



Airline Investments: Has the Opportunity Passed?

Description

Historically, airlines have been regarded as some of the worst investments that can be made. Warren Buffett famously expressed his disdain for airline investments: “The worst sort of business is one that grows rapidly, requires significant capital to engender the growth, and then earns little or no money. Thank airlines.”

That doesn't sound like a very promising investment opportunity.

Airlines: good or bad investments?

The airline business has historically been known for extreme cycles of growth followed by extreme cycles of contraction.

Airlines also have much higher costs than other businesses. Costs include repair crews, unionized gate agents, pilots, flight crews, and not to mention the US\$100 million price tag on the plane itself.

During the extreme growth period, airlines have historically spent on upgrading aircraft, rolling out new livery, and adding routes to attract new customers. In short, it was an aggressive spending spree on a variety of initiatives.

The problem with this approach was that the extreme growth period didn't last long, and airlines were left with a long list of expenses to account for on less revenue.

How has the airline industry changed?

Industry experts see several important changes that have occurred in the past decade that have led to the airlines becoming great investment options.

Over the past decade, most of the top airlines in the U.S. as well as in Europe have been party to one or more mergers. US Airways was merged with **American Airlines Group Inc.** ([NASDAQ:AAL](#)). **Delta Air Lines, Inc.** ([NYSE:DAL](#)) acquired Northwest Airlines. Continental Airlines merged with United, forming **United Continental Holdings Inc.** (NYSE:UAL).

Thanks to these mergers, the surviving airlines have emerged stronger, with larger, more modern fleets, and they boast healthier networks.

Looking beyond the mergers, another significant change in the industry stems from the myriad of fees and surcharges that airlines have put on customers over the past decade.

Everything from paying for extra legroom space, traveling with additional (or, in some cases, any) checked luggage, early boarding access, and fuel surcharges are fees that were added because of specific temporary events, such as a spike in fuel prices; these fees remain in place today, contributing to the overall bottom line.

Perhaps one of the most significant changes worth noting is that the airline industry has matured. Airlines still add new routes to woo customers, but they are added in a conservative fashion that keeps costs in line.

Are airlines good investments?

Airlines have quietly become some of the best-performing stocks on the market. Over the course of the past year, American Airlines has appreciated by over 20%, and Delta has shot up over 440% in the past five years and offers a dividend with a yield of 2.57%. Over that same five-year period, United Continental has surged over 225%.

Despite this incredible growth, airlines remain relatively cheap, with P/E values under 10, fueled by a series of impressive quarterly results over the past few years.

Airlines have become such impressive investment opportunities that even Warren Buffett has moved past his prior comments, investing upwards of US\$10 billion in the airline industry.

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