Competitive landscape discussion

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Competitive landscape for Legacies and LCCs

For Legacy and LCC competitors, we want to align on a number of elements in order to clearly define the competitive challenges we face:

- **Profitability**
  - Current profitability measures (ROIC, Net margin, Profit per plane)
  - Historic trends and future projections

- **Revenue landscape**
  - RASM
  - Historic trends and future projections

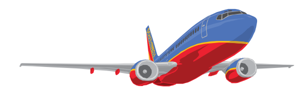
- **Cost landscape**
  - Overall CASM
  - Labor CASM
  - Historic trends and future projections

- **Network strategies**
  - Route overlap by competitor set

- **Fleet strategies** (i.e., What will competitors fleets look like in 10 years, and how will this impact their revenues and costs?

- **Other trends (e.g., AA bankruptcy, Legacy international expansion plans)**

Competitive landscape discussion



In the past 41 years, we have succeeded like no other domestic airline

Southwest's Historic Successes

- Provided the best industry returns to investors and Employees
  - 39 years of positive net income and excellent stock performance
- Created the largest domestic carrier
  - One of the industry leaders in ASMs and passenger traffic
- Navigated through recessions and crises
  - Did not furlough Employees or cut pay after 9/11 and continued growth and profitability

We are one of the only carriers that has not gone bankrupt since 2000

U.S. Airline Industry Bankruptcies, 2000-2011

Chapter 7	Aloha Airlines	Southeast Airlines, Inc.	Midway
	2008	2004	2003
Chapter 11	AA American Airlines	Frontier Airlines	ATA
	2011	2008	2008 & 2004
	Mesaba Airlines	Delta	Comair
	2005	2005	2005
	nwa	US Airways	Hawaiian Airlines
	2005	2004 & 2002	2003
	United	Midway	TWA
	2002	2001	2001

SOURCE: Airlines for America (A4A)

We have an unprecedented run near the top of the airline profitability rankings, but are starting to see warning signs…

Went through bankruptcy or change in control

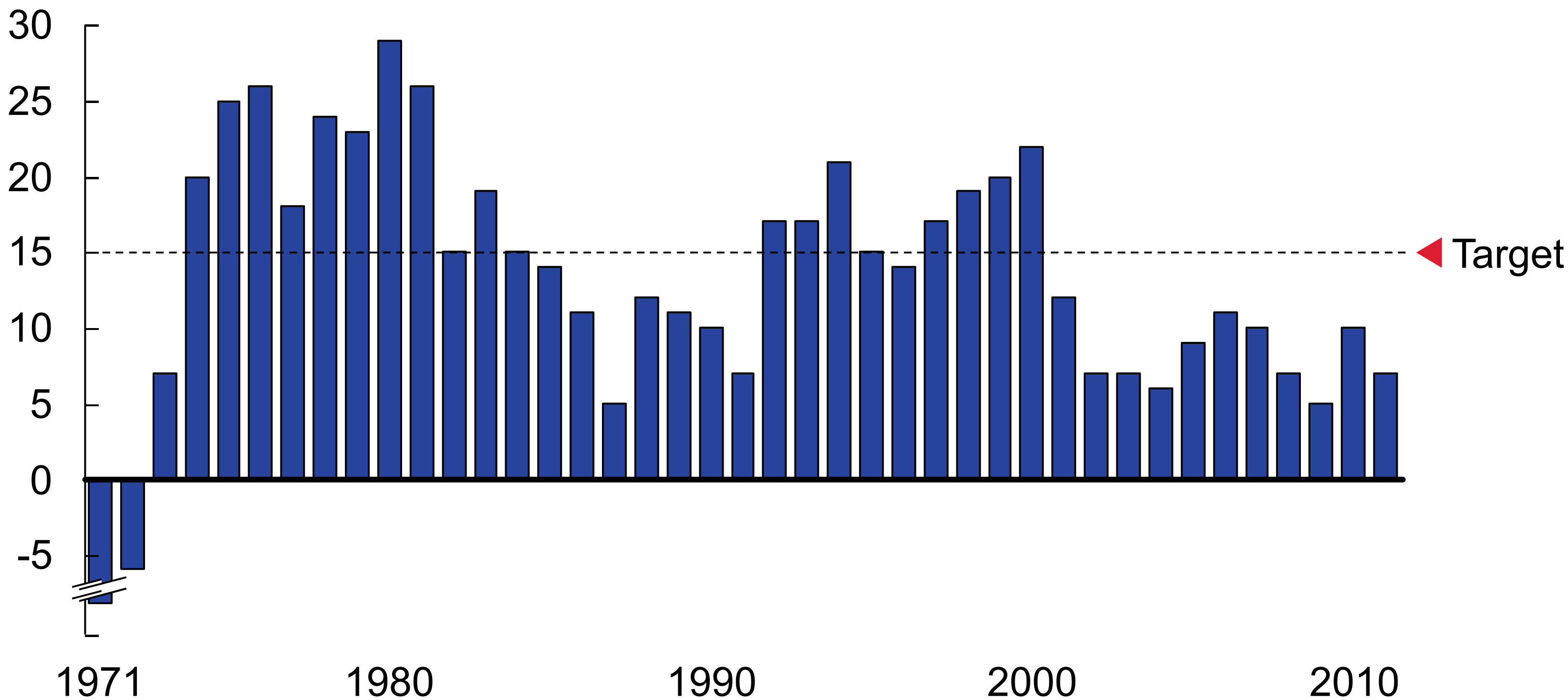
US Domestic Carrier Rankings by Net Profit (%), 1980-2011

