

Southwest Airlines(LUV)

\$25.45 (As of 05/07/20)

Price Target (6-12 Months): **\$27.00**

Long Term: 6-12 Months

Zacks Recommendation:

Neutral

(Since: 05/05/20)

Prior Recommendation: Underperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

3-Hold

Zacks Style Scores:

VGM:F

Value: C

Growth: F

Momentum: F

Summary

Shares of Southwest Airlines have plunged more than 40% since March due to plummeting air travel demand in the wake of the coronavirus outbreak. Despite a limited impact from the health peril, the company's first-quarter passenger revenues dropped as much as 19% leading to a 17.8% drop in the top line. The second quarter is likely to be even worse. Capacity is expected to decline at least 60% in the current quarter. Apart from impact on passenger revenues, the carrier is also seeing large declines in ancillary and other revenues. The coronavirus crisis is also affecting the carrier's fleet plans. The negativity is evident from the Zacks Consensus Estimate for current-year earnings being pegged at a loss of \$4.24. However, cost savings from low fuel prices, reduced capacity and cost-cutting measures should support the bottom line.

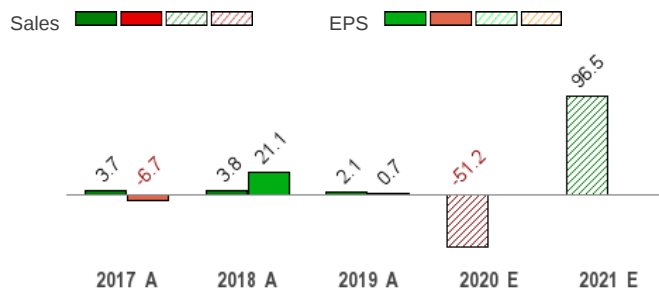
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$58.83 - \$24.77
20 Day Average Volume (sh)	27,768,900
Market Cap	\$13.0 B
YTD Price Change	-52.9%
Beta	1.27
Dividend / Div Yld	\$0.72 / 2.8%
Industry	Transportation - Airline
Zacks Industry Rank	Bottom 42% (147 out of 253)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	68.8%
Last Sales Surprise	-3.7%
EPS F1 Est- 4 week change	-4,178.3%
Expected Report Date	07/23/2020
Earnings ESP	0.0%
P/E TTM	7.4
P/E F1	NA
PEG F1	NA
P/S TTM	0.6

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	5,257 E	6,030 E	5,854 E	5,938 E	21,497 E
2020	4,234 A	540 E	4,296 E	4,970 E	10,939 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	\$0.61 E	\$1.36 E	\$1.09 E	\$1.14 E	\$3.47 E
2020	-\$0.15 A	-\$3.27 E	-\$0.02 E	\$0.60 E	-\$4.24 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.

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 05/07/2020. The reports text is as of 05/08/2020.

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.

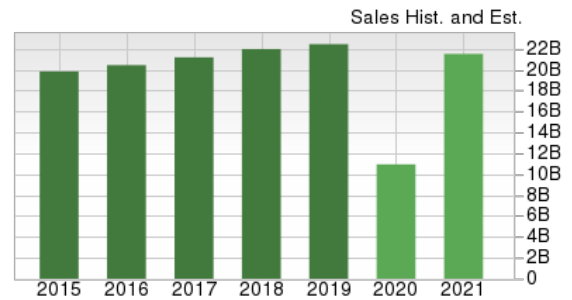
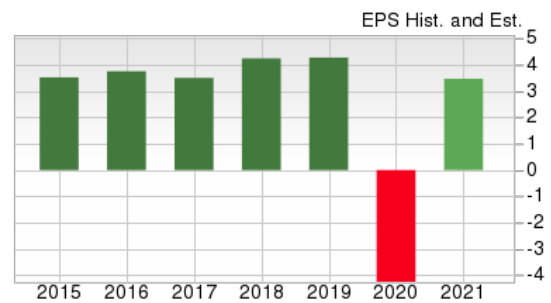
Additionally, during 2018, the carrier started shipping cargo to international destinations like Mexico City, Cancun, Cabo San Lucas/Los Cabos, Puerto Vallarta, Montego Bay, and San Jose, Costa Rica.

