



Here's What Warren Buffett Meant by "The World has Changed for Airlines"

Description

Back in April, the Oracle of Omaha said that "the world has changed for airlines" when he exited his \$6 billion position in four U.S. airlines. After six months, as the world returns to the COVID-19 economy, airplanes remain empty. Most airlines are seeing domestic travel return, mostly from leisure travelers. But business travel remains low. The primary reason for low business travel is the 14-day quarantine requirement.

Air travel in the COVID-19 economy

The world for airlines changed because they were the reason why COVID-19 became a global pandemic. The coronavirus started in China. The rising volume of international flights carried people infected by the virus across the globe. When the World Health Organization declared COVID-19 a pandemic, airlines refused to take passengers who showed symptoms like fever and cough.

The governments worldwide closed borders for nonessential travel. This restriction grounded more than 90% of major airlines' capacity. While people were not flying, the cargo was. The rise of e-commerce in the wake of lockdown surged demand for air cargo.

Passenger airlines versus air cargo

Passenger airlines like **Air Canada** ([TSX:AC](#)) converted some of their passenger planes into cargo planes by ripping off the seats. AC's revenue from cargo surged 52% while its revenue from passengers fell 95% year-over-year in the [second quarter](#). But as the company earns over 90% of its revenue from passengers, this trade-off between passengers and cargo had little impact. Its revenue fell 89% YoY to \$527 million.

One company that prospered in the pandemic is **Cargojet** (TSXLCJT), which provides time-sensitive, premium, overnight packages through its fleet of 26 aircraft. This air cargo company saw a significant surge in transit volumes of e-commerce. It also saw a surge in transit of personal protective equipment and other medical supplies from Asia to Canada.

Generally, passenger flights also transit cargo. But the sudden cancellation of passenger flights diverted their cargo customers to Cargojet. In the second quarter, Cargojet reported its highest quarterly revenue growth of 65% in five years.

The contrasting impact of the pandemic on passenger and cargo planes was visible in their stock price. AC stock fell 67% while Cargojet stock rose 82.5% year to date.

Passenger airlines face a greater risk

The problem with

AC has introduced several measures to make air travel safe again. To rebuild consumer's confidence in air travel, AC has opened voluntary COVID-19 testing booths and is offering a complimentary medical and quarantine insurance for COVID-19. AC has also changed the basis of calculating reward points from the distance traveled to airfare.

But these efforts will take years to materialize into profits

What Warren Buffett says about airlines?

Warren Buffett was never in favour of airlines before 2016 when he first purchased airline stocks. In his 1992 letter to Berkshire shareholders, he said, "Investors have regularly poured money into the domestic airline business to finance profitless (or worse) growth." He was right as most airlines have undergone bankruptcy and mergers. They went into the red during the September 2001 attack, the 2002 SARS epidemic, and the 2009 financial crisis.

However, with mega-mergers and significant restructuring, most airlines became profitable again and delivered stable cash flows for a decade. Looking at the major airlines' balance sheets, shareholder returns, and the increasing number of people flying more frequently, he invested in their stocks. But once again the industry witnessed its worst crisis in history where things were beyond the control of the CEOs.

Even if airlines have become financially stronger, the magnitude of the crisis has also increased. The [next three years](#) will determine which airline weather and which gets caught in the financial storm.

I would prefer the Buffett's route of staying away from a risky business and instead invest in companies that show growth in the future.

CATEGORY

1. Coronavirus
2. Investing

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1. TSX:AC (Air Canada)
2. TSX:CJT (Cargojet Inc.)

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Author

pujatayal

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