

# WestJet Airlines Ltd.

## Equity Research Report



Industrial Sector

Date: 01/25/2012

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Mac Investment Club

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Stock Rating:

**BUY**

Sector Weighting:

**NEUTRAL**

Today's Date: 01/24/2012

Price Target: \$14.00

Target Price Date: 02/10/2012

### COMPANY MARKET STATISTICS

Ticker: WJA

Exchange: TSX

Fiscal Year End DECEMBER

52-week range (High/Low) \$16.02/\$10.00

Shares Outstanding 130.6M

Avg. Daily Trading Vol. 472429

Market Capitalization 1.63B

Annual Dividend \$0.20

Dividend Yield 1.70%

Price/Earnings 10.19

Enterprise Value 1.21B

EV/EBITDA 2.75

Price to Book 1.21

BETA 0.88

Short Interest % 1.40%

### REVENUE BREAKDOWN

Guest: 92.22%

Charter and Other: 7.78%

### ANNUAL EARNINGS PER SHARE (EPS)

2011 Est. \$1.01

2010 \$0.94

2009 \$0.74

2008 \$1.39

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### HIGHLIGHTS

- WestJet and Delta have entered into a code-sharing agreement on flights within the United States and Canada, expanding a partnership launched 11 months ago
- WestJet is considering the launch of a new short-haul, regional airline as early as 2013 using a fleet of approximately 40 smaller, turboprop aircraft
- The regional market in both Canada and the U.S. transborder is about a C\$2 billion market according to WestJet CFO, Vito Culmone
- 5.3% load factor growth year over year in Q3 2011
- Successfully big on LaGuardia airport slot
- Q4 Earnings release on February 9, 2012

