



Canadian Airlines Are Cheap: Is the Risk Worth the Reward?

Description

On a purely fundamental valuation standpoint, Canadian airlines are, by all measures, cheaper than they have been in a long time. I've looked at both **Air Canada** ([TSX:AC](#))(TSX:AC.B) and **WestJet Airlines Ltd.** (TSX:WJA) recently and have come to the same conclusion: these companies are cheap — really cheap.

I'm going to look at reasons why investors may want to look at these companies — or look away.

The upside

Canadian airlines have rebounded quite nicely over the past few years as investors have largely changed their sentiment toward Canadian names such as Air Canada or WestJet. With oil prices dropping, and other fundamental metrics, such as passengers flown and revenue per available seat mile, increasing of late, even iconic investors such as the Oracle of Omaha, Mr. Warren Buffett himself, is dabbling in an industry he publicly vowed never to invest in again.

Buffett's **Berkshire Hathaway Inc.** has pumped billions into the largest American airlines, such as **United Continental**, **American Airlines Group**, **Delta Airlines Inc.**, and, most recently, **Southwest Airlines**.

It turns out that for many investors, the valuations for airlines are simply too cheap for the free cash flows these businesses are generating. For Canadian airlines, many of these fundamentals look just as good (and in some cases better) than their American counterparts.

WestJet's long-term advantage generally lies with the fact that it has a modest dividend combined with an operational structure many analysts believe to be better than that of Air Canada. Without union constraints and increased flexibility to aggressively pursue new opportunities, WestJet earns the higher valuation of the two.

While often considered to be the older, clunkier airline, Air Canada's fundamentals and price make it hard to ignore in this current environment. Air Canada has been forced (largely by its operational structure) to pursue cost-saving opportunities and streamline its operations for efficiencies, which have

boosted earnings of late, making Air Canada the real value pick for investors in Canadian airlines.

The downside

Airlines are in an industry once hated by Warren Buffett for a reason: these are super-cyclical stocks that boom and crash frequently; they often crash a lot harder than they boom. Of late, many industry fundamentals have led to widespread profitability for all firms. The famous saying, “a rising tide lifts all boats” has taken form. The question in the back of many long-term investors’ minds is, “How long can this last?”

Stay Foolish, my friends.

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