

2014 FT MBA Capstone Preparation for Monday, December 8th

WestJet Case Question:

On Monday, December 8th we will be covering the WestJet case. Please note that there is no need to do any additional research or access any more data beyond what is provided here. In preparation for participating in the case discussion, over this coming weekend, please read the attached case, examine the data below, and come prepared to discuss the following issue.

“As companies age, they fall victim to rising costs, an ageing workforce, lower productivity and an eroding culture making them vulnerable to a new lower-cost entrant. Can a company like WestJet stay “on top” and break the traditional and somewhat predictable cycle? Can WestJet continue to win by competing with culture?”

On Monday morning you will be assigned to student teams and will be given 30 minutes to prepare for the following debate. We will randomly select teams to argue one of the following positions:

- a. WestJet’s demise is inevitable and here is why (i.e., identify the warning signs).
- b. WestJet’s demise is not inevitable. Here is why and here are specific steps that the company can take to ensure its future success.

“WestJet’s culture is based on care, and that’s evident in the way WestJetters enthusiastically go above and beyond to take care of each other and our guests. Our goal is to remain a top-ten employer, and we’ll continue to listen to WestJetters and work with them to create an environment and employment experience they want to be a part of.”

Ferio Pugliese
President, WestJet Encore, and Executive Vice-President, WestJet

Our Mission

To enrich the lives of everyone in WestJet’s world by providing safe, friendly and affordable air travel.

Our Vision

By 2016, WestJet will be one of the five most successful international airlines in the world providing our guests with a friendly and caring experience that will change air travel forever.

By 2016, we strive to be one of the top five airlines in the world as measured through key metrics such as on-time performance, safety, profitability and guest satisfaction.

Our Values

- Commitment to safety
- Positive and passionate in everything we do
- Appreciative of our people and guests
- Fun, friendly and caring
- Align the interests of WestJetters with the interests of the company
- Honest, open and keep our commitments

Will WestJet's actual and projected performance (as illustrated below) enable them to be in a better position than Air Canada to be one of the top 5 airlines in terms of profitability?