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 Buy:

- ▲ With passenger revenues dropping due to the coronavirus-induced decline in air-travel demand, the carrier is offering cargo-only flights for the first time in its history. The cargo flights are being operated on a charter basis with only the likes of pilots and other crew members, on board. The airline is carrying 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.
- ▲ 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 significant drop in oil prices, fuel costs declined 7.3% in the first quarter. The company estimates fuel price in the range of \$1-\$1.1 per gallon for the second quarter compared with \$2.13 in the year-ago period. The savings on fuel should support the bottom line.
- ▲ Apart from low fuel prices, capacity cuts are causing a significant decline in operating expenses. The company expects a 40% decline in second-quarter operating expenses due to capacity reductions and low fuel prices. Moreover, cost-cutting measures, such as freezing hiring, pausing salary hikes and reducing capital expenses, are expected to reduce operating costs by more than \$2 billion and capital expenditures by more than \$1 billion in 2020.
- ▲ Debt-to-capitalization ratio, which is an indicator of a company's leverage, increased to 0.42 at the end of first-quarter 2020 from 0.29 at the end of fourth-quarter 2019. Moreover, the cash and equivalents at Southwest Airlines for first-quarter 2020 stands at \$5,545 million, way above the current debt figure of \$3,125 million, implying that the company has enough cash to meet its short-term debt burden.

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

Reasons To Sell:

- ▼ After witnessing strong passenger bookings in January and February, Southwest Airlines started feeling the heat of coronavirus in March. Despite this limited impact, the company's passenger revenues (accounting for approximately 90% of the top line) declined 19% in the first quarter, leading to a 17.8% drop in the top line. The situation is likely to get worse in the second quarter. Southwest Airlines anticipates operating revenues to decline 90-95% year over year for April and May. Capacity is expected to decline at least 60% in the second quarter. The carrier is also seeing a decline in partner revenues from Chase as the credit card portfolios are experiencing reduced spending and lower acquisitions due to the coronavirus crisis. The airline's ancillary and other revenues have also decreased dramatically.
- ▼ 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. The company expects its MAX flights to remain suspended through the end of October 2020.
- ▼ 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. Fleet size reduced further to 742 at the end of the first quarter due to the ongoing capacity cuts in wake of the coronavirus outbreak. Due to the crisis, the airline plans to take delivery of less than the 27 MAX aircraft from Boeing this year and may temporarily remove or retire additional aircraft from its fleet if needed.

Coronavirus is likely to have a more severe impact on the carrier's second-quarter performance.

Last Earnings Report

Narrower Than Expected Loss in Q1

Southwest Airlines incurred loss of 15 cents per share (excluding 3 cents from non-recurring items) in the first quarter of 2020, narrower than the Zacks Consensus Estimate of 48 cents. In the year-ago period, the company reported earnings of 70 cents per share. The results reflect the coronavirus-induced drop in passenger demand.

Meanwhile, operating revenues of \$4,234 million lagged the Zacks Consensus Estimate of \$4,397 million. The top line declined 17.8% year over year with passenger revenues, accounting for bulk (90.8%) of the top line, sliding 19%.

Quarter Ending **03/2020**

Report Date	Apr 28, 2020
Sales Surprise	-3.71%
EPS Surprise	68.75%
Quarterly EPS	-0.15
Annual EPS (TTM)	3.43

Operating Statistics

Airline traffic, measured in revenue passenger miles, declined 22% year over year to 23.93 billion in the quarter under review. Also, capacity or available seat miles (ASMs) fell 6.7% to 35.35 billion due to the MAX groundings as well as the coronavirus pandemic. Load factor (percentage of seats filled by passengers) came in at 67.7%, down 1330 basis points on a year-over-year basis as the decline in traffic was wider than the capacity contraction.

Passenger revenue per available seat mile (PRASM: a key measure of unit revenues) dropped 13.1% to 10.88 cents. Moreover, revenue per available seat mile (RASM) declined 11.8% year over year to 11.98 cents owing to decline in load factor.

