

Southwest Airlines Reports Second Quarter Earnings

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Southwest Airlines (NYSE:LUV) today reported its second quarter 2008 results. Net income for second quarter 2008 was \$321 million, or \$.44 per diluted share, compared to \$278 million, or \$.36 per diluted share, for second quarter 2007.

Excluding special items, second quarter 2008 net income was \$121 million, or \$.16 per diluted share, compared to \$195 million, or \$.25 per diluted share, for second quarter 2007. The second quarter 2008 results exceed First Call's mean estimate of \$.12 per diluted share. Refer to the reconciliation in the accompanying tables for further information regarding special items.

Second Quarter 2008 Financial Highlights:

Record quarterly revenues of \$2.9 billion, up 11.1 percent from second quarter 2007

Net income, excluding special items, of \$121 million, down 37.9 percent

Net income per diluted share, excluding special items, of \$.16, down 36 percent

Favorable cash settlements of \$511 million from fuel contracts were reflected in net income, excluding special items

Gary C. Kelly, Chairman of the Board, President, and Chief Executive Officer, stated: "With the weak domestic economy and unprecedented jet fuel prices, we are pleased to report our 69th consecutive quarter of profitability. Although we have prepared ourselves well for today's challenging environment and are proud of our ability to sustain profitability, we cannot stand still. We must continue to make the necessary adjustments to adapt to higher jet fuel prices and restore our profit margins.

"In addition to our major revenue initiatives underway, we continue to raise fares to avoid nickel and diming our Customers with added fees. With new schedule planning tools and processes and fleet flexibility, we believe we are well-positioned to respond to a rapidly changing environment and have the flexibility to adjust our flight schedule, as necessary, to eliminate unproductive flying. At present, we plan to grow our year-over-year available seat mile (ASM) capacity no more than four percent in 2008 to primarily meet Customer demand in developing markets, such as Denver. Customers have responded exceptionally well to Southwest service in Denver. As a consequence, we will grow to 115 daily departures to 32 markets in November. We are evaluating our current fleet plans and may not grow our ASM capacity in 2009.

"As previously outlined, we have much work underway to grow revenues, and I am proud of the progress we are making. Despite the tough economy and more difficult year-over-year comparisons caused by Easter falling in March this year (versus April last year), we reported record operating revenues of \$2.9 billion for the second quarter 2008 and an operating revenue per available seat mile (RASM) year-over-year growth rate of 5.3 percent. Based on revenue and booking trends so far this quarter, we are expecting strong yield growth but with lower load factors versus third quarter 2007. Thus far, our RASM growth rate in July has surpassed our second quarter year-over-year increase.

"Although our revenue trends are strong, energy prices continue to soar. Even with \$511 million in favorable cash settlements from derivative contracts in the second quarter 2008, our economic fuel costs increased 35.2 percent to \$2.19 per gallon. Although better than we anticipated, the considerable year-over-year increase in fuel costs was by far the most significant driver of the 10.5 percent increase in our second quarter 2008 unit costs, excluding special items. We have derivative contracts for approximately 80 percent of our third quarter 2008 estimated fuel consumption at an average crude-equivalent price of approximately \$61 per barrel (compared to approximately 90 percent at approximately \$51 per barrel for third quarter 2007). Based on this derivative position and current market prices, we currently anticipate our third quarter 2008 economic fuel cost per gallon to be in the \$2.50 range.

"The current market value of our fuel derivative contracts for third quarter 2008 through 2012 is approximately \$4.3 billion as a result of the extraordinary increase in fuel prices this year. In addition to our third quarter 2008 derivative contracts, we currently have derivative contracts for approximately 80 percent of our estimated fuel consumption for the fourth quarter 2008 at an average crude-equivalent price of approximately \$58 per barrel, approximately 70 percent in 2009 at an average crude-equivalent price of \$66 per barrel, approximately 40 percent in 2010 at an average crude-equivalent price of approximately \$81 per barrel, and over 20 percent in 2011 and 2012 at an average crude-equivalent price of approximately \$77 and \$76 per barrel, respectively.

