be over 50%, and the recovery time could be more than five years after the stock price hits the bottom.

So, if you decide to invest in any airline stock, then make sure you take profits off the table before they're lost during the next economic collapse. The buy-and-hold-forever strategy does not work with these types of cyclical stocks.

Air Canada

Air Canada enjoyed a huge 33.89% rally last year, but the positive momentum tapered off in the latter part of the year. The company enjoyed an incredible Q3 2016 earnings report; profits increased 75%. The quarter blew analyst expectations out of the water, and I believe there's still more fuel in the tank for more impressive earnings beats this year. TD Securities has a $24 price target on shares of Air Canada, which represents a whopping 77% upside from current levels.

The company has a massive amount of cash flow growth potential, and I believe the stock is an absolute steal at current levels. It currently trades at a 4.1 price-to-earnings multiple and a 1.7 price-to-cash flow multiple, both of which are lower than the company's five-year historical average multiples of 31.2 and 2.4, respectively.

WestJet Airlines Ltd.

WestJet Airlines enjoyed a modest 15.91% gain last year, which was a lot less than its peers in the airline space. The company has a focus on lower costs and has typically flown with costs that are 25% less per mile flown than Air Canada. The company reduces costs by keeping its fleet limited to three different models of aircraft.

WestJet has a healthy balance sheet and a lot of room to run in 2017. The company also offers an attractive 2.5% dividend yield which investors can collect as they wait for the stock to lift off.

Shares are also ridiculously cheap with price-to-earnings, price-to-book, and price-to-cash flow multiples at nine, 1.3, and 3.4, respectively, all of which are lower than the company's five-year historical average multiples of 11.4, 1.8, and 4.9, respectively.

Which one is the better buy?

For a medium-term trade, I would pick Air Canada because there's a ridiculous amount of cash flow growth potential, and it's very likely we could see the company report more huge profit beats in the quarters for this year.

Although WestJet has performed better during an economic downturn, I would choose Air Canada because I believe it's got more upside, and we're assuming you will eventually sell the name because it's a medium-term trade and not a long-term investment.

CATEGORY

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