Operating Expenses & Income

In the first quarter, operating loss totaled \$110 million against operating income of \$505 million in the year-ago quarter. Total adjusted operating expenses (excluding profit sharing, fuel and oil expense) dropped 1.9%.

Fuel price per gallon (inclusive of fuel tax: economic) was down 7.3% to \$1.9. However, consolidated unit cost or cost per available seat mile (CASM), excluding fuel, oil and profit-sharing expenses, increased 5.1% year over year to 9.83 cents. Majority of the cost increase was due to lower capacity stemming from the Boeing 737 MAX grounding. Unit costs are expected to continue to rise in the second quarter due to the MAX grounding as well as capacity cuts owing to the coronavirus outbreak. The company expects its MAX flights to remain suspended through the end of October 2020.

Liquidity

The company had cash and equivalents of \$5,545 million at the end of the first quarter. As of Mar 31, 2020, the company had long-term debt (less current maturities) of \$2,288 million compared with \$1,846 million at 2019-end. You can see the complete list of today's Zacks #1 Rank (Strong Buy) stocks here.

Southwest returned \$639 million to shareholders through share buybacks and dividend payments during the first quarter. The same is suspended as of now until further notice.

Outlook

With persistent weakness in passenger demand and bookings, Southwest anticipates operating revenues to plunge 90-95% year over year in April. Meanwhile, ASMs are expected to decline 60% and load factor is estimated at only 6% for the month. In May too, operating revenues are predicted to drop in the 90-95% range with 60-70% decrease in capacity and load factor in the 5-10% band.

Capacity is expected to decline at least 60% in the second quarter. Economic fuel costs are forecast in the range of \$1-\$1.1 per gallon in the same period. Meanwhile, the company's cost-cutting measures, such as freezing hiring, pausing salary hikes and reducing capital expenses, are expected to reduce operating costs by more than \$2 billion and capital expenditures by more than \$1 billion in 2020.

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 are down 52.9% and 51.5% in the year-to-date period and over the trailing 12-month period respectively. Stocks in the Zacks sub-industry and the Zacks Transportation sector are down 59.8% and 27% in the year-to-date period respectively. Over the past year, the Zacks sub-industry and the sector are down 57.8% and 25.1% respectively.

The S&P 500 index is down 11.5% and 1% in the year-to-date period and in the past year respectively.

The stock is currently trading at 7.42X trailing 12-month price to earnings, which compares to 4.13X for the Zacks sub-industry, 11.54X for the Zacks sector and 18.2X for the S&P 500 index.

Over the past five years, the stock has traded as high as 19.05X and as low as 7.21X, with a 5-year median of 13.21X. Our Neutral recommendation indicates that the stock will perform in-line with the market. Our \$27 price target reflects 7.87X trailing 12-month earnings.

The table below shows summary valuation data for LUV

Valuation Multiples - LUV					
		Stock	Sub-Industry	Sector	S&P 500
P/E TTM	Current	7.42	4.13	11.54	18.2
	5-Year High	19.05	13.2	19.58	22.17
	5-Year Low	7.21	4.13	11.54	15.91
	5-Year Median	13.21	10.78	15.53	18.95
EV/EBITDA TTM	Current	3.89	3.21	6.01	10.44
	5-Year High	12.64	7.03	11.16	12.86
	5-Year Low	3.81	3.19	5.42	8.28
	5-Year Median	6.81	5.92	7.36	10.78
P/S F 12M	Current	0.88	0.45	1	3.21
	5-Year High	1.86	0.98	1.42	3.44
	5-Year Low	0.69	0.38	0.85	2.54
	5-Year Median	1.3	0.77	1.2	3.01

As of 05/07/2020

Industry Analysis Zacks Industry Rank: Bottom 42% (147 out of 253)



Top Peers

Company (Ticker)	Rec	Rank
Allegiant Travel Company (ALGT)	Neutral	3
Alaska Air Group Inc (ALK)	Neutral	3
Hawaiian Holdings Inc (HA)	Neutral	3
JetBlue Airways Corporation (JBLU)	Neutral	3
Spirit Airlines Inc (SAVE)	Neutral	3
United Airlines Holdings Inc (UAL)	Neutral	3
Controladora Vuela Compania de Aviacion SAB de CV (VLRS)	Neutral	3
Delta Air Lines Inc (DAL)	Underperform	3