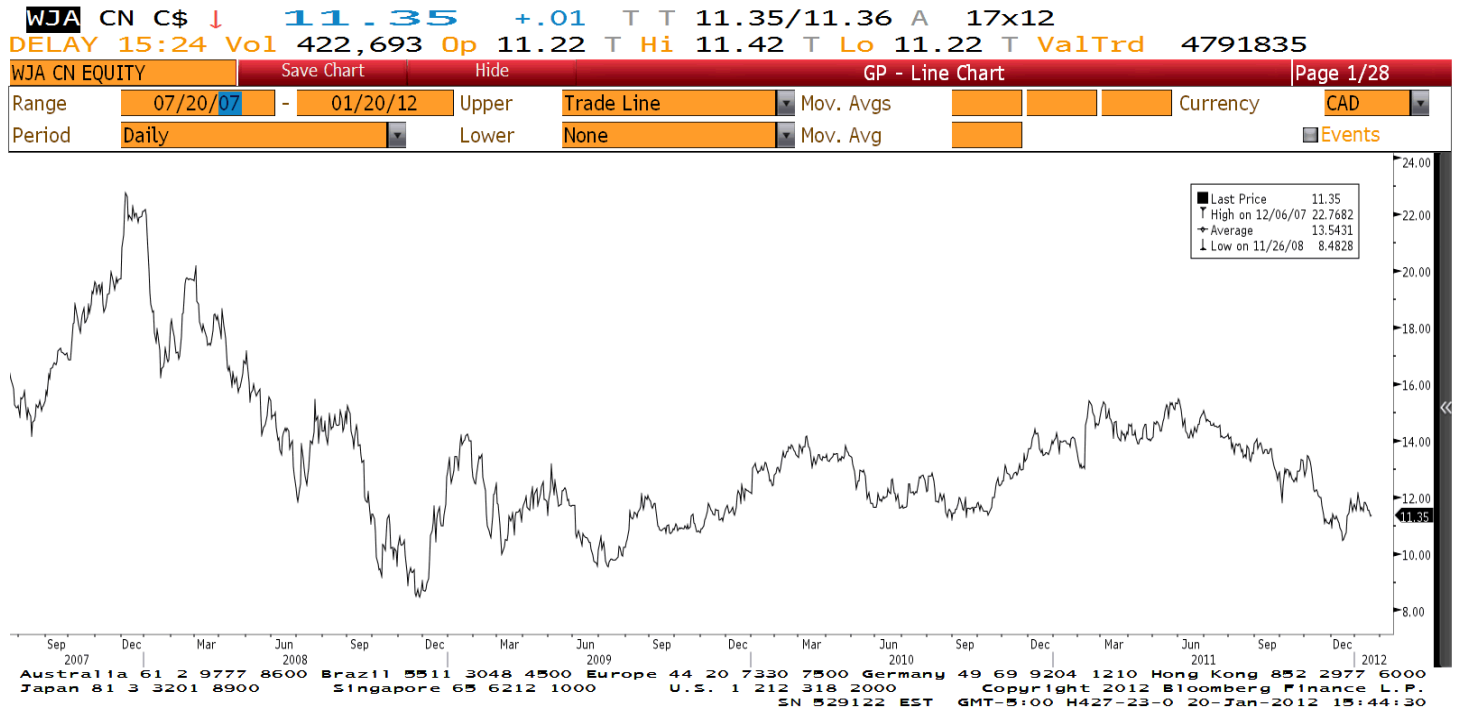
### OVERVIEW

WestJet Airlines (TSX:WJA) founded in 1996 has taken off in Canada and has expanded following the Southwest Airlines model. Westjet is Canada's second largest airline behind Air Canada. The low-fare carrier serves about 70 destinations, mainly in Canada but also in the US, Caribbean, and Mexico. It operates a fleet of over 80 Boeing 737's. The carrier is constantly expanding its fleet and is soon expected to purchase 40 regional turboprop planes. Most of WestJet's destinations outside Canada are vacation spots, and subsidiary WestJet Vacations allows customers to book hotel accommodations along with their airline tickets.



## PRICE CHARTS

### Five Year Price Chart

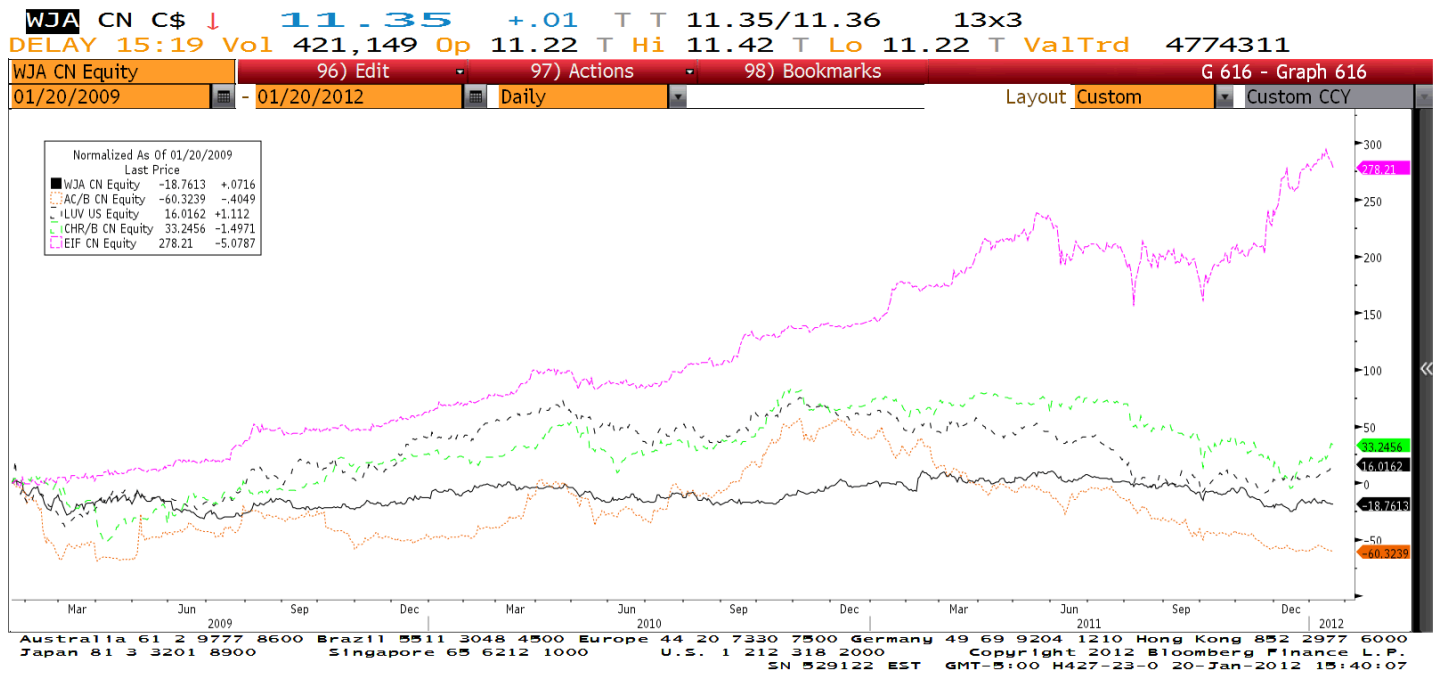


Shortly after hitting a 52-week low in mid December, WestJet appears to have rebounded nicely back into the mid \$11 range. The drop in late 2011 was due to recession related fears and slightly decreased load factors.

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## One Year Price Chart versus its competitors



WestJet (Solid Black Line) compared to its main competitors: Air Canada (Yellow Line), Chorus Aviation (Green Line), Southwest Airlines (Dotted Black Line) and Exchange Income Corporation (Pink Line). The vertical axis represents the percentage appreciation. In comparison to its competitors, WestJet has been relatively stable in the past 3 years.

