

# Southwest Airlines Co.

**S&P Recommendation** BUY ★★★★★

**Price**  
\$14.17 (as of May 31, 2013)

**12-Mo. Target Price**  
\$18.00

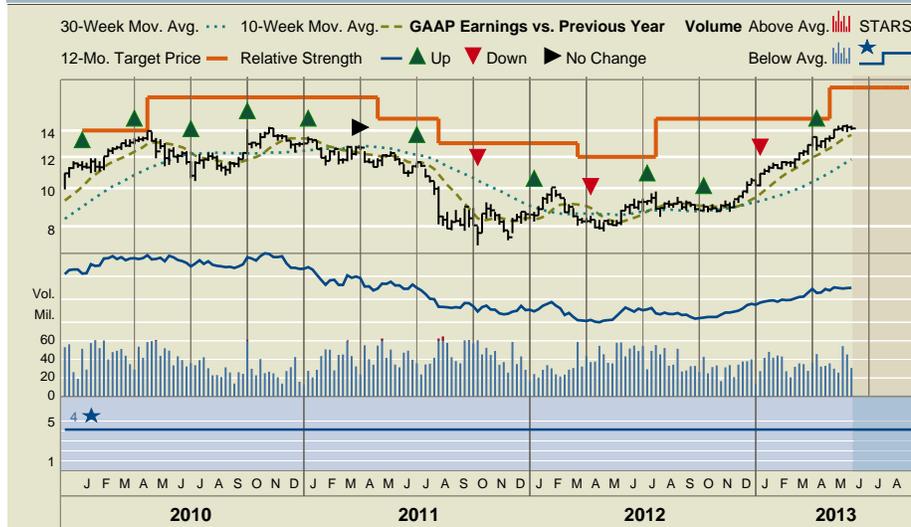
**GICS Sector** Industrials  
**Sub-Industry** Airlines

**Summary** The fourth largest U.S. airline, Southwest offers discounted fares, primarily on shorter-haul, point-to-point flights.

**Key Stock Statistics** (Source S&P, Vickers, company reports)

52-Wk Range	<b>\$14.56– 8.45</b>	S&P Oper. EPS 2013E	<b>1.00</b>	Market Capitalization(B)	<b>\$10.317</b>	Beta	<b>1.15</b>
Trailing 12-Month EPS	<b>\$0.51</b>	S&P Oper. EPS 2014E	<b>1.25</b>	Yield (%)	<b>1.13</b>	S&P 3-Yr. Proj. EPS CAGR(%)	<b>NA</b>
Trailing 12-Month P/E	<b>27.8</b>	P/E on S&P Oper. EPS 2013E	<b>14.2</b>	Dividend Rate/Share	<b>\$0.16</b>	S&P Credit Rating	<b>BBB-</b>
\$10K Invested 5 Yrs Ago	<b>\$10,976</b>	Common Shares Outstg. (M)	<b>728.1</b>	Institutional Ownership (%)	<b>83</b>		

**Price Performance**



**Qualitative Risk Assessment**

LOW MEDIUM HIGH

Even though Southwest participates in the highly volatile airline industry, we think its conservative balance sheet, with low debt relative to total capitalization, and its track record of 39 consecutive years of profitability mitigate this risk.

**Quantitative Evaluations**

**S&P Quality Ranking** B

D C B- B B+ A- A A+

**Relative Strength Rank** STRONG

80 (LOWEST = 1, HIGHEST = 99)

**Revenue/Earnings Data**

<b>Revenue (Million \$)</b>						
	1Q	2Q	3Q	4Q	Year	
2013	4,084	--	--	--	--	
2012	3,991	4,616	4,309	4,173	17,088	
2011	3,103	4,136	4,311	4,108	15,658	
2010	2,630	3,168	3,192	3,114	12,104	
2009	2,357	2,616	2,666	2,712	10,350	
2008	2,530	2,869	2,891	2,734	11,023	

<b>Earnings Per Share (\$)</b>						
	1Q	2Q	3Q	4Q	Year	
2013	0.08	E0.42	E0.29	E0.22	E1.00	
2012	-0.13	0.30	0.02	0.11	0.56	
2011	0.01	0.21	-0.18	0.20	0.23	
2010	0.01	0.15	0.27	0.18	0.61	
2009	-0.12	0.12	-0.02	0.16	0.13	
2008	0.05	0.44	-0.16	-0.08	0.24	

Fiscal year ended Dec. 31. Next earnings report expected: Early June. EPS Estimates based on S&P Operating Earnings; historical GAAP earnings are as reported.