RK	1980	1983	1986	1989	1992	1995	1998	2001	2004	2007	2010	2011
1	Pan Am	Hawaiian	New York	Piedmont	Hawaiian	ValuJet	SOUTHWEST	JetBlue	Allegiant	Northwest	Allegiant	Spirit
2	SOUTHWEST	SOUTHWEST	SOUTHWEST	SOUTHWEST	SOUTHWEST	Northwest	Alaska	SOUTHWEST	SOUTHWEST	Delta	Hawaiian	Allegiant
3	US Air	Alaska	US Air	Delta	Delta	SOUTHWEST	American	Frontier	JetBlue	Allegiant	Alaska	Delta
4	Frontier	US Air	American	Alaska	TWA	Delta	Delta	Hawaiian	Air Tran	SOUTHWEST	Delta	United
5	Delta	American	Piedmont	Northwest	Continental	Spirit	US Air	Spirit	Alaska	Alaska	SOUTHWEST	JetBlue
6	Piedmont	People Express	Delta	American	American	Continental	United	Alaska	Frontier	US Air	US Air	SOUTHWEST

SOURCE: Form 41 Schedule T2, Press releases

…and we have not hit our 15% ROIC target since 2000

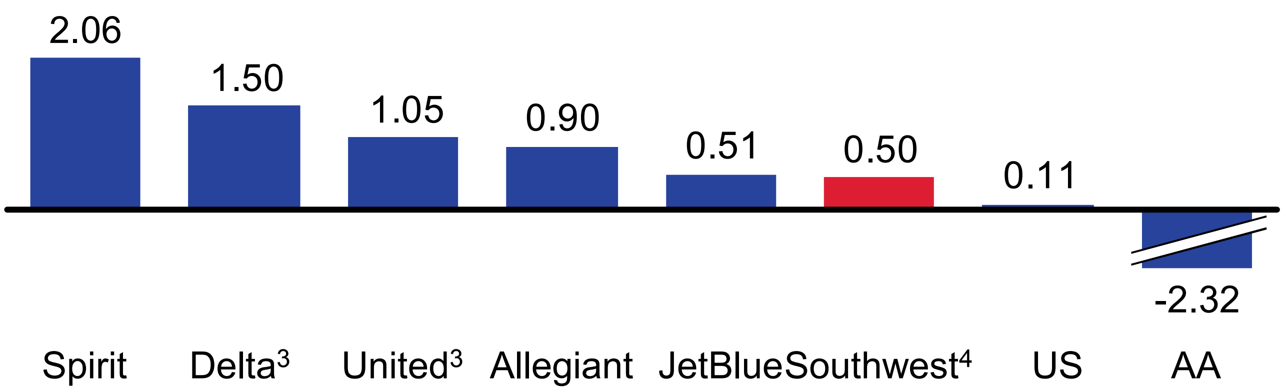
WN Pre-Tax ROIC (non-GAAP)
%, 1971-2011



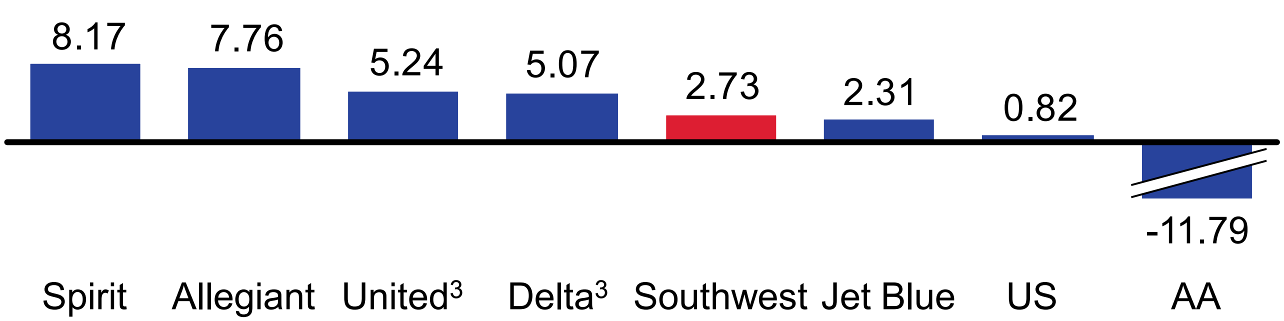
SOURCE: Southwest Airlines Investor Relations, Bloomberg

