



## Better Buy: WestJet Airlines Ltd. vs. Air Canada

### Description

With one proclamation from Warren Buffett, Canada's airlines suddenly went from being uninvestable to a compelling opportunity — at least for many investors.

The announcement came in February, when Buffett disclosed that **Berkshire Hathaway** had amassed large positions in several prominent U.S. airlines, including **United Continental**, **Delta Air Lines**, and **Southwest Airlines**.

Despite being previously bearish on the sector, Buffett pointed out that the industry has changed in the last decade with carriers settling into a holding pattern of sorts. As long as airlines don't go nuts trying to undercut each other or add unneeded capacity, they should be able to avoid the fate of so many airlines in the 20th century.

Much of what Buffett likes about the sector is prevalent in Canada's airline sector. We have two dominant players — **Air Canada** ([TSX:AC](#))(TSX:AC.B) and **WestJet Airlines Ltd.** (TSX:WJA) — which control some 90% of the market.

Which of these two airlines should investors choose? Let's take a closer look.

### The skinny

Air Canada is the largest Canadian airline. It not only has hundreds of routes inside North America, but it also flies to Europe, South America, and Asia. WestJet, meanwhile, has limited itself to North America and the Caribbean, although it has recently expanded to include routes to the United Kingdom and further into Central America.

There are two major differences between the two carriers. The first is that Air Canada's employees are unionized, while WestJet has been able to avoid unionization. When times are good, having a union isn't a big deal. It's during tough times when it's easy to see the disadvantage of having a union. It's much tougher to get rid of staff.

WestJet has also done a terrific job keeping its costs down. Most of WestJet's fleet is the same plane

model, which keeps maintenance costs down. Not having a union helps as well. As a result of the company's focus on cost control, WestJet spends about 25% less than Air Canada on a per-mile-flown basis.

## Valuation

Amazingly, even after Buffett made a big splash in the sector, Canada's airline stocks really haven't budged. They're still very cheap versus the rest of the market.

Let's start with Air Canada. In 2016, the company earned \$3.10 per share. The stock currently trades hands at \$13.27, giving it a trailing price-to-earnings ratio of 4.3.

No, that's not a typo. Air Canada really is that cheap.

Analysts project earnings will fall to \$2.76 per share in 2017 before recovering to \$3.19 per share in 2018. Even on a forward basis, Air Canada shares are an incredible value.

Compare that to WestJet, which isn't quite as cheap as Air Canada. WestJet earned \$2.45 per share in 2016 — a decline of 16% versus 2015. Still, that puts shares at just 9.4 times trailing earnings.

Analysts expect WestJet to earn just \$2.09 per share in 2017 before earnings recover to hit \$2.47 per share in 2018.

WestJet is still cheaper than most stocks in Canada, but Air Canada easily takes this category.

## Growth potential

Both airlines are poised to grow nicely over the next decade as more and more Canadians decide to travel. In addition, there will be millions of people elevated to the middle class in places like China, India, and other developing nations. They will get the travel bug.

It's only a matter of time until WestJet starts expanding into Asian markets. In the meantime, the company plans to add capacity across North America. It has had great success muscling into competitive routes and using its low costs to offer cheap introductory fares. It then raises the price when it has a sufficient market share.

In addition, WestJet has done a nice job growing ancillary revenues from sources such as charging for checked bags and WiFi on its flights.

## The bottom line

Both WestJet and Air Canada are poised to be good investments. They each offer solid balance sheets, cheap valuations, and compelling growth potential over the long term.

Ultimately, if I were to choose one over the other, I'd pick WestJet. It offers greater expansion potential, better customer loyalty, and a solid 2.4% dividend.

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