UCD Michael Smurfit Graduate Business School

Yale SCHOOL OF MANAGEMENT

Southwest Airlines (LUV)

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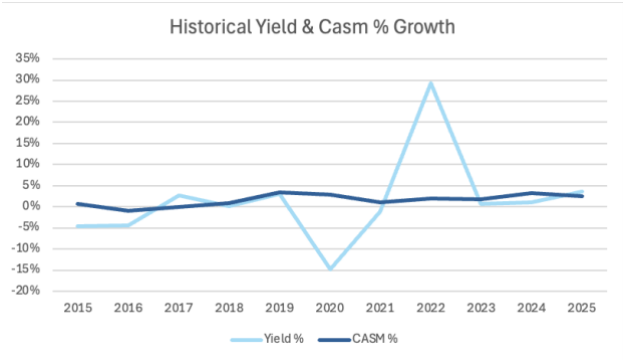
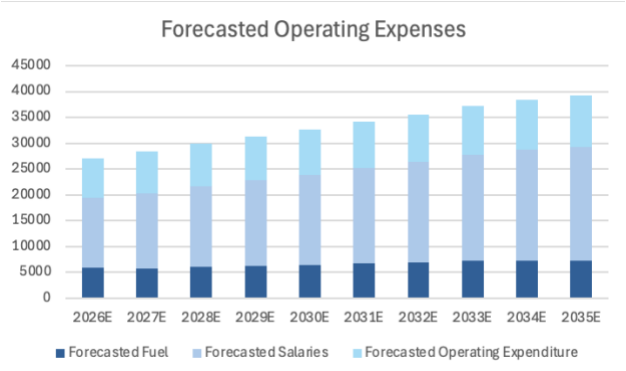
Recommendation: Hold

Share Price: $29.67

Target Valuation: $30.56

Conclusion: 3% Upside





Investment Thesis

ASM

ASMs are expected to increase at a CAGR of 3.38%, driven by fleet expansion as the firm enters a recovery phase.

Future Aircraft Deliveries

The firm has repaid much of its pandemic debt, enabling greater investment in fleet renewal supported by favourable aircraft retirements over the forecast period.

Labour Inefficiencies

A slowdown in ASM growth has led to notable labour inefficiencies for the firm, which are further amplified by its higher average salary levels relative to competitors.

Passenger Fare

Passenger fares are expected to rise in line with inflation, reflecting broader industry pressure as many competitors face PRASM levels that are below CASM.

November 5th 2025

Revenue

Airline revenues are primarily generated from three main business segments: Passenger, Cargo and Other Revenue.

Passenger revenue can be forecasted by:

$$Passenger\ Revenue = Passengers\ Carried * Average\ Passenger\ Fare$$

Available Seat Mile (ASM)

This metric is the standard measure of airline capacity, representing the number of seats available multiplied by the miles flown.

To forecast ASM, the following formula was used.

$$ASM = Departures * Weighted\ Average\ Number\ of\ Seats * Average\ Stage\ Length$$

A review of the company's fleet schedule was carried out, taking into account its existing aircraft orders and delivery commitments with Boeing, to whom Southwest is entirely exposed. The disruptions experienced by Boeing have materially limited Southwest's capacity growth and its ability to expand ASM.

Boeing's historical production record reveals alternating periods of expansion and contraction that broadly conform to a normal distribution, though the number of observations remains limited. This data was analysed to estimate the probability distribution of Boeing's annual production growth, providing insight into the variability and likelihood of different production outcomes.

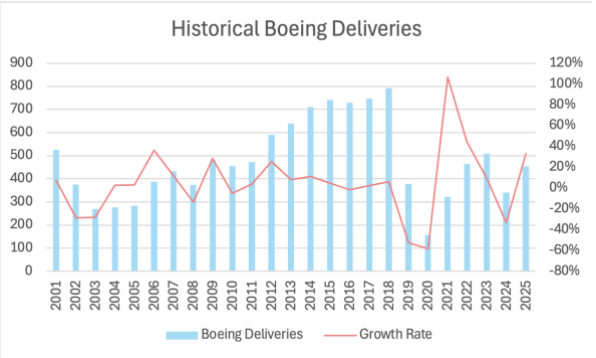
Based on this analysis, a probability-weighted expected production growth rate of 2.89% was derived, capturing the potential for both positive and negative production years. The calculation followed the standard normal probability density function, expressed as:

$$\frac{1}{\sigma\sqrt{2\pi}}\ e^{-\frac{(x-\mu)^2}{2\sigma^2}}$$

This distribution was then used to compute the geometric mean:

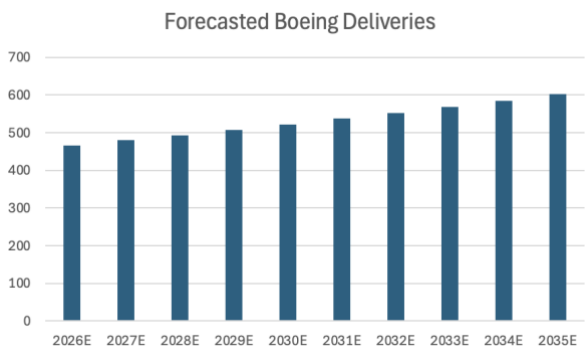
$$e^{\sum(wi*\ln(1+\mathrm{ri}))} - 1$$

Figure 1: Historical Boeing Deliveries



Source: Boeing[1]

Figure 2: Forecasted Boeing Deliveries



Source: Own Estimate

The expected production growth rate, along with Boeing's total outstanding orders and Southwest's allocated share, was used to forecast how many aircraft Southwest will receive each year. Southwest's share of Boeing orders, estimated at 10.65%, is assumed to stay constant over the projection period.