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## One Year Price Chart versus TSX, S&P 500



WestJet seems to have been following the TSX quite closely, except for the recent downfall in November and December. This was in large part due to the airline industry typically being very capital intensive and highly leveraged both negative attributes in a predicted global recession.

## NEWS AND EVENTS

WestJet has had a very successful 2011 holiday season. On January 5th, 2012, they published a news release reporting a record December traffic results with a load factor of 80.9%, tying its second highest December load factor ever. This success should be reflective on the earnings released on February 8th, 2012. Other areas of significant growth included the Revenue passenger miles (RPMs) and overall capacity, which is measure in available seat miles (ASMs). The RPMs increased by 8% over a one year period and capacity grew by 7.1% over the same time period. WestJet flew nearly 1.4 million guests in the month of December.

Another significant change has been headlining the WestJet news in the month of January. On January 17th, Reuters announced that WestJet is on the path of launching a regional airline, using a fleet of turboprop aircraft to serve smaller markets in Canada. This new strategy would present another new challenge to their bigger rival Air Canada, and WestJet is aiming to depart from its successful low-cost strategy and become a major competitor. Analysts are suggesting that the turboprop aircrafts would most likely be the Q400 series, which would be purchased from the fellow Canadian company Bombardier Inc. The WestJet owners are currently voting on this new proposition, to have this plan implemented in the near future.

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## COMPANY RISK

With regard to the airline industry WestJet's performance is very stable. It's low beta, below 1 but close to 1, suggests its returns will be less volatile than the market, but will still follow the market rather closely. This is a benefit as the TSX still has lots of room to recover from the drops it took near the end of 2011. The volatility seen is more a measure of market volatility than WestJet's volatility as a company, although it is a cyclical business and a recession would likely hurt performance. WestJet's WACC of 8.21% is relatively low for the airline industry and reflects their low leverage and high liquidity. WestJet also hedges about 20% to 25% of fuel costs to ensure that a price spike does not crush their profit margins. The majority of operations being in North America mean that WestJet is almost immune to political conflict, as the airline industry is currently suffering it is also relatively immune to any negative changes in policies, especially over the short term. The airline industry is very capital intensive and is typically considered to have low margins and be a very risky investment. WestJet manages this risk well and focuses on minimizing these negative aspects, making it one of the least risky airlines in the world to invest in.

<b>BETA</b>	<b>Volatility</b>	<b>WACC</b>
0.88	27.89%	8.21%

## PEER COMPARISON

Ticker	Market Cap	Price	Div. Yield	Trailing P/E	Forward P/E	Annual Revenue	1-Mo Return	3-Mo Return	1-Yr Return
WJA	C\$1.57B	C\$11.34	1.76%	14.67	11.27	C\$2.61B	5.39%	-9.59%	-18.35%
AC.B	C\$0.28B	C\$0.99	NA	8.85	-1.74	C\$10.79B	-1.00%	-29.29%	-68.37%
CHR	C\$0.44B	C\$3.60	16.67%	5.42	7.6	C\$1.49B	25.68%	-2.83%	-22.81%
EIF	C\$0.44B	C\$25.66	6.31%	18.09	22.31	C\$0.25B	6.64%	29.32%	41.17%
LUV	C\$7.38B	C\$9.40	0.19%	19.91	21.86	C\$15.49B	9.33%	6.62%	-26.34%

It is clear by looking at the one year returns of WestJet and its competitors that the airline industry has taken a hit recently. EIF does not show this decline as it is a diversified and stable small cap growth company. This decline is due in large part to fears of a global recession. Airlines performance is largely cyclical and entering into a global recession while recovering from the last crisis would likely shake up the airline business and may even push a few into insolvency. This global recession however has yet to be seen. WestJet has taken the least decline due to its high liquidity levels and low leverage. These factors would indicate that WestJet could take a significant shock and still perform confidently. This is in contrast to a few of WestJet's competitors in North America who are leveraged to a greater extent and have lower levels of liquidity.

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## REVENUE AND EARNINGS

As the economy recovered in 2011 WestJet benefitted from this cyclical demand and carried a record number of guests in Q3. WestJet continues to increase capacity and its number of guests carried year after year. Q4 is expected to see slightly less year over year growth than Q3 but still remain in the 5% range. Load factors were down slightly in December, however this is due to the increased capacity from new 737s and not a reflection of decreased demand for the airline. Q4 earnings have a low target relative to the quarter before as analysts expect rising costs to cut into stable revenues. WestJet is better than most other airlines at maximizing net income by keeping costs low. Having a fleet of only 737s is one of the ways WestJet maintains low but rising maintenance costs. Rising fuel prices have cut into earnings in 2011 and this trend is expected to continue, however fuel prices are hedged over 20%, dampening the effect large fuel price shocks may have. Although current fears of a global recession may depress demand for vacations, WestJet as a low cost provider is in a strong position to reap a large portion of this demand. Recently announced expansion into the growing regional market through purchase of more short-haul efficient turboprops is one of the biggest ways WestJet seeks to continue its year over year revenue growth. WestJet will also follow the same low cost strategy in the regional market to ensure maximization of profit margins. They will buy 40 of the same turboprops to achieve economies of scale on everything from training to maintenance.

