

Southwest Airlines(LUV)

\$54.84 (As of 01/02/20)

Price Target (6-12 Months): **\$58.00**

Long Term: 6-12 Months

Zacks Recommendation:

Neutral

(Since: 04/03/19)

Prior Recommendation: Underperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

4-Sell

Zacks Style Scores:

VGM:B

Value: B

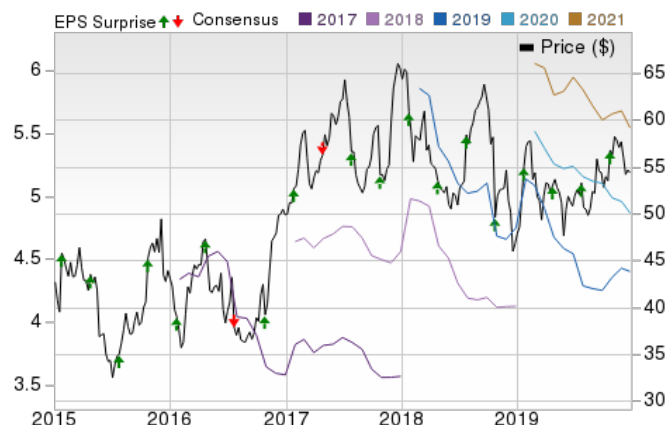
Growth: B

Momentum: D

Summary

We are appreciative of Southwest Airlines' efforts to reward its shareholders through dividends and buybacks. In 2018, the company rewarded \$2.3 billion to its shareholders. Continuing with its pro-investor approach, the carrier's board increased its quarterly dividend by 12.5% and cleared a new buyback program in May 2019. Passenger-revenue growth despite the MAX groundings is an added positive. Declining fuel costs also support bottom-line growth. Owing to these tailwinds, shares of Southwest Airlines have outperformed its industry in a year's time. However, non-fuel unit costs are rising due to the MAX groundings and might limit bottom-line growth. Fuel-efficiency is also being hampered with the company's most fuel-efficient aircraft remaining grounded. The carrier expects the jets to remain grounded through Apr 13, 2020.

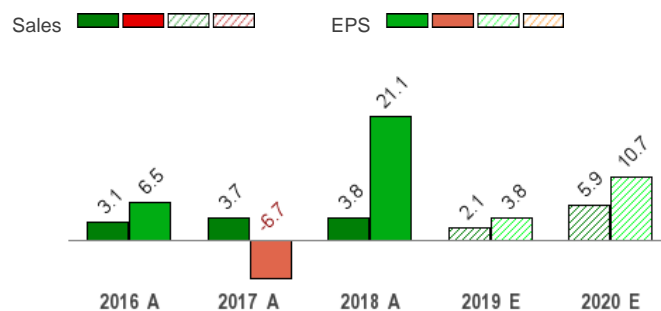
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$58.77 - \$45.99
20 Day Average Volume (sh)	3,283,377
Market Cap	\$28.9 B
YTD Price Change	1.6%
Beta	1.40
Dividend / Div Yld	\$0.72 / 1.3%
Industry	Transportation - Airline
Zacks Industry Rank	Top 28% (72 out of 253)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	12.8%
Last Sales Surprise	-0.1%
EPS F1 Est- 4 week change	-1.2%
Expected Report Date	01/23/2020
Earnings ESP	-6.6%
P/E TTM	12.3
P/E F1	11.3
PEG F1	1.2
P/S TTM	1.3

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2020	5,251 E	6,175 E	6,041 E	6,149 E	23,746 E
2019	5,149 A	5,909 A	5,639 A	5,723 E	22,421 E
2018	4,944 A	5,742 A	5,575 A	5,704 A	21,965 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2020	\$0.64 E	\$1.46 E	\$1.29 E	\$1.36 E	\$4.87 E
2019	\$0.70 A	\$1.37 A	\$1.23 A	\$1.11 E	\$4.40 E
2018	\$0.75 A	\$1.26 A	\$1.08 A	\$1.17 A	\$4.24 A

*Quarterly figures may not add up to annual.

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 01/02/2020. The reports text is as of 01/03/2020.