**Dividend Data** (Dates: mm/dd Payment Date: mm/dd/yy)

Amount (\$)	Date Decl.	Ex-Div. Date	Stk. of Record	Payment Date
0.010	07/26	08/14	08/16	09/06/12
0.010	11/15	12/04	12/06	01/03/13
0.010	01/31	03/05	03/07	03/28/13
0.040	05/15	06/03	06/05	06/26/13

Dividends have been paid since 1976. Source: Company reports.

Analysis prepared by Equity Analyst **Jim Corridore** on May 13, 2013, when the stock traded at **\$14.08**.

**Highlights**

- LUV completed its acquisition of AirTran Holdings on May 2, 2011, for a total of \$1.4 billion in cash and stock. After a 9% rise in 2012, partly as a result of the acquisition, we look for LUV's revenues to rise about 4% in 2013, on improving demand, yields and revenue synergies from adding frequencies and connections to AirTran markets. We see incremental revenues from the sale of assigned boarding slots, a more sophisticated revenue management system, and other ancillary revenue-generating initiatives, and we expect increased sales activity during less seasonally strong periods to stimulate demand.
- We see margins in 2013 being aided by revenue and mix improvements stemming from LUV's recent initiative to redeploy flights to more profitable markets, coupled with a rebound in business travel. We think a new frequent flyer program and the addition of the Atlanta market via the AirTran acquisition will help increase LUV's presence among business travelers. We expect fuel costs to grow about 1% in 2013, less than the revenue growth we are forecasting.
- We estimate 2013 EPS of \$1.00, comparing favorably to 2012 operating EPS of \$0.56.

**Investment Rationale/Risk**

- While LUV has strayed from its traditional business model with the acquisition of AirTran, we think the benefits are likely to outweigh the risks. LUV got about 20% larger without adding a single seat to industrywide capacity. AirTran shares a low-cost culture and has a strong presence in Atlanta, a heavy business travel market. We are positive on the news that LUV will sublease AirTran's 717s to Delta Air Lines (DAL 18, Buy), which reduces the risk of the acquisition, in our view. We believe LUV has the healthiest balance sheet among the major U.S. airlines, with an adjusted debt to capital ratio of about 29%.
- Risks to our recommendation and target price include a poorly integrated acquisition, a possible price war with one or more competitors, and weakening air travel demand. We are concerned about LUV's corporate governance relating to its use of affiliated outsiders on its board of directors' nominating and compensation committees.
- Our 12-month target price of \$18 values the shares at an enterprise value-to-EBITDAR (EBITDA plus aircraft rent) multiple of 6.5X our 2013 EBITDAR estimate, a premium to peers.

**Southwest Airlines Co.****Business Summary** May 13, 2013

**CORPORATE OVERVIEW.** Southwest Airlines was the largest provider of scheduled domestic passenger air travel in the U.S. in 2012. Overall, the airline ranks as the fourth largest in U.S., based on total revenue passenger miles (RPMs). At January 23, 2013, it served 78 cities in 39 states and the District of Columbia. LUV specializes in low-fare, point-to-point, short-haul, high-frequency service. Although 80% of its work force belongs to unions, the company believes that it has generally enjoyed harmonious labor relations. LUV began service to Atlanta in February 2012. We do not expect LUV to add any additional cities in 2013 as the company works to integrate the acquisition of AirTran.

On May 2, 2011, LUV acquired AirTran Holdings, the parent company of AirTran Airlines (AAI), for \$3.75 a share in cash plus 0.321 of a LUV share for each AAI share. Based on LUV's closing price on September 24, the deal was valued at \$1.0 billion, or \$3.2 billion including the assumption of debt and operating leases. AirTran is a low-cost carrier based primarily in the southeast U.S. with 2010 revenues of \$2.6 billion.

**MARKET PROFILE.** The U.S. airline industry is a \$192 billion market, according to 2011 data from industry lobbying group Airlines for America. With 2011 revenues of \$15.7 billion (which rose 2%, to \$17.1 billion, in 2012), LUV comprised around 8.2% of total industry revenues. Southwest also has an approximate 15% market share when measured by RPMs, as of June 2012. Southwest was profitable in 2012 for the 40th consecutive year and was profitable throughout the industry downturn that took place after 9/11/01, with net income totaling \$2.1 billion in 2001-2005. Over the same period, S&P believes the 10 largest U.S. airlines lost about \$58.6 billion.

