

## Southwest Airlines(LUV)

**\$34.46** (As of 08/20/20)

Price Target (6-12 Months): **\$37.00**

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:C

Value: B

Growth: C

Momentum: F

### Summary

Shares of Southwest Airlines have plunged more than 26% since the beginning of March due to coronavirus-led weak air travel demand. With travel demand significantly below year-ago levels, passenger revenues declined 55.5% year over year in the first six months of 2020. Moreover, the carrier reduced capacity by 31.6% in the same period to match the low-demand scenario. For the third quarter, capacity is expected to fall 30-35%. However, savings from low fuel prices and other cost-cutting measures, are supporting the bottom line. Notably, operating expenses declined 32.4% in the first half of 2020. The metric is expected to decline in the 10-20% band in the third quarter. The carrier's focus on its cargo unit is also encouraging. The improvement in demand witnessed in August is an added positive. Booking trends for September have also improved.

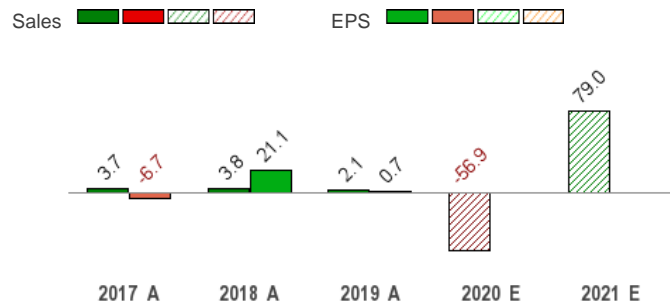
### Price, Consensus & Surprise



### Data Overview

52 Week High-Low	\$58.83 - \$22.47
20 Day Average Volume (sh)	12,050,612
Market Cap	\$20.3 B
YTD Price Change	-36.2%
Beta	1.17
Dividend / Div Yld	\$0.00 / 0.0%
Industry	<a href="#">Transportation - Airline</a>
Zacks Industry Rank	Bottom 6% (237 out of 252)

### Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	-5.5%
Last Sales Surprise	16.0%
EPS F1 Est- 4 week change	-42.9%
Expected Report Date	10/22/2020
Earnings ESP	0.0%
P/E TTM	NA
P/E F1	NA
PEG F1	NA
P/S TTM	1.2

### Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	3,498 E	4,298 E	4,541 E	4,906 E	17,298 E
2020	4,234 A	1,008 A	1,594 E	2,773 E	9,661 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	-\$0.22 E	\$0.43 E	\$0.52 E	\$0.86 E	\$1.39 E
2020	-\$0.15 A	-\$2.67 A	-\$2.50 E	-\$1.11 E	-\$6.35 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 08/20/2020. The reports text is as of 08/21/2020.

## 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.

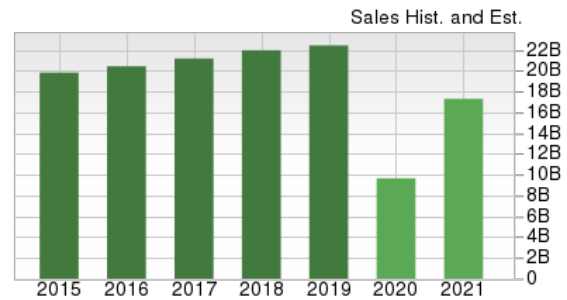
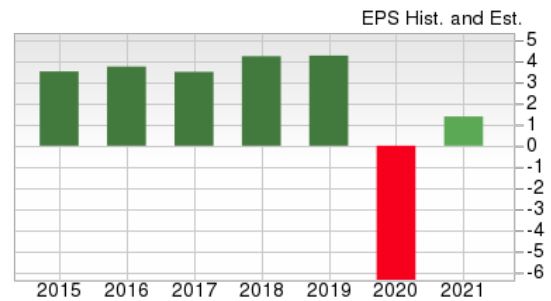
Additionally, during 2018, the carrier started shipping cargo to international destinations like Mexico City, Cancun, Cabo San Lucas/Los Cabos, Puerto Vallarta, Montego Bay, and San Jose, Costa Rica.

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.



