The Airline Industry Ascended to New Records in 2014
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Just as the U.S. economy is in full-recovery mode, so too is the airline industry. It’s lately made an impressive about-face from only a decade ago and, in 2014, soared to several new benchmarks.

This industry is flying high again.

In 2014, a record 98 million passengers flew to foreign destinations on U.S. carriers. Meanwhile, 662 million traveled domestically by air, the highest number since 2007.

According to the U.S. Department of Transportation, the percentage of seats filled in 2014 climbed to 83.4 percent—another fresh record.

This year, the daily number of available seats for international-bound flights out of the U.S. will rise to an all-time high of over 350,000. That’s 20,000 more seats per day than were available just last year.
And the success stories just keep on coming. Air travel in March and April is typically strong, but this season is expected to be the strongest since before the recession.

I often travel through Houston, and it’s a good case study to illustrate the boom in air travel demand, domestic as well as international. In 2014, the city’s two main airports, the 46-year-old George Bush Intercontinental Airport—it was renamed in 1997—and William P. Hobby Airport, both broke passenger
traffic records that had been set in the previous year. Intercontinental saw an increase of 9.2 percent in international travelers and 3.6 percent in domestic fliers, while Hobby’s total traffic for the year rose to 11.9 million passengers—an all-time high for the fifth straight year.

All told, over 53 million people from around the globe passed through these two Houston airports. And yes, you guessed it—that’s another new record.

**Waxing Wanderlust**

Some of the key factors driving this unprecedented air travel demand are an expanding U.S. economy, rising personal incomes and the highest consumer confidence level since before the recession.

**U.S. Consumer Confidence at Pre-Recession Levels**

*University of Michigan Consumer Sentiment Index*

In a recent poll, the travel website TripAdvisor surveyed 44,000 people around the world on a number of travel-related issues. Of the Americans who participated, 67 percent reported that they were planning an international trip for leisure, up from 50 percent last year.

TripAdvisor also wanted to find out where participants had been in the last 12 months, where they planned on going in the next 12 months and what their dream destination was. Although Australia topped the list of ideal vacation spots, followed closely by the U.S., less than 5 percent said they had actually made the trip down under.

On the other hand, about 20 percent of respondents, or close to 8,800 people, said they had visited the U.S. in the last year, while the same percentage of people said they would likely travel to the U.S. in the coming months.
Air travel between the U.S. and China is expected to increase now that multi-entry visas for citizens of both countries have been extended from one year to 10 years. International flights out of China have already been trending steadily upwards for years, a result of a growing middle class. The visa policy revision should help ramp up Chinese outbound air travel even more.
As I pointed out last month, Chinese travelers are the world’s highest spenders while on vacation. The average Chinese visitor spends between $6,000 and $7,200 per trip to the U.S. The visa revision is welcome news not only for airlines such as Air China, which we own in our China Region Fund (UXCOX), but also hotels, restaurants, car rental companies and others in the travel and leisure services industry.

It should also be a tailwind to luxury retailers that are increasingly setting up shop in international airports.

**The “Sixth Continent” and Luxury Shopping**

For the first time in 2013, more than one billion people traveled internationally, prompting luxury brand executives to name this cohort “the sixth continent.” With there being such a huge surge in captive consumers, we are entering a golden age of luxury shopping opportunities in airports that might very well supplant tacky souvenir shops and cell phone accessory kiosks. In many airports around the globe, you’re now just as likely to pass by a Coach—which we own in our All American Equity Fund (GBTFX)—or a Tiffany & Co.—held in our Gold and Precious Metals Fund (USERX)—as you are a Cinnabon.

According to retail consultancy firm Verdict Retail, sales in airport gift shops are expected to grow 73 percent between 2013 and 2019, at which point the entire global market will be worth an astounding $59 billion. Leading the way are beauty products and alcohol, as shoppers seek to avoid value-added taxes and duties.
Paris-based advertising firm JCDecaux, after conducting a study of people’s airport spending habits in eight countries, found that the three most frequently purchased types of merchandise were fashion items, cosmetics & high-end fragrances and general accessories. This is a clear sign that luxury shopping while travelers await their connecting flights is becoming more of the norm rather than the exception.

**Focusing on Shareholders**

It’s easy to forget that between 2005 and 2008, about 70 percent of the U.S. airline industry was operating under Chapter 11 bankruptcy protection, including leaders such as Delta Air Lines, which we hold in our Holmes Macro Trends Fund (MEGAX). The industry’s recent recovery is in lockstep with many other once-struggling industries that were forced to consolidate and restructure their businesses following the 2007-2008 financial crisis.

How things have changed since then. As I pointed out last month, airlines posted some of their best earnings ever last year. Many are now turning their attention toward making investors happy by paying dividends, boosting earnings per share and buying back their stock. According to SEC filings, 10 U.S. airlines—including Delta and Alaska Air, which we also own in MEGAX—are collectively paying down massive amounts of debt.

![U.S. Airlines Tackling the Mountain of Debt](image)

*Source: Airlines for America, U.S. Global Investors*

A recent Goldman Sachs equity research report finds that “U.S. airline stocks are trading at comparatively attractive valuations relative to the S&P 500. The discount is 48 percent.” It adds: “Not only are the U.S. airlines generating more growth, we expect their cash returns on cash invested...
(CROCI) to improve the most in 2015,” compared to previous years.

It will be challenging indeed for the industry to meet these expectations. Last year, after all, was “unusually strong,” according to management consultancy firm Oliver Wyman. But airlines have so far charted a very promising course.

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