Aircraft retirements were estimated using company disclosures and Boeing's published delivery schedules, enabling a detailed assessment of the expected timing of fleet retirements. The percentage change in total fleet count derived from this analysis was then used to forecast the company's ASM.

Table 1: Southwest's Historical Fleet

Historical Fleet											
Year	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025
737-300	118	87	87	-	-	-	-	-	-	-	-
737-500	11	-	-	-	-	-	-	-	-	-	-
737-700	471	494	512	512	506	470	452	426	387	353	318
737-800	104	142	181	207	207	207	207	207	207	205	205
737 MAX 8	-	-	13	31	34	41	69	137	223	245	216
Total	704	723	793	750	747	718	728	770	817	803	739

Source: Southwest Company Reports

Table 2: Southwest's Historical Fleet

Forecasted Fleet										
Year	2026E	2027E	2028E	2029E	2030E	2031E	2032E	2033E	2034E	2035E
737-700	286	258	232	209	188	169	144	122	104	88
737 - MAX 7		30	62	94	128	162	197	234	271	310
737 - 800	205	205	205	205	205	205	205	205	171	119
737 - MAX 8	266	286	307	329	351	374	398	422	447	472
Total	757	779	806	837	872	910	944	983	993	989

Source: Own Estimate

Table 3: Southwest's Forecasted Weighted Average Number of Seats

Forecasted Weighted Average Number of Seats										
Year	2026E	2027E	2028E	2029E	2030E	2031E	2032E	2033E	2034E	2035E
Number of Seats	163	163	163	163	163	163	163	163	163	162

Source: Own Estimate

[1] Boeing (2025)

Stage Length

Southwest's average stage length has shown a modest upward trend over the past ten years, rising at a CAGR of 0.41%. This same growth rate is carried forward into the forecast period to project future stage length.

Table 4: Southwest's Historical Stage Length

Historical Stage Length											
Year	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025
Average Stage Length	750	760	754	757	748	743	790	728	730	763	781

Source: Southwest Company Reports

Table 5: Southwest's Forecasted Stage Length

Forecasted Stage Length										
Year	2026E	2027E	2028E	2029E	2030E	2031E	2032E	2033E	2034E	2035E
Average Stage Length	781	784	787	791	794	797	800	803	807	810

Source: Own Estimate

Departures

The firm's number of departures is driven by both fleet size and average stage length. Since stage length is expected to remain relatively stable, departures per aircraft are also assumed to stay consistent given the firm's already efficient operations. The estimate is based on the average number of departures from 2018–2019 and 2023–2025, periods that best reflect the firm's current fleet while excluding the pandemic-related reductions.

Table 6: Southwest's Historical Departure's Per Aircraft

Historical Departures Per Aircraft											
Year	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025
Departures	1,267,358	1,311,149	1,347,893	1,375,030	1,367,727	897,540	1,066,934	1,298,219	1,459,427	1,443,866	1,410,319
Departures per Aircraft	1,800	1,813	1,909	1,833	1,831	1,250	1,466	1,686	1,786	1,798	1,908

Source: Southwest Company Reports

Table 7: Southwest's Forecasted Departure's Per Aircraft

Forecasted Departures Per Aircraft										
Year	2026E	2027E	2028E	2029E	2030E	2031E	2032E	2033E	2034E	2035E
Departures per Aircraft	1,831	1,831	1,831	1,831	1,831	1,831	1,831	1,831	1,831	1,831
Fleet Size	757	779	806	837	872	910	944	983	993	989
Forecasted Total Departures	1,386,501	1,427,244	1,476,318	1,532,887	1,596,561	1,666,996	1,728,421	1,799,922	1,818,277	1,811,993

Source: Own Estimate

Available Seat Miles

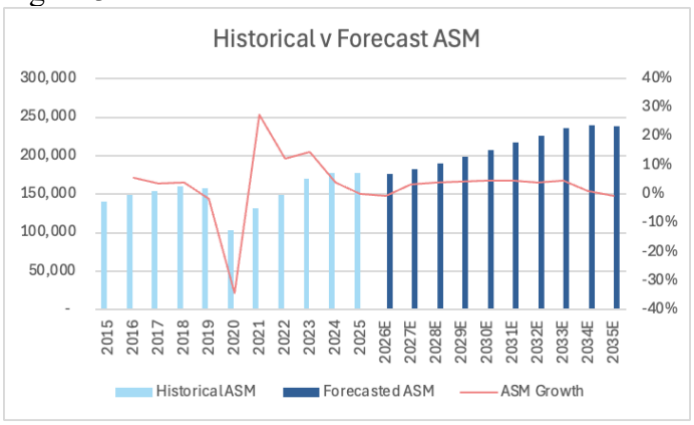
The firm's expanding fleet is expected to drive a significant increase in ASM over the forecast period. A purple patch is anticipated, during which only the Boeing 737-700 aircraft reach retirement age, creating a favourable window for accelerated fleet growth. These inputs were combined to calculate ASMs, which are projected to rise across most of the forecast horizon before gradually tapering off as retirements begin to normalise.