We are facing stiff competition from a new band of LCCs and rejuvenated legacies

Net profit per plane[1]
$ Millions, 2011



Net profit per seat mile[2]
$ Millions per 1000 ASM, 2011



Implications

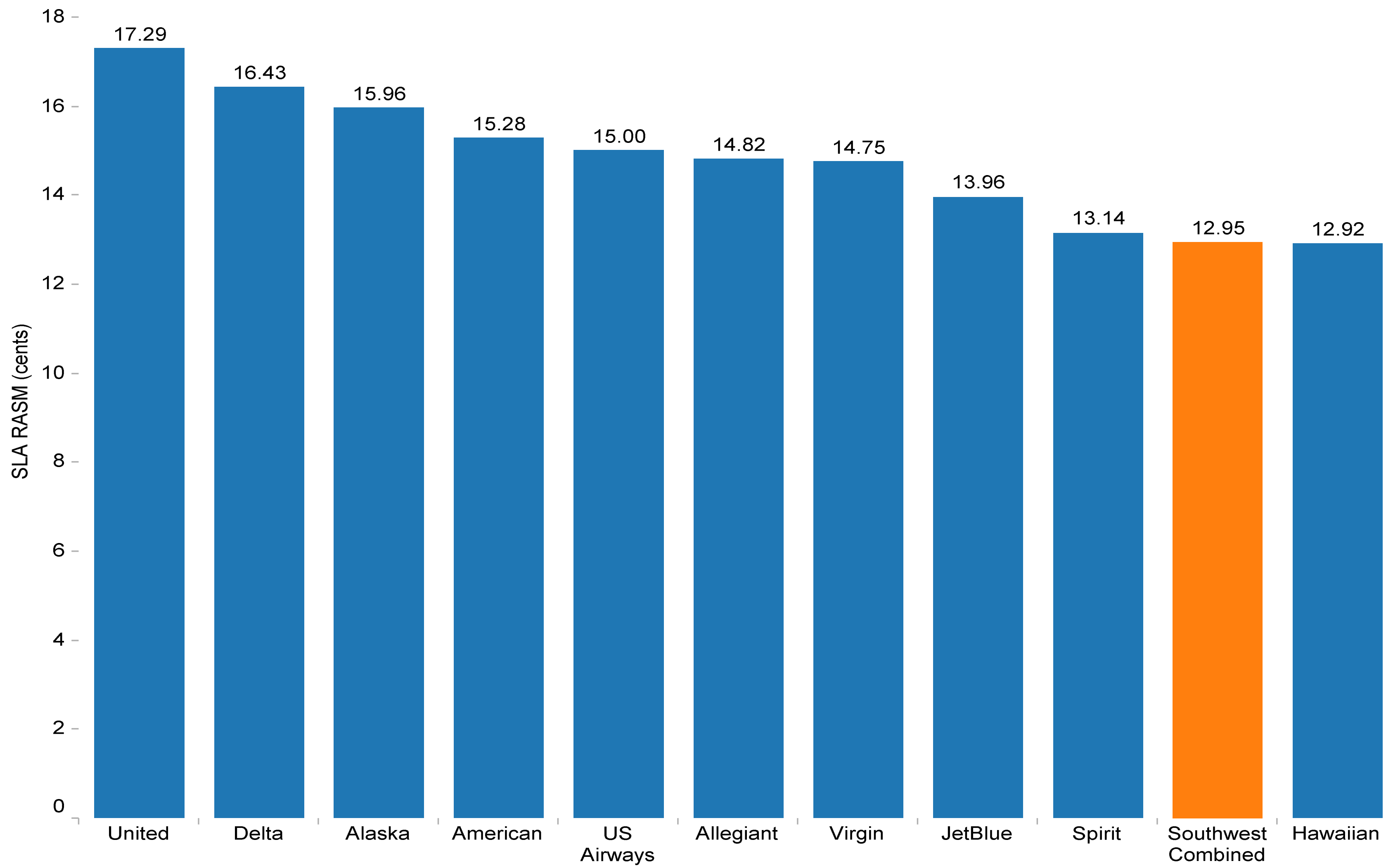
- The new band of ultra-LCCs like Spirit and Allegiant is achieving success by adopting numerous parts of the Southwest playbook (but not our focus on Customer Service!)
- Delta and United have emerged from bankruptcy stronger than ever, and are also beating us on a profit per plane basis

1 Net income divided by fleet size at year-end
2 Net income divided by total ASMs (mainline and regional)
3 United and Delta net income both are non-GAAP net income, excluding special items
4 WN profit per plane based on adjusted net profit (non-GAAP)
SOURCE: Southwest FP&A, Company Financial reports.