**COMPETITIVE LANDSCAPE.** The industry consists of about 50 mainline commercial passenger airlines, of which about 15 are considered major airlines, defined as airlines with annual revenues in excess of \$1.0 billion. Major competitors include Delta Air Lines (16% market share, as measured by RPMs, as of June 2012), AMR Corp.'s American Airlines (13%), United Continental Holdings (17%) US Airways (8%) and Jet-Blue Airways (5%). The U.S. airline industry is highly competitive. Barriers to entry are high, and there are strongly entrenched competitors. Pricing is extremely competitive. Fuel costs, the second largest cost category for Southwest, have risen sharply over the past three years. After having the industry's best fuel hedge position for years, LUV locked into some unfavorable prices in 2008 near oil's record highs. Those hedges will work off in the first quarter of 2013.

**CORPORATE STRATEGY.** The company primarily offers short-haul flights that require no connections through a hub. The average flight length in 2012 was 693 miles; about 71% of customers fly nonstop. By eschewing the hub-and-spoke structure favored by other major airlines, avoiding interlining, feeder services and congested airports, LUV has been able to keep aircraft turnaround times low. In addition, by serving mainly short-haul markets, the company believes it holds down food costs, as well as ground service that keeps aircraft out of service and requires leasing more airport gate space.

The company has one of the industry's lowest cost structures; it spent \$0.1285 per seat mile in 2012, up from \$0.1240 per seat mile in 2011 and \$0.1129 per seat mile in 2010. LUV books over 95% of customers electronically, and about 78% of 2011 passenger revenues were obtained from sales over its own Internet site. LUV's strategy to control costs has historically involved flying only one aircraft type, simplifying scheduling, maintenance and training. Although, this shifted with the acquisition of AirTran, which added the 717 to the company's fleet of 737s, LUV has reached an agreement with Delta to sublease most of the 717 fleet and will not operate the remaining planes. At the end of 2012, the company operated 694 aircraft. The average fleet age at the end of 2011 was about 11.4 years, up from 11.3 years at the end of 2009. For 2013, LUV had firm orders to take delivery of 20 new aircraft.

In December 2004, LUV won a bid to purchase six gates at Chicago Midway airport from ATA Holdings, parent company of ATA Airlines. Under terms of the agreement, LUV paid \$40 million for the gates, and provided ATA with a \$40 million debtor-in-possession financing loan for the company, which was in bankruptcy.

**FINANCIAL TRENDS.** Over the 10 years through 2012, LUV exhibited a compound annual growth rate (CAGR) for revenues of about 11%, while net margins were 2.4% of revenues in 2012, up from 2.1% in 2011, and compared with a ten year high of 7.2% in 2005. Net income in 2009 of \$99 million was the lowest the company had recorded over the past 10 years, reflecting fuel hedging losses. Net income rebounded to \$459 million in 2010, declined in 2011 on increased fuel prices and increased in 2012 on better revenues. LUV has outperformed the industry in profitability over the past 10 years and has maintained a strong balance sheet, in our view. The company's debt to total capitalization ratio stood at 29% as of the end of 2012, which we think reflects a healthy capital structure.

**Corporate Information****Investor Contact**

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G.C. Kelly**EVP & General Counsel**  
R. Ricks**COO & EVP**  
M.G. Van De Ven**SVP & CFO**  
T. Romo**EVP & Chief Admin Officer**  
J. Lamb**Board Members**D. W. Biegler  
D. H. Brooks  
J. G. Denison  
N. B. Loeffler  
T. M. NealonJ. V. Biggins  
W. H. Cunningham  
G. C. Kelly  
J. T. Montford  
D. D. Villanueva**Domicile**

Texas

**Founded**

1967

**Employees**

45,861

**Stockholders**

13,687

# Southwest Airlines Co.



## Quantitative Evaluations

<b>S&amp;P Fair Value Rank</b>	5+	1	2	3	4	5
		LOWEST				HIGHEST
Based on S&P's proprietary quantitative model, stocks are ranked from most overvalued (1) to most undervalued (5).						

<b>Fair Value Calculation</b>	\$16.70	Analysis of the stock's current worth, based on S&P's proprietary quantitative model suggests that LUV is Undervalued by \$2.53 or 17.9%.
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<b>Investability Quotient Percentile</b>	33	LOWEST = 1	HIGHEST = 100
LUV scored lower than 67% of all companies for which an S&P Report is available.			