Air Canada Annual Financials

| C\$ million's, unless otherwise indicated | 2010 | 2011 | 2012 | 2013 | 2014E | 2015E | 2016E |
|---|----------|----------|----------|----------|----------|----------|----------|
| Operating Revenues | | | | | | | |
| Passenger | 9,427 | 10,208 | 10,737 | 11,021 | 11,772 | 12,141 | 12,363 |
| Cargo | 466 | 481 | 488 | 474 | 496 | 509 | 526 |
| Other | 893 | 923 | 889 | 887 | 979 | 998 | 1,018 |
| | 10,786 | 11,612 | 12,114 | 12,382 | 13,246 | 13,648 | 13,907 |
| Operating Expenses | | | | | | | |
| Salaries, Wages and Benefits | 1,913 | 1,991 | 2,110 | 2,247 | 2,256 | 2,235 | 2,209 |
| Aircraft Fuel | 2,652 | 3,375 | 3,561 | 3,534 | 3,808 | 3,967 | 3,947 |
| Aircraft Rent | 353 | 335 | 336 | 318 | 314 | 340 | 391 |
| Airport and Navigation Fees | 961 | 1,007 | 992 | 983 | 1,024 | 1,052 | 1,079 |
| Aircraft Maintenance, Materials and Supplies | 654 | 681 | 672 | 632 | 699 | 659 | 656 |
| Communications and Information Technology | 195 | 193 | 188 | 190 | 200 | 208 | 214 |
| Food, Beverages and Supplies | 279 | 278 | 291 | 289 | 307 | 322 | 333 |
| Depreciation, Amortization and Obsolescence | 801 | 728 | 669 | 548 | 504 | 497 | 502 |
| Sales and Distribution | 581 | 612 | 603 | 613 | 667 | 699 | 713 |
| Commissions | - | - | - | - | - | - | - |
| CPA Fees | 971 | 1,003 | 1,072 | 1,123 | 1,187 | 1,217 | 1,209 |
| Other | 1,194 | 1,230 | 1,305 | 1,338 | 1,457 | 1,543 | 1,586 |
| | 10,554 | 11,433 | 11,799 | 11,815 | 12,422 | 12,741 | 12,839 |
| EBIT | 232 | 179 | 315 | 567 | 824 | 907 | 1,068 |
| EBITDAR | 1,386 | 1,242 | 1,320 | 1,433 | 1,642 | 1,745 | 1,961 |
| EBITDA | 1,033 | 907 | 984 | 1,115 | 1,328 | 1,405 | 1,570 |
| Interest Income | 19 | 36 | 37 | 32 | 38 | 43 | 41 |
| Interest Expense | (397) | (320) | (304) | (397) | (361) | (418) | (381) |
| Interest Capitalized | - | - | 18 | 46 | 15 | - | - |
| Gain (Loss) on Sale of Assets | (1) | - | - | - | - | - | - |
| Gain (Loss) on Financial Instruments | (3) | (63) | (20) | 37 | 21 | - | - |
| Special Charges For Labor Restructuring | - | - | - | - | - | - | - |
| Foreign Exchange Gain (Loss) | 184 | (54) | 106 | (120) | (169) | 0 | 13 |
| Other Non-Operating Income (Expense) | (105) | (28) | (294) | (215) | (140) | (126) | (125) |
| One-time Items | 46 | - | 7 | (24) | 41 | - | - |
| | (257) | (429) | (450) | (641) | (556) | (501) | (452) |
| EBT | (25) | (250) | (135) | (74) | 268 | 406 | 616 |
| Income Taxes | 1 | 1 | (1) | 8 | - | - | - |
| Net Income | (24) | (249) | (136) | (66) | 268 | 406 | 616 |
| Basic EPS | (\$0.12) | (\$0.92) | (\$0.51) | \$0.02 | \$0.92 | \$1.41 | \$2.14 |
| Diluted EPS | (\$0.12) | (\$0.92) | (\$0.51) | \$0.02 | \$0.92 | \$1.41 | \$2.14 |
| Adjusted Diluted EPS | na | na | \$0.20 | \$1.21 | \$1.75 | \$1.85 | \$2.53 |
| Free Cash Flow | \$729 | \$329 | \$211 | (\$190) | (\$495) | (\$221) | (\$39) |
| Free Cash Flow per share | \$2.68 | \$1.18 | \$0.76 | (\$0.68) | (\$1.72) | (\$0.77) | (\$0.14) |
| ROIC | | | 6.6% | 10.5% | 11.7% | 11.4% | 12.2% |
| Growth | | | | | | | |
| Revenue | 11% | 8% | 4% | 2% | 7% | 3% | 2% |
| EBITDAR | 104.1% | (10.4%) | 6.3% | 8.6% | 14.6% | 6.3% | 12.4% |
| EBIT | (214%) | (23%) | 76% | 80% | 45% | 10% | 18% |
| Profitability | | | | | | | |
| EBITDAR Margin | 13% | 11% | 11% | 12% | 12% | 13% | 14% |
| EBIT Margin | 2.2% | 1.5% | 2.6% | 4.6% | 6.2% | 6.6% | 7.7% |
| Free Cash Flow Margin | 6.9% | 3.2% | 1.5% | -1.9% | -3.8% | 0.2% | 1.3% |
| Leverage | | | | | | | |
| Net Debt To Capitalization | 248% | (120%) | (110%) | 320% | 219% | 158% | 120% |
| Total Debt To Trailing EBITDA | 4.4x | 4.8x | 3.8x | 3.9x | 4.3x | 4.0x | 3.8x |
| Total Debt to Trailing EBITDAR | 5.2x | 5.6x | 4.7x | 4.6x | 5.0x | 4.7x | 4.6x |
| Operating Highlights | | | | | | | |
| Available Seat Miles (millions) | 63,497 | 66,460 | 67,272 | 68,575 | 73,589 | 77,357 | 80,317 |
| Growth | 7.0% | 4.7% | 1.2% | 1.9% | 7.3% | 5.1% | 3.8% |
| Fleet Size | 336 | 338 | 334 | 335 | 347 | 345 | 348 |
| Revenue Passenger Miles (millions) | 51,875 | 54,222 | 55,645 | 56,792 | 61,095 | 63,675 | 65,741 |
| Growth | 8.3% | 4.5% | 2.6% | 2.1% | 7.6% | 4.2% | 3.2% |
| Load Factor | 81.7% | 81.6% | 82.7% | 82.8% | 83.0% | 82.3% | 81.9% |
| Passenger Yield (cents) | 18.17 | 18.83 | 19.30 | 19.41 | 19.27 | 19.07 | 18.80 |
| Growth | 2.4% | 3.6% | 2.5% | 0.6% | (0.7%) | (1.0%) | (1.4%) |
| Operating Revenue Per ASM (RASM, cents) | 16.99 | 17.47 | 18.01 | 18.06 | 18.00 | 17.64 | 17.32 |
| Growth | 3.5% | 2.9% | 3.1% | 0.3% | (0.3%) | (2.0%) | (1.9%) |
| Operating Cost Per ASM (CASM, cents) | 16.62 | 17.20 | 17.54 | 17.23 | 16.88 | 16.47 | 15.99 |
| Operating Cost Per ASM (CASM ex-fuel, cents) | 12.44 | 12.12 | 12.25 | 12.08 | 11.71 | 11.34 | 11.07 |
| Growth | (4.5%) | (2.6%) | 1.0% | (1.4%) | (3.1%) | (3.1%) | (2.4%) |
| Operating Cost Per ASM (CASM ex-fuel, ACV, cents) | | | 11.77 | 11.60 | 11.19 | 10.80 | 10.51 |
| Growth | | | | (1.5%) | (3.5%) | (3.5%) | (2.7%) |
| Operating Margin per ASM (cents) | 0.37 | 0.27 | 0.47 | 0.83 | 1.12 | 1.17 | 1.33 |
| Assumptions | | | | | | | |
| US WTI Oil Price (\$US/bbl) | 78.00 | 95.00 | 95.00 | 97.00 | 101.00 | 96.00 | 91.00 |
| Jet fuel Refining Spread (\$US/bbl) | 10.00 | 28.00 | 33.00 | 28.00 | 23.00 | 25.00 | 27.00 |
| \$US/\$C Exchange Rate | 0.97 | 1.01 | 1.00 | 0.97 | 0.91 | 0.90 | 0.91 |
| Realized Jet fuel (Canadian cents per litre) | \$0.70 | \$0.86 | \$0.89 | \$0.89 | \$0.92 | \$0.92 | \$0.89 |