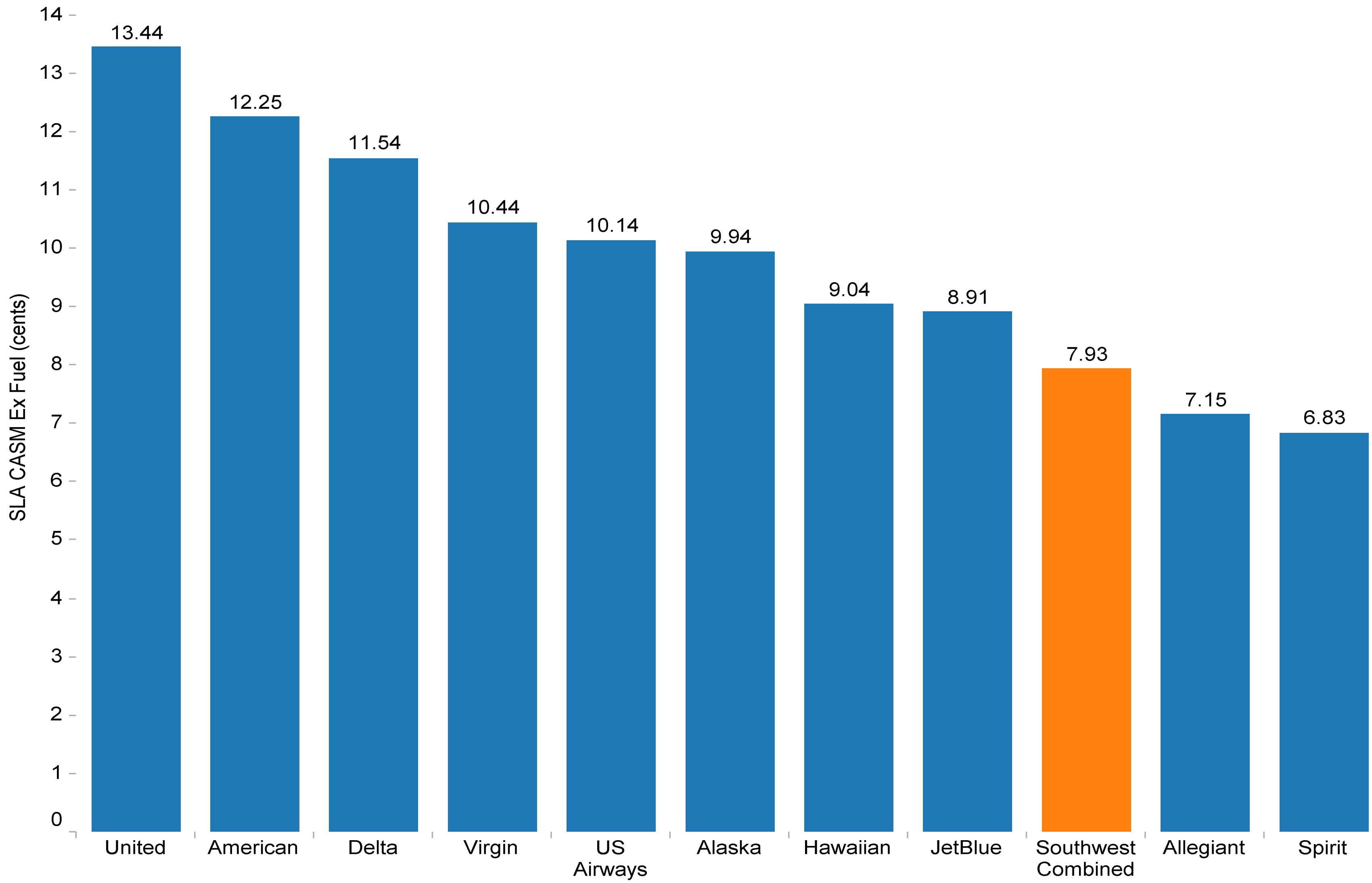
Changes in competitive landscape

- We are facing significant competitive threats from “new” Legacy carriers as well as from a new band of ultra-LCCs
- Delta and United have emerged from bankruptcy stronger than ever, and American will likely come out of Chapter 11 much leaner than before
- LCCs are using their much lower labor costs to compete with us head-to-head, and their unit costs will go even lower as they continue to grow their fleets

Industry RASM: DOT Domestic Mainline (FY2011)
Stage Length Adjusted to WN/FL Combined Stage Length

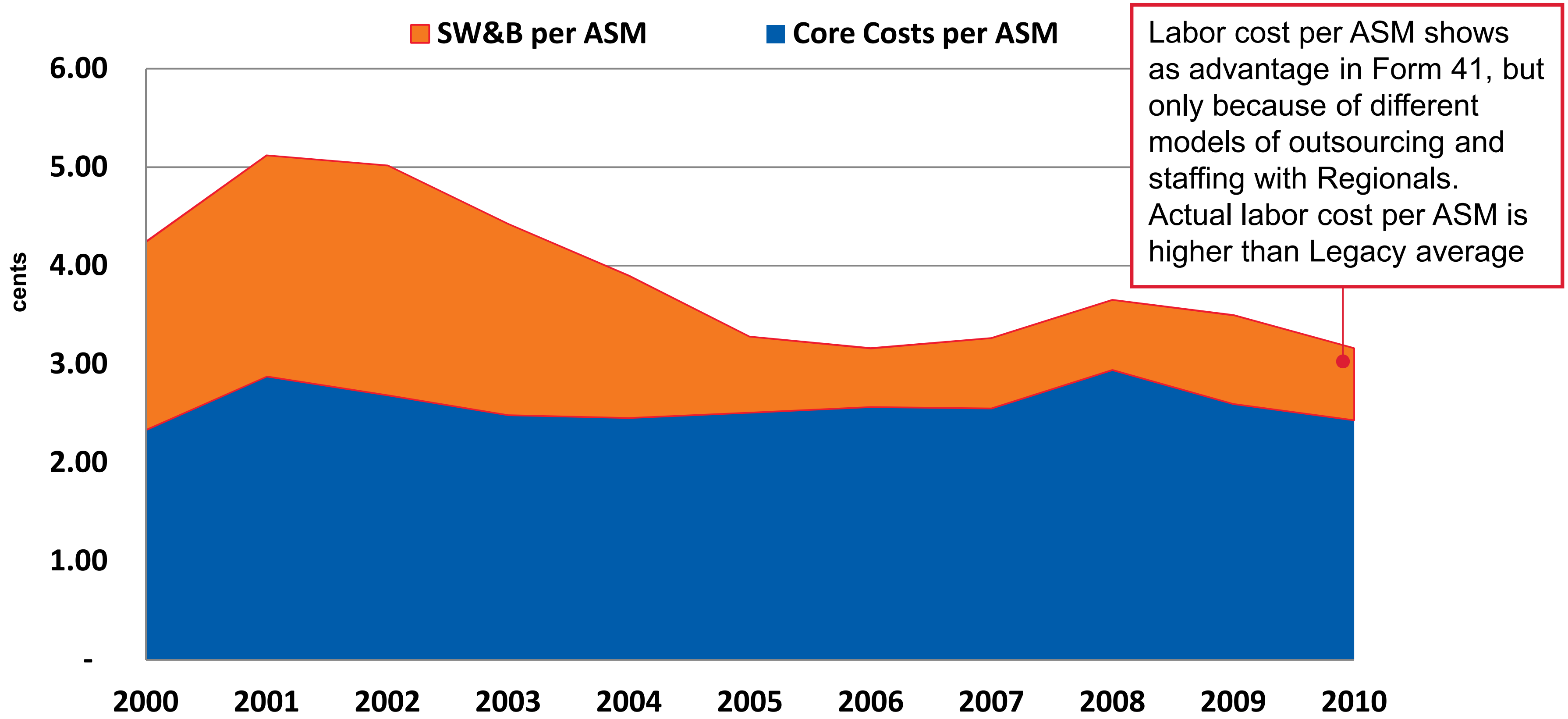


Industry CASM Ex-Fuel: DOT Domestic Mainline (FY2011) Stage Length Adjusted to WN/FL Combined Stage Length



Our labor cost advantage against Legacies has disappeared as competitors have restructured through bankruptcy…