### Revenue

	Q1	Q2	Q3	Q4	Total
<b>Current</b>	\$ 772.42	\$ 742.29	\$ 775.28	\$ 769.78	\$ 3,059.77
<b>2010</b>	\$ 619.29	\$ 611.68	\$ 684.10	\$ 692.82	\$ 2,607.89
<b>2009</b>	\$ 579.28	\$ 531.16	\$ 600.63	\$ 570.04	\$ 2,281.11
<b>2008</b>	\$ 599.35	\$ 616.00	\$ 718.38	\$ 615.78	\$ 2,549.51

### Net Income

	Q1	Q2	Q3	Q4	Annual Total
<b>Current</b>	\$ 48.25	\$ 2.60	\$ 39.27	\$ 25.92	\$ 116.04
<b>2010</b>	\$ 2.37	\$ 6.83	\$ 43.83	\$ 47.91	\$ 100.94
<b>2009</b>	\$ 37.43	\$ 9.15	\$ 31.42	\$ 20.18	\$ 98.18
<b>2008</b>	\$ 52.51	\$ 26.84	\$ 57.88	\$ 42.03	\$ 179.26

### EPS

	Q1	Q2	Q3	Q4	Total
<b>Current</b>	\$ 0.34	\$ 0.18	\$ 0.28	\$ 0.19	\$ 0.99
<b>2010</b>	\$ 0.02	\$ 0.05	\$ 0.30	\$ 0.33	\$ 0.70
<b>2009</b>	\$ 0.29	\$ 0.07	\$ 0.24	\$ 0.14	\$ 0.74
<b>2008</b>	\$ 0.40	\$ 0.21	\$ 0.45	\$ 0.33	\$ 1.39

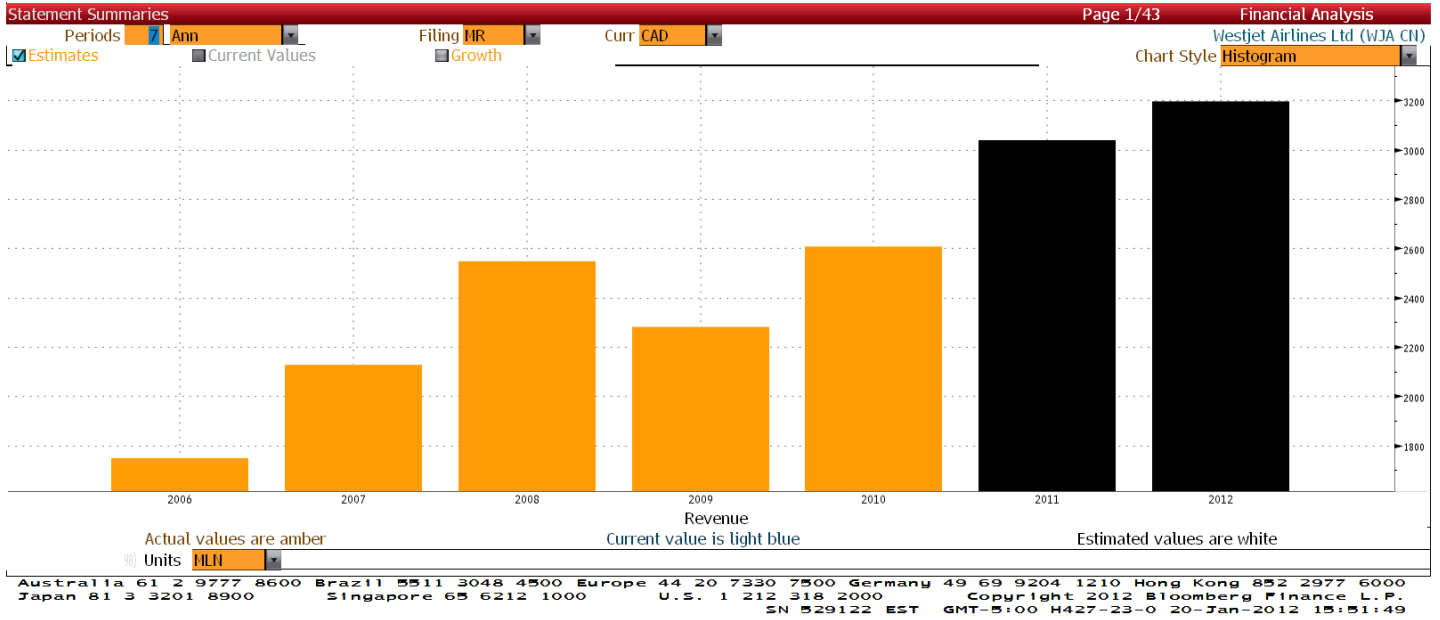
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## Revenue Annually