<b>Volatility</b>	LOW	AVERAGE	HIGH
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<b>Technical Evaluation</b>	BULLISH	Since November, 2012, the technical indicators for LUV have been BULLISH.
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<b>Insider Activity</b>	NA	UNFAVORABLE	NEUTRAL	FAVORABLE
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## Expanded Ratio Analysis

	2012	2011	2010	2009
Price/Sales	0.45	0.42	0.80	0.82
Price/EBITDA	4.70	4.30	6.00	8.97
Price/Pretax Income	11.32	20.54	13.01	51.64
P/E Ratio	18.41	37.27	21.12	85.55
Avg. Diluted Shares Outstg (M)	757.0	775.0	747.0	741.0

Figures based on calendar year-end price

## Key Growth Rates and Averages

Past Growth Rate (%)	1 Year	3 Years	5 Years	9 Years
Sales	9.13	19.26	11.97	11.85
Net Income	NM	40.43	-1.70	-6.68

Ratio Analysis (Annual Avg.)	2012	2011	2010	2009
Net Margin (%)	2.46	2.46	1.99	3.78
% LT Debt to Capitalization	28.19	29.11	31.62	24.96
Return on Equity (%)	6.07	5.54	4.30	5.96

## Company Financials Fiscal Year Ended Dec. 31

Per Share Data (\$)	2012	2011	2010	2009	2008	2007	2006	2005	2004	2003
Tangible Book Value	8.06	7.45	8.34	7.36	6.69	10.49	8.23	8.38	7.04	6.40
Cash Flow	1.67	1.15	1.46	0.96	1.05	1.56	1.23	1.25	0.91	1.00
Earnings	0.56	0.23	0.61	0.13	0.24	0.84	0.61	0.67	0.38	0.54
S&P Core Earnings	0.56	0.22	0.61	0.12	0.23	0.83	0.60	0.62	0.30	0.48
Dividends	0.03	0.02	0.02	0.02	0.02	0.02	0.02	0.02	0.02	0.02
Payout Ratio	6%	8%	3%	14%	8%	2%	3%	3%	5%	3%
Prices:High	10.61	13.59	14.32	11.78	16.77	16.96	18.20	16.95	17.06	19.69
Prices:Low	7.76	7.15	10.42	4.95	7.05	12.12	14.61	13.05	12.88	11.72
P/E Ratio:High	19	59	24	91	70	20	30	25	45	36
P/E Ratio:Low	14	31	17	38	29	14	24	19	34	22

Income Statement Analysis (Million \$)	2012	2011	2010	2009	2008	2007	2006	2005	2004	2003
Revenue	17,088	15,658	12,104	10,350	11,023	9,861	9,086	7,584	6,530	5,937
Operating Income	1,650	1,542	1,616	944	1,058	1,371	1,449	1,289	985	867
Depreciation	844	715	628	616	599	555	515	469	431	384
Interest Expense	126	182	149	165	130	119	77.0	83.0	49.0	58.0
Pretax Income	685	323	745	164	278	1,058	790	874	489	708
Effective Tax Rate	38.5%	44.9%	38.4%	39.6%	36.0%	39.0%	36.8%	37.3%	36.0%	37.6%
Net Income	421	178	459	99.0	178	645	499	548	313	442
S&P Core Earnings	418	174	456	93.2	169	635	489	504	236	385

Balance Sheet & Other Financial Data (Million \$)	2012	2011	2010	2009	2008	2007	2006	2005	2004	2003
Cash	2,970	3,144	3,538	2,593	1,803	2,779	1,390	2,280	1,305	1,865
Current Assets	4,218	4,345	4,279	3,358	2,893	4,443	2,601	3,620	2,172	2,313
Total Assets	18,596	18,068	15,463	14,269	14,308	16,772	13,460	14,218	11,337	9,878
Current Liabilities	4,650	4,533	3,305	2,676	2,806	4,838	2,887	3,848	2,142	172
Long Term Debt	2,850	3,107	2,875	3,325	3,498	2,050	1,567	1,394	1,700	1,332
Common Equity	6,992	6,877	6,237	5,466	4,953	6,941	6,449	6,675	5,524	5,052
Total Capital	10,110	10,628	9,617	8,981	10,355	11,526	10,120	9,965	8,834	7,804
Capital Expenditures	1,348	968	493	585	923	1,331	1,399	1,210	1,775	1,238
Cash Flow	1,265	893	1,087	715	777	1,200	1,014	1,017	744	826
Current Ratio	0.9	1.0	1.3	1.3	1.0	0.9	0.9	0.9	1.0	13.4
% Long Term Debt of Capitalization	28.2	29.2	29.9	37.0	33.8	17.8	15.5	14.0	19.2	17.1
% Net Income of Revenue	2.5	1.1	3.8	1.0	1.6	6.5	5.5	7.2	4.8	7.4
% Return on Assets	2.3	1.1	3.1	0.7	1.2	4.3	3.6	4.3	3.0	4.7
% Return on Equity	6.1	2.7	7.8	1.9	3.0	9.6	7.6	9.0	5.9	9.3