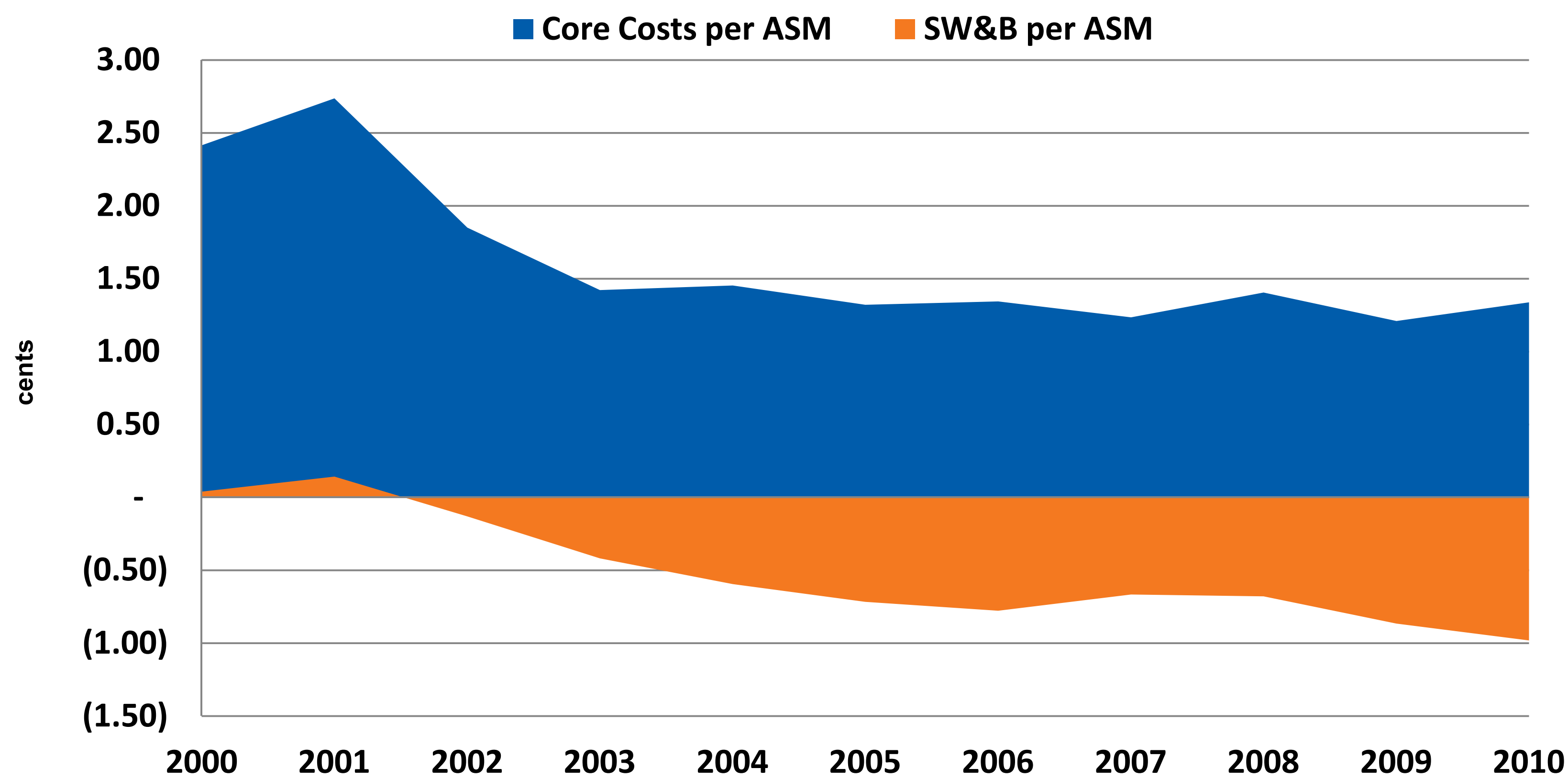
Since 2000, Southwest has retained a core cost per ASM advantage, but our SW&B per ASM advantage has declined (and is even a disadvantage once adjusted for differences in operating models)



Core costs include: Marketing and Advertising, Landing Fees and Rentals, Depreciation and Amortization, Maintenance, Materials, & Repairs, and Other Operating Expenses
Source: DOT Form 41, Stage Length Adjusted to WN ASL

…and we now have a significant labor cost disadvantage against LCCs

Since 2000, Southwest's core costs* per ASM advantage over the low cost carriers has declined 45%, and our SW&B per ASM advantage has turned into a disadvantage

