



Warren Buffett Is Wrong! Airlines Will Bounce Back

Description

All signs seem to indicate that Warren Buffett has abandoned the airline industry. He recently sold his investments in America's four largest airlines at a steep loss. Buffett's abrupt change of heart served as a red flag for Canada's airline industry as well. **Air Canada** ([TSX:AC](#)), for example, has lost 27.5% of its value since June.

I have nothing but respect for the Oracle of Omaha. After all, you don't become one of the wealthiest investors on the planet without being right more often than you're wrong. However, on this decision, I disagree with him. Here are three reasons I believe Buffett made a mistake and why airlines like Air Canada could rebound in the years ahead.

Evidence

Air Canada has cut several routes this year. This decision was driven by a collapse in domestic air travel demand and border restrictions that have stymied international travel. In other words, barely anyone is flying right now.

However, the number of domestic air passengers has slowly bounced back from its March-April lows. As the number of coronavirus cases subside across the country, people are traveling to domestic destinations for summer vacations.

International travel is also gradually opening up, with several countries in the European Union and Asia accepting Canadian tourists this year. Japan, Iceland, and Greece are even subsidizing foreign visitors.

Meanwhile, domestic air travel in the U.S. has more than doubled from 87,000 in April to over 200,000 in May, 2020. That could indicate that the worst is over for the airlines.

Valuation

While borders were being shut, and the economy was being locked down, Air Canada was restructuring its operations to lower costs and boost cash. The company has raised \$1.6 billion by

offering new shares and raising debt funding in June. Meanwhile, the airline has sold 79 planes, laid off 20,000 employees, and announced a cost-savings initiative of \$1 billion.

The stock now trades at a price-to-book value ratio of 2.5 and a price-to-sales ratio of 0.36. In other words, the company has bolstered its business, but the stock price still reflects the worst-case scenario. Air Canada seems to have enough cash to survive for years, as air travel gradually recovers and the world mitigates the virus's impact.

Warren Buffett's thesis

To be fair, Buffett's investment strategy has always focused on predictability. In his letter to shareholders, he says there were too many unknown variables to make a bet on airlines with conviction. There could be a second wave of infections, a vaccine could take longer than expected, or airlines could face losses due to extended periods of physical distancing.

However, all these risks seem to have been priced into Air Canada's stock price. This means the downside for investors is limited, even if the worst-case scenario plays out. However, the [stock could rebound sharply](#) if there's any positive catalyst on the horizon. This risk/reward ratio makes Air Canada an ideal bet for any investor with an appetite for risk.

Bottom line

Warren Buffett's fire sale of airline stocks serves as a red flag for the industry. But Air Canada stock seems to have priced in the worst-case scenario. Investors should take another look.

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Date

2025/09/14

Date Created

2020/08/13

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