SOUTHWEST AIRLINES "Without heart, It's just a machine"[1]

INTRODUCTION

As introduction, we would like to point out our motivation when choosing this research, the working hypothesis, the methodology and the difficulties we have found while analysing the company.

Our main goal is to learn how to succeed in the business world, as Jean Jacques Rousseau said:

"Youth is the time to study wisdom; old age is the time to practice it".

With this in mind, asked ourselves: how can a company succeed even when there are external factors that threat their business model?

Once we knew where we wanted to go, we began the search for a company that fixed perfectly with our idea of work. After searching for a while, we finally found it: Southwest Airlines, a prestigious American low cost aviation company, that, thanks to its internal policies and its management team, has been the only US profitable airline even during the oil crisis of the nineties and the 9/11, maintaining its customer's service level and outstanding quality.

When studying the Company, we struggled while having to select the right information in order to make an appropriate analysis, due to the fact that the Business is not Spanish. Because of its internationality, we could not find the material in the regular data base that we are used to, which made the research a lot harder that it would have been. In addition, we thought it could be very interesting to do our project in English, since the Company is American. However, that implicated more effort, but we do not regret it at all. In fact, we like challenges because we think it's a way of forcing ourselves that will be rewarding for us in the future.

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[1] Case written by Adriana Mur Flórez, Javier Navas Mir and Lucía Matas Duffo, UPF Barcelona School of Management, 2017

The project is divided in two different parts. The first one is composed by a short description of the Business and its main characteristics and the second one is an analysis of the key of the success, complemented by a study of the Southwest financial statements.

A. DESCRIPTION OF THE BUSINESS

1. A GLANCE TO SOUTHWEST

1.1. HISTORY AND WHAT THEY DO

Herb Kelleher, founder of Southwest, wanted to make a different airline, based on a simple business idea: to transport passengers to their destinations whenever they wanted, on time and with the lowest possible rates. However, it was not that easy. In 1967, when Kelleher had cofounded Southwest Airlines and applied for the certification to fly, Kelleher had to face some competitors such as Braniff, Texas International and Continental, who jumped all over the upstart, dragging it into court and claiming to any judge that the Texas market couldn't possibly support another carrier. Notwithstanding, what competitors did not expect, was that this would make Southwest stronger as Kelleher stated years later: *"I felt enraged by this. You know, anger can be a great motivator. For me, this became a cause. I was a crusader freeing Jerusalem from the Saracens*[1]*"*

Finally, after three years of bitter legal skirmishes followed, Kelleher won the battle pursuing the case all the way to the U.S. Supreme Court and Southwest got off the ground in 1971, flying four planes in varying states of emptiness between three Texas cities.

To initially attract attention, Southwest not only made his hostesses take shorts but also took advantage of its location (at Love Field) to launch the advertising campaign "Make Love, Not War", which is why the company refers to itself as airline "Love" (LUV), and all planes have painted a small heart on the side.

With more than 44 years of experience, Southwest Airlines is distinguished among all airlines for its high-quality service at a low price. The company's motto is: *"Keep it cheap, keep it simple, focus your energy"*[2] has always helped them keep loyal clients. To simplify its activities, meals on flights have never been offered, as they can add $40 per passenger to the cost of a flight; instead, they serve passengers drinks, peanuts "crackers" or other light snacks.

Southwest rather than the hub-and-spoke service provided by most major U.S airlines provides point-to-point service. The hub-and-spoke system concentrates most of an airline's operations at a limited number of central hub cities and serves most other destinations in the system by providing one-stop or connecting service through a hub. Consequently, Southwest point-to-point route structure has allowed for more direct nonstop routing than hub-and-spoke.

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[1] Welles, Edward, "Captain Marvel" Inc., January 1992.
[2] http://www.inc.com (Captain Marvel: How Southwest's Herb Kelleher Keeps Loyalty Sky High, 1992)

The pillar of Southwest is the client. Southwest executives and employees are always striving to improve their service, culture and to create even more loyal customers. Their customers mean everything to them.