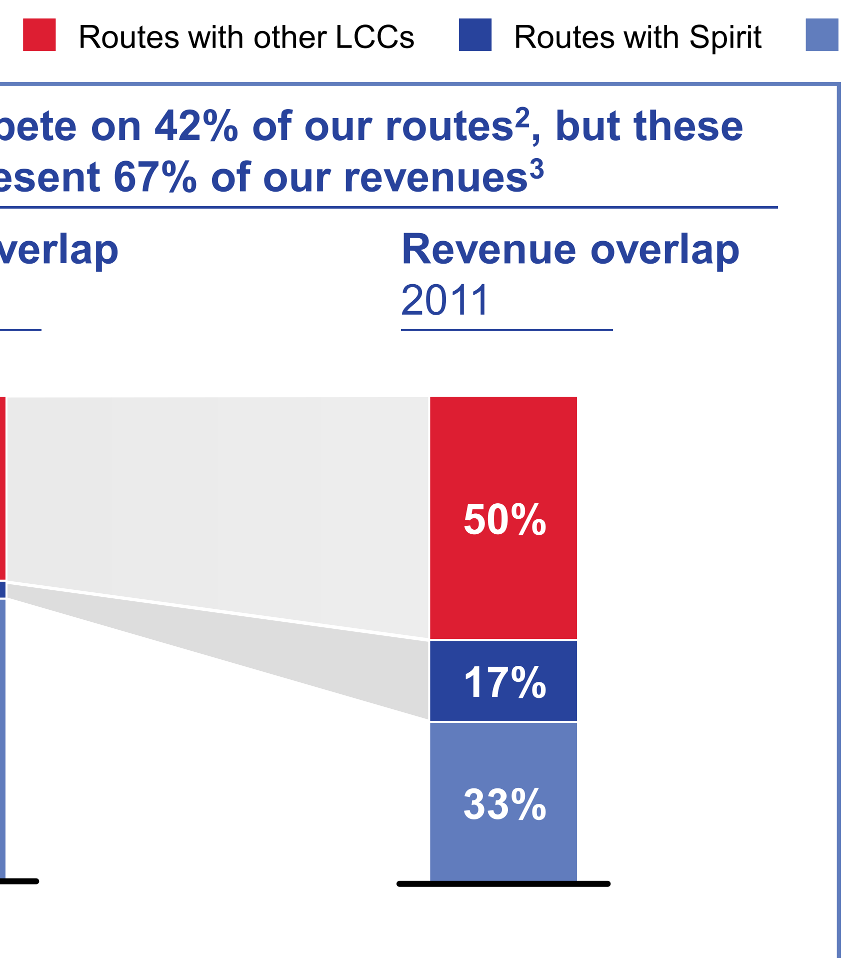


Core costs include: Marketing and Advertising, Landing Fees and Rentals, Depreciation and Amortization, Maintenance, Materials, & Repairs, and Other Operating Expenses
Source: DOT Form 41, Stage Length Adjusted to WN ASL

Discussion of competitors' commercial and fleet strategies

Airline	Commercial Strategy	Fleet Plan
Network Carriers		
Alaska	Be the preferred carrier in the Pacific Northwest and enhance relevance in West Coast cities by opportunistically filling service gaps.	Retire 737-400; replace and grow with 737-8/9
American	Regain preferred carrier status in NYC, Miami, Chicago, DFW, and LA with a comprehensive network and unmatched onboard experience.	Retire MD80,757,767; replaced with 737-800 and A320
Delta	Be the airline of choice to, from, and within the US via a global network and premium product options.	Retire CRJs, DC9, MD80; replace with 717/737-900
United	Generate premium revenue by serving business customers with the best network, schedule, and customer experience in the largest US cities.	Retire 757/767; replace with 737-900 and 787
US Airways	Be a relevant choice for US customers via a comprehensive network and competitive fare; be the carrier of choice in CLT, PHX, PHL, and at DCA.	Retire 737/757; replace with A320 family
Low-Cost Carriers		
Allegiant	Link small cities directly with large leisure destinations via a completely unbundled product.	2011: 53 MD80 2016: 81 MD80*/757/A319 *Modifying w/add'l seats
Frontier	Connect underserved cities with robust Western-US network via DEN hub and offer limited point-to-point service to large leisure markets.	2011: 60 A318/319/320* *Modifying w/add'l seats
JetBlue	Upscale economy onboard product targeting leisure/VFR traffic in NYC, Florida, and Caribbean; business and leisure focus in Boston.	2011: 170 A320/E190 2016: 221 A320/321/E190
Spirit	Use low base fares to attract price-sensitive customers and generate substantial ancillary revenue in large US domestic and US-Latin citypairs.	2011: 37 A319/320/321 2016: 70 A319/320/321
Virgin America	Premium customer experience between the largest US cities; SFO/California focus.	2011: 46 A319/320 2016: 82 A319/320

