Why Investing in Airlines Is a Lucrative Opportunity

Description

One of the best performing sectors of the economy has been quietly flying over our heads for the past few years with few realizing the incredible growth of the past few years.

Yes, I'm referring to the airline industry. Over the past five years, the industry has become more efficient, reined in costs, tacked on fees, and, thanks to lower fuel prices, increased revenues significantly.

Chief among those best performers are **Air Canada** (TSX:AC)(TSX:AC.B) **American Airlines Group Inc.** (NASDAQ:AAL), and **Delta Air Lines, Inc.** (NYSE:DAL).

How can airlines be performing so well?

Warren Buffett famously stated his distaste for airline investments over a decade ago: "The worst sort of business is one that grows rapidly, requires significant capital to engender the growth, and then earns little or no money. Think airlines."

Airlines are well known for their extreme cycles of growth and contraction. Replacing or upgrading a US$100 million plane is not a minor expense, and neither are the myriad of expenses involved in running an airline from the unionized gate agent to airport landing fees and fuel costs.

Fortunately, things have changed significantly in the past decade. Buffett's **Berkshire Hathaway Inc.** now owns over US$10 billion of airline stock between several of the largest airliners in the U.S.

There is no single reason why airlines are performing well; it's more a combination of factors. Among those is the bevy of fees introduced in the past decade that monetized every aspect of the flight. In the years following the 9/11 attacks, airlines were forced to remove full-service meals and replace them with pay-only service on most flights. This was cited as a cost-savings measure at the time, but demand has since recovered, and the pay-only service still exists on most airlines.

A similar structure was put in place to counter the hike in fuel prices nearly a decade ago. Fuel surcharges, fees for taking luggage, offering discounted fares in lieu of cabin luggage, and paying more for exit row seating are just some of the measures introduced by airlines over the past decade that remain in place today, despite airlines operating in a healthier environment.

Air Canada has soared approximately 60% in the past year and an incredible 1,400% in the past five years. Air Canada recently reported fiscal 2016 results, posting record EBITDAR of $2.768 billion, topping the previous record of $2.542 billion set in 2015.

A similar situation was observed at American Airlines. American Airlines posted a pre-tax profit of US$500 million, or US$289 million net profit, in the most recent quarter. The company also finished the fiscal year with US$4.6 billion in share repurchases and dividends and authorized an additional US$2 billion for the next fiscal year.

Delta posted net income of US$622 million, or US$0.84 per diluted share, for the most recent quarter. Delta also had a share-repurchase program in place with the airline repurchasing or distributing US$3.1 billion through dividends over the course of the fiscal year.

Are airlines good investments?

The well-known cycles that airlines go through are well documented. What makes this latest swing different, however, is the maturity with which airlines are reacting to the added revenue lining their pockets. Airlines are still upgrading planes and rebranding with new liveries, but they're doing so with a modest approach that keeps large amounts of cash on hand for the inevitable shift in the economy.

In some ways, airlines have moved past the growing pains of the past and have become a viable investment option, even for Warren Buffett.

CATEGORY

1. Investing

TICKERS GLOBAL

1. NASDAQ:AAL (American Airlines Group Inc.)
2. NYSE:DAL (Delta Air Lines, Inc.)
3. TSX:AC (Air Canada)

PARTNER-FEEDS

1. Msn
2. Newscred
3. Yahoo CA

Category

1. Investing

Date
2025/07/04
Date Created
2017/04/11
Author

dafxentiou