Table 8: Southwest's Forecasted Available Seat Miles

Forecasted Available Seat Miles										
Year	**2026E**	**2027E**	**2028E**	**2029E**	**2030E**	**2031E**	**2032E**	**2033E**	**2034E**	**2035E**
Forecasted Total Departures	1,386,501	1,427,244	1,476,318	1,532,887	1,596,561	1,666,996	1,728,421	1,799,922	1,818,277	1,811,993
Weighted Average Seats	163	163	163	163	163	163	163	163	163	162
Stage Length	781	784	787	791	794	797	800	803	807	810
Available Seat Miles	176,400	182,624	189,860	198,028	207,094	217,031	226,046	236,319	238,967	237,959

Source: Own Estimate

Figure 3: Historical v Forecast ASM

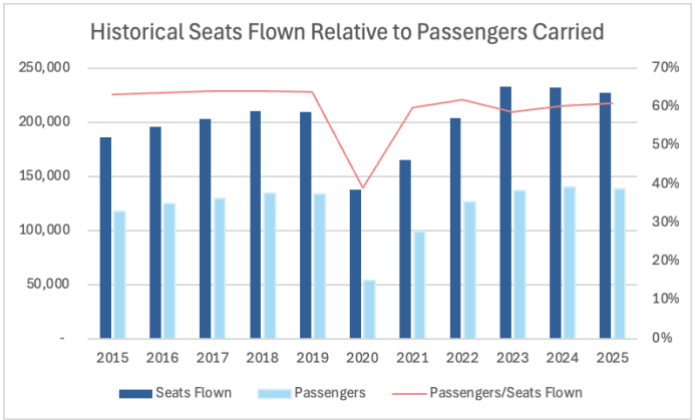


Source: Southwest Company Reports

Passengers Carried

Passengers carried were projected by applying the historical average ratio of 0.60 to seats flown, which was calculated as departures multiplied by the weighted average number of seats. This ratio has remained relatively stable and therefore provides a reliable basis for the forecast.

Figure 4: Historical Seats Flown Relative to Passengers Carried



Source: Southwest Company Reports

Average Passenger Fare

Given the maturity of the airline industry and the strong price sensitivity of consumers, the firm's average passenger fare has declined in real terms since 2015. This decline is largely explained by the inflationary environment over the period. General inflation rose by roughly 35%, and the firm was unlikely to pass the full extent of these cost increases on to customers. Looking ahead, CPI forecasts indicate cumulative inflation of about 22% over the projection period. The firm is expected to pass through inflation of this magnitude, which is consistent with the level it was able to pass through over the previous decade.

Table 9: Southwest's Historical Average Passenger Fare

Historical Average Passenger Fare											
Year	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025
Average Passenger Fare Nominal	154.95	149.20	151.77	151.52	154.90	136.97	138.99	168.62	172.04	178.37	187.36
Average Passenger Fare Real	154.95	147.34	146.74	143.02	143.60	125.40	121.56	136.57	133.81	134.76	136.90

Source: Southwest Company Reports

CPI was then forecasted using IMF projections[2], adjusted based on the mean error identified through back-testing the IMF's 1- to 5-year forecasts against actual outcomes. This adjustment accounts for the historical bias in IMF inflation forecasts.

Table 10: CPI Forecast Error

CPI Forecast Error														
Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
Actual CPI	3.10	2.10	1.50	1.60	0.10	1.30	2.10	2.40	1.80	1.30	4.70	8.00	4.10	3.00
1-Year Forecast Error	1.68	0.89	(0.27)	0.09	(2.03)	0.15	(0.24)	0.27	(0.35)	(0.97)	1.94	4.54	0.59	0.24
2-Year Forecast Error	-	0.74	0.60	(0.15)	(1.68)	(0.84)	0.26	(0.25)	(0.81)	(1.00)	2.27	5.90	1.44	0.77
3-Year Forecast Error	-	-	(0.08)	0.48	(1.72)	(0.65)	(0.11)	0.23	(0.72)	(1.10)	2.51	5.66	1.99	0.40
4-Year Forecast Error	-	-	-	(0.14)	(1.28)	(0.73)	(0.04)	0.28	(0.48)	(1.09)	2.49	5.82	1.80	0.83
5-Year Forecast Error	-	-	-	-	(1.76)	(0.36)	0.00	0.18	(0.19)	(1.08)	2.36	5.70	1.91	0.72

Source: International Monetary Fund

Table 11: Forecasted CPI

Forecasted CPI										
Year	2026E	2027E	2028E	2029E	2030E	2031E	2032E	2033E	2034E	2035E
Forecast CPI	2.40	2.20	2.20	2.20	2.20	2.20	2.20	2.20	2.20	2.20
Mean Error	0.15	0.11	0.11	0.16	0.20	0.20	0.20	0.20	0.20	0.20
Adjusted Forecast CPI	2.25	2.09	2.09	2.04	2.00	2.00	2.00	2.00	2.00	2.00

Source: International Monetary Fund & Own Estimate

This was then used to forecast the average passenger fare in nominal terms.

Table 12: Forecasted CPI

Forecasted Average Passenger Fare										
Year	2026E	2027E	2028E	2029E	2030E	2031E	2032E	2033E	2034E	2035E
Average Passenger Fare	190.44	194.42	198.48	202.52	206.57	210.70	214.92	219.22	223.61	228.08

Source: Own Estimate

[2] International Monetary Fund (2025)

Passenger Revenue

Passenger revenue was estimated by multiplying projected passengers carried by the forecasted passenger fare. Revenue growth over the forecast horizon is primarily driven by the substantial expansion in the number of aircraft operated, which supports higher passenger volumes. As fleet growth moderates toward the end of the period, passenger revenue is likewise expected to plateau as well.

Table 13: Forecasted Passenger Revenue

Forecasted Passenger Revenue										
Year	2026E	2027E	2028E	2029E	2030E	2031E	2032E	2033E	2034E	2035E
Passengers Carried	136.44	140.72	145.71	151.36	157.65	164.55	170.69	177.73	178.99	177.51
Passenger Fare	190.44	194.42	198.48	202.52	206.57	210.70	214.92	219.22	223.61	228.08
Passenger Revenue	25,984	27,359	28,919	30,653	32,566	34,671	36,685	38,961	40,024	40,488

Source: Own Estimate

Cargo Revenue

The firm has not addressed cargo or freight revenue in its reports. However, the figure has remained relatively stable over the past ten years, showing little movement alongside passenger revenue. It is therefore assumed that the company operates under negotiated freight contracts that remain broadly consistent over time. As such, cargo revenue has been forecast at its 10-year historical average of $174.

