WestJet Airlines: a company on the rise

Unless you've been living under a rock since last June, you'll have noticed the fall in oil prices. Heavy losses have been felt by companies in the exploration and production (E&P), refining, drilling and servicing subsectors. This has clearly been creating interesting opportunities for those able to pick the right companies, but "timing" is the most difficult part of this process. That being said, weak oil prices are advantageous for several economic sectors. Any company counting fuel costs as one of its largest expenses will see its margins improve shortly if oil prices stay at their current levels—which, according to OPEC's statements, could very well be the case. Amongst the industries with the most direct benefit to lower energy prices, Airlines stand to gain the most.

The Airline industry hasn't been a consensus pick. For one, it is well known that Warren Buffet has hated the industry for a long time. However, looking at the Airline industry, we see a more consolidated market, with competitive landscape more reduced than in past years. The Canadian market in particular is an oligopoly in which WestJet Airlines (WJA) has been winning important market share, as the 2nd largest carrier. In 2001, Air Canada held 83% of market share. In 2011, Air Canada held 51% of market share, WestJet owned 29%[1].

Focusing only on WestJet, the company's recent history has been incredibly successful. A recent initiative that has seen such success is the company's December 2013 "WestJet Christmas Miracle" YouTube campaign which has tallied over 40 million views. It is hard to evaluate the direct impact of any marketing campaign, but it's worth noting that during the 2013 holiday campaign, WestJet's website traffic doubled, bookings increased 77%, and revenues increased 86% relative to the same holiday period in 2012. In 2014, WestJet went one step further with its causal marketing campaign, releasing another campaign showing employees helping a community-in-need in the Dominican Republic. It's a simple but under-used marketing strategy. The theory being that given equal price and quality, consumers will opt for the company associated to a better cause. WestJet certainly does a good job staying in a positive public light—and that's important for both its clients and its shareholders.

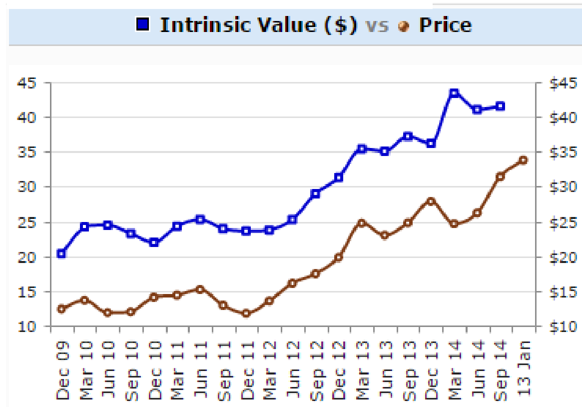
As is often publicized, WestJet employees are shareholders in the company. This is a clear alignment of their incentives to continue to offer excellent consumer experience. The company is in a position today where they need to renegotiate with 2600 flight crew who have rejected an initial agreement-in-principle for the next 5 years. WestJet flight crew are not unionized, but are represented by an employee association. The situation is still a long way from what we witnessed with Air Canada and its unions a few years back, and should resolve itself without any substantial impact.

As we can see in StockPointer, the annualized 5 year growth for earnings per share and dividends are 33% and 30% respectively. For Q3 2014, WestJet announced that their adjusted net earnings and earnings per share had increased 31% and 32% respectively, making it the best Q3 in the company's history.

Knowing that the company's growth rate is a lot more attractive than the market average, WestJet's stock is not very expensive, trading at a price-to-earnings ratio of 16.2. At the current price, the company is trading at around 10.8x 2015 expected earnings ($3.07 per share). WestJet generally has a return on capital above 12%, and has maintained a cost of capital under 7% for the last 3 years. It is thus easy to

[1] http://centreforaviation.com/analysis/air-canada-considering-launch-of-new-leisure-lcc-as-competition-in-leisure-market-intensifies-49833

Graph 1: WJA's intrinsic value



Source:StockPointer

understand why the company has created wealth for its shareholders. Its return on equity is stable and high, around 15%-16%, and WestJet has constantly improved its operating margin for the last 5 years. Its cost structure is efficient and the debt ratio is relatively low. The intrinsic value calculated by StockPointer's EVA methodology prices WestJet at $41.50, suggesting the stock is currently undervalued (see attached graph).

In 2014, we witnessed that WestJet's fidelity program, its updated reservation system and *Encore*—its new regional service—are now established and expected to contribute to future growth. When considering the new "first luggage" fees being instated by WestJet and Air Canada, as well as low fuel costs, WestJet's growth prospects for 2015 look promising.

Please note that this article is written as of January 9th 2015. The ideas and facts mentioned above should not be interpreted as investment advice or a recommendation to trade.

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