Source: Company reports, TD Securities Inc

WestJet Annual Financials

| \$ 000's, unless otherwise indicated | 2010 | 2011 | 2012 | 2013 | 2014E | 2015E | 2016E |
|--|------------|------------|------------|------------|------------|------------|------------|
| Operating Revenues | | | | | | | |
| Guest Revenues | 2,390,887 | 2,790,299 | 3,133,492 | 3,337,569 | 3,651,540 | 3,844,971 | 4,072,057 |
| Charter And Other | 216,407 | 281,241 | 293,917 | 324,628 | 386,314 | 445,043 | 503,236 |
| | 2,607,294 | 3,071,540 | 3,427,409 | 3,662,197 | 4,037,855 | 4,290,015 | 4,575,293 |
| Operating Expenses | | | | | | | |
| Aircraft Fuel | 674,608 | 915,878 | 992,787 | 1,039,448 | 1,148,858 | 1,196,697 | 1,229,346 |
| Airport Operations | 388,112 | 421,561 | 454,114 | 459,465 | 512,701 | 548,571 | 592,436 |
| Maintenance | 117,057 | 146,260 | 154,406 | 169,197 | 210,618 | 225,643 | 243,901 |
| Flight Operations and Navigational Charges | 325,582 | 344,442 | 366,871 | 410,052 | 451,213 | 474,087 | 507,156 |
| Depreciation and Amortization | 170,462 | 174,751 | 185,401 | 200,840 | 229,307 | 254,622 | 269,776 |
| Marketing, General and Administrative | 194,481 | 209,880 | 208,620 | 222,567 | 228,590 | 233,536 | 244,456 |
| Sales and Distribution | 255,732 | 273,364 | 313,082 | 356,988 | 376,600 | 393,524 | 418,160 |
| Aircraft Leasing | 143,381 | 165,571 | 173,412 | 175,646 | 183,783 | 174,137 | 167,083 |
| Inflight | 124,303 | 139,478 | 156,411 | 176,907 | 169,652 | 176,978 | 188,820 |
| Employee Profit Share | 22,222 | 23,804 | 46,585 | 51,577 | 54,922 | 80,083 | 105,495 |
| | 2,415,940 | 2,814,989 | 3,051,689 | 3,262,687 | 3,566,243 | 3,757,877 | 3,966,629 |
| EBIT | 191,354 | 256,551 | 375,720 | 399,510 | 471,612 | 532,138 | 608,664 |
| EBITDAR | 505,197 | 596,873 | 734,533 | 775,996 | 884,702 | 960,896 | 1,045,524 |
| EBITDA | 361,816 | 431,302 | 561,121 | 600,350 | 700,919 | 786,759 | 878,441 |
| Interest Income | 9,910 | 15,987 | 18,391 | 17,848 | 18,125 | 23,639 | 26,519 |
| Interest Expense | (70,914) | (60,911) | (48,900) | (43,447) | (47,624) | (56,123) | (52,334) |
| Gain (Loss) on Foreign Exchange | 2,579 | 3,350 | 1,061 | 1,136 | (970) | - | - |
| Gain (Loss) on Disposals and Unusual Items | 570 | (919) | 469 | (2,962) | (55,045) | - | - |
| Loss on Derivatives | (34) | (6,052) | (6,512) | - | - | - | - |
| | (57,889) | (48,545) | (35,491) | (27,425) | (85,514) | (32,483) | (25,815) |
| EBT | 133,465 | 208,006 | 340,229 | 372,085 | 386,098 | 499,654 | 582,849 |
| Income Taxes | | | | | | | |
| Current | 1,573 | 1,236 | 66,230 | 154,964 | 145,952 | 171,689 | 200,142 |
| Future | 41,695 | 58,068 | 31,607 | (51,601) | (27,940) | (31,745) | (37,005) |
| Income Taxes | 43,268 | 59,304 | 97,837 | 103,363 | 118,012 | 139,944 | 163,136 |
| Net Income | 90,197 | 148,702 | 242,392 | 268,722 | 268,086 | 359,710 | 419,713 |
| Basic EPS | | | | | | | |
| Basic EPS | \$0.62 | \$1.06 | \$1.79 | \$2.05 | \$2.32 | \$2.86 | \$3.33 |