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## Reasons To Buy:

- ▲ The improvement in demand for the month of August after the disappointment in July is encouraging. Booking trends for September have also improved modestly. In July, Southwest's average core cash burn was approximately \$17 million per day. For the third quarter, average core cash burn is anticipated to be approximately \$20 million per day. Owing to recent improvements in revenue trends, this forecast represents an improvement over the previous estimation for average daily core cash burn of approximately \$23 million. Moreover, the carrier's focus on its cargo unit is also encouraging. With passenger demand plummeting from year ago levels, the cargo-only operations should help the carrier 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 per gallon, including fuel tax (economic), declined 17.7% in the first half of 2020. The company estimates fuel price in the range of \$1.2-\$1.3 per gallon for the third quarter compared with \$2.07 in the year-ago period. The savings on fuel expenses are supporting the bottom line.
- ▲ Southwest's cost-reduction efforts to mitigate the effects of weak travel demand are encouraging. During the third quarter, operating expenses, excluding fuel and oil expense, special items, and profit-sharing expense, are estimated to decrease 10-20% year over year. The voluntary-separation programs aimed at reducing workforce are expected to generate cost savings of more than \$400 million in the fourth quarter due to reduction in salaries, wages and benefits expenses. With reduction in discretionary spending, low fuel prices and capacity cuts, the company's operating expenses have declined 32.4% in the first half of 2020. Thanks to the company's cost-cutting measures, including staff-reduction plans and savings on fuel expenses and reduced capacity, operating expenses are expected to decline more than \$2.7 billion in 2020. Moreover, Southwest's cash and cash equivalents at the end of the second quarter stood at \$12.35 billion, way above the current debt of \$695 million, implying that the company has sufficient cash to meet its current debt obligations. Owing to constant efforts to preserve cash and bolster liquidity, the carrier is confident that it does not have to participate in the non-binding loan program of approximately \$2.8 billion, which the company signed with the U.S. Treasury Department. Instead, it feels, if needed it can secure additional financing at better terms. As of Aug 18, 2020, Southwest had cash and short-term investments of approximately \$15.2 billion.

Modest fuel prices are helping in partly offsetting the loss of passenger revenues.

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## Reasons To Sell:

- ▼ Southwest is suffering significant loss of passenger revenues due to weak travel demand amid coronavirus concerns. Notably, passenger revenues declined 55.5% year over year in the first six months of 2020. This in turn led to 52.6% plunge in the top line in the first half of 2020. The carrier's top line is expected to remain under pressure as coronavirus woes keep air travel demand suppressed. To match its network with the low-demand scenario, the airline reduced capacity by 31.6% in the first six months of 2020.
  - ▼ The already weak travel demand scenario weakened further in July, thanks to spike in coronavirus cases in some parts of the United States and new quarantine rules. The modest improvement in demand which Southwest witnessed in May and June has faded with surge in coronavirus cases. In July, Southwest's operating revenues plunged 70-75% year over year, while capacity decreased 31%. Load factor (percentage of seats filled by passengers) in the period was approximately 43%. For the third quarter, capacity is expected to fall 30-35%, compared with the previous estimation of a decline in the range of 20-30%. To allow passengers to maintain social-distancing, the carrier plans to keep middle seats vacant (for customers not traveling together) through at least Oct 31, 2020. The reduction in capacity is likely to result in a huge increase third-quarter unit costs.
  - ▼ 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 has suspended the MAX aircraft from its schedule through mid-December 2020. The groundings have also caused the carrier to adjust plans pertaining to its fleet.
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Southwest's top line is expected to remain under pressure as coronavirus concerns keep travel demand suppressed.

## Last Earnings Report

### Wider Than Expected Loss in Q2

Southwest Airlines incurred loss of \$2.67 per share (excluding \$1.04 from non-recurring items) in the second quarter of 2020, wider than the Zacks Consensus Estimate of a loss of \$2.53. In the year-ago period, the company had reported earnings of \$1.37 per share. Similar to the first quarter, second-quarter results reflect the coronavirus-induced drop in passenger demand.

Meanwhile, operating revenues of \$1,008 million beat the Zacks Consensus Estimate of \$868.9 million. The top line declined 82.9% year over year, with passenger revenues accounting for bulk (69.8%) of the top line, sliding 87.2%.

Quarter Ending **06/2020**

Report Date	Jul 23, 2020
Sales Surprise	<b>16.00%</b>
EPS Surprise	<b>-5.53%</b>
Quarterly EPS	<b>-2.67</b>
Annual EPS (TTM)	<b>-0.61</b>

### Operating Statistics

Airline traffic, measured in revenue passenger miles, declined 83.7% year over year to 5.61 billion in the quarter under review. With reduced passenger demand as a result of the coronavirus pandemic, capacity or available seat miles ("ASMs") fell 55.3% to 17.89 billion. Load factor (percentage of seats filled by passengers) came in at 31.4%, down 5500 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 71.3% to 3.94 cents. Moreover, revenue per available seat mile ("RASM") declined 61.9% year over year to 5.63 cents, owing to decline in load factor and passenger revenue yield.