# Southwest Airlines Co.

## Sub-Industry Outlook

We have a positive fundamental outlook for the airline sub-industry for the next 12 months. Traffic statistics showed improving demand and revenues in 2012, which we see carrying on through 2013. We believe the U.S. airline industry is seeing good demand, despite the still-temper U.S. economy. In addition, we think that since the industry has reduced capacity levels, it should be able to raise fares as passenger travel demand improves, and hold the line on fares if demand weakens. Oil and jet fuel prices, should they continue to rise, represent a risk to the fragile industry recovery. We think the airlines are likely to see tougher comparisons in 2013 after rising unit revenues in 2012, but we expect demand for air travel to remain strong.

We think investor sentiment on airline stocks could improve on signs that the U.S. economy is recovering and if oil prices retreat. The bankruptcy filing of AMR Corp., parent of American Airlines, should lead to additional domestic and international capacity cuts as American restructures. In addition, American intends to merge with U.S. Airways, which should lead to even more capacity rationalization over time. The industry successfully instituted a number of fare hikes in 2011 and 2012, and will likely look to continue to raise fares in 2013. Many of the shares warrant added risk premiums, in our view.

We estimate that the top 10 U.S. carriers earned \$4.0 billion in both 2011 and 2012 and \$3.7 billion in 2010, after losing \$5 billion in 2009 and \$4 billion in 2008. Results in 2012 benefited from fare increases, improved business travel and lower oil prices, while increases in ancillary fees such as baggage, change fees and premium seating have slowed. We think cuts to domestic and international supply over the past three years have improved airlines' pricing power.

Total revenue passenger miles (RPMs) rose 0.6% in 2012, versus a 0.7% increase in 2011. Yields rose 3.2%, after a 9.4% advance in 2011. Available seat miles fell 0.4%, after a 1.0% increase in 2011. The passenger load factor rose by 0.8 percentage points to 82.8%, after a 0.3 percentage point decline in 2011.

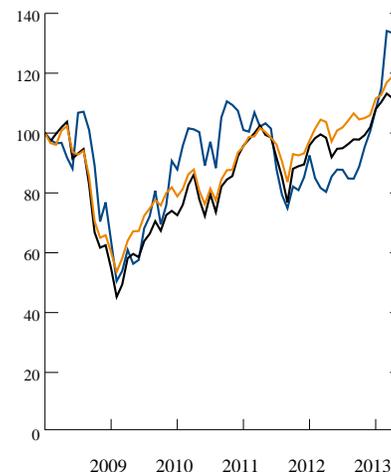
Year to date through May 3, the S&P Airlines Index rose 35.5%, versus a 13.2% rise for the S&P 1500. In 2012, the S&P Airlines Index increased 18.0% versus a 13.7% rise in the 1500. The 5-year compound annual growth rate for the S&P Airlines index through January 4, 2013, was 1.3%, versus 1.7% for the 1500.

--Jim Corridore

## Stock Performance

GICS Sector: Industrials  
Sub-Industry: Airlines

Based on S&P 1500 Indexes  
Month-end Price Performance as of 5/31/13



Sub-Industry      Sector      S&P 1500

NOTE: All Sector & Sub-Industry information is based on the Global Industry Classification Standard (GICS)