Overview

Based in Dallas, TX, Southwest Airlines is a passenger airline that provides scheduled air transportation in the United States and 'ten near-international' markets. The company, incorporated in Texas in 1967, commenced operations on Jun 18, 1971, with three Boeing 737 jets serving the cities of Dallas, Houston and San Antonio.

Per the U.S. Department of Transportation's latest available data, Southwest Airlines has emerged as the largest domestic air carrier (measured in terms of the number of domestic originating passengers boarded) in the United States. During 2018, the carrier commenced operating flights from Indianapolis, San Jose, Sacramento, Columbus, New Orleans, Pittsburgh, and Raleigh-Durham.

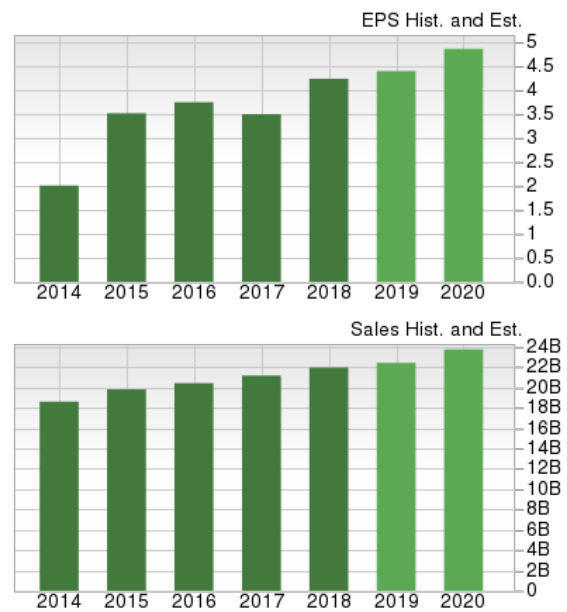
Additionally, during 2018, the carrier started shipping cargo to international destinations like Mexico City, Cancun, Cabo San Lucas/Los Cabos, Puerto Vallarta, Montego Bay, and San Jose, Costa Rica.

The company is constantly looking to modernize its fleet. At 2018-end, Southwest Airlines operated 750 Boeing 737 jets, offering services to 99 destinations spanning across 40 states, the District of Columbia, the Commonwealth of Puerto Rico and near-international countries such as Mexico, Jamaica, The Bahamas, Aruba, Dominican Republic, Costa Rica, Belize, Cuba, the Cayman Islands, and Turks and Caicos. As part of its expansion efforts, Southwest Airlines has started operating flights to Hawaii from March 2019.

Southwest Airlines provides short-haul, high frequency, point-to-point and low-fare services. The company's point-to-point route structure includes services to and from many secondary or downtown airports such as Dallas Love Field, Houston Hobby, Chicago Midway, Baltimore-Washington International and Ft. Lauderdale-Hollywood. In fact, roughly 77% of the carrier's passengers flew nonstop during 2018. The carrier served 704 non-stop city pairs as of Dec 31, 2018.

The company also offers long-haul nonstop service between markets like Oakland and Orlando, Los Angeles and Nashville, Las Vegas and Orlando, San Diego and Baltimore, Houston and New York LaGuardia, Los Angeles and Tampa, Oakland and Baltimore, San Diego and Newark.

Passenger revenues account for the bulk (93.1% in 2018) of the top line at Southwest Airlines. Freight revenues accounted for 0.8% and the remaining came from other sources.



Reasons To Buy:

▲ High passenger revenues have been aiding Southwest Airlines' top line. Notably, passenger revenues increased 2.1% year over year in the first nine months of 2019. Passenger revenues are likely to be strong, going forward, as well. The carrier's employee-friendly approach is impressive as well. To this end, it paid \$544 million to its employees as part of the company's 2018 profit-sharing plan. In December 2019, Southwest Airlines inked a deal with Boeing for partial compensation for losses due to the grounding of the 737 MAX jets in its fleet. The carrier aims to share part of the compensation with its workers under its profit sharing scheme, again reflecting its employee-friendly approach.