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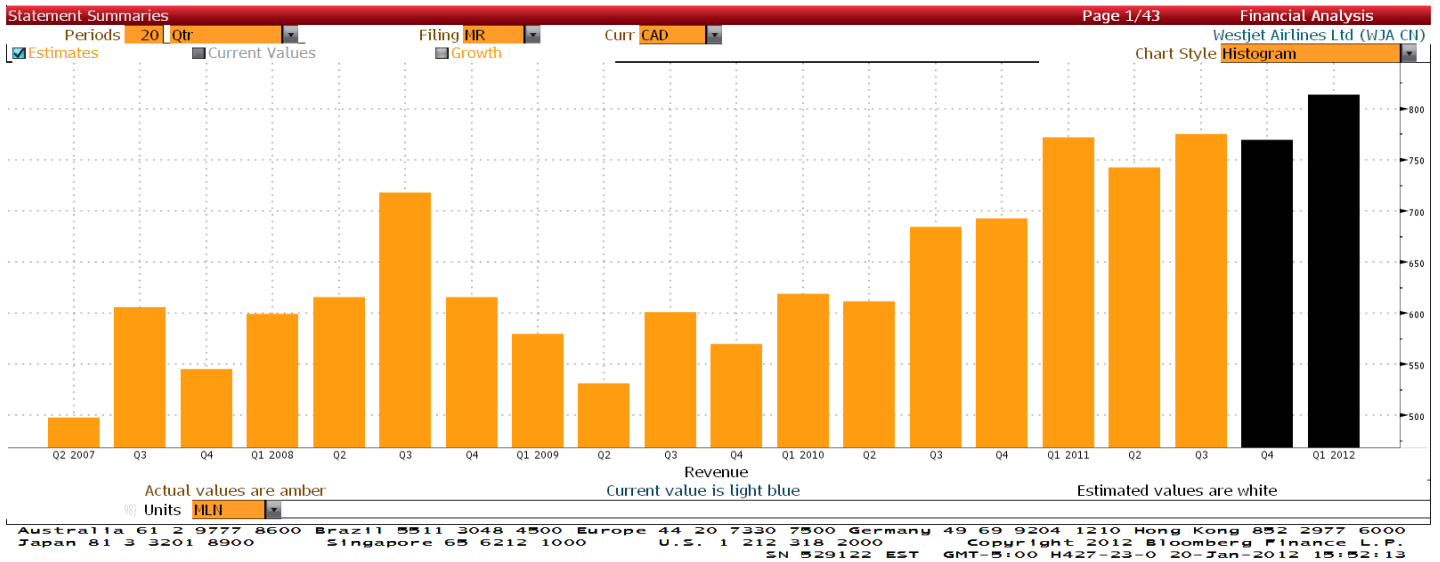
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## Revenue Quarterly

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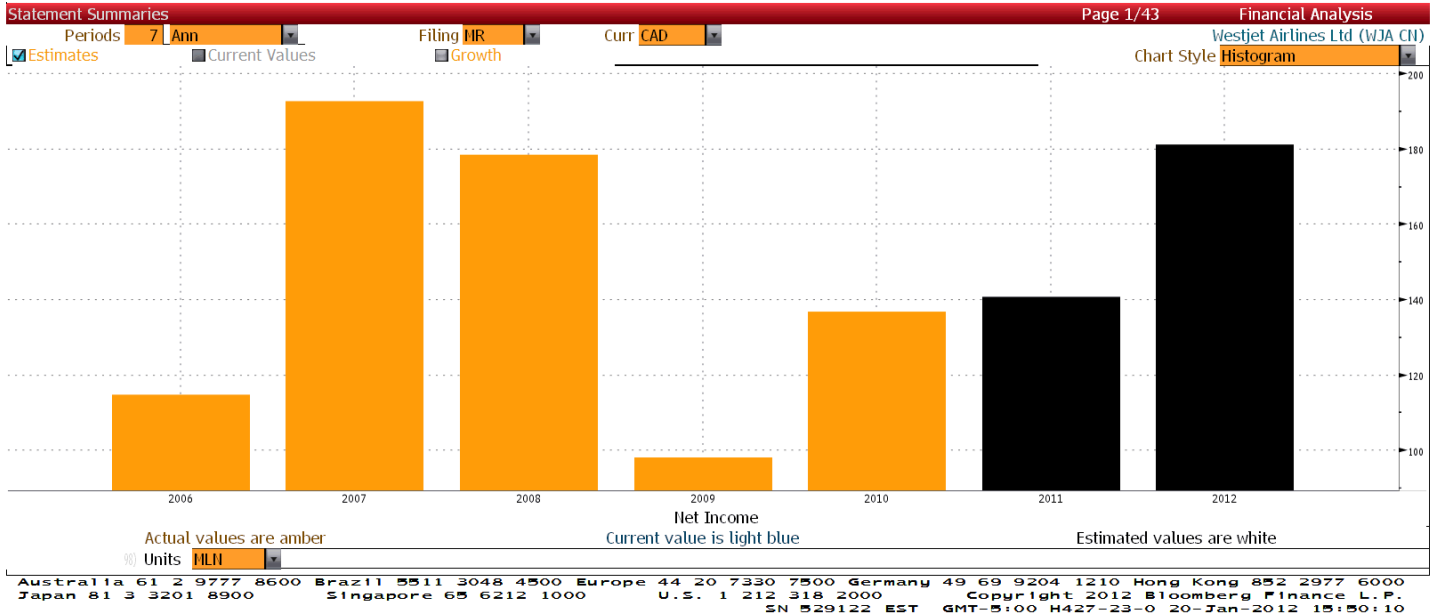