## Sub-Industry : Airlines Peer Group\*: Airlines (U.S.) - Major

Peer Group	Stock Symbol	Stk.Mkt. Cap. (Mil. \$)	Recent Stock Price(\$)	52 Week High/Low(\$)	Beta	Yield (%)	P/E Ratio	Fair Value Calc.(\$)	Quality Ranking	S&P IQ %ile	Return on Revenue (%)	LTD to Cap (%)
<b>Southwest Airlines</b>	<b>LUV</b>	<b>10,317</b>	<b>14.17</b>	<b>14.56/8.45</b>	<b>1.15</b>	<b>1.1</b>	<b>28</b>	<b>16.70</b>	<b>B</b>	<b>33</b>	<b>2.5</b>	<b>28.2</b>
AMR Corp	AAMRQ	1,676	5.00	7.15/0.36	1.82	Nil	NM	NA	D	2	NM	4952.2
Alaska Air	ALK	3,997	56.82	68.00/32.16	0.62	Nil	13	56.50	B	38	6.8	36.2
Delta Air Lines	DAL	15,272	18.01	19.43/8.42	0.66	Nil	17	15.70	NR	20	2.8	106.2
JetBlue Airways	JBLU	1,752	6.21	7.28/4.76	0.88	Nil	17	8.90	B-	23	2.6	50.8
US Airways Group	LCC	2,868	17.57	19.70/9.74	0.88	Nil	5	59.60	B-	21	4.6	78.4
United Continental Holdings	UAL	10,840	32.46	35.27/17.45	0.77	Nil	NM	54.40	NR	15	NM	82.0

NA-Not Available NM-Not Meaningful NR-Not Rated. \*For Peer Groups with more than 15 companies or stocks, selection of issues is based on market capitalization.

**Southwest Airlines Co.****S&P Analyst Research Notes and other Company News****May 30, 2013**

Southwest Airlines announced the promotion of Randy Sloan to SVP as the company's Chief Information Officer. The Leadership of the Chief Information Officer's Team will support the work of hundreds of Employees focused on delivering the systems and technology to support Southwest's Legendary Customer Service.

**April 25, 2013**

07:45 am ET ... S&P KEEPS BUY OPINION ON SHARES OF SOUTHWEST AIRLINES (LUV 13.42\*\*\*\*): We keep our '13 EPS estimate at \$1.00. We raise our 12-month target price by \$3 to \$18, an Enterprise Value to EBITDAR multiple of 6.5X our '13 EBITDAR estimate, above peers, due to our view that LUV's balance sheet is superior to peers. Q1 operating EPS of \$0.07, vs. a \$0.02 loss, missed our \$0.15 estimate but beat the Capital IQ consensus of \$0.03. We think the AirTran integration and revenue initiatives will give LUV a better share among business travelers. LUV sees falling unit revenues in April, but we expect lower fuel costs to more than offset this impact. /J. Corridore

**April 25, 2013**

09:18 am ET ... S&P DOWNGRADES OPINION ON SHARES OF JETBLUE AIRWAYS TO SELL FROM HOLD (JBLU 7.18\*\*): We cut our '13 EPS estimate to \$0.46 from \$0.65 on Q1's miss and rising maintenance cost assumptions. We keep our 12-month target price at \$6.50, an Enterprise Value to EBITDAR multiple of 5.6X our '13 EBITDAR estimate, above peers but below Southwest (LUV 13, Buy) which we expect to outperform JBLU financially over the next year. Q1 EPS of \$0.05, vs. \$0.09, missed our \$0.12 estimate and the Capital IQ consensus of \$0.10. Maintenance costs remain a concern and with a slower growth profile, we do not think the shares deserve the premium to peers they currently have. /J. Corridore

**April 22, 2013**

Southwest Airlines announced Craig Maccubbin will join the airline as its new Chief Technology Officer (CTO) and Vice President of Technology Operations, effective May 6, 2013. In his new position, Maccubbin will be responsible for the Technology Operations for the airline, which includes all current Infrastructure and Services areas and Mobile Platform. Maccubbin most recently served as Vice President and CIO of Spirit Airlines, where he was responsible for all information technology and systems. As CTO, Maccubbin joins the Technology Leadership team and will oversee approximately 500 Employees engaged in support of the airline's technology agenda. His primary function is to support the day-to-day operational aspects of running technology solutions for all of Southwest Airlines, including operations of the airline's data centers. In addition, he will lead the Quality Assurance function within Technology.