Other Revenue

Other revenue has remained relatively stable compared to passenger revenue over time. Given its close correlation with passenger revenue, it is projected at 9.10% of passenger revenue, based on the 10-year historical average excluding 2020.

Total Revenue

Overall, the firm's revenue is expected to rise over the forecast period, driven by varying growth rates across its three revenue segments, with passenger revenue contributing the largest share of this increase.

Table 14: Forecasted Total Revenue

Forecasted Total Revenue										
Year	2026E	2027E	2028E	2029E	2030E	2031E	2032E	2033E	2034E	2035E
Passenger Revenue	25,984	27,359	28,919	30,653	32,566	34,671	36,685	38,961	40,024	40,488
Cargo Revenue	174	174	174	174	174	174	174	174	174	174
Other Revenue	2,364	2,489	2,631	2,789	2,963	3,155	3,338	3,545	3,642	3,684
Total Revenue	28,522	30,022	31,725	33,616	35,703	37,999	40,197	42,680	43,840	44,346

Source: Own Estimate

Cost of Goods Sold

Fuel

The fuel burn rate, calculated as fuel consumption over ASM, has steadily declined over time, reaching 1.22%. The firm has indicated that the Boeing 737 MAX aircraft, which account for all outstanding orders, are approximately 14% more fuel efficient than the aircraft they are replacing. To capture this improvement, the forecasted fleet composition was adjusted each year based on the number of new aircraft deliveries and retirements. As older aircraft were replaced by 737 MAX models, the weighted average fuel burn rate for the fleet declined proportionally to the share of more efficient aircraft. This resulted in an annual reduction in the fuel burn rate of 1-2% per year over the forecast period.

$$Fuel\ Burn\ Rate = 1.22\% * (1 - 0.14 * Cumulative\ MAX\ 737)$$

Table 15: Historical Fuel Burn Rate

Historical Fuel Burn Rate											
Year	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025
Fuel Consumption	1,901	1,996	2,044	2,094	2,076	1,273	1,668	1,921	2,143	2,194	2,163
ASM	140,501	148,522	153,811	159,795	157,253	103,457	132,006	148,468	170,323	177,250	177,528
Fuel Burn Rate	1.35%	1.34%	1.33%	1.31%	1.32%	1.23%	1.26%	1.29%	1.26%	1.24%	1.22%

Source: Southwest Company Reports & Own Estimate

Table 16: Forecasted Fuel Burn Rate

Forecasted Fuel Burn Rate										
Year	2026E	2027E	2028E	2029E	2030E	2031E	2032E	2033E	2034E	2035E
Fleet	739	757	779	806	837	872	910	944	983	993
Retirement	32	29	26	23	21	19	25	22	52	68
Additions	50	51	53	54	56	57	59	61	62	64
Old Aircraft	707	679	653	630	609	590	565	543	491	423
Cumulative MAX 737	50	101	153	207	263	320	379	440	502	566
Share of MAX 737	0.07	0.13	0.20	0.26	0.31	0.37	0.42	0.47	0.51	0.57
Fuel Burn Rate	0.99	0.98	0.97	0.96	0.94	0.94	0.93	0.92	0.91	0.90

Source: Own Estimate

The firm's fuel consumption was then forecasted by multiplying the total ASM by the Fuel Burn Rate.

Table 17: Forecasted Fuel Consumption

Forecasted Fuel Consumption										
Year	2026E	2027E	2028E	2029E	2030E	2031E	2032E	2033E	2034E	2035E
ASM	176,400	182,624	189,860	198,028	207,094	217,031	226,046	236,319	238,967	237,959
Fuel Burn Rate	1.21%	1.20%	1.19%	1.18%	1.17%	1.17%	1.16%	1.15%	1.14%	1.13%
Fuel Consumption	2,133	2,193	2,261	2,341	2,431	2,533	2,622	2,725	2,731	2,691

Source: Own Estimate

Future fuel expenses were therefore derived by multiplying the forecast fuel consumption by Gulf Coast Jet Fuel futures prices[3], with an added 16% premium to reflect the difference between the airline's average realised price and the settled market price. This adjustment captures the historical spread between the firm's realised fuel cost per gallon and benchmark futures prices.

Table 18: Forecasted Fuel Expense

Forecasted Fuel Expense										
Year	2026E	2027E	2028E	2029E	2030E	2031E	2032E	2033E	2034E	2035E
Fuel Consumption	2,133	2,193	2,261	2,341	2,431	2,533	2,622	2,725	2,731	2,691
Jet Fuel Price	2.62	2.49	2.49	2.49	2.49	2.49	2.49	2.49	2.49	2.49
Fuel Expense	5,591	5,470	5,640	5,838	6,064	6,317	6,540	6,796	6,813	6,713

Source: Own Estimate

Salaries

The pandemic, followed by the company's exposure to Boeing, has revealed fundamental issues in workforce productivity at Southwest. Within the industry, the number of employees relative to ASM has been used here as an indicator of operational performance. This metric highlights the superior efficiency demonstrated by Delta and United over the period, while Southwest has trailed considerably.

A decline in the employee/ASM ratio indicates that the firm is generating more ASM per employee, reflecting improved workforce productivity and operational efficiency. The company's progress has been constrained by limited ASM growth, and it is projected that the employee/ASM ratio will continue to decline toward its 2015–2018 average of 0.3615 by 2033, in line with ASM expansion, before stabilising at that level.

