

# Buffett and airlines \$BRK \$DAL \$UAL \$LUV

Over the weekend, Berkshire filed a filed forms that showed them blowing out of their positions in Southwest and Delta. It was a pretty surprising move: Berkshire had been buying pretty aggressively as recently as a month ago, Buffett had been singing the airlines praises pretty consistently for the past few years, and Buffett had to know that blowing out of his stake would have some negative consequences (the stocks would take a hit as traders tried to front run him unloading the rest of his stake, the CEOs of those companies probably won't be returning his calls in the near future, and I'm sure he was sensitive to further shaking confidence in the travel industry at a time like this). I saw plenty of "hot takes" on the sale (some anger that he sold, some mocking him that he invested in the first place, etc.). My reaction was a little different (likely colored by my recent experience with AER), so I wanted to share it. My thought on Buffett selling the airlines: dude's still got it.

A quick point before we start: no one knows why Buffett sold the airlines except for Buffett. He could be teeing up a deal to buy out United (which he owns ~9% of as of last filing; he's not required to report buys or sells on them yet. I'd guess he sold, but who knows?) tomorrow, and he needed to sell the stakes in the other airlines to avoid antitrust issues. That feels crazy unlikely, but it is possible. Still, Occam's razor probably works here: Buffett bought the airlines because he thought they represented a good risk / reward, and he sold the airlines because he no longer thought that was the case. (If you wanted to go even crazier, you could paint a picture where a ton of Berkshire's businesses are stalling + it turns out their insurance opp was exposed to a ton of pandemic risk, so Berkshire needs the liquidity and that's why they're

selling. That's almost certainly conspiracy theory levels of crazy; I don't think Berkshire insurance had any extreme pandemic exposure, and it's unlikely that they'd only be selling airlines if they needed liquidity)

Ok, great. Let's turn to why Buffett bought the airlines. I think the investment case was pretty simple: domestic airlines were a mature business with light barriers to entry (mainly driven by government regulation, but union labor and the supply of planes being controlled by a duopoly also helped). Airlines had seemingly gotten religion on capital allocation, and in a world where aggregating consumers was increasingly difficult (but profitable if you can do it!), airlines rewards programs and consumer access were becoming increasingly valuable and had interesting optionality. The airlines were also reasonably priced (most traded for high single digit / low double digit multiples) in a market where most large / mega caps (the only field Berkshire can play in!) looked pretty expensive. I think you could paint a reasonable scenario where Buffett was buying the equity stakes not just as a good investment today, but also with an eye towards acquiring an airline in a recession (similar to how he bought BNSF). There'd be loose synergies across his portfolio (off the top of my head, the insurance companies could be interesting with an airline's pension plans plus financing aircraft, Precision Cast Parts might pick up some share, etc.), though I don't think he'd factor that into the purchase. Instead, I think the driving force behind a potential acquisition would be cheap valuation if you looked across a cycle and (assuming the price was right) it just feels like buying an airline would have fit well into the persona / legacy he was trying to build (buy american; I am! Planes and trains!).

So that's why he bought the airlines. Let's turn to why he sold.

The airline industry is a disaster today. Disaster honestly

doesn't describe it; Buffett's been investing for ~70 years, and the airline and travel industry environment today is orders of magnitude worse than it's ever been over that time. It's really tough to put it into words how awful the environment is. The TSA travel data is a nice start (it shows travelers down ~95% YoY), but my personal favorite is this: on March 10th, United came out with a "dire" forecast scenario that called for the industry to be down 70% in April if things got really bad. They suggested the forecast was "too aggressive." Many people (me included!) thought the forecast was intentionally awful just to stress how resilient they could be in the short term.... Well, three weeks later, the Delta CEO letter showing them burning \$60m a day showed an environment that was significantly worse than United's dire forecast.

Personally, when thinking about AER, I thought the worst type of scenario would be something like 9/11; something bad happens, traffic is cut in ~half for a quarter or so, and then traffic gradually recovers. I never imagined a scenario like today's (well, I imagined it, I just didn't think it could feasibly happen): global traffic basically ground to halt for ~half a year, with substantial demand destruction likely to last for another year after that. Buffett is way better than thinking about downsides than me (or basically anyone), but I'm guessing his investment in the airlines shows that even he didn't think demand destruction on this level was possible (or maybe he did and just thought it was a risk worth taking, though his buys in late February suggest otherwise to me).

A lesser investor than Buffett would probably look at the investment in the airlines and think "I own a lot of these companies, and the market is super negative on them right now. I'll just wait for the market to get a little more positive. Besides, if I sold now, I'd crush the market given how much I own." I've certainly been guilty of that type of thinking in the past. Buffett is having none of that: he saw an investment

that was in an environment way worse than he ever forecasted and that there was a chance his capital would get impaired further than it already had been. He cut bait quick. Note here that it probably helps that the whole market is way down: if Corona had played out in a way that only airlines were distressed, Buffett may not have sold. But the market is trading in a way that multiple sectors are in distress. So not only does selling the airlines protect Berkshire from a further loss of capital; it actually raises capital to redeploy into other stressed situations. Yes, those situations might not have quite the same upside as airlines today, but they likely come with significantly less downside and a much easier path to realizing value.

Anyway, that's my take on Buffett selling the airlines. I'm sure it was a hard choice, but the man is a legend and, on a risk adjusted / opportunity cost basis, I bet he made the right decision here.

Four more things while I'm here:

1. The current operating environment for airlines is a disaster, but the short term headwinds aren't the only issue facing them. There's going to be a huge oversupply of planes for years coming out of this, there's going to be a bunch of out of work air workers, and there are going to be a bunch of unused gates / travel routes given the decrease in demand. You know what that sounds like a great environment for? Starting a new airline with a clean balance sheet to compete. The thesis on airlines for the past few years was "merged into a rational oligopoly that won't go into price wars again." An industry with massive overcapacity is ripe for price wars and / or upstarts with clean balance sheets.
2. A sneaky part of the airline industry has been the Boeing / Airbus duopoly kept the supply picture a little tilted towards a plane shortage. That was probably good for the whole industry. Coming out of this, there's

likely to be a huge plane oversupply, and some of the most powerful suppliers around may be in a bit of distress (I'm thinking of Boeing here obviously). When a super powerful supplier enters distress, it can have strange knock on effects that can reshape an industry. A simple example: what if Boeing and their suppliers decided a specific plane line was unprofitable, and they instantly stopped producing it / dramatically stopped supporting it? You could imagine any airline heavy on that type of plane suddenly sees their value demolished. I'm not saying that's likely or even possible; I'm just saying that the whole industry has had stability from Boeing / Airbus for decades and there's a chance that underlying foundation is ripped out or severely altered in the near future, and when foundations are unexpectedly demolished it often has unpredictable consequences for everyone touching the foundation.

3. I'm also not saying the airlines can't trade up from here. They absolutely could! But when the whole industry is asking for government bailouts and saying they'll run out of cash in a few months without one, it's probably a sign the whole industry is on the verge of collapse and equity value is likely to be scarce.
4. When whole industries need bailouts, funny things can happen. Particularly in politically sensitive industries with defense ramifications and union workers. I'm thinking here in particular of the GM bailout where unions got paid ahead of creditors, but I'm sure there were plenty of others. Equity is the easiest to screw over in these situations (and probably should be zeroed), but I'd be hesitant to be any type of creditor in an industry that needs massive government bailouts across the board.