

Southwest Airlines(LUV)

\$32.77 (As of 04/07/20)

Price Target (6-12 Months): **\$28.00**

Long Term: 6-12 Months

Zacks Recommendation: Underperform

(Since: 04/06/20)

Prior Recommendation: Neutral

Short Term: 1-3 Months

Zacks Rank: (1-5)

5-Strong Sell

Zacks Style Scores:

VGM:D

Value: C

Growth: D

Momentum: C

Summary

Shares of Southwest Airlines have plunged more than 40% since the beginning of February due to the drop in air-travel demand in the wake of the coronavirus outbreak. Thanks to the coronavirus-induced decline in air-travel demand, the carrier issued a bearish unit revenue view for first-quarter 2020. Also, it aims to reduce capacity by more than 40% effective May 3 through Jun 5. Notably, the pandemic is an added headwind to the company, which is already bearing high non-fuel unit costs due to the prolonged grounding of the 34 Boeing 737 MAX jets in its fleet. The negativity surrounding the stock can be gauged from the Zacks Consensus Estimate for current-year earnings having moved south over the past 60 days. However, low fuel prices are expected to partly mitigate the adversity and aid the bottom line in turn.

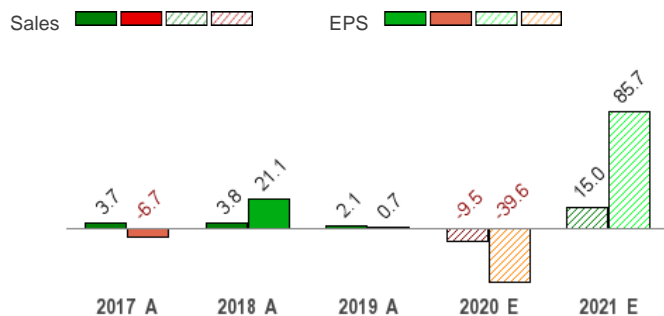
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$58.83 - \$29.15
20 Day Average Volume (sh)	11,776,207
Market Cap	\$17.0 B
YTD Price Change	-39.3%
Beta	1.63
Dividend / Div Yld	\$0.72 / 2.2%
Industry	Transportation - Airline
Zacks Industry Rank	Bottom 12% (222 out of 253)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	-11.7%
Last Sales Surprise	0.2%
EPS F1 Est- 4 week change	-42.9%
Expected Report Date	04/23/2020
Earnings ESP	-100.0%

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	5,397 E	6,215 E	6,053 E	6,150 E	23,330 E
2020	5,011 E	4,609 E	5,058 E	5,612 E	20,289 E
2019	5,149 A	5,909 A	5,639 A	5,729 A	22,428 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	\$0.74 E	\$1.57 E	\$1.36 E	\$1.33 E	\$4.79 E
2020	\$0.27 E	\$0.56 E	\$0.78 E	\$1.22 E	\$2.58 E
2019	\$0.70 A	\$1.37 A	\$1.23 A	\$0.98 A	\$4.27 A

*Quarterly figures may not add up to annual.

P/E TTM	7.7
P/E F1	12.7
PEG F1	1.3
P/S TTM	0.8

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 04/07/2020. The reports text is as of 04/08/2020.

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.

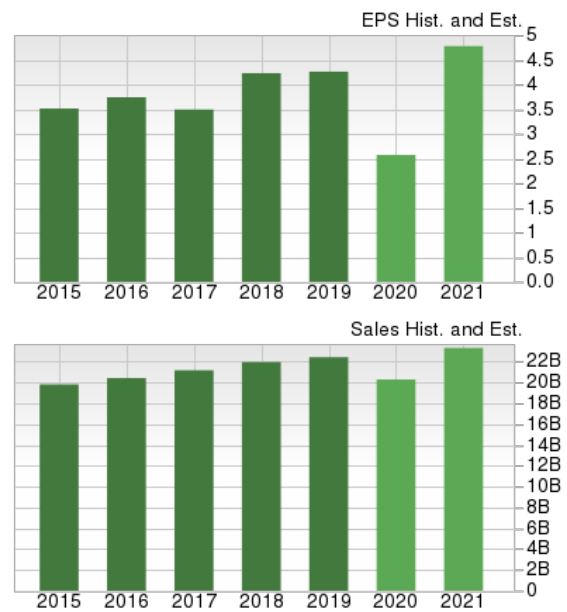
Additionally, during 2018, the carrier started shipping cargo to international destinations like Mexico City, Cancun, Cabo San Lucas/Los Cabos, Puerto Vallarta, Montego Bay, and San Jose, Costa Rica.