Table 19: Historical Southwest & Competitors Employee/ASM

Historical Competitors Employee/ASM											
Year	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025
Southwest Number of Employees	49,583	53,536	56,110	58,803	60,767	56,537	55,093	66,656	74,806	72,450	72,223
ASM	140,501	148,522	153,811	159,795	157,253	103,457	132,006	148,468	170,323	177,250	177,528
Employees/ASM	0.3529	0.3605	0.3648	0.3680	0.3864	0.5465	0.4174	0.4490	0.4392	0.4087	0.4068
Delta Airlines Number of Employees	79,655	82,949	83,756	86,564	88,680	91,000	74,000	90,000	90,000	100,000	100,000
ASM	239,676	246,764	251,867	254,325	263,365	275,379	134,339	194,474	233,226	272,033	288,394
Employees/ASM	0.207	0.217	0.223	0.231	0.231	0.205	0.410	0.343	0.321	0.266	0.250
United Airlines Number of Employees	82,000	82,100	83,900	86,000	86,641	90,116	74,400	84,100	92,800	103,300	107,300
ASM	246,021	250,003	253,590	262,386	275,262	284,999	122,804	178,684	247,858	291,333	311,185
Employees/ASM	0.333	0.328	0.331	0.328	0.315	0.316	0.606	0.471	0.374	0.355	0.345

Source: Southwest, Delta and United Company Reports

Table 20: Forecasted Southwest Employee/ASM

Forecasted Southwest Employee/ASM										
Year	2026E	2027E	2028E	2029E	2030E	2031E	2032E	2033E	2034E	2035E
Number of Employees	70,654	72,015	73,711	75,692	77,933	80,409	82,454	85,429	86,387	86,022
ASM	176,400	182,624	189,860	198,028	207,094	217,031	226,046	236,319	238,967	237,959
Employees/ASM	0.4005	0.3943	0.3882	0.3822	0.3763	0.3705	0.3648	0.3615	0.3615	0.3615

Source: Own Estimate

[3] CME (2025)

To forecast the average salary, Southwest's historical salary growth was found to closely follow movements in the Transportation Wage Employment Cost Index (ECI)[4]. As no long-term forecasts for this index are available, the projection was based on the historical spread between transportation wage inflation and CPI, which averaged 0.00774938.

Table 21: Historical Southwest Average Salary

Historical Southwest Average Salary																
Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
Firm Average Salary	99,868	106,129	96,295	103,552	112,311	117,421	128,734	126,980	130,191	130,078	136,472	120,470	140,544	140,663	149,079	168,944
Transportation Wage Inflation	100	102	104	107	109	112	115	118	122	127	132	138	143	148	156	167
Firm Average Salary (Real Terms)	99,868	104,174	92,936	97,139	102,700	104,754	112,385	107,316	106,486	102,379	103,179	87,568	98,399	94,733	95,827	101,128

Source: Southwest Company Report, FRED and Own Estimate

Table 22: Forecasted Transportation Employment Cost Index

Forecasted Transportation Employment Cost Index										
Year	2026E	2027E	2028E	2029E	2030E	2031E	2032E	2033E	2034E	2035E
Forecast CPI	2.40	2.20	2.20	2.20	2.20	2.20	2.20	2.20	2.20	2.20
Mean Error	0.15	0.11	0.11	0.16	0.20	0.20	0.20	0.20	0.20	0.20
Forecast ECI	2.258	2.098	2.098	2.048	2.008	2.008	2.008	2.008	2.008	2.008

Source: International Monetary Fund & Own Estimate

In line with the company's ratified labour agreements, a 4% annual wage increase has been incorporated for the next two years, followed by a 3.5% increase in 2028. A terminal average salary of $237,047 was then established, and post-2028 salary projections were derived by working backwards from this value to ensure consistency with the long-term wage trajectory.

The above calculations were then used to derive the firm's total salary expense over the forecast period.

Table 23: Forecasted Southwest Salary

Forecasted Southwest Salary										
Year	2026E	2027E	2028E	2029E	2030E	2031E	2032E	2033E	2034E	2035E
Number of Employees	70,654	72,015	73,711	75,692	77,933	80,409	82,454	85,429	86,387	86,022
Average Salary	183,857	191,212	197,904	203,073	208,376	213,819	219,403	225,134	231,013	237,047
Salary Expense	12,990	13,770	14,588	15,371	16,239	17,193	18,091	19,233	19,957	20,391

Source: Own Estimate

SG&A

Other Operating Expenses

Other operating expenses include items such as maintenance, landing fees, distribution, and overhead, which were forecasted over ASM. The CAGR of this relationship was observed to be 3.16% and this was used to forecast other operating expenditure at this rate.

Table 24: Forecasted Other Operating Expenses

Forecasted Other Operating Expenses										
Year	2026E	2027E	2028E	2029E	2030E	2031E	2032E	2033E	2034E	2035E
Other Operating Expenses	7,635	7,877	8,126	8,383	8,649	8,923	9,205	9,497	9,798	10,108

Source: Own Estimate

[4] FRED (2025)

CapEx, PP&E D&A

CapEx

Based on Southwest Airlines' fleet expansion plans, capital expenditures have been projected at the company's historical average of 9.93% of revenue, excluding 2020 and 2021. While supply chain disruptions and delays in Boeing deliveries may affect the pace of fleet growth, advance deposits on aircraft are expected to help smooth these impacts. Comparing the projected number of aircraft deliveries with estimated purchase prices produces totals that are broadly consistent with the CapEx forecast, though this method tends to slightly understate capital expenditures as a share of revenue in the later years of the forecast.