### Operating Expenses & Income

In the second quarter, operating loss totaled \$1,127 million against operating income of \$968 million in the year-ago quarter. Total adjusted operating expenses (excluding profit sharing, special items, fuel and oil expense) dropped 20.7%, thanks to the company's cost-cutting measures and reduction in salaries, wages and benefits among other expenses.

Fuel costs per gallon (inclusive of fuel tax: economic) was down 37.6% to \$1.33. However, consolidated unit cost or cost per available seat mile ("CASM") excluding fuel, oil and profit-sharing expenses, and special items, increased 77.3% year over year to 16.12 cents due to significant reduction in capacity.

### Liquidity

The company had cash and cash equivalents of \$12,351 million at the end of the second quarter, compared with \$2,548 million at the end of 2019. As of Jun 30, 2020, the company had long-term debt (less current maturities) of \$8,905 million compared with \$1,846 million at 2019-end.

### Outlook

Spike in COVID-19 cases in some parts of the United States has dampened the modest improvement in demand which Southwest witnessed in May and June. With bookings having decreased and trip cancellations slightly increased, Southwest anticipates operating revenues to plunge 70-75% year over year in July. In the same period, capacity is estimated to decline approximately 30% year over year, while load factor is expected in the band of 40-45%. For August, operating revenues are anticipated to decrease 70-80% year over year. The company predicts capacity to decline approximately 20% year over year next month, while load factor is estimated in the range of 30-40%.

For the third quarter, Southwest anticipates economic fuel costs between \$1.2 and \$1.3 per gallon. This compares with fuel costs of \$2.07 per gallon in the third quarter of 2019. The company expects to record a charge of \$540 million in the third quarter related to voluntary-separation charges for employees. An additional charge of more than \$800 million is also estimated regarding a similar voluntary program for employees.

During the third quarter, operating expenses, excluding fuel and oil expense, special items, and profit-sharing expense, are estimated to decrease 10-20% year over year. Capacity is estimated to decrease 20-30% year over year in the third quarter.

## Recent News

### August Demand Improves — Aug 19, 2020

Even though, leisure-passenger traffic increased in May and June compared with March and April, demand stalled in July with a spike in coronavirus cases. However, in August, the company saw demand gradually picking up.

In July, Southwest's operating revenues plunged 70-75% year over year, while capacity decreased 31%. Load factor (percentage of seats filled by passengers) in the period was approximately 43%. Operating revenues are expected to decline 70-75% year over year in August. Capacity in the period is estimated to decrease 27%, while load factor is predicted to be in the range of 30-40%. Booking trends for September have also improved modestly. Consequently, operating revenues are estimated to decline 65-75% year over year. For September capacity is forecast to drop approximately 40% (previous expectation: decline of 20-25%). Load factor is anticipated in the band of 40-50%.

## Valuation

Southwest Airlines shares are down 36.2% and 32.7% 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 46.1% and 0.9% in the year-to-date period respectively. Over the past year, the Zacks sub-industry is down 40.6% while the sector is up 6.5%.

The S&P 500 Index is up 5.1% and 16.7% year to date and over the past year, respectively.

The stock is currently trading at 1.4X forward 12-month price to sales, which compares to 0.67X for the Zacks sub-industry, 1.35X for the Zacks sector and 3.71X for the S&P 500 index.

Over the past five years, the stock has traded as high as 1.86X and as low as 0.69X, with a 5-year median of 1.3X. Our Neutral recommendation indicates that the stock will perform in-line with the market. Our \$37 price target reflects 1.5X forward 12-month sales.

The table below shows summary valuation data for LUV

Valuation Multiples - LUV					
		Stock	Sub-Industry	Sector	S&P 500
P/S F 12M	Current	1.4	0.67	1.35	3.71
	5-Year High	1.86	0.94	1.41	3.71
	5-Year Low	0.69	0.37	0.84	2.53
	5-Year Median	1.3	0.74	1.2	3.05
EV/EBITDA TTM	Current	25.08	15.28	10.34	12.81
	5-Year High	26.17	15.7	11.07	12.85
	5-Year Low	3.66	3.22	5.4	8.25
	5-Year Median	6.86	5.63	7.24	10.91
EV/S TTM	Current	0.99	1.91	1.2	3.42
	5-Year High	1.95	1.91	1.42	3.44
	5-Year Low	0.47	1.17	0.85	2.53
	5-Year Median	1.39	1.62	1.2	3.02