LCCs are using their low costs to attack our most profitable routes

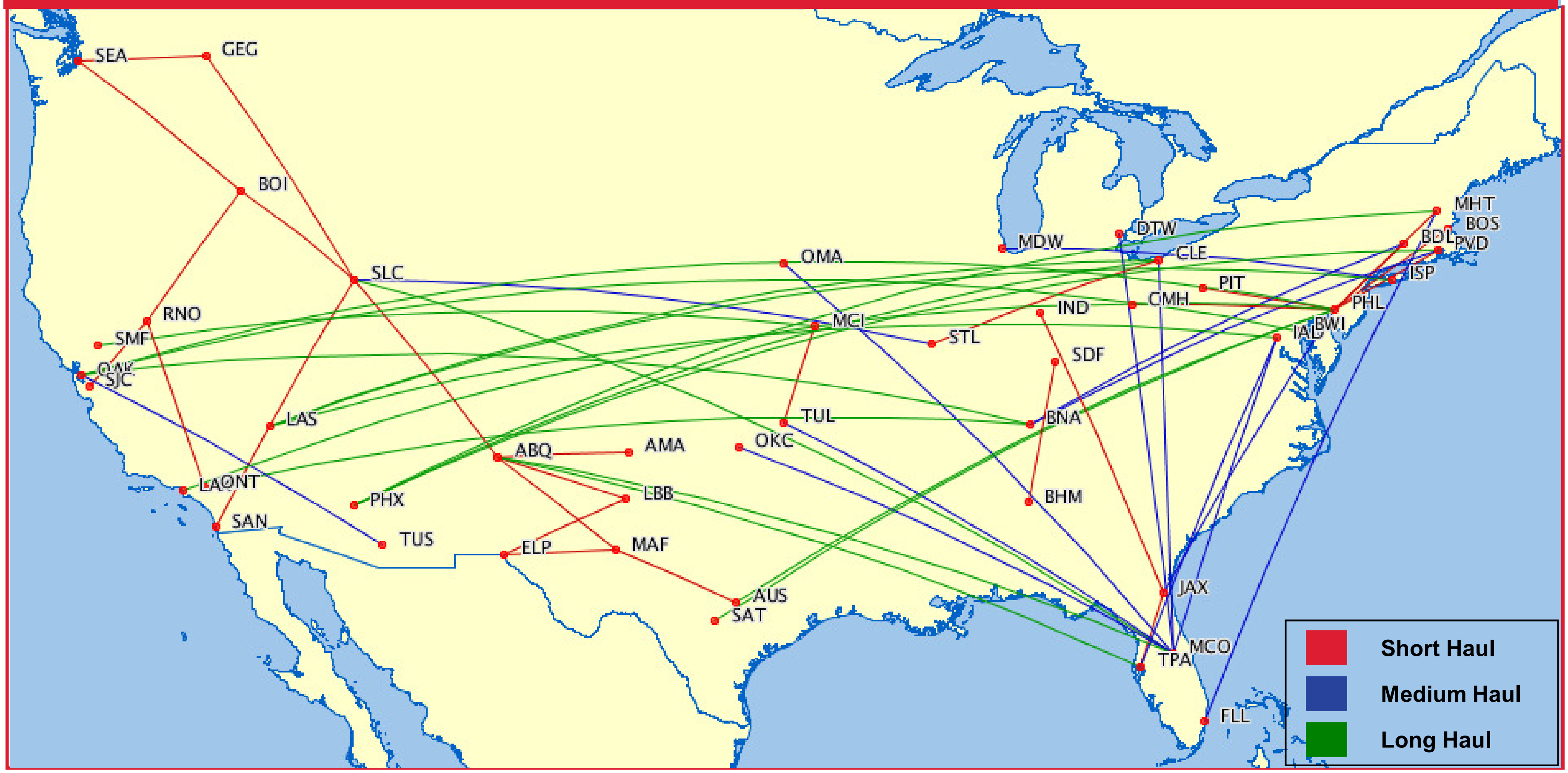


1 LCCs include Airtran, Allegiant, Frontier, JetBlue, Spirit, and Virgin America
2 O&D pairs, including connections; compares multiple airports within metro areas including Los Angeles, San Francisco, Chicago, Dallas, Houston, Washington, Orlando, New York, Miami, Boston, Tampa, and Philadelphia
3 Marketing carrier revenue, 12 months ended 4Q 2011

SOURCE: FP&A O&D overlap analysis

We used to enter cities and never left, but we recently exited 57 of the ~400 routes we operated in 2007…

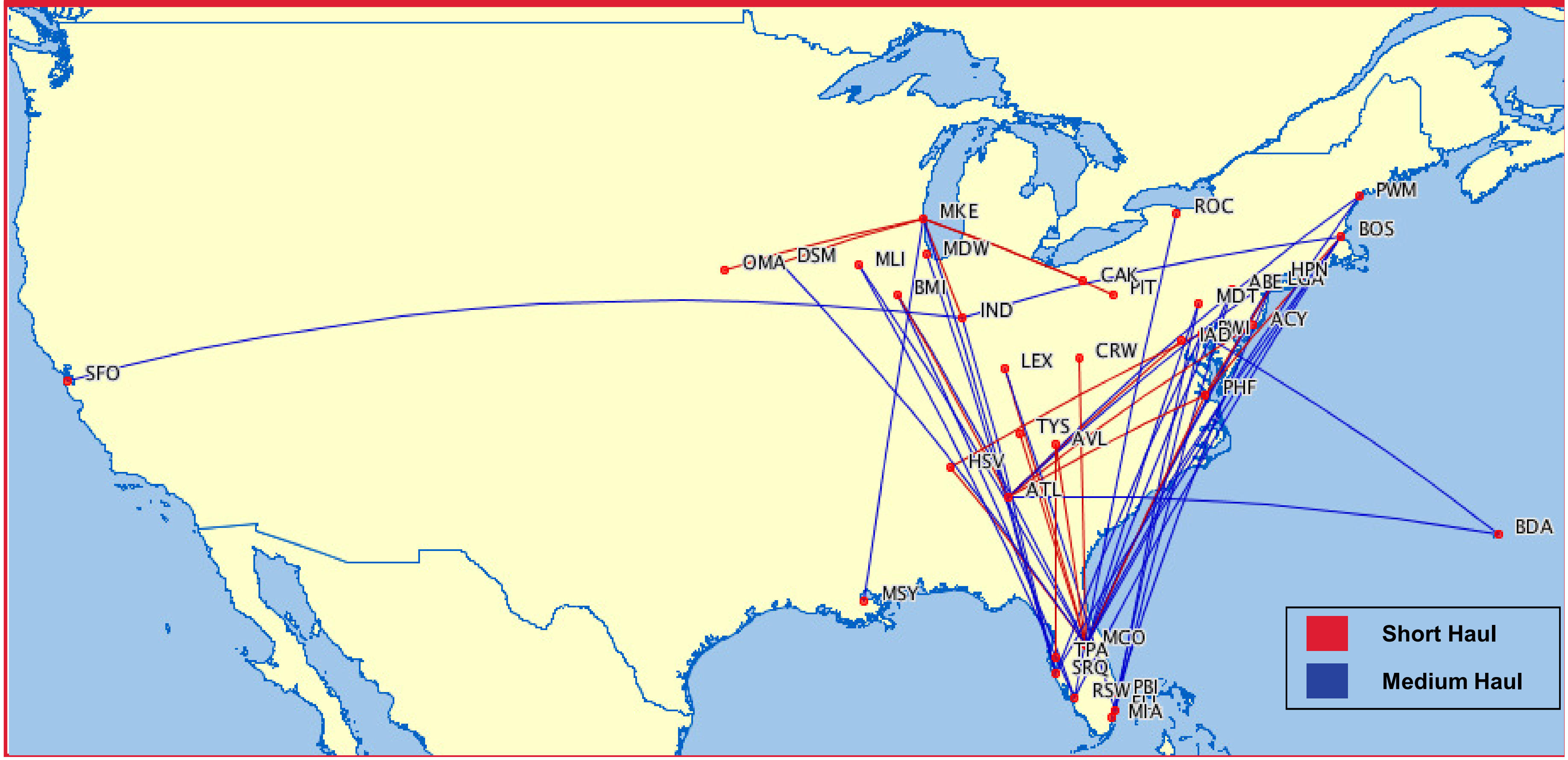
Cancelled Southwest Routes Since 2007



SOURCE: Internal Southwest data

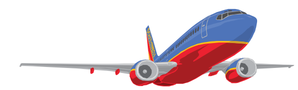
…and we have announced exits for an additional 49 of AirTran's routes, largely because we cannot profitably fly them with our costs