Table 25: Forecasted CapEx

Forecasted CapEx										
Year	2026E	2027E	2028E	2029E	2030E	2031E	2032E	2033E	2034E	2035E
CapEx	2,831	2,980	3,149	3,337	3,544	3,772	3,990	4,236	4,351	4,402
Total Revenue	28,522	30,022	31,725	33,616	35,703	37,999	40,197	42,680	43,840	44,346
CapEx %	9.93%	9.93%	9.93%	9.93%	9.93%	9.93%	9.93%	9.93%	9.93%	9.93%

Source: Own Estimate

PP&E

PP&E was projected on a rolling basis, with each year's balance calculated by adding current-year capital expenditures to the prior year's PP&E balance. Although the historical data show some variation, including a notable spike in 2019, the overall trend remains relatively stable.

Table 26: Variance in Historical PP&E

Variance in Historical PP&E											
Year	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025
PP&E	24,685	26,464	28,229	29,256	27,713	27,574	27,574	30,984	33,818	33,947	35,275
CapEx	2,041	2,038	2,123	1,922	1,026	515	505	3,924	3,520	2,055	2,275
Lagged PP&E	24,554	26,723	28,587	30,151	30,282	28,228	28,079	31,498	34,504	35,873	36,222
% Variation	-0.53%	0.98%	1.27%	3.06%	9.27%	2.37%	1.83%	1.66%	2.03%	5.67%	2.68%

Source: Southwest Company Reports & Own Estimate

Table 27: Forecasted PP&E

Forecasted PP&E										
Year	2026E	2027E	2028E	2029E	2030E	2031E	2032E	2033E	2034E	2035E
PP&E	38,106	41,086	44,235	47,572	51,115	54,887	58,877	63,113	67,465	71,867
CapEx	2,831	2,980	3,149	3,337	3,544	3,772	3,990	4,236	4,351	4,402

Source: Own Estimate

D&A

The firm's D&A was forecast based on the historical average of Southwest's D&A as a percentage of PP&E, which was 4.45%. This aligns with the company's depreciation policies, under which Boeing 737 aircraft and related flight equipment are depreciated on a straight-line basis over approximately 25 years with residual values between 14% and 20%, while ground and other property and equipment are depreciated over 5 to 30 years with residual values ranging from 0% to 10%.

Table 28: Forecasted D&A

Forecasted D&A										
Year	2026E	2027E	2028E	2029E	2030E	2031E	2032E	2033E	2034E	2035E
PP&E	38,106	41,086	44,235	47,572	51,115	54,887	58,877	63,113	67,465	71,867
D&A	1,694	1,827	1,967	2,115	2,272	2,440	2,618	2,806	2,999	3,195

Source: Own Estimate

Aircraft Rentals

Aircraft rentals were forecast using the 10-year historical average of $177 as a target value by 2033. As the firm's fleet expands, reliance on leased aircraft is expected to decline, leading to a gradual reduction in aircraft rental expenses over the forecast period.

Table 29: Historical Aircraft Rentals Expense

Historical Aircraft Rentals											
Year	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025
Aircraft Rentals	238	229	198	161	182	150	205	188	177	185	252

Source: Southwest Company Reports

Table 30: Forecasted Aircraft Rentals Expense

Forecasted Aircraft Rentals										
Year	2026E	2027E	2028E	2029E	2030E	2031E	2032E	2033E	2034E	2035E
Aircraft Rentals	241	231	221	211	202	193	185	177	177	177

Source: Own Estimate

Net Working Capital (NWC)

NWC was forecast by projecting operating current assets and operating current liabilities as a percentage of revenue. Operating current assets included items directly related to core operations, such as receivables and inventories, excluding cash and equivalents. Operating current liabilities comprised payables and other operating obligations, with debt excluded from the analysis. Historically, operating current assets have averaged around 8% of revenue, while operating current liabilities have averaged approximately 37%, based on periods excluding 2020 and 2021.

Table 31: Net Working Capital

Net Working Capital											
Year	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025
Total Current Assets	973	1,193	1,542	1,339	1,902	1,839	2,532	2,516	2,481	2,549	2,377
CA/Revenue	0.05	0.06	0.07	0.06	0.08	0.20	0.16	0.11	0.10	0.09	0.09
Total Current Liabilities	6,769	6,386	6,515	7,299	7,780	6,980	8,472	10,111	12,019	10,318	10,661
CL/Revenue	0.34	0.31	0.31	0.33	0.35	0.77	0.54	0.42	0.46	0.38	0.39

Source: Southwest Company Reports

Table 32: Forecasted Change in Net Working Capital

Forecasted Δ NWC										
Year	2026E	2027E	2028E	2029E	2030E	2031E	2032E	2033E	2034E	2035E
NWC	(8,189)	(8,619)	(9,108)	(9,651)	(10,250)	(10,909)	(11,540)	(12,253)	(12,586)	(12,732)
Δ NWC	95	(431)	(489)	(543)	(599)	(659)	(631)	(713)	(333)	(145)

Source: Own Estimate

Unlevered Free Cash Flow (UFCF)

The firm had produced stable unlevered free cash flows pre-pandemic, where UFCF's are gradually expected to recover over the forecast period.

Table 33: Historical Unlevered Free Cash Flow

Historical Unlevered Free Cash Flow											
Year	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025
EBIAT	2,817	2,456	3,524	2,506	2,299	(3,601)	(1,587)	829	56	188	350
Plus: Depreciation & Amortization	1,015	1,221	1,218	1,201	1,219	1,255	1,272	1,351	1,522	1,657	1,596
Less: Capital Expenditures (net)	2,041	2,038	2,123	1,922	1,026	515	505	3,924	3,520	2,055	2,275
Less: Increase in Net Working Capital	(1,070)	603	220	(987)	82	737	(799)	(1,655)	(1,943)	1,769	(515)
Unlevered Free Cash Flow	2,861	1,036	2,399	2,772	2,410	(3,598)	(21)	(89)	1	(1,979)	186

Source: Southwest Company Reports

UFCF was calculated by starting with EBIAT, adding back D&A, and deducting CapEx and changes in NWC. The firm is expected to have a negative UFCF in 2026, with the remaining forecasts expecting to be positive.