▲ Despite the MAX groundings, the company's operating revenue per available seat mile (RASM: a key measure of unit revenues) guidance for fourth-quarter 2019 is praiseworthy. RASM is expected to have increased up to 2% year over year in the December-end quarter. Detailed results will be out on Jan 23, 2020. Additionally, with fuel prices at modest levels, the carrier expects economic fuel costs to have been in the range of \$2.05-\$2.15 per gallon. The company reported fuel price per gallon of \$2.25 in the fourth quarter of 2018. The lower costs should support the bottom line as fuel comprises a major chunk of airline expenditures.

▲ We are appreciative of the company's efforts to enhance its shareholders' wealth through dividends and share buybacks. During 2018, the company returned \$2.3 billion to its shareholders through buybacks (\$2 billion) and dividends (\$332 million). Continuing with its shareholder-friendly approach, the company returned \$1.8 billion to its shareholders through buybacks (\$1.45 billion) and dividends (\$372 million) during the first nine months of 2019. In fact, Southwest Airlines hiked its quarterly dividend by 12.5% to 18 cents per share in May. Additionally, the company's board of directors approved a new share buyback program worth \$2 billion. Robust free cash flow generation (\$3.1 billion in 2018 and \$2.4 billion in the first nine months of 2019) is a major positive in this regard and will lead to an uptick in shareholder-friendly activities.

We are appreciative of the company's efforts to enhance its shareholders' wealth through dividends and share buybacks.

Reasons To Sell:

- ▼ Southwest Airlines has the largest exposure to Boeing 737 MAX jets among U.S. carriers with 34 such jets in its fleet. All such jets have remained grounded since March 2019 after being involved in two fatal air crashes in different parts of the world over a span of five months apparently due to software malfunctioning. Thanks to the groundings, operating income of Southwest Airlines in the first nine months of 2019 was hurt to the tune of \$435 million approximately. Southwest Airlines expects the jets to remain grounded through Apr 13, 2020.
- ▼ Amid the MAX groundings, non-fuel unit costs are rising due to lower capacity, which in turn, are likely to bottom-line growth going forward. Notably, cost per available seat miles (CASM) excluding fuel and oil expense and profitsharing expense is estimated to have increased 4-6% year over year in the fourth quarter of 2019. Moreover, with the carrier's most fuel-efficient aircraft being grounded, fuel efficiency is estimated to have dipped 1-2% in fourth-quarter 2019.
- ▼ During the first nine months of 2019, traffic dipped 1.5% while capacity decreased 1.8%. Moreover, Southwest Airlines expects 2019 capacity to have slipped 1.5% due to delays in the Boeing 737 MAX aircraft's return to service. The groundings have also caused the carrier to adjust plans pertaining to its fleet. For instance, the carrier deferred the retirement of seven of its owned 737-700 aircraft.

Rising non-fuel unit costs are likely to hamper results going forward.

Last Earnings Report

Earnings Beat at Southwest Airlines in Q3

Southwest Airlines delivered third-quarter 2019 earnings per share of \$1.23, beating the Zacks Consensus Estimate of \$1.09. Moreover, the bottom line improved 13.9% year over year despite higher costs from the MAX groundings.

Meanwhile, operating revenues of \$5,639 million lagged the Zacks Consensus Estimate of \$5,642 million. However, the top line rose 1.2% year over year. Passenger revenues accounting for bulk (92.7%) of the top line inched up 0.7% year over year.

Quarter Ending **09/2019**

Report Date	Oct 24, 2019
Sales Surprise	-0.05%
EPS Surprise	12.84%
Quarterly EPS	1.23
Annual EPS (TTM)	4.47

Operating Statistics

Airline traffic, measured in revenue passenger miles, dipped 3.3% year over year to 32.9 billion in the quarter under review. Also, capacity or available seat miles (ASMs) slipped 2.9% to 39.38 billion. Load factor (percentage of seats filled by passengers) came in at 83.5%, down 40 basis points on a year-over-year basis as traffic decline was more than the capacity contraction.

Passenger revenue per available seat mile (PRASM: a key measure of unit revenues) increased 3.8% to 13.28 cents. Moreover, in the reported quarter, revenue per available seat mile (RASM) rose 4.2% year over year to 14.32 cents owing to 4.1% increase in passenger revenue yield.