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**January 24, 2013**

08:38 am ET ... S&P KEEPS BUY OPINION ON SHARES OF SOUTHWEST AIRLINES (LUV 11.36\*\*\*\*): We lift our '13 EPS estimate \$0.05 to \$1.00, and keep our target price at \$15, an Enterprise Value to EBITDAR multiple of 5.3X our '13 EBITDAR (EBITDA plus aircraft rent) estimate. This is a premium to peers, warranted, in our view, by what we see as LUV's relatively healthier balance sheet compared to peers. Q4 operating EPS of \$0.09, vs. \$0.09, missed our \$0.15 estimate but was a penny above the Capital IQ consensus. We expect LUV to benefit from incremental revenue streams and operating leverage, as we expect most costs to rise at a slower rate than revenues this year. /J. Corridore

**December 11, 2012**

Southwest Airlines Co. announced that Madeleine Johnson, the company's Vice

President and General Counsel, has announced her decision to retire, effective Feb. 1, 2013. Her successor will be Mark Shaw, currently Southwest's Associate General Counsel of Corporate & Transactions. Shaw, 49, has been named to succeed Johnson as Vice President and General Counsel. Shaw joined Southwest in 2000 as an attorney in the General Counsel Department and was promoted in 2008 to his current role as Associate General Counsel of Corporate & Transactions. As Vice President and General Counsel, Shaw will assume the leadership role providing legal advice to Southwest on all legal matters and running the Company's General Counsel Department. The leadership changes will be effective Feb. 1, 2013.

**October 18, 2012**

01:53 pm ET ... S&P REITERATES BUY OPINION ON SHARES OF SOUTHWEST AIRLINES (LUV 9.02\*\*\*\*): We cut our '12 EPS estimate to \$0.71 from \$0.95 and '13's to \$0.95 from \$1.36. We keep our target price at \$15, valuing the stock at a premium to peers on an enterprise value to EBITDAR (EBITDA plus aircraft rent) basis. LUV is experiencing cost pressures related to the AirTran integration, technology initiatives and fleet modernization. Revenue is being impacted by network changes. We think the integration, when complete, will provide significant revenue opportunities, and cost pressures should start to ease next year. We see LUV's balance sheet as strong relative to peers. /J. Corridore

**October 16, 2012**

Southwest Airlines welcomes J. Randolph Randy Babbitt as Senior Vice President of Labor Relations to direct and oversee the carrier's labor related activities. Babbitt will report directly to Chief Operating Officer Mike Van de Ven and have responsibility for all negotiation, communication, and ongoing relationships between the Company and the eleven organizations that represent 87% of Southwest Employees. Mike Ryan, Southwest's Vice President of Labor Relations, and the Labor Relations Team will report to Babbitt. Babbitt began his aviation career as a pilot, flying 25 years for Eastern Airlines. Babbitt later served as the FAA's sixteenth administrator from June 2009 through December 2011 after more than eight years on the agency's Management Advisory Council providing guidance to other Administrators on a range of topics ranging from air traffic modernization to regulatory policy and safety oversight within the airline industry and the FAA.

**October 5, 2012**

LUV says it flew 7.8B revenue passenger miles (RPMs) in September 2012, down 2.1% compared to 7.9B RPMs flown in September 2011. Available seat miles (ASMs) fell 1.0% to 10.1B in September '12 from 10.2B ASMs in September '11. The September '12 load factor was 77.0%, vs. 77.8% in September '11. For September '12, passenger revenue per ASM (PRASM) is estimated to have decreased in the 2%-3% range vs. September '11.

# Southwest Airlines Co.

## Glossary

### S&P STARS

Since January 1, 1987, S&P Capital IQ Equity Research has ranked a universe of U.S. common stocks, ADRs (American Depositary Receipts), and ADSs (American Depositary Shares) based on a given equity's potential for future performance. Similarly, S&P Capital IQ Equity Research has used STARS® methodology to rank Asian and European equities since June 30, 2002. Under proprietary STARS (STock Appreciation Ranking System), S&P equity analysts rank equities according to their individual forecast of an equity's future total return potential versus the expected total return of a relevant benchmark (e.g., a regional index (S&P Asia 50 Index, S&P Europe 350® Index or S&P 500® Index)), based on a 12-month time horizon. STARS was designed to meet the needs of investors looking to put their investment decisions in perspective. Data used to assist in determining the STARS ranking may be the result of the analyst's own models as well as internal proprietary models resulting from dynamic data inputs.

### S&P Quality Ranking

Growth and stability of earnings and dividends are deemed key elements in establishing S&P's earnings and dividend rankings for common stocks, which are designed to encapsulate the nature of this record in a single symbol. It should be noted, however, that the process also takes into consideration certain adjustments and modifications deemed desirable in establishing such rankings. The final score for each stock is measured against a scoring matrix determined by analysis of the scores of a large and representative sample of stocks. The range of scores in the array of this sample has been aligned with the following ladder of rankings:

A+ Highest	B- Below Average
A High	C Lower
A- Above Average	D Lowest
B+ Average	NR In Reorganization
B Below Average	

### S&P Issuer Credit Rating

A Standard & Poor's Issuer Credit Rating is a current opinion of an obligor's overall financial capacity (its creditworthiness) to pay its financial obligations. This opinion focuses on the obligor's capacity and willingness to meet its financial commitments as they come due. It does not apply to any specific financial obligation, as it does not take into account the nature of and provisions of the obligation, its standing in bankruptcy or liquidation, statutory preferences, or the legality and enforceability of the obligation. In addition, it does not take into account the creditworthiness of the guarantors, insurers, or other forms of credit enhancement on the obligation.

