WestJet Airlines Ltd. vs. Air Canada: 1 Stock to Buy (and 1 to Short Sell)

Description

WestJet Airlines Ltd. (TSX:WJA) and **Air Canada** (TSX:AC)(TSX:AC.B) are two battered airline stocks that have fallen ~21% and ~6%, respectively, year to date. Both airlines appear to be severely undervalued stocks with their single-digit trailing P/E multiples of 8.66 and 3.48, respectively, at the time of writing.

Although such low P/E multiples may be indicative of a "cigar butt" stock that possesses a valuation that's too good to be true, it looks to me that Air Canada is a real opportunity that could be ripe to soar in the second half of 2018. WestJet, however, is clearly troubled and may have a stock that's about to encounter even more turbulence in the year ahead following management's recent guidance downgrade.

Air Canada is ready to fly high. WestJet could be in for an abrupt landing

When it came to the first-quarter results for the year, it's clear that Air Canada and WestJet are on different ends of the spectrum. Air Canada is in far better shape to capitalize on the strengthening Canadian economy over the medium term compared to WestJet, which may not be able to make the most of the opportunity that's on the horizon.

It's not just higher fuel prices that have been a drag on WestJet shares either, as all airlines had to deal with this headwind. WestJet's company-specific issues (like implications from a strike) are to blame for the stock's tumble, and with the recent guidance downgrade, I find it less likely that the company will hit its ROIC target, as the troubling downtrend in year-over-year ROIC continues.

Could WestJet shares miss out on air time once again?

WestJet has been one of the most underwhelming names to own in the airline space. The stock didn't really participate in the last leg-up when Air Canada shares more than tripled over a two-year span. Given WestJet's unique situation this time around, it looks like the company is set to miss out on a magnificent industry-wide rally, yet again.

Bottom line

Air Canada is not only cheaper than WestJet based on traditional valuation metrics but is poised to enjoy ample cost-savings over the medium term, as prior initiatives finally begin to pay off. Given Air Canada's superior position at this point in time, and the existence of near-term catalysts that could send the stock flying, I think the discount on Air Canada shares versus the airline industry is unwarranted.

Moving forward, Air Canada looks very well equipped to return to growth. This, when combined with improved margins across the board, may cause shares to double within the next three years.

As for WestJet, I think shares are doomed to underperform over the medium term, so investors looking for a long/short strategy may find that going long Air Canada and shorting WestJet could end up being a very profitable endeavour over the next year or so.

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