



Was Warren Buffett Too Hasty in Selling Airline Stocks?

Description

Airline stocks came crashing down in March when the pandemic grounded more than 90% of their capacity. Warren Buffett didn't think twice and sold US\$6 billion worth of airline stocks in April. At that time, he [said](#), "the world has changed for airlines." Buffett is a celebrated value investor who made his fortune from the stock market. Many retail investors follow him. Hence, when airline stocks surged in November on COVID-19 vaccine news, a question emerged.

Was Buffett too hasty in selling airline stocks?

Airlines have a history of going bankrupt during crises, because of their high operating cost (80-90% of their revenue). If they are not flying, they are making losses. In the 9-11 attack, the SARS epidemic, and the 2009 financial crisis, many airlines went bankrupt. Hence, when the industry witnessed its worst crisis to date, Buffett exited his position in airlines.

Airline fundamentals don't attract value investors like Buffett

Buffett's investing style is identifying value stocks that have strong fundamentals and opportunities to generate cash flows in the long term. But these stocks are not valued to their potential. He prefers buying stocks that he would want to hold for 10 years. Looking at Buffett's investing style, he made no mistake in selling airline stocks.

Buffett held stakes in the top four U.S. airlines: **American Airlines**, **Delta Airlines**, **United Airlines**, and **Southwest Airlines** ([NYSE:LUV](#)). The first three airlines reported more than US\$5 billion in losses in the first nine months. Even after making severe cost cuts, they are burning US\$25 million daily.

To sustain these losses, they are piling up debt to alarming levels. Their net debt is in the range of US\$12-US\$24 billion. And this is the scenario while they are getting a government bailout.

A company's fundamentals include various metrics related to its revenue, expenses, profits, and cash flow. A company that is earning just 20% of its revenue capacity and taking debt to meet its operating expenses paints a bleak future with no profit or a few years. This only spells bankruptcy risk where shareholders lose.

The only North American airlines that are better off than others are Southwest and **Air Canada** ([TSX:AC](#)). They have contained their net loss at US\$3 billion and \$3.5 billion, respectively. Southwest even has a net cash position of \$3.2 billion, which shows it has sufficient cash to service debt. Southwest is among the very few airlines that survived all the past crisis [without reporting a loss](#). Air Canada has a net debt of almost \$5 billion. These fundamentals didn't attract Buffett, and hence he exited.

How to invest in airline stocks

But airline stocks have surged significantly between 22% and 50% in November. This rally is not backed by fundamentals but sentiments around the COVID-19 vaccine. When investors' excitement fades, the fundamentals will take over, and the stock price will see some correction. Hence, the airline stock price rally is not sustainable, unless there are signs of profits.

If you still want to get exposure to airline stocks, I would suggest you place your bet on those that have the lowest debt and loss. Those airlines have a higher probability of averting bankruptcy. Southwest Airlines and AC are comparatively better off to handle the current crisis.

Investor corner

I would not suggest investing in airlines, because the future is still vague and difficult to forecast. But you can buy AC and Southwest stocks when they see a correction or sustain their current price for a month. When a stock is on a path to recovery, it tends to grow faster than its normal course of growth, as it is recouping the losses. This is not a stock price rally I would suggest jumping on, because there is no clear sight that air travel demand, especially business travel, will return for the next two to three years.

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1. Coronavirus
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