| Diluted EPS | \$0.62 | \$1.06 | \$1.78 | \$2.03 | \$2.30 | \$2.86 | \$3.33 |
| Diluted EPS (ex-items) | \$0.64 | \$1.06 | \$1.78 | \$2.03 | \$2.50 | \$2.86 | \$3.33 |
| Free Cash Flow | | | | | | | |
| Free Cash Flow | 370,207 | 396,365 | 409,272 | (143,702) | 56,919 | 378,017 | 411,181 |
| Free Cash Flow per Share | \$2.54 | \$2.83 | \$3.01 | (\$1.09) | \$0.49 | \$3.01 | \$3.26 |
| ROIC | 8.1% | 10.1% | 13.7% | 13.9% | 14.2% | 14.5% | 15.4% |
| Growth | | | | | | | |
| Revenue | 14.3% | 17.8% | 11.6% | 6.9% | 10.3% | 6.2% | 6.6% |
| EBITDAR | 10.8% | 18.1% | 23.1% | 5.6% | 14.0% | 8.6% | 8.8% |
| EBIT | (9.1%) | 34.1% | 46.5% | 6.3% | 18.0% | 12.8% | 14.4% |
| Profitability | | | | | | | |
| EBITDAR Margin | 19.4% | 19.4% | 21.4% | 21.2% | 21.9% | 22.4% | 22.9% |
| EBIT Margin | 7.3% | 8.4% | 11.0% | 10.9% | 11.7% | 12.4% | 13.3% |
| Free Cash Flow Margin | 14.2% | 12.9% | 11.9% | (3.9%) | 1.4% | 8.8% | 9.0% |
| Leverage | | | | | | | |
| Net Debt To Capitalization | -14% | -81% | -96% | -38% | -25% | -45% | -68% |
| Total Debt To Trailing EBITDA | 2.8x | 1.6x | 1.3x | 1.5x | 1.8x | 1.6x | 1.4x |
| Total Debt To Trailing EBITDAR | 4.2x | 3.2x | 2.8x | 2.8x | 3.0x | 2.8x | 2.4x |
| Operating Highlights | | | | | | | |
| Available Seat Miles (ASM's, 000's): | 19,535,291 | 21,186,304 | 22,062,000 | 23,970,000 | 25,581,183 | 26,374,477 | 27,827,299 |
| Growth | 11.1% | 8.5% | 4.1% | 8.6% | 6.7% | 3.1% | 5.5% |
| Revenue Passenger Miles (RPM's, 000's) | 15,613,122 | 16,890,941 | 18,264,000 | 19,591,000 | 20,902,825 | 21,361,848 | 22,467,989 |
| Growth | 12.9% | 8.2% | 8.1% | 7.3% | 6.7% | 2.2% | 5.2% |
| Load Factor | 79.9% | 79.7% | 82.8% | 81.7% | 81.7% | 81.0% | 80.7% |
| Fleet Size | | | | | | | |
| Mainline | 91 | 97 | 100 | 105 | 107 | 112 | 115 |
| Regional | | | | 8 | 16 | 25 | 34 |
| Total | 91 | 97 | 100 | 113 | 123 | 137 | 149 |
| Passenger Yield (cents) | 15.31 | 16.52 | 17.16 | 17.04 | 17.47 | 18.00 | 18.12 |
| Growth | 2.5% | 7.9% | 3.9% | -0.7% | 2.5% | 3.0% | 0.7% |
| Operating Revenue Per ASM (RASM, Cents) | 13.35 | 14.50 | 15.54 | 15.28 | 15.78 | 16.27 | 16.44 |
| Growth | 3.0% | 8.6% | 7.2% | -1.7% | 3.3% | 3.0% | 1.1% |
| Operating Cost Per ASM (CASM, cents) | 12.37 | 13.29 | 13.83 | 13.61 | 13.94 | 14.25 | 14.25 |
| Operating Cost Per ASM, (CASM ex-fuel, ex-profit share, cents) | 8.80 | 8.85 | 9.12 | 9.06 | 9.24 | 9.41 | 9.46 |
| Growth | 1.3% | 0.6% | 3.0% | -0.7% | 1.9% | 1.9% | 0.5% |
| Operating Margin Per ASM (cents) | 0.98 | 1.21 | 1.70 | 1.67 | 1.84 | 2.02 | 2.19 |
| Assumptions | | | | | | | |
| US WTI oil price (\$US per bbl) | 78.00 | 95.00 | 95.00 | 97.00 | 101.00 | 96.00 | 91.00 |
| Jet fuel refining spread (US\$ per bbl) | 10.00 | 28.00 | 33.00 | 28.00 | 23.00 | 25.00 | 27.00 |
| US\$/Cdn\$ Exchange rate | 0.97 | 1.01 | 1.00 | 0.97 | 0.91 | 0.90 | 0.91 |
| Jet fuel (Canadian cents per litre) | \$0.57 | \$0.76 | \$0.80 | \$0.81 | \$0.85 | \$0.85 | \$0.82 |

