Sohaib Ali Idea Generation Project: United Airlines Holdings (NYSE: UAL)

United Airlines is the third largest airline in the United States holding a market share of 15.9% of all domestic airfare. United has a very strong network of both domestic and international destinations through its vast hub and spoke business model. United's strategic placement of its hubs within the U.S. allows the airline to serve more domestic destinations than any other domestic carrier. United has established hubs in every region of the U.S such as Chicago (ORD), Denver (DEN), Houston (IAH), Los Angeles (LAX), Newark (EWR), San Francisco (SFO), and Washington, DC (IAD). The hubs are the basis for the domestic network as United outsources its regional flights to commuter airlines operating under the "United Express" brand which essentially connects smaller airports to United hubs that serve extensive destinations. Similar to the competitive advantage in its domestic travel, United serves more international destinations than any other United States airline.

The domestic airline sector is concentrated heavily by 4 companies, United, American, Delta, and Southwest and it is not expected to grow because there are high barriers to entry. The most significant moat United Airlines possesses is its network effects created by its strategic hub and spoke model. The only potential competition major airlines faced in recent years was the rise of regional budget airlines, however, United has been able to mitigate this by offering cheaper flights through a variety of methods. United sells basic economy tickets at discounted fares through practices such as disallowing free carry-on bags, making seats smaller, and charging change fees. United also keeps costs low by outsourcing much of its overhead such as ground handling, customer service, aircraft maintenance, IT, and regional flight operations to third parties which allows the company to focus on its core business of selling airfare.

United Airlines has anchored its operating strategy based on two fundamental principles which are putting customers first and keeping costs low. The company can provide a quality service to its customers at an economical price by generating revenue through high-margin ancillary fees such as checked bags, priority boarding, confirmed seat selection, and upgrades. These fees allow for the company to generate high profit margins to offset its low fares as these services cost the airline little to none to provide in comparison to the price customers pay. Furthermore, the airline generates significant revenue through its international codeshare agreements within Star Alliance by selling tickets for flights not operated by United. As discussed above outsourcing is also a main driver in United's ability to keep fares low.

These business strategies have translated into revenue as displayed on its financial statements. In quarter 3 of 2023, United generated $10.4 billion in revenue which is 27% higher than the same quarter in 2022 strongly because the company saw an increase in passenger traffic by 29%. The company generated $900 million in profit in Q3 2023 which is up 135% from Q3 2022 due to a reduction of overhead through outsourcing labor. The company stated that is it continuing to reduce costs going into the next quarter.

Potential Mispricing

The market is not factoring in United's exemplary financial performance as the stock is down over 20% within the last 6 months. Short investors have a thesis that the company will lose

profit due to rising fuel costs, and potential recession. However, the strategic cost-cutting strategy offsets the increase in the price of input fuel, and the recession argument has been consistently made while the company has proven that air travel has increased regardless of inflation. United is trading at a significantly low price-to-earnings ratio being 4.24, a strong indicator that the market is undervaluing the stock and isn't considering the financial performance. Investors are overreacting to temporary news events rather than the company itself, this is displayed best by the fact that the stock fell to a 12-month low because the airline suspended flights to Israel despite beating earnings. The fall is unjustified as Israel is a minuscule destination that has a negligible effect on United's international travel segment. United generates 68% of its revenue from domestic flights alone and the other 32% from international travel and when that segment is broken down the demand for Israel is low. Suspending these flights keeps costs down for United allowing for the company to focus on more lucrative destinations. The 6-month price chart is attached below which displays the market's failure to recognize United's strong business.