Operating Expenses & Income

In the third quarter, operating income (excluding special items) totaled \$819 million compared with \$796 million in the year-earlier period. The Boeing 737 MAX 8 grounding affected operating income to the tune of \$210 million in the period and \$435 million in the first nine months of 2019. The company expects the adversity to persist in 2020. Further, total adjusted operating expenses (excluding profit sharing, fuel and oil expense plus special items) climbed 4.3% year over year. The increase in costs was due to the groundings and the resultant lower capacity during the quarter.

Fuel price per gallon (inclusive of fuel tax: economic) was down 8% year over year to \$2.07. However, with the company's most fuel-efficient aircraft being grounded, its fuel efficiency slid 0.9% in the third quarter. Additionally, consolidated unit cost or cost per available seat mile (CASM) excluding fuel, oil and special items increased 7.5% year over year to 9.47 cents. The Boeing 737 MAX groundings pushed up costs.

Liquidity

The company had cash and cash equivalents of \$2,488 million at the end of the third quarter compared with \$1,854 million at the end of 2018. As of Sep 30, 2019, the company had a long-term debt (less current maturities) of \$2,398 million compared with \$2,771 million at 2018 end.

While the carrier generated a free cash flow of \$2.4 billion during the first nine months of 2019, it returned \$1.8 billion to its shareholders through \$372 million in dividends and \$1.45 billion via share repurchases.

Q4 & 2019 Outlook

Southwest Airlines anticipates RASM to either remain flat year over year or ascend up to 2%. With the removal of the MAX aircraft from its fourth-quarter flight schedule, the carrier's peak travel period is being hampered due to fleet deficit. Economic fuel costs are envisioned in the range of \$2.05-\$2.15 per gallon.

Fuel efficiency is estimated to slid 1-2% in the fourth quarter. Moreover, CASM — excluding fuel and oil expense and profit-sharing expense — is estimated to augment 4-6% in the ongoing quarter, primarily due to lower capacity from the MAX groundings. Effective tax rate is predicted to be approximately 23% in the quarter.

ASMs are expected to dip 0.5-1% year over year in the fourth quarter. The same for 2019 is estimated to slip approximately 1.5% (previous estimate: fall between 1% and 2%).

Due to delivery delays of the MAX aircraft, Southwest now anticipates capital expenditures between \$1.1 billion and \$1.2 billion in 2019 compared with \$1.2-\$1.3 billion guided previously.

Recent News

737 MAX Grounding Period Extended — Dec 17, 2019

Southwest Airlines extended the grounding period of the Boeing 737 MAX jets in its fleet by more than a month. Southwest Airlines expects the jets to remain grounded through Apr 13, 2020, as opposed to Mar 6, expected earlier. With the extension of the grounding period, Southwest Airlines expects fourth-quarter available seat miles (a measure of capacity) to decrease approximately 1% year over year compared with its previous expectation of a decline between 0.5 and 1%.

Valuation

Southwest Airlines shares are up 14.6% over the trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Transportation sector are up 13.4% and 18.1% in the past year, respectively. Over the past year, the S&P 500 Index has gained 27.4%.

The stock is currently trading at 6.84X trailing 12-month Enterprise Value to EBITDA, which compares to 6.67X for the Zacks sub-industry, 7.97X for the Zacks sector and 12.01X for the S&P 500 index.

Over the past five years, the stock has traded as high as 12.64X and as low as 4.12X, with a 5-year median of 6.97X. Our Neutral recommendation indicates that the stock will perform in-line with the market. Our \$58 price target reflects 13.17X forward 12-month earnings.

The table below shows summary valuation data for LUV

Valuation Multiples - LUV					
		Stock	Sub-Industry	Sector	S&P 500
EV/EBITDA TTM	Current	6.84	6.67	7.97	12.01
	5-Year High	12.64	7.36	11.13	12.86
	5-Year Low	4.12	4.31	6.06	8.49
	5-Year Median	6.97	6.06	7.43	10.66
P/E F12M	Current	12.45	9.34	13.05	19.07
	5-Year High	18.55	12.3	17	19.34
	5-Year Low	8.07	6.85	10.46	15.17
	5-Year Median	11.2	9.08	13.13	17.44
P/S F12M	Current	1.29	0.74	1.13	3.46
	5-Year High	1.86	0.98	1.44	3.46
	5-Year Low	1.06	0.63	1.02	2.54
	5-Year Median	1.34	0.79	1.24	3