The company is constantly looking to modernize its fleet. At 2019-end, Southwest Airlines had 747 Boeing 737 jets in its fleet. The carrier used its fleet to serve 101 destinations in 40 states, the District of Columbia, the Commonwealth of Puerto Rico, and ten near-international countries: 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 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 2019. The carrier served 720 non-stop city pairs as of Dec 31, 2019.

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 (92.6% in 2019) of the top line at Southwest Airlines. Freight revenues accounted for 0.8% and the remaining came from other sources.



Reasons To Sell:

- ▼ Southwest Airlines, like most other carriers, is witnessing a significant drop in passenger bookings due to the coronavirus outbreak. The carrier recently issued a bearish view on revenue per available seat miles (RASM: a key measure of unit revenues) for first-quarter 2020 (detailed results will be available on Apr 23). The carrier now expects first-quarter RASM to either dip 2% or increase up to 1% from the year-ago figure. The company had earlier anticipated a RASM increase in the 3.5-5.5% range for the March quarter. Notably, the company witnessed upbeat passenger bookings in January and February (the first two months of the quarter). However, recently, demand declined significantly coupled with an increase in trip cancellations. Notably, first-quarter operating revenues are expected to decline between \$200 and \$300 million.
 - ▼ The negativity surrounding the stock is evident from the Zacks Consensus Estimate for current-year earnings being revised downward over the past 60 days. Particularly, due to coronavirus-induced low demand, shares of the company have slumped more than 40% since the beginning of February. With the crisis showing no signs of fading, the stock price may depreciate further, dampening investor confidence in the stock.
 - ▼ 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, 2019 operating income of Southwest Airlines was hurt to the tune of \$828 million. Southwest Airlines expects the jets to remain grounded through early August.
 - ▼ The groundings have also caused the carrier to adjust plans pertaining to its fleet. Prior to the MAX groundings, the company planned to take delivery of 44 MAX jets (37 MAX 8s and seven MAX 7s). Moreover, it expected to retire 18 Boeing 737-700 jets. This would have resulted in carrier's fleet size being 776 at the end of 2019. However, due to the groundings, Southwest Airlines took delivery of only three MAX 8 planes and retired only six Boeing 737-700 jets. As a result of the deficit, the fleet size was only 747 jets at the end of 2019. While, five retirements have been shifted to first-half 2020, the carrier deferred the retirement of the other seven 737-700 jets. The coronavirus outbreak might hurt its fleet-modernization plans further.
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The coronavirus outbreak has resulted in a sharp drop in passenger bookings.

Risks

- With passenger revenues dropping due to the coronavirus-induced decline in air-travel demand, the carrier announced in April that it will be offering cargo-only flights for the first time in its history. The cargo flights will be offered on a charter basis with only the likes of pilots and other crew members, on board. The airline will carry the freight in the bellies of its Boeing 737 aircraft. With passenger demand plummeting, the cargo-only operations should help Southwest recoup a bit of the lost revenues.
 - Southwest Airlines' employee-friendly approach is impressive. Also, 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.
 - Declining fuel costs are an added positive. Fuel price per gallon (inclusive of fuel tax: economic) was down 5% year over year to \$2.09 in 2019. With oil prices falling, fuel costs are likely to decline further. This should support bottom-line growth.
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Last Earnings Report

Earnings Miss at Southwest Airlines in Q4

Southwest Airlines' earnings per share of 98 cents missed the Zacks Consensus Estimate of \$1.11. Moreover, the bottom line declined 16.2% year over year due to higher costs from the MAX groundings.

Meanwhile, operating revenues of \$5,729 million surpassed the Zacks Consensus Estimate of \$5,719 million. The top line also inched up marginally. However, passenger revenues accounting for bulk (92.8%) of the top line dipped slightly year over year.