Industry Comparison Industry: Transportation - Airline				Industry Peers		
	LUV	X Industry	S&P 500	HA	JBLU	SAVE
Zacks Recommendation (Long Term)	Neutral	-	-	Neutral	Neutral	Neutral
Zacks Rank (Short Term)	3	-	-	3	3	3
VGM Score	F	-	-	D	B	C
Market Cap	12.95 B	1.90 B	19.51 B	542.20 M	2.21 B	720.35 M
# of Analysts	7	4	14	4	6	6
Dividend Yield	2.83%	0.00%	2.15%	4.07%	0.00%	0.00%
Value Score	C	-	-	C	C	B
Cash/Price	0.37	0.51	0.06	1.04	0.55	1.20
EV/EBITDA	2.54	2.98	11.77	1.99	2.62	3.78
PEG Ratio	NA	2.00	2.54	NA	NA	NA
Price/Book (P/B)	1.43	0.63	2.67	0.51	0.49	0.32
Price/Cash Flow (P/CF)	3.74	2.08	10.44	1.44	2.16	1.23
P/E (F1)	NA	20.59	19.30	NA	NA	NA
Price/Sales (P/S)	0.60	0.28	1.99	0.20	0.28	0.19
Earnings Yield	-16.66%	-25.16%	4.91%	-59.83%	-28.00%	-39.87%
Debt/Equity	0.38	0.64	0.75	0.98	0.56	1.45
Cash Flow (\$/share)	6.80	4.15	7.01	8.18	3.79	8.51
Growth Score	F	-	-	D	B	F
Hist. EPS Growth (3-5 yrs)	4.95%	3.16%	10.87%	17.35%	0.16%	3.49%
Proj. EPS Growth (F1/F0)	-199.33%	-208.41%	-9.87%	-253.42%	-220.26%	-182.22%
Curr. Cash Flow Growth	-3.22%	12.49%	5.88%	-9.18%	14.33%	19.78%
Hist. Cash Flow Growth (3-5 yrs)	8.55%	9.63%	8.55%	13.32%	14.43%	15.50%
Current Ratio	0.69	0.69	1.24	0.81	0.67	1.00
Debt/Capital	27.38%	47.44%	44.23%	49.54%	35.83%	59.14%
Net Margin	8.46%	3.34%	10.68%	1.58%	3.32%	6.71%
Return on Equity	18.92%	11.22%	16.36%	14.48%	8.46%	10.59%
Sales/Assets	0.81	0.64	0.55	0.69	0.68	0.54
Proj. Sales Growth (F1/F0)	-51.22%	-34.28%	-2.26%	-51.25%	-39.13%	-37.76%
Momentum Score	F	-	-	D	D	B
Daily Price Chg	2.09%	0.00%	1.52%	0.94%	2.00%	-9.00%
1 Week Price Chg	-0.34%	3.74%	0.53%	13.37%	13.46%	8.40%
4 Week Price Chg	-30.22%	-7.24%	0.73%	-0.17%	-13.90%	-25.36%
12 Week Price Chg	-56.53%	-56.46%	-21.09%	-58.61%	-62.06%	-76.42%
52 Week Price Chg	-51.49%	-53.79%	-10.17%	-55.82%	-55.40%	-78.73%
20 Day Average Volume	27,768,900	189,942	2,398,409	1,568,895	14,934,958	7,817,374
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	-0.89%	0.00%	0.00%
(F1) EPS Est 4 week change	-4,178.30%	-117.41%	-6.95%	-108.96%	-200.66%	-241.17%
(F1) EPS Est 12 week change	-192.83%	-178.13%	-15.68%	-280.59%	-193.08%	-176.21%
(Q1) EPS Est Mthly Chg	-146.96%	-62.13%	-13.12%	-134.24%	-91.44%	-121.87%

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	C
Growth Score	F
Momentum Score	F
VGM Score	F

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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