"Excluding fuel, second quarter 2008 unit costs increased 1.8 percent from a year ago, which was better than we anticipated. Based on current trends, we expect our third quarter 2008 unit costs, excluding fuel and special items, to be in line with second quarter 2008's 6.72 cents.

"Although we have enormous cost challenges, primarily due to persistently higher fuel costs, we believe we have equally large opportunities to improve our revenue production. At the same time, we are enhancing our already strong brand and Customer Experience. The responses to our Business Select product, new boarding method, and makeover of the gate areas have been overwhelmingly positive. We are also making progress with our efforts to expand our network through codeshare arrangements and are excited about our recently announced plans to codeshare with WestJet to Canada by the end of 2009.

"While our Employees are working harder than ever to secure our future, they continue to deliver warm, caring, and friendly Southwest-style service. Our People have incredible Warrior Spirits and huge hearts, which is why we lead the industry in Customer Satisfaction according to the American Customer Satisfaction Index and most recently captured The Reputation Institute's top ranking of the U.S. airlines by reputation. Their efforts are remarkable, their results superb, and I and am very grateful to each of them. Our People are, truly, the core strength of our Company."

Operating Results

Total operating revenues for second quarter 2008 increased 11.1 percent to \$2.9 billion, compared to \$2.6 billion for second quarter 2007. Total second quarter 2008 operating expenses were \$2.7 billion, compared to \$2.3 billion in second quarter 2007. Operating income for second quarter 2008 was \$205 million compared to \$328 million in second quarter 2007. Excluding special items, operating income was \$242 million in second quarter 2008 compared to \$328 million last year. Operating income, excluding special items, reflects fuel and oil expense of \$857 million and \$607 million for second quarter 2008 and 2007, respectively, which is based on the Company's true economic cost of fuel, including the benefit of cash settlements from derivative contracts of \$511 million and \$173 million, respectively.

"Other income" was \$324 million for second quarter 2008, compared to \$119 million for second quarter 2007. The \$205 million increase principally resulted from higher unrealized gains associated with Statement of Financial Accounting Standard (SFAS) 133, "Accounting for Derivative Instruments and Hedging Activities," as amended. These unrealized gains represent the most significant difference between the Company's net income and net income, excluding special items. The cost of the hedging program (which includes the premium costs of derivative contracts) of \$14 million in second quarter 2008 and second quarter 2007 is also included in "other (gains) losses." The \$20 million year-over-year increase in net interest expense for second quarter 2008 resulted from lower interest rates on cash, cash equivalents, and investments and lower Boeing aircraft progress payments, which generated less capitalized interest.

Net cash provided by operations for the six months ended June 30, 2008 was \$3.3 billion, which included a \$2.4 billion increase in fuel derivative collateral deposits related to future periods, and capital expenditures were \$587 million. During second quarter 2008, the Company borrowed \$600 million under a new term loan secured by 21 aircraft. The Company ended second quarter 2008 with \$5.8 billion in cash and short-term investments, which included \$4.4 billion in fuel derivative collateral deposits (with a corresponding liability recorded in Accrued Liabilities). At present, the value of the Company's fuel derivative contracts for third quarter 2008 through 2012 is approximately \$4.3 billion with corresponding fuel derivative collateral deposits of \$3.7 billion. In addition, the Company had a fully available unsecured revolving credit line of \$600 million.

Total operating revenues for the six months ended June 30, 2008 increased 12.9 percent to \$5.4 billion, while total operating expenses increased 16.9 percent to \$5.1 billion, resulting in operating income in first half 2008 of \$293 million versus \$412 million in first half 2007. Excluding special items, operating income was \$341 million and \$398 million, respectively, for the six months ended June 30, 2008 and 2007. Net income for the six months ended June 30, 2008 was \$355 million, or \$.48 per diluted share, compared to \$371 million, or \$.47 per diluted share, for the same period last year. Excluding special items, net income for the six months ended June 30, 2008 was \$164 million, or \$.22 per diluted share, compared to \$228 million, or \$.29 per diluted share, for the same period last year.

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