



Are Airlines Good Long-Term Investments?

Description

Most investors don't even realize that some of the best-performing stocks in the market right now are airlines. Traditionally viewed as some of the worst investments that anyone can make, airlines are in an extended period of growth that has them outperforming the market by a considerable margin.

Airlines as bad investments

Warren Buffett is famously known for his distaste for the airline industry; a decade ago he said, "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."

To some extent, that is still true. Airlines are very expensive businesses to operate that require highly specialized and trained sets of crew, pilots, and engineers in both the departing and arrival airports, as well as in the air. And then there's the cost and maintenance of the plane itself, which can cost \$100 million or more, as well as jet fuel costs and landing fees, to name just a few.

Up until the last decade, airlines operated in an extreme environment. Short periods of rapid, strong growth were followed by losses and cutbacks. When times were good, airlines spent money to buy new planes, paint new liveries, add new routes, and try to grow.

When times were not so good, the cuts were deep and painful; an external event, such as the 9/11 attacks, brought the entire industry to a screeching halt.

What changed?

Part of the improvements come down to the monetization of every aspect of a trip. Airline tickets used to include a host of benefits and amenities, but many of those no longer apply. Gone are the days of a free hot meal on a short flight; that's been replaced with cold sandwiches that can cost more than \$10.

Also gone are the days of checking multiple bags in for your flight for no charge — some airlines now charge as much as \$100 for each bag, which is an added cost on top of the much-increased ticket price.

That monetization applies to the operations side as well. Several years ago, airlines instituted what they said were “fuel surcharges” to the cost of the ticket that were to be used to offset the (at the time) higher price of fuel.

The fees all add up and are one of the key reasons that airlines are doing so well today. **Air Canada** ([TSX:AC](#))(TSX:AC.B) in particular is up 78% over the course of the past year, yet it still trades at fairly inexpensive levels, despite posting impressive results and investing significantly in growth.

WestJet Airlines Ltd. (TSX:WJA) is also up, appreciating over 45% in the past five years. WestJet recently announced plans to start an ultra-low-cost carrier network as well as the purchase of new wide-body aircraft poised to start operating on new international routes.

In short, both airlines are flying high right now and are priced at great levels.

Are airlines good investments for the long term?

The perception of airlines has changed considerably in recent years with even Warren Buffet ignoring his prior comments; **Berkshire Hathaway Inc.** invested a total of US\$10 billion in the largest airlines in the U.S.

You could say that the airline industry has matured considerably and is acting more conservatively to grow, taking a moderate approach towards expansion and fleet renewals, while keeping finances shored up for the inevitable slowdown cycle.

Until that time comes, airlines will remain one of the better investment opportunities in the market.

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