## Income Annually

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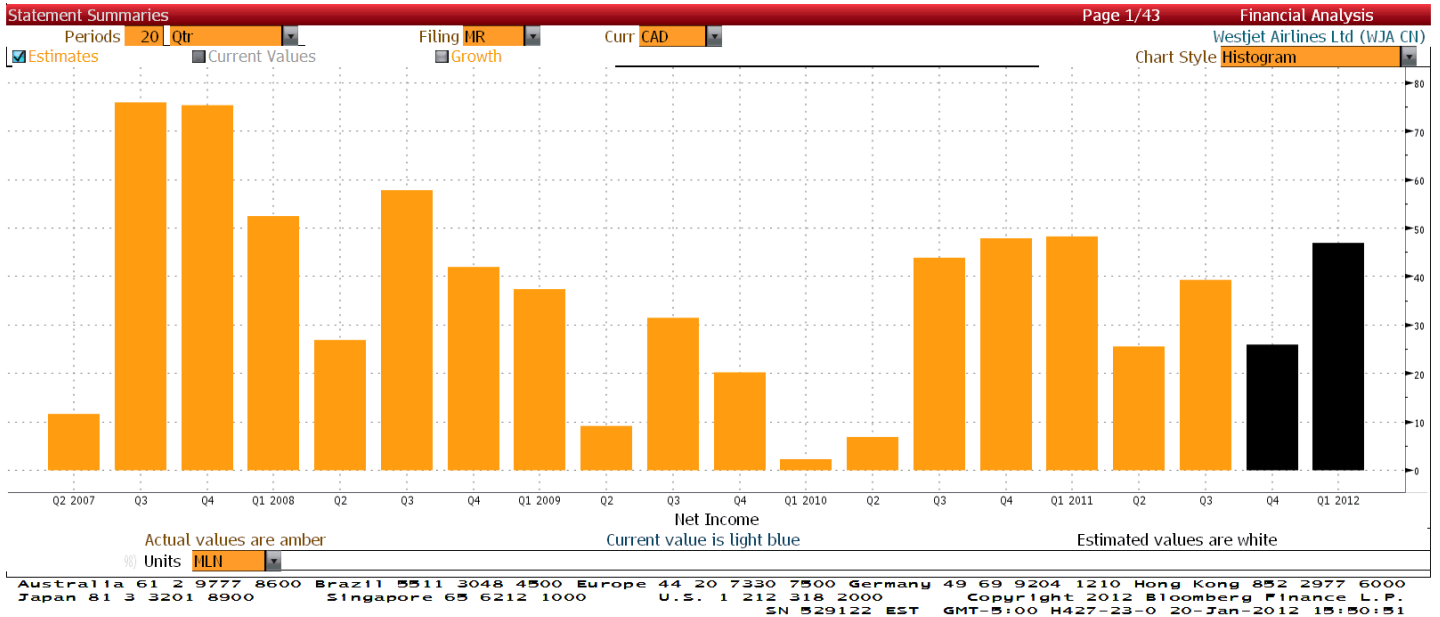
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## Income Quarterly