As of 08/20/2020

## Industry Analysis Zacks Industry Rank: Bottom 6% (237 out of 252)



## Top Peers

Company (Ticker)	Rec	Rank
Allegiant Travel Company (ALGT)	Neutral	3
Alaska Air Group, Inc. (ALK)	Neutral	4
Delta Air Lines, Inc. (DAL)	Neutral	4
Hawaiian Holdings, Inc. (HA)	Neutral	4
JetBlue Airways Corporation (JBLU)	Neutral	4
Spirit Airlines, Inc. (SAVE)	Neutral	4
United Airlines Holdings Inc (UAL)	Neutral	3
Controladora Vuela Compania de Aviacion, S.A.B. de C.V. (VLRS)	Neutral	2

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	-	-	4	4	4
VGM Score	C	-	-	B	C	D
Market Cap	20.33 B	2.05 B	23.46 B	587.38 M	2.95 B	1.53 B
# of Analysts	12	4	14	4	7	6
Dividend Yield	0.00%	0.00%	1.65%	0.00%	0.00%	0.00%
Value Score	B	-	-	A	B	B
Cash/Price	0.70	0.61	0.07	1.22	0.93	0.80
EV/EBITDA	3.88	3.72	13.34	2.21	3.07	5.09
PEG Ratio	NA	0.41	3.00	NA	NA	NA
Price/Book (P/B)	1.87	0.72	3.12	0.71	0.72	0.65
Price/Cash Flow (P/CF)	5.07	2.43	12.60	1.56	2.86	2.02
P/E (F1)	NA	36.54	21.61	NA	NA	NA
Price/Sales (P/S)	1.22	0.45	2.44	0.28	0.50	0.53
Earnings Yield	-18.43%	-26.52%	4.43%	-77.21%	-52.13%	-49.51%
Debt/Equity	0.98	0.98	0.76	1.54	1.01	1.54
Cash Flow (\$/share)	6.80	4.09	6.93	8.18	3.79	8.51
Growth Score	C	-	-	D	D	F
Hist. EPS Growth (3-5 yrs)	3.78%	2.82%	10.44%	5.61%	-6.90%	1.58%
Proj. EPS Growth (F1/F0)	-248.75%	-263.53%	-5.53%	-314.40%	-396.77%	-267.35%
Curr. Cash Flow Growth	-3.22%	11.77%	5.20%	-9.18%	14.33%	19.78%
Hist. Cash Flow Growth (3-5 yrs)	8.55%	8.55%	8.52%	13.32%	14.43%	15.50%
Current Ratio	1.70	0.80	1.33	0.93	0.95	1.31
Debt/Capital	49.42%	52.86%	44.50%	60.58%	50.20%	60.60%
Net Margin	0.99%	-4.63%	10.13%	-5.83%	-4.05%	-0.26%
Return on Equity	-4.11%	-4.11%	14.67%	-8.35%	-7.24%	-7.51%
Sales/Assets	0.58	0.49	0.51	0.51	0.48	0.40
Proj. Sales Growth (F1/F0)	-56.92%	-46.66%	-1.54%	-64.04%	-59.74%	-52.17%
Momentum Score	F	-	-	C	D	F
Daily Price Chg	0.55%	0.00%	-0.59%	-1.84%	-1.46%	0.12%
1 Week Price Chg	4.87%	4.56%	1.09%	2.74%	6.69%	2.78%
4 Week Price Chg	5.09%	2.20%	1.91%	-5.55%	1.03%	2.20%
12 Week Price Chg	5.87%	6.65%	6.82%	-14.01%	6.39%	33.10%
52 Week Price Chg	-32.68%	-42.52%	1.47%	-47.23%	-39.92%	-55.64%
20 Day Average Volume	12,050,612	181,936	1,873,576	1,051,030	10,290,752	10,397,180
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	0.00%	0.00%	-7.58%
(F1) EPS Est 4 week change	-42.85%	-21.38%	1.79%	-29.47%	-47.11%	-53.25%
(F1) EPS Est 12 week change	-33.07%	-37.97%	3.35%	-32.38%	-70.78%	-42.88%
(Q1) EPS Est Mthly Chg	-96.00%	-91.67%	0.42%	-70.36%	-85.50%	-157.73%

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## 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.

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### 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>B</b>
Growth Score	<b>C</b>
Momentum Score	<b>F</b>
VGM Score	<b>C</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.

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