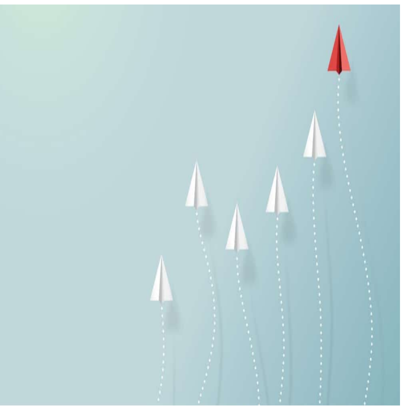

Airline Stocks Abandoned by Buffett

Description

Airline stocks have been pummelled by the coronavirus pandemic. Even Warren Buffett sold his stake in the four major U.S. carriers and admitted he made a mistake. Airlines stocks dipped sharply after Buffett offloaded his entire holding of **Delta Airlines**, **American Airlines**, **Southwest Airlines** and **United Airline**. **Air Canada** (TSX:AC), despite not being a Buffett investment, was also dragged down.

Buffett's foray into airlines caught many investors by surprise. The Oracle of Omaha had long derided the industry, even describing it as a death-trap for investors. Buffett's sale may have contributed to Berkshire Hathaway's US$50 billion loss for the three months to March 2020.

Challenging operating environment for airlines

After disclosing the sale, Buffett said, “The world has changed for the airlines.” He was referring to the impact of the coronavirus and how the pandemic has effectively shut down the global travel and tourism industry.

The CEO of Air Canada recently stated that it may take up to three years for airline travel volumes to return to something resembling pre-coronavirus levels. This will have a sharp impact on many airlines, especially those with high debt and costs.

Weaker airline earnings

The profound impact of the coronavirus on airlines has already been reflected in their first-quarter 2020 results. Delta, the largest U.S. carrier by revenue, has shed 62% since the start of 2020. It reported a first-quarter US$534 million loss. Delta has loaded up on debt, boosting its liquidity to survive the crisis. Since early March it has raised US$5.4 billion in capital and drew down US$3 billion under existing credit facilities.

Delta is focused on slashing costs and has reduced capital expenditures by US$3 billion. This is being driven by sharp flight reductions. Delta has cut domestic capacity by 80% and international by 90%.

Substantially weaker oil prices will also aid Delta and other airlines, considerably reducing fuel costs, which is one of the most significant expenses faced by airlines.

While Delta will certainly emerge from the current crisis the tremendous amount of debt that it took on will weigh on its financial performance for some time to come. Delta also operates in a hotly contested U.S. market, meaning it faces considerable competition. That with a substantial debt load and considerable financing costs will weigh on Delta’s profitability.

Buy Air Canada?

Air Canada, which has lost 70%, announced a $1 billion first-quarter loss. That highlights the significant impact of the coronavirus crisis on the national carrier.

By the end of the first quarter, Air Canada’s debt had ballooned by 20% compared to the end of 2019, to a whopping $9 billion. While that may appear to be a worrying number, Air Canada finished the period with $6.1 billion in cash and short-term investments. In April 2020, the carrier bolstered its liquidity further, arranging around $1.6 billion in financing.

Air Canada’s second-quarter 2020 numbers will be worse, because it will be the first reporting period where the full impact of the coronavirus pandemic will be felt.

Canada's flag carrier has introduced a range of initiatives to slash expenses. These include cutting second-quarter capacity by 85%–90%, furloughing employees, reducing executive remuneration and slashing spending.

Foolish takeaway

Quality airline stocks like Delta and Air Canada will emerge from the pandemic and go on to deliver value for shareholders. While now is not the time to bet the house on airline stocks, Air Canada presents a compelling speculative option where the risk/reward equation is in favour of investors.

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