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S&P Capital IQ earnings per share (EPS) estimates reflect analyst projections of future EPS from continuing operations, and generally exclude various items that are viewed as special, non-recurring, or extraordinary. Also, S&P Capital IQ EPS estimates reflect either forecasts of S&P Capital IQ equity analysts; or, the consensus (average) EPS estimate, which are independently compiled by Capital IQ, a data provider to S&P Capital IQ Equity Research. Among the items typically excluded from EPS estimates are asset sale gains; impairment, restructuring or merger-related charges; legal and insurance settlements; in process research and development expenses; gains or losses on the extinguishment of debt; the cumulative effect of accounting changes; and earnings related to operations that have been classified by the company as discontinued. The inclusion of some items, such as stock option expense and recurring types of other charges, may vary, and depend on such factors as industry practice, analyst judgment, and the extent to which some types of data is disclosed by companies.

### S&P Core Earnings

S&P Capital IQ Core Earnings is a uniform methodology for adjusting operating earnings by focusing on a company's after-tax earnings generated from its principal businesses. Included in the S&P Capital IQ definition are employee stock option grant expenses, pension costs, restructuring charges from ongoing operations, write-downs of depreciable or amortizable operating assets, purchased research and development, M&A related expenses and unrealized gains/losses from hedging activities. Excluded from the definition are pension gains, impairment of goodwill charges, gains or losses from asset sales, reversal of prior-year charges and provision from litigation or insurance settlements.

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CAGR - Compound Annual Growth Rate
CAPEX - Capital Expenditures
CY - Calendar Year
DCF - Discounted Cash Flow
EBIT - Earnings Before Interest and Taxes
EBITDA - Earnings Before Interest, Taxes, Depreciation and Amortization
EPS - Earnings Per Share
EV - Enterprise Value
FCF - Free Cash Flow
FFO - Funds From Operations
FY - Fiscal Year
P/E - Price/Earnings
P/NAV - Price to Net Asset Value
PEG Ratio - P/E-to-Growth Ratio
PV - Present Value
R&D - Research & Development
ROE - Return on Equity
ROI - Return on Investment
ROIC - Return on Invested Capital
ROA - Return on Assets
SG&A - Selling, General & Administrative Expenses
SOTP - Sum-of-The-Parts
WACC - Weighted Average Cost of Capital

**Dividends on American Depositary Receipts (ADRs) and American Depositary Shares (ADSs) are net of taxes (paid in the country of origin).**

# Southwest Airlines Co.

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### S&P Capital IQ Global STARS Distribution as of March 31, 2013

Ranking	North America	Europe	Asia	Global
Buy	35.0%	27.7%	38.7%	34.3%
Hold	56.0%	48.6%	50.3%	54.2%
Sell	9.0%	23.7%	11.0%	11.5%
Total	100%	100%	100%	100%

**5-STARS (Strong Buy):** Total return is expected to outperform the total return of a relevant benchmark, by a wide margin over the coming 12 months, with shares rising in price on an absolute basis.

**4-STARS (Buy):** Total return is expected to outperform the total return of a relevant benchmark over the coming 12 months, with shares rising in price on an absolute basis.

**3-STARS (Hold):** Total return is expected to closely approximate the total return of a relevant benchmark over the coming 12 months, with shares generally rising in price on an absolute basis.

**2-STARS (Sell):** Total return is expected to underperform the total return of a relevant benchmark over the coming 12 months, and the share price is not anticipated to show a gain.

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Relevant benchmarks: In North America, the relevant benchmark is the S&P 500 Index, in Europe and in Asia, the relevant benchmarks are the S&P Europe 350 Index and the S&P Asia 50 Index, respectively.

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Ranking	North America	Europe	Asia	Global
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Hold	20.1%	21.8%	18.5%	19.8%
Sell	39.9%	36.1%	28.0%	33.8%
Total	100%	100%	100%	100%

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