Cancelled AirTran Routes After Southwest Acquisition



SOURCE: Internal Southwest data

Appendix



Pilot-specific data for fact base agreement

How do we compare to Legacy and LCC competitors in the following areas…

Wages
- Base wage scales
- Estimated tenure mix (e.g., % of Pilots who are topped out)

Benefits
- Health care
- Retirement
- Vacation/Sick/Holidays

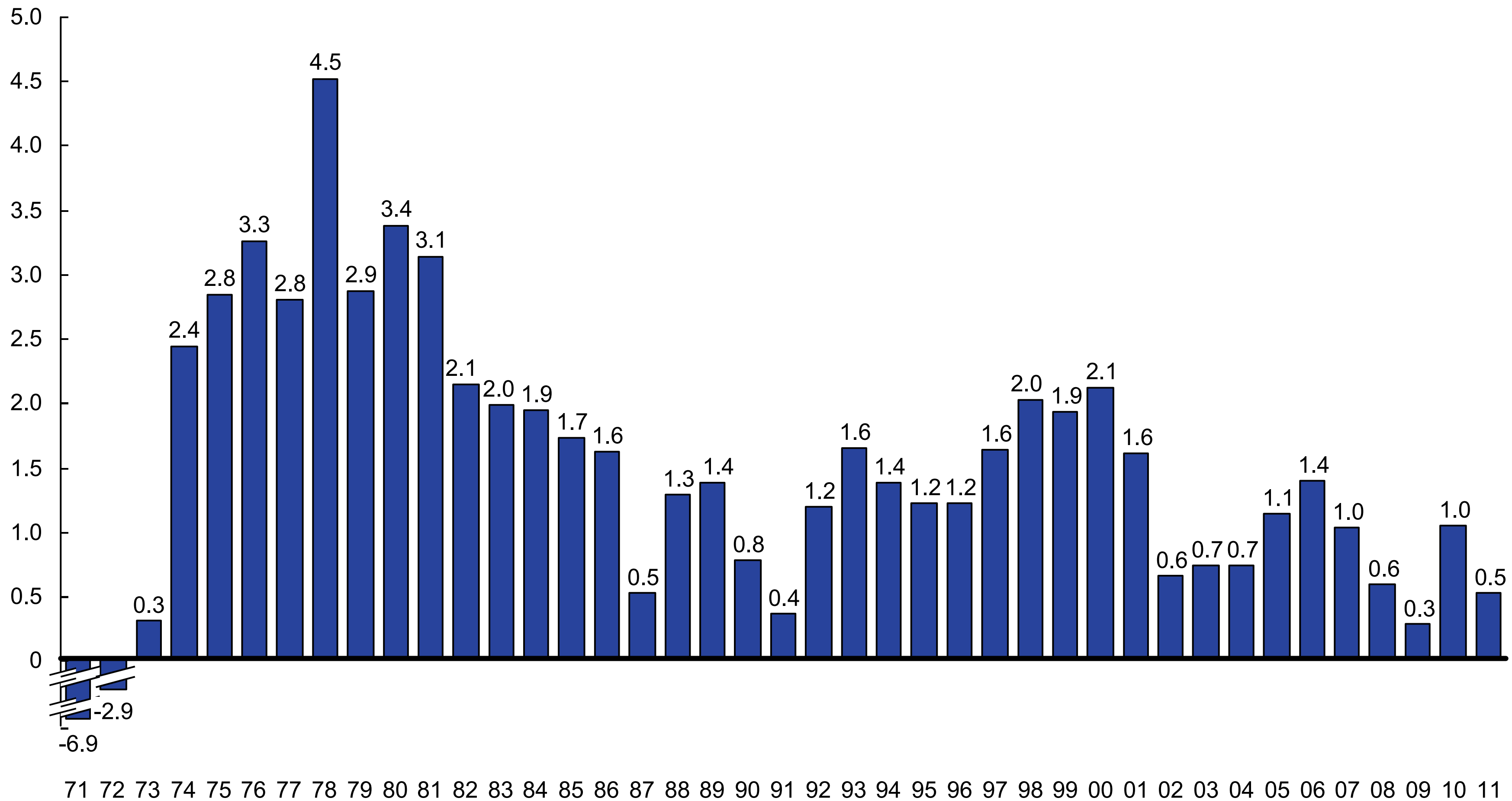
Work rules
- Scope
- Reserve policy
- Monthly and Daily Guarantees
- Duty periods
- Per Diems
- Other

Pilot productivity
- Blocks hours per pilot
- ASMs per pilot

Other topics
- Stage length adjustment
- Seats per plane adjustment
- Block speed/Taxi time adjustments
- Data set agreement (e.g., Domestic Mainline)

Profit per aircraft, adjusted for inflation

WN profit per plane[1]
Adjusted for inflation into 2011 $ Millions[2]



1 For 1971-2001, calculated as GAAP net income per aircraft. From 2002-11, calculated as Adjusted net income (non-GAAP) per aircraft
2 Adjusted for inflation into 2011 dollars, using CPI-U from BLS

SOURCE: Southwest Airlines Investor Relations, Form 41, BLS