Invest like Warren Buffett … or Not?

Description

Warren Buffett once famously quipped that investing in airlines has been such a losing proposition that "if a farsighted capitalist had been present at Kitty Hawk, he would have done his successors a huge favor by shooting Orville (Wright) down." Many investors have since taken that mantra as gospel and have stayed away from airline stocks over the years.

But even Buffett has since dipped his toe back into airline stocks, once again taking a chance on the volatile airline industry. With his holding company **Berkshire Hathaway** purchasing shares of several airline companies including **American Airlines Group** and several others. His company's foray back into the airline industry makes investors question their decision of avoiding airlines altogether.

Two of Canada's major airlines, **WestJet Airlines** (TSX:WJA) and **Air Canada** (TSX:AC)(TSX:AC.B) are both investment choices that Canadians can look into if they want to get into the airline industry.

WestJet

Since it was first established as a regional airline, WestJet has grown to become a competitive airline both in Canada and abroad. From its roots of only conducting low-cost western Canadian flights to its contemporary flights that reach South America, Australia, and Europe, WestJet has grown its business considerably over the years.

In the fourth-quarter results published recently, WestJet affirmed its mission to grow globally. This put some pressure on its reported earnings, as did rising fuel costs associated with the rebound in oil prices. The airline reported a 67.2% reduction in earnings as compared to the fourth quarter of 2017. Revenue was positive, however, growing by 5% over the previous year's results.

Air Canada

After being crushed by the recession following the financial crisis, Air Canada has experienced a stunning rebound in its share price. The shares, which traded below $1 in 2009, have roared back to over $30 a share at present.

With its results for full year 2018 coming up on Feb. 15, investors may want to wait to see how the airline is performing. But according to its Q3 2018 results, the airline has been making positive headway. Revenues in Q3 increased 11.7% year over year and free cash flow increased by 45%. Basic earnings per share were down by 62% year over year in part due to similar costs experienced by WestJet.

Which is the best buy?

If you want to buy one of the two airlines, it really depends on what you are looking for. Air Canada has the advantage of being the better known of the two internationally. It also already has a large, established network of flights. The fact that it has the word "Canada" in its name doesn't hurt either, since the government would be more likely to backstop this flagship airline if it happened to get under pressure.

If you want a dividend, then WestJet is the clear choice of the two since Air Canada does not have one. WestJet's yield of 2.77% is enough to draw income investors. While it has not dropped its dividend, it has not raised it in some time either, so growth investors may not be intrigued. The dividend should be safe with WestJet's payout ratio of around 50% supporting it.

Both airlines are cheap on a valuation basis. WestJet's trailing price-to-earnings (P/E) ratio of 8.6 and Air Canada's P/E of 4.19 certainly draws my eyes. The same could be said of WestJet's price-to-book (P/B) ratio of one and Air Canada's of 1.8. But keep in mind that the airline business is cyclical, and cyclical stocks always appear cheap at the height of the cycle.

Personally, I still ascribe to Warren Buffett's earlier statement. The good times have rolled on for some time, and the risk of a recession has grown. As well as these airlines have performed and as cheap as they are, recession risks are high. Airlines will most likely not do well, as people and businesses cut travel if a recession hits.

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