As of 01/02/2020

Industry Analysis Zacks Industry Rank: Top 28% (72 out of 253)



Top Peers

Allegiant Travel Company (ALGT)	Neutral
Alaska Air Group, Inc. (ALK)	Neutral
Delta Air Lines, Inc. (DAL)	Neutral
Hawaiian Holdings, Inc. (HA)	Neutral
JetBlue Airways Corporation (JBLU)	Neutral
Spirit Airlines, Inc. (SAVE)	Neutral
United Airlines Holdings Inc (UAL)	Neutral
Controladora Vuela Compania de Aviacion, S.A.B. de C.V. (VLRS)	Neutral

Industry Comparison Industry: Transportation - Airline				Industry Peers		
	LUV Neutral	X Industry	S&P 500	HA Neutral	JBLU Neutral	SAVE Neutral
VGM Score	B	-	-	A	A	C
Market Cap	28.86 B	5.15 B	23.76 B	1.36 B	5.45 B	2.78 B
# of Analysts	12	3.5	13	5	8	8
Dividend Yield	1.31%	0.00%	1.78%	1.64%	0.00%	0.00%
Value Score	B	-	-	A	A	A
Cash/Price	0.14	0.24	0.04	0.54	0.18	0.37
EV/EBITDA	6.38	6.41	13.97	3.71	8.23	9.96
PEG Ratio	1.15	0.69	2.02	NA	0.48	NA
Price/Book (P/B)	2.97	1.28	3.38	1.28	1.14	1.28
Price/Cash Flow (P/CF)	8.48	5.80	13.70	3.44	5.89	5.70
P/E (F1)	11.05	9.67	18.83	7.66	8.01	8.25
Price/Sales (P/S)	1.29	0.68	2.68	0.48	0.68	0.75
Earnings Yield	8.88%	10.34%	5.30%	13.07%	12.49%	12.13%
Debt/Equity	0.36	0.89	0.72	1.09	0.43	1.32
Cash Flow (\$/share)	6.47	3.88	6.94	8.50	3.21	7.13
Growth Score	B	-	-	B	B	F
Hist. EPS Growth (3-5 yrs)	10.60%	3.40%	10.56%	24.25%	5.01%	3.40%
Proj. EPS Growth (F1/F0)	10.56%	12.62%	7.41%	-16.17%	23.09%	1.36%
Curr. Cash Flow Growth	9.35%	4.80%	14.83%	-0.12%	-4.51%	28.39%
Hist. Cash Flow Growth (3-5 yrs)	16.81%	9.94%	9.00%	24.94%	15.59%	18.42%
Current Ratio	0.65	0.68	1.23	0.87	0.53	1.33
Debt/Capital	26.52%	47.00%	42.92%	52.10%	30.18%	56.96%
Net Margin	10.90%	6.10%	11.08%	7.30%	7.19%	9.29%
Return on Equity	24.71%	15.38%	17.10%	22.23%	12.03%	17.52%
Sales/Assets	0.85	0.67	0.55	0.76	0.73	0.60
Proj. Sales Growth (F1/F0)	5.91%	4.90%	4.20%	4.07%	7.50%	14.90%
Momentum Score	D	-	-	B	D	C
Daily Price Chg	1.59%	0.91%	0.33%	-0.20%	0.91%	0.84%
1 Week Price Chg	-0.57%	-0.01%	0.13%	-1.52%	-1.67%	-1.91%
4 Week Price Chg	-1.24%	2.83%	3.31%	-0.75%	-1.31%	6.78%
12 Week Price Chg	2.18%	7.27%	9.70%	5.49%	11.81%	19.59%
52 Week Price Chg	20.24%	13.32%	30.28%	14.22%	18.58%	-24.67%
20 Day Average Volume	3,283,377	86,836	1,603,615	447,846	3,291,676	958,555
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
(F1) EPS Est 4 week change	-1.22%	0.00%	0.00%	0.00%	-0.79%	0.38%
(F1) EPS Est 12 week change	-4.36%	0.00%	-0.57%	7.14%	4.08%	-2.12%
(Q1) EPS Est Mthly Chg	-4.78%	0.00%	0.00%	0.00%	-2.22%	4.95%

Zacks Stock Rating System

We offer two rating systems that take into account investors' holding horizons: Zacks Rank and Zacks Recommendation. Each provides valuable insights into the future profitability of the stock and can be used separately or in combination with each other depending on your investment style.