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## EPS Annually

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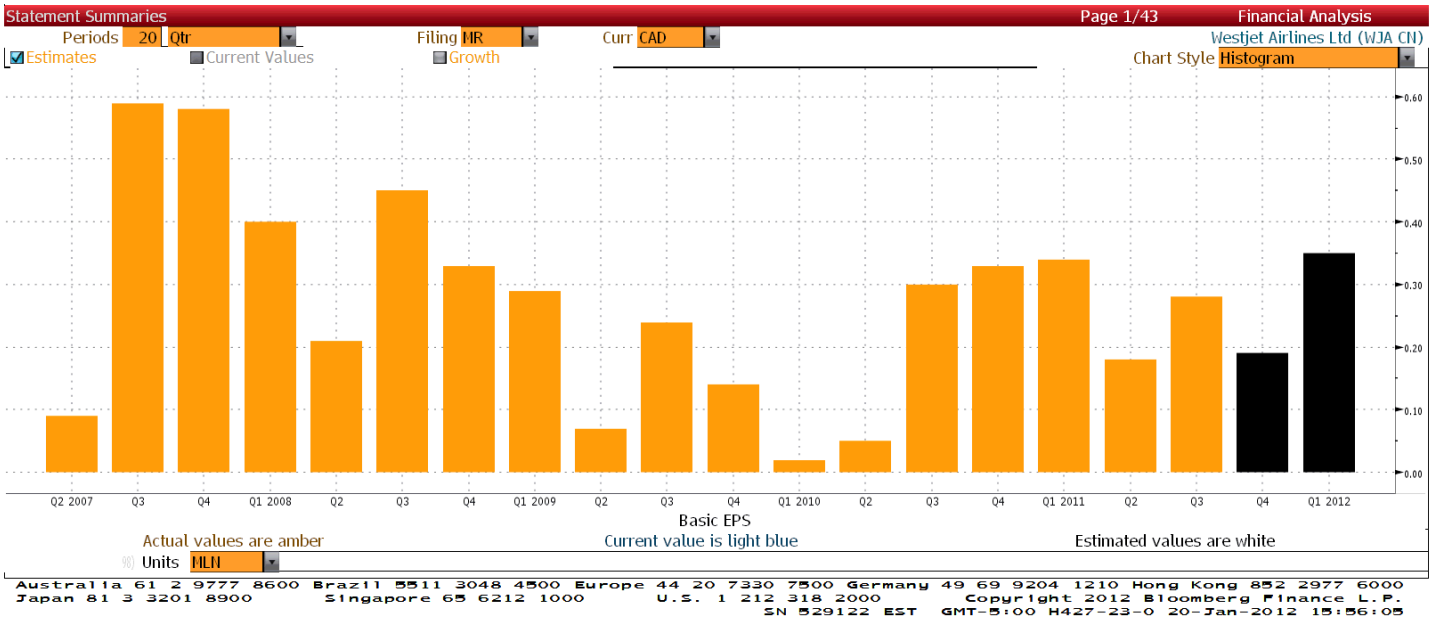
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## EPS Quarterly

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## FUNDAMENTAL RATIO ANALYSIS

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The ratios below are based on the last year period. Currently trading at slightly over ten times earnings, the company is undervalued by industry standards. WestJet's fundamental ratios are stable and mostly in line with the industry. Based off of the gross and profit margins, the company is in a position to cover its' expenses while remaining profitable. The current ratio of 1.52 indicates that they are able to meet short-term obligations. A current ratio almost identical to its quick ratio implies a small and well controlled inventory. A price to book ratio of less than one again suggests room for significant growth, especially when the company is being managed very well. WestJet is also evidently undervalued when comparing its enterprise multiple of 2.75 with other airlines. Southwest Airlines, a very comparable company, has an enterprise multiple of over 5. This suggests WestJet currently has room and reason for significant growth. All in all, the fundamental ratios indicate that WestJet is financially sound for the foreseeable future and is undervalued relative to the current market.

<b>Revenue Growth</b>	<b>ROE</b>	<b>Current Ratio</b>	<b>Price to Book</b>
13.33%	12.12%	1.52	0.982
<b>Gross Margin</b>	<b>ROA</b>	<b>Quick Ratio</b>	
34.10%	9.07	1.5	
<b>Profit Margin</b>	<b>P/E</b>	<b>Debt/Capital</b>	
5.68%	10.19	0.85	

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## CASH FLOW ANALYSIS

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Westjet is in a very strong position with regard to cash flow. A net cash position of over one billion dollars signifies good management of cash as well as a strong position in the face of a possible global recession. Westjet's ability to sustain a large cash base during a recession says a lot about their management and treatment of risk. Risk is seen to be substantial in the capital intensive airline industry and a large cash base minimizes the effect of this. Westjet started paying out a small dividend in 2011 of \$0.20 annually. This sends a confident signal to investors that Westjet is doing well and able to pay out some of that excess cash while still maintaining growth. Although they sit on a large amount of cash it is doubtful that dividends will be increased anytime soon as much of that will be needed to the coming expansion into the short-haul sector.