Source: Company reports, TD Securities Inc.

Available Seat Mile (ASM): The Basic Measure of Capacity

- One seat (empty or filled) flying one mile is an ASM
- A 140-seat MD-80 flying a 500-mile segment creates 70,000 ASMs
- System ASMs are simply the sum of each of these individual segment calculations

Revenue Passenger Mile (RPM): The Basic Measure of Production

- A paying passenger flying one mile creates an RPM
- 100 passengers flying 500 miles generates 50,000 RPMs
- System RPMs are the sum of this calculation for each of the revenue segments we fly

Load Factor: Production Compared to Capacity

- To calculate system-wide load factor, divide RPMs by ASMs; in 2007 it's 138.5 billion RPMs divided by 169.9 billion ASMs, or 81.5 percent
- For an individual flight, divide the revenue passengers on board by the aircraft capacity; in the MD-80 example above, it is 100 divided by 140, or 71.4 percent
- High load factors are not necessarily desirable - How much each passenger pays is also important, as we see in the next measure

Yield: Revenue per Passenger Mile

- To calculate system yield, divide passenger revenue by total RPMs to calculate a customer's individual yield, divide ticket price by mileage; if a customer pays \$98.00 for the 500-mile segment above, the yield would be 19.6 cents per mile

Revenue per Available Seat Mile (R/ASM): The Best Basic Measure

- Multiply load factor times yield to get the measure of how much revenue we generate per increment of capacity; using the 2007 example above, it's 81.5 percent times 13.1 cents or 10.7 cents

Cost per Available Seat Mile (C/ASM): The Basic Measure Of Cost

- Unit costs represent how much it costs to fly one seat (empty or filled) one-mile. To calculate unit costs, divide total operating expenses by Total ASM capacity