Zacks Recommendation

The Zacks Recommendation aims to predict performance over the next 6 to 12 months. The foundation for the quantitatively determined Zacks Recommendation is trends in the company's estimate revisions and earnings outlook. The Zacks Recommendation is broken down into 3 Levels; Outperform, Neutral and Underperform. Unlike many Wall Street firms, we have an excellent balance between the number of Outperform and Neutral recommendations. Our team of 70 analysts are fully versed in the benefits of earnings estimate revisions and how that is harnessed through the Zacks quantitative rating system. But we have given our analysts the ability to override the Zacks Recommendation for the 1200 stocks that they follow. The reason for the analyst over-rides is that there are often factors such as valuation, industry conditions and management effectiveness that a trained investment professional can spot better than a quantitative model.

Zacks Rank

The Zacks Rank is our short-term rating system that is most effective over the one- to three-month holding horizon. The underlying driver for the quantitatively-determined Zacks Rank is the same as the Zacks Recommendation, and reflects trends in earnings estimate revisions.

Zacks Style Scores

The Zacks Style Score is as a complementary indicator to the Zacks rating system, giving investors a way to focus on the highest rated stocks that best fit their own stock picking preferences.

Academic research has proven that stocks with the best Value, Growth and Momentum characteristics outperform the market. The Zacks Style Scores rate stocks on each of these individual styles and assigns a rating of A, B, C, D and F. We also produce the VGM Score (V for Value, G for Growth and M for Momentum), which combines the weighted average of the individual Style Scores into one score. This is perfectly suited for those who want their stocks to have the best scores across the board.

Value Score	B
Growth Score	B
Momentum Score	D
VGM Score	B

As an investor, you want to buy stocks with the highest probability of success. That means buying stocks with a Zacks Recommendation of Outperform, which also has a Style Score of an A or a B.

Disclosures

This report contains independent commentary to be used for informational purposes only. The analysts contributing to this report do not hold any shares of this stock. The analysts contributing to this report do not serve on the board of the company that issued this stock. The EPS and revenue forecasts are the Zacks Consensus estimates, unless indicated otherwise on the reports first page. Additionally, the analysts contributing to this report certify that the views expressed herein accurately reflect the analysts personal views as to the subject securities and issuers. ZIR certifies that no part of the analysts compensation was, is, or will be, directly or indirectly, related to the specific recommendation or views expressed by the analyst in the report.

Additional information on the securities mentioned in this report is available upon request. This report is based on data obtained from sources we believe to be reliable, but is not guaranteed as to accuracy and does not purport to be complete. Any opinions expressed herein are subject to change.

ZIR is not an investment advisor and the report should not be construed as advice designed to meet the particular investment needs of any investor. Prior to making any investment decision, you are advised to consult with your broker, investment advisor, or other appropriate tax or financial professional to determine the suitability of any investment. This report and others like it are published regularly and not in response to episodic market activity or events affecting the securities industry.

This report is not to be construed as an offer or the solicitation of an offer to buy or sell the securities herein mentioned. ZIR or its officers, employees or customers may have a position long or short in the securities mentioned and buy or sell the securities from time to time. ZIR is not a broker-dealer. ZIR may enter into arms-length agreements with broker-dealers to provide this research to their clients. Zacks and its staff are not involved in investment banking activities for the stock issuer covered in this report.

ZIR uses the following rating system for the securities it covers. **Outperform-** ZIR expects that the subject company will outperform the broader U.S. equities markets over the next six to twelve months. **Neutral-** ZIR expects that the company will perform in line with the broader U.S. equities markets over the next six to twelve months. **Underperform-** ZIR expects the company will underperform the broader U.S. equities markets over the next six to twelve months.

No part of this report can be reprinted, republished or transmitted electronically without the prior written authorization of ZIR.