



Warren Buffett Loses Big on Airlines: Should You Avoid Air Canada (TSX:AC)?

Description

Warren Buffett is synonymous with stock market [investing success](#). The billionaire, who is ranked as one of the world's greatest investors, has opposed investing in airlines for years. Nevertheless, by the end of 2019 two of his top-20 stock holdings were **Southwest Airlines** and **Delta Airlines** ([NYSE:DAL](#)).

Recently, Buffett sold large volumes of stock in both carriers, slashing his exposure to an increasingly troubled industry. Analysts are tipping that he will take a big hit on his airline investments. That sees many smaller investors questioning whether the stocks are a good investment.

Are airlines bad investments?

Airlines have been among the stocks hardest hit by the coronavirus pandemic and resulting economic fallout. Economic slumps are never good for airlines, because tourism and air travel is typically seen as non-essential by consumers. During difficult economic times, when consumers as well as businesses are tightening their belts, airline earnings decline.

Buffett's decision to invest in airlines was surprising. For years he vocally eschewed investing in the industry. In 2013, Buffett called the airline business a "death trap" for investors.

A long history of bankruptcies, thin margins, and earnings volatility highlight why he had such a negative view of the industry. The vulnerability of airlines to external events like the coronavirus pandemic magnifies the risks associated with investing in the business.

Airlines suffer losses

Since the start of 2020, Southwest has lost 43% while Delta's stock plunged by a whopping 63%. Canada's flag carrier **Air Canada** ([TSX:AC](#))(TSX:AC.B) has performed worse, plummeting by 69%.

Buffett's foray into the airlines appears to have been a costly mistake. Pundits estimate that Warren

Buffett's **Berkshire Hathaway** took a US\$5 billion hit on its airline investments. Late last week Buffett sold roughly US\$390 million of Southwest and Delta stock, causing both airlines to fall further.

This left many investors questioning the value of airlines as investments. The COVID-19 pandemic is hammering the industry. Unlike earlier downturns, the impact on airlines is being magnified by government travel restrictions, border closures, social distancing requirements, and the shutdown of tourism across the world.

One U.S. airline executive says no one will be flying for at least one or two months. There is speculation that another round of bankruptcies will rock the industry over the next year.

Delta is deep in debt

I have never been a fan of investing in airlines. The industry's considerable competition and volatility make it highly unappealing.

Delta appears to be particularly vulnerable in the current, harsh environment. It finished 2019 with US\$29 billion in non-current liabilities, including a massive US\$9 billion in long-term debt and US\$8 billion in pension liabilities.

To survive, Delta has significantly reduced international and domestic capacity, ceased hiring, cut capital expenditures, as well as pension payments, and parked a large portion of its fleet. Delta recently secured a US\$2.6 billion credit facility, which will provide the additional capital needed to survive the latest slump. It will, however, burden Delta's already heavily levered balance sheet with further debt that will need to be serviced and ultimately repaid.

These reasons, coupled with the considerable uncertainty which remains, means I think Buffett made the right decision to substantially reduce exposure to Delta.

Is Air Canada different?

Despite the unattractiveness of airlines at this time, Air Canada [appears appealing](#) with the risk/reward equation skewed in favour of investors. It has implemented a range of measures to weather the growing uncertainty impacting airlines. These include grounding its fleet, furloughing a considerable proportion of its staff, and boosting liquidity through a \$1 billion credit facility.

Air Canada also possesses several advantages over other airlines, including Delta. It is Canada's national flag carrier, which means it will receive support from Ottawa during the current crisis, including a bailout if required. Air Canada is also subject to less competition, meaning it will recover from the current crisis faster than many of its international peers.

The airline finished 2019 sitting on almost \$6 billion in cash and short-term investments. This along with relatively low debt and an additional \$1 billion credit facility positions Air Canada to emerge from the harsh operating environment in reasonably good shape.

I think that Air Canada, while being a speculative contrarian play, will rally once the pandemic and economic fallout subsides.

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