Table 34: Forecasted Unlevered Free Cash Flow

Forecasted Unlevered Free Cash Flow										
Year	2026E	2027E	2028E	2029E	2030E	2031E	2032E	2033E	2034E	2035E
EBIAT	459	809	1,053	1,432	1,859	2,345	2,807	3,261	3,205	2,954
Plus: Depreciation & Amortization	1,694	1,827	1,967	2,115	2,272	2,440	2,618	2,806	2,999	3,195
Less: Capital Expenditures (net)	2,831	2,980	3,149	3,337	3,544	3,772	3,990	4,236	4,351	4,402
Less: Increase in Net Working Capital	95	(431)	(489)	(543)	(599)	(659)	(631)	(713)	(333)	(145)
Unlevered Free Cash Flow	(773)	86	360	753	1,186	1,672	2,066	2,544	2,186	1,893

Source: Own Estimate

Total Debt

The firm's Debt/EBITDAR ratio has been highlighted by management as a key benchmark for guiding future debt decisions. This ratio was relatively stable prior to the substantial increase in borrowing in 2020, and management has indicated a target range of 1x to 2.5x EBITDAR. After the GFC, the firm undertook significant deleveraging and eventually operating with a ratio below 1. With a large portion of recent debt now repaid, the firm is expected to maintain the ratio at the lower end of the target range, consistent with the pattern observed following the GFC.

Table 35: Historical Debt/EBITDAR

Historical Debt/EBITDAR											
Year	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025
Debt	3,210	4,002	3,668	3,377	4,081	12,282	12,363	9,473	9,229	8,080	5,258
EBITDAR	3,163	5,369	5,210	4,848	4,568	4,356	(3,378)	238	2,556	1,922	2,164
Debt/EBITDAR	1.01	0.75	0.70	0.70	0.89	2.82	(3.66)	39.80	3.61	4.20	2.43

Source: Southwest Company Reports

The firm recently repaid a substantial portion of its debt, providing capacity to issue new debt annually in order to maintain its target leverage ratio.

Table 36: Forecasted Debt Schedule

Forecasted Debt Schedule											
Year	2025E	2026E	2027E	2028E	2029E	2030E	2031E	2032E	2033E	2034E	2035E
Opening Debt	5,258	4,958	4,958	3,217	3,592	4,235	4,953	5,760	6,545	7,331	7,450
Debt Repayment	300	-	1,922	-	-	500	1,092	-	-	-	139
Pre-Issuance Debt	4,958	4,958	3,036	3,217	3,592	3,735	3,861	5,760	6,545	7,331	7,311
EBITDAR	2,304	2,548	3,136	3,592	4,235	4,953	5,760	6,545	7,331	7,450	7,311
New Issuance	-	-	181	375	643	1,218	1,899	785	786	119	
Closing Debt	4,958	4,958	3,217	3,592	4,235	4,953	5,760	6,545	7,331	7,450	7,311
Debt/EBITDAR	2.15	1.95	1.03	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00

Source: Own Estimate

Cost of Debt

The firm's weighted average interest rate on outstanding debt is 3.47%, which is below the current risk-free rate of 3.99%. To adjust for this, the firm's BBB credit rating was considered, and Moody's estimated probability of default of 1.46% was applied, resulting in an implied cost of debt of 5.45%.

Discounting the Unlevered Free Cash Flows

The firm has not historically maintained a constant Debt/Equity ratio. Going forward, the firm is expected to issue new debt annually to maintain its target leverage ratio. For this reason, the Adjusted Present Value (APV) framework is regarded as the more appropriate approach for discounting the unlevered free cash flows.

Table 37: Historical Debt/Equity

Historical Debt/Equity											
Year	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025
Debt/Equity	0.11	0.13	0.09	0.10	0.13	0.36	0.29	0.30	0.33	0.31	0.22

Source: Own Estimate

The table below was used to discount future cash flows.

Table 38: Discounting Variables

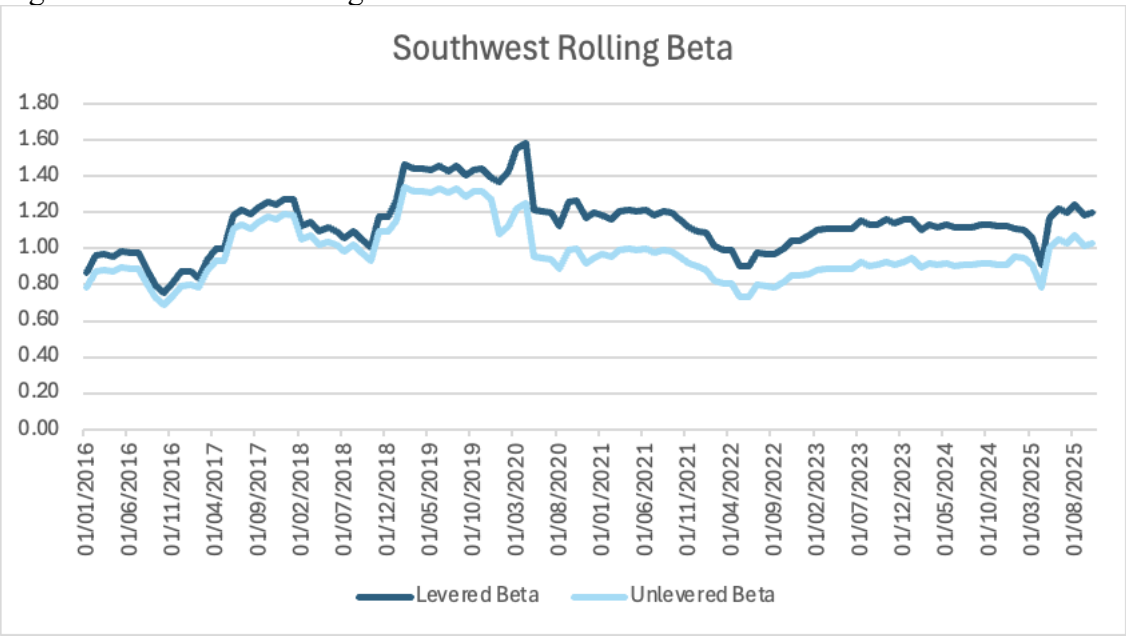
Discounting Variables	
Risk-Free Rate	3.99%
Market Risk Premium	5.15%
Tax Rate	25%
Cost of Debt (rD)	5.45%
Cost of Equity (rE)	10.17%
Levered Beta	1.2
Unlevered Beta	1
Cost of Unlevered Equity	9.14%
Debt/Equity	0.22
Terminal Growth	2%

