



## Was Buffett Right in Selling Airline Stocks?

### Description

Warren Buffett is the most famous value investor whose investing ideas are followed by many. On Friday, U.S. President Donald Trump stated that Buffett had made a mistake by exiting his position in the big four U.S. airlines. Trump's statement came as many airline stocks jumped on positive U.S. employment data and an uptick in travel demand.

Stocks of **American Airlines**, **United Airlines**, and **Delta Airlines** jumped 11.18%, 8.45%, and 5.5%, respectively. Even **Air Canada** ([TSX:AC](#)) stock rose 4.48%. One bump in airline stocks doesn't mean that Buffett's decision in airline stocks was a mistake. Although the billionaire investor has made mistakes in the past, exiting airline stocks wasn't one of them.

## Airline jobs are still hanging on the cliff

The U.S. Labor Department [reported](#) an unexpected rise of 2.5 million jobs in May. None of these jobs came from air transportation. Instead, the sector saw 50,000 more job losses in May, following 79,000 in April.

Most U.S. airlines have barred themselves from cutting jobs only because the \$50 billion government bailout refrains them from doing so until September 30. Once the government money is exhausted, most airlines will shrink their fleet size and workforce to cut costs.

Cowen analyst Helane Becker believes that U.S. airlines could retire 800-1,000 aircraft and cut 95,000-105,000 jobs. The number of job cuts will depend on the recovery of travel demand this summer and airlines' liquidity against their debt.

Unlike U.S. airlines, however, Air Canada did not receive any government bailout. Moreover, it has \$4.2 billion in net debt, which encouraged the company to reduce its workforce by 60% and raise around \$1.6 billion through shares and convertible bonds.

## Airlines are burning cash despite an uptick in travel demand

U.S. airlines are seeing an increase in domestic travel because of the pent-up demand during the lockdown and the reopening of states. Compared to last year's capacity, American Airlines is planning to operate at 30% and 40% capacity in June and July. United Airlines is expecting to operate at 30% of its domestic capacity in July, up from 23% in June.

As airlines spend 80-90% of their revenue on operating expenses, they need to fill at least 70-80% of their seats to breakeven. Even before the pandemic, AC spent 90% of its revenue on operating expenses. A drop in flights in March pushed it into a net loss of \$1 billion in the first quarter. It will have to operate in full capacity and fill all its seats for several consecutive months to break even.

Airlines make money from business travelers taking long-haul international flights. The demand is dry in that segment, and is unlikely to return anytime soon. In the meantime, airlines will continue to burn cash on domestic flights. But this cash burn would be lower than what they were losing when the planes were grounded.

## Why did Buffett sell his airlines stocks?

In April, Buffett exited the airline industry by selling US\$6 billion worth of stocks in the big four U.S. airlines. He was worried about the uncertainty the COVID-19 pandemic created in air travel demand. It is unclear when air travel will return to the pre-pandemic level. During this period of uncertainty, airlines are left with too many planes and a huge debt load.

Moreover, airlines will have to repay a portion of [the government bailout](#) in the long-term through interests and equity warrants. When the government exercises these warrants, it will dilute equity shareholders'

## Buffett's action reflects his learning from the past mistake

Airline stocks are reacting to short-term positives, but the long-term outlook is bleak. Buffett has learned from his past mistake that "If you get in a lousy business, get out of it." Back in 1964, he invested in textile company **Berkshire Hathaway**, which continued to close mills and repurchase shares from the proceeds.

Buffett did not sell his shares as he did not get the desired price. The result was 25% of his capital was stuck in a loss-making company, which he held for another 20 years hoping for a recovery. He later admitted that if he had cashed out and invested that money in the insurance company, Berkshire's net worth would have been twice that what it is today.

Don't rush to buy AC stocks on short-term jumps. The overall industry is still in deep red with little visibility of the future.

### CATEGORY

1. Coronavirus

2. Investing

## TICKERS GLOBAL

1. TSX:AC (Air Canada)

## PARTNER-FEEDS

1. Business Insider
2. Msn
3. Newscred
4. Sharewise
5. Yahoo CA

## Category

1. Coronavirus
2. Investing

## Date

2025/08/16

## Date Created

2020/06/08

## Author

pujatayal

default watermark

default watermark