<b>Net Cash Position</b> \$1.32B	<b>Dividend</b> \$ 0.20	<b>Div. Growth Rate</b> 300%	<b>Price/Cash Flow</b> 3.25
<b>FCF Per Share</b> \$ 2.97	<b>Dividend Yield</b> 1.69%	<b>Cash from Operation</b> \$443.28M	
<b>FCF Yield</b> 24.88%	<b>Dividend Payout</b> 5.30%		

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## TECHNICAL ANALYSIS

When analyzing WestJet from a technical perspective, there are four main indicators used: trading volume, the relative strength index, moving average convergence - divergence and stochastic oscillators.

### The Relative Strength Index & Trading Volume



Relative strength index is a technical momentum indicator that compares the magnitude of recent gains to recent losses. It is used to determine when an asset is overbought or oversold, an asset is deemed to be overbought when it approaches 70 and oversold when it approaches 30. WestJet is currently around the 55 mark level, indicating that it is neither overbought or oversold. There appears to be a great upside potential.

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## Moving Average Convergence - Divergence

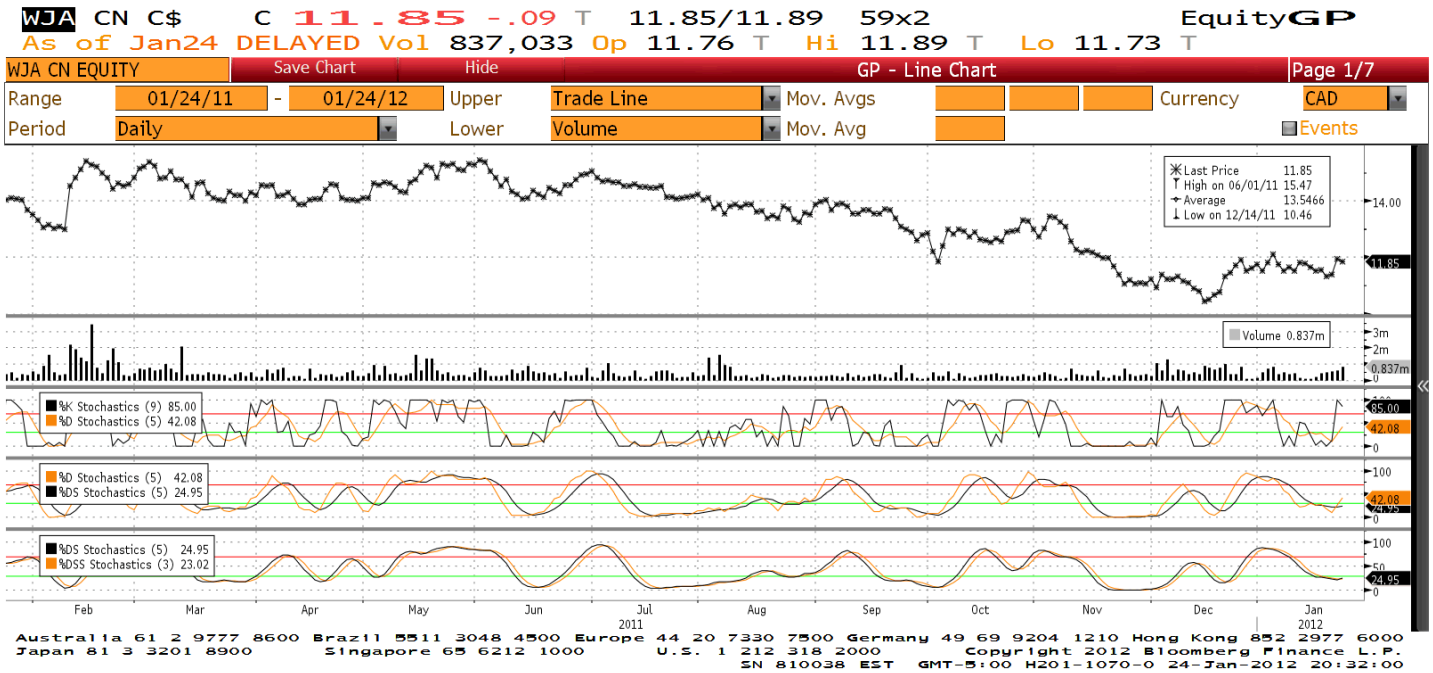


The moving average convergence-divergence is a trend-following momentum indicator that shows the relationship between two moving averages of prices. The MACD line in this instance appears to cross the signal line twice in a short timeframe. The MACD line is currently over the signal line, suggesting that the price is likely to experience an upward momentum.

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## Stochastic Oscillators



The Stochastic Oscillator is a momentum indicator that shows the location of the close relative to the high-low range over a set number of periods. It follows the speed or the momentum of price. In all instances, the stochastic oscillators indicate that WestJet is about to begin an upward momentum.

## SELECTION METHODOLOGY

This stock was selected due to obvious underpricing relative to the industry that is not warranted based on its strong fundamentals and low risk level. It appears to be positioned well for continued future growth. Coming announcement of Q4 earnings also provides a catalyst for price growth.

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