Source: Own Estimate

Beta

The levered and unlevered betas were estimated using a rolling regression from 2016 to 2025 with the CRSP market index as the benchmark. The firm's most recent unlevered beta is 1.0, and this has been relatively stable post pandemic with recent exposure to Boeing elevating this figure. For this forecast, the unlevered beta of 1.0 was used to discount the UFCFs.

Figure 6: Southwest Rolling Beta



Source: Yahoo Finance

Risk-Free Rate

The risk-free rate was obtained by getting the return of one-month treasuries, which equalled 3.99%.

Market Risk Premium (MRP)

The MRP was obtained by using the historical equity risk premium, which was 5.15%[5].

Tax Rate

The tax rate was obtained from management's reports, which were given at 25%.

Debt/Equity

The firm's Debt/Equity ratio of 0.22 was obtained using its LTM figures.

Cost of Equity

The cost of equity was derived using the Capital Asset Pricing Model (CAPM). With a risk-free rate of 3.99%, a market risk premium of 5.15%, and a levered beta of 1.2, the implied cost of equity is 10.17%.

[5] Damodaran (2025)

Unlevered Cost of Equity

The unlevered cost of equity was derived using the unlevered beta of 1 and applying the same risk-free rate of 3.99% and market risk premium of 5.15%, the implied unlevered cost of equates to 9.14%.

Tax Shield Beta

The tax shield was estimated to have a beta of approximately 0.70. This was calculated by taking the covariance between the firm's annual changes in debt and the CRSP market return, divided by the variance of the market return. The resulting beta indicates a moderate relationship between the tax shield and market movements, consistent with the firm's tendency to increase borrowing in stronger markets. The tax shield beta was then adjusted each period to reflect changes in the firm's debt levels.

Unlevered Free Cash Flows

The UCFCs were then discounted at the unlevered cost of equity at 9.14%, and the terminal growth rate used was 2%. The present value of projected future cash flows is equal to $17,374 million.

Table 39: PV of Equity

PV of Equity										
Year	2026E	2027E	2028E	2029E	2030E	2031E	2032E	2033E	2034E	2035E
Unlevered Free Cash Flow	(773)	86	360	753	1,186	1,672	2,066	2,544	2,186	1,893
Discounted @ 9.14%	(708)	72	277	531	766	990	1,120	1,264	995	790
Terminal Value										27,046
PV of TV										11,279
PV of Equity										17,374

Source: Own Estimates

PV of the Tax Shield

The firm's tax shield beta each year was adjusted for changes in leverage. The PV of the tax shield is equal to $1,024 million.

Table 40: PV of Tax Shield

PV of Tax Shield										
Year	2026E	2027E	2028E	2029E	2030E	2031E	2032E	2033E	2034E	2035E
Forecasted Debt	4,958	4,958	3,217	3,592	4,235	4,953	5,760	6,545	7,331	7,450
Cost of Debt	5.45%	5.45%	5.45%	5.45%	5.45%	5.45%	5.45%	5.45%	5.45%	5.45%
Tax Rate	25%	25%	25%	25%	25%	25%	25%	25%	25%	25%
Tax Shield	68	68	44	49	58	67	78	89	100	102
Tax Shield Beta	0.70	0.70	0.47	0.52	0.62	0.72	0.84	0.95	1.07	1.08
Discount Rate	7.62%	7.62%	6.40%	6.68%	7.16%	7.70%	8.30%	8.89%	9.48%	9.57%
Discounted Tax Shield	63	58	36	37	41	44	48	50	51	47
Terminal Value										1,368
PV of Terminal Value										549
PV of Tax Shield										1,024

Source: Own Estimate

Equity Value

The company's current share price of $29.67, compared with the forecasted value of $30.56, indicates an implied upside of 3%. Several factors support this outlook. The firm is expected to benefit from a favourable phase in the aircraft retirement cycle, which should ease capacity constraints and facilitate fleet expansion. It is also one of the few major airlines with Passenger Revenue per ASM exceeding Cost per ASM, although this likely reflects its position as a low-cost carrier and its limited exposure to more price-inelastic customer segments.

Operational efficiency remains a notable challenge. The firm trails competitors in employees per ASM and carries a higher average salary cost. If improvements in workforce productivity surpass expectations, the firm could achieve stronger financial performance than currently projected. The firm has managed its debt position effectively, using excess cash to reduce outstanding obligations during a period when Boeing's delivery delays have limited opportunities to invest in new aircraft.

Table 41: PV of Equity

PV of Equity	
PV of UFCF	17,374
PV of Tax Shield	1,024
Enterprise Value	18,398
Less Net Debt	2,356
Estimated Market Cap	16,042
Shares Outstanding	525
Estimated Price per Share	30.56

Source: Own Estimate

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