Quarter Ending **12/2019**

Report Date	Jan 23, 2020
Sales Surprise	0.18%
EPS Surprise	-11.71%
Quarterly EPS	0.98
Annual EPS (TTM)	4.28

Operating Statistics

Airline traffic, measured in revenue passenger miles, dipped 1.5% year over year to 33.22 billion in the quarter under review. Also, capacity or available seat miles (ASMs) slipped 0.9% to 40 billion due to the MAX groundings. Load factor (percentage of seats filled by passengers) came in at 83.1%, 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) inched up 0.8% to 13.28 cents. Moreover, in the reported quarter, revenue per available seat mile (RASM) rose 1.3% year over year to 14.32 cents owing to 1.5% increase in passenger revenue yield.

Operating Expenses & Income

In the fourth quarter, operating income (excluding special items) totaled \$665 million compared with \$820 million in the year-earlier period. The Boeing 737 MAX 8 grounding affected operating income to the tune of \$313 million in the period and \$828 million in 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 4.1% 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 7.1% year over year to \$2.09. However, with the company's most fuel-efficient aircraft being grounded, its fuel efficiency slid 0.8% in the fourth quarter. Additionally, consolidated unit cost or cost per available seat mile (CASM) excluding fuel, oil and special items increased 8.2% year over year to 9.9 cents. The Boeing 737 MAX groundings pushed up costs.

Liquidity

The company had cash and cash equivalents of \$2,548 million at the end of the fourth quarter compared with \$1,854 million at the end of 2018. As of Dec 31, 2019, the company had long-term debt (less current maturities) of \$1,846 million compared with \$2,771 million at 2018 end.

Q1 & 2020 Outlook

Southwest anticipates RASM to increase 3.5-5.5% year over year in the first quarter of 2020. Lower capacity due to removal of the MAX flights among other factors is likely to positively impact this metric. Economic fuel costs are envisioned in the range of \$2.05-\$2.15 per gallon compared with \$2.05 reported in the first quarter of 2019. Capacity is expected to decrease 1.5-2.5% year over year. Fuel efficiency is estimated to slip 2-3% in the current quarter.

CASM excluding fuel and oil expense and profitsharing expense is predicted to increase 6-8% year over year in the first quarter. The forecast includes a seven-point negativity due to lower capacity from the Boeing MAX groundings. Higher expenses on salaries, wages and benefits as well as maintenance also weighed on the view.

Additionally, 2020 fuel costs are estimated in the band of \$2-\$2.10 per gallon. Capital expenditures are estimated between \$1.4 billion and \$1.5 billion in the ongoing year.

Recent News

Coronavirus Update — Mar 31, 2020

Southwest Airlines plans to cut capacity by more than 40% effective May 3 through Jun 5 as passenger demand sees an uninterrupted drop due to the coronavirus pandemic.

With this trimmed schedule, the airline will fly 2,000 flights per day, down by 1,700 from its normal level. Apart from schedule reduction, the low cost carrier is shortening the time period for its operations by removing most departures before 7 a.m. and after 8 p.m.

Valuation

Southwest Airlines shares have been down 39.3% and 36.8% year to date and over the past year, respectively. Stocks in the Zacks sub-industry have shed 57.1% and 58.3% of value so far this year and in a year's time each. Stocks in the Zacks Transportation sector have declined 28.2% and 26.5% year to date and in the past year, respectively. The S&P 500 Index has lost 17.2% and 7.5% year to date and in the past 12 months, respectively.

The stock is currently trading at 7.16X trailing 12-month price to earnings, which compares to 11.91X for the Zacks sub-industry, 12.85X for the Zacks sector and 16.91X for the S&P 500 index.

Over the past five years, the stock has traded as high as 18.55X and as low as 6.84X, with a 5-year median of 11.12X. Our Underperform recommendation indicates that the stock will perform worse than the market. Our \$28 price target reflects 6.12X forward 12-month earnings.

The table below shows summary valuation data for LUV

Valuation Multiples - LUV					
		Stock	Sub-Industry	Sector	S&P 500
P/E F12M	Current	7.16	11.91	12.85	16.91
	5-Year High	18.55	12.3	17.05	17.34
	5-Year Low	6.84	6.6	10.47	15.19
	5-Year Median	11.12	9.11	13.11	17.44
EV/EBITDA TTM	Current	4.08	3.43	6.25	9.76
	5-Year High	12.64	7.01	11.12	12.86
	5-Year Low	3.8	3.33	5.69	8.27
	5-Year Median	6.83	5.98	7.39	10.78
P/S F12M	Current	0.72	0.35	0.86	2.92
	5-Year High	1.86	0.98	1.41	3.44
	5-Year Low	0.69	0.35	0.85	2.54
	5-Year Median	1.31	0.77	1.2	3

As of 04/07/2020

Industry Analysis Zacks Industry Rank: Bottom 12% (222 out of 253)



Top Peers

Controladora Vuela Compania de Aviacion, S.A.B. de C.V. (VLRS)	Outperform
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
Allegiant Travel Company (ALGT)	Underperform

Industry Comparison Industry: Transportation - Airline				Industry Peers		
	LUV Underperform	X Industry	S&P 500	HA Neutral	JBLU Neutral	SAVE Neutral
VGM Score	D	-	-	D	B	D
Market Cap	16.95 B	2.35 B	18.38 B	487.98 M	2.36 B	783.13 M
# of Analysts	10	4.5	13	4	6	6
Dividend Yield	2.20%	0.00%	2.31%	4.52%	0.00%	0.00%
Value Score	C	-	-	C	C	B
Cash/Price	0.26	0.67	0.06	1.41	0.63	1.51
EV/EBITDA	3.73	3.13	11.23	1.88	2.74	3.79
PEG Ratio	1.33	1.07	1.91	NA	NA	NA
Price/Book (P/B)	1.72	0.59	2.45	0.46	0.53	0.35
Price/Cash Flow (P/CF)	4.82	1.96	9.63	1.30	2.31	1.34
P/E (F1)	12.70	10.99	15.92	NA	NA	NA
Price/Sales (P/S)	0.76	0.29	1.94	0.17	0.29	0.20
Earnings Yield	7.87%	4.76%	6.15%	-31.83%	-10.27%	-10.93%
Debt/Equity	0.30	0.66	0.70	0.98	0.56	1.41
Cash Flow (\$/share)	6.80	4.14	7.01	8.18	3.79	8.51
Growth Score	D	-	-	C	A	D
Hist. EPS Growth (3-5 yrs)	7.94%	4.00%	10.92%	17.35%	0.16%	3.49%
Proj. EPS Growth (F1/F0)	-39.63%	-83.87%	-0.12%	-173.42%	-147.54%	-124.56%
Curr. Cash Flow Growth	-3.22%	12.49%	5.93%	-9.18%	14.33%	19.78%
Hist. Cash Flow Growth (3-5 yrs)	8.55%	8.82%	8.55%	13.32%	14.43%	15.50%
Current Ratio	0.67	0.68	1.24	0.81	0.67	1.25
Debt/Capital	23.31%	47.20%	42.36%	49.54%	35.83%	58.43%
Net Margin	10.26%	6.96%	11.64%	7.91%	7.03%	8.75%
Return on Equity	23.31%	12.61%	16.74%	21.20%	12.06%	16.38%
Sales/Assets	0.85	0.64	0.54	0.72	0.71	0.57
Proj. Sales Growth (F1/F0)	-9.53%	-9.09%	0.85%	-24.84%	-24.63%	-17.94%
Momentum Score	C	-	-	F	F	F
Daily Price Chg	6.74%	3.76%	0.69%	8.92%	13.32%	9.26%
1 Week Price Chg	-16.05%	-14.03%	-4.40%	-13.82%	-23.28%	-28.94%
4 Week Price Chg	-28.07%	-35.72%	-10.67%	-39.18%	-39.92%	-49.11%
12 Week Price Chg	-39.86%	-53.11%	-23.70%	-64.13%	-52.70%	-71.48%
52 Week Price Chg	-36.85%	-53.42%	-15.92%	-63.78%	-46.39%	-79.13%
20 Day Average Volume	11,776,207	180,816	4,068,329	2,169,054	16,210,822	6,841,091
(F1) EPS Est 1 week change	-24.33%	0.00%	0.00%	-280.56%	-2,184.62%	-327.96%
(F1) EPS Est 4 week change	-42.93%	-75.47%	-5.24%	-190.55%	-137.17%	-122.76%
(F1) EPS Est 12 week change	-46.54%	-76.02%	-6.86%	-190.16%	-138.12%	-125.68%
(Q1) EPS Est Mthly Chg	-61.42%	-171.35%	-8.25%	-255.93%	-226.48%	-171.35%

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	C
Growth Score	D
Momentum Score	C
VGM Score	D

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.

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