Southwest commenced service with three Boeing 737 aircraft serving three Texas cities: Dallas, Houston and San Antonio. The company ended in 2015 serving 97 destinations in 40 states. During 2015, the company added its first three destinations in Central America and commenced Southwest service to a fourth destination in Mexico. The Company has grown from 71 airplanes in 1986 to more than 700 in 2015, carrying more customers in the United States today than any other airline. They've also grown from more than 5,800 Employees (excluding TranStar) to more than 50,000. The 97 different destinations all over the U.S as are in the map.[3]

Figure 1: Southwest's destinations – Source: [Southwest webpage]

Southwest Airlines is celebrating 43 years of consecutive profitability. It was named "Airline of the Year" by Air Transport World in 2015 and named one of the Top 20 America's Best Employers of 2016 by Forbes. Southwest, is one of the most honoured airlines in the world, known for its strong mission to provide the highest quality customer service with warmth,

[3] Southwest website, Gary's greeting

friendliness and individual satisfaction. Following this strategy, Southwest has always been seen as a competitor not only by airlines, but also by all kinds of surface transport.

1.2. WHO

It is widely believed that a great leader is always hiding behind a big company and Southwest is a clear example of it. Herb Kelleher has undoubtedly been a crucial key for Southwest's success.

Kelleher was a very optimistic person who managed to translate his philosophy of life to Southwest, creating a culture of values such as hard work, equality, dedication and fun. He was described as a passionate, funny and handed person, who would continuously interact with customers and employees, regularly visited the maintenance facility at dawn, as Tom Burnett, teamster union leader, in an interview stated: *"I'll tell you this: how many company presidents are in a rest room cleaning staff at three o'clock in the morning on Sunday handing out "donuts" or by a monkey to clean a plane?"*[4]

Kelleher made and authentic revolution in the airline sector with the creation of the concept of low cost and, without him, we would not have had in Europe companies as relevant today as Ryanair, EasyJet or Vueling, whose strategies were very inspired by Southwest. Proof of this is that the founder of Vueling, Álex Cruz, was formed as a CEO in Southwest.

Indeed, Kelleher was so good that Ken Labich, a Fortune reporter concluded his article with the following conclusion: *"The greatest obstacle to long-term prosperity of Southwest could be Kelleher own mortality''*[5]

Such doubts disappeared when in May 2008, Southwest Airlines announced that Kelleher would step down, followed by Gary C. Kelly the new Chairman of the Board of Directors. Some were afraid of it, however, Kelleher was not one of them. He roundly feared the absence of change: *"You have to be ready for change. In fact, sometimes only in change is there security".*[6]

Gary C. Kelly is not just any one either. Under his leadership, Southwest has grown to become the nation's largest airline in terms of originating domestic passengers carried, and is a mainstay on Fortune magazine's list of the most admired companies in the world, ranking seventh in 2016.

Gary is a 30-year Southwest veteran who began his career at Southwest Airlines as Controller, moving up to Chief Financial Officer and Vice President Finance, then Executive Vice President and CFO, before being promoted to CEO and Vice Chairman in July 2004. Finally, as we said earlier, Gary assumed the roles of Chairman and President in 2008. He has pioneered the airline's

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[4] O'Brian, Bridget, "Southwest is a rare carrier: It still makes money", The Wall Street Journal, October 26th 1992.
[5] Ken Labich on his article: "Is Herb Kelleher America's Best CEO?", May 2, 1994.

[6] http://www.inc.com (Captain Marvel: How Southwest's Herb Kelleher Keeps Loyalty Sky High, 1992).

transformation through several key initiatives, including the acquisition of AirTran Airways, the repeal of the Wright Amendment, and the launch of international destinations for the first time in Southwest's history.

Gary has received numerous awards and recognitions over the years. In 2010, he was honoured with the Distinguished Alumnus Award from the University of Texas; he's been named one of the best CEOs in America by Institutional Investor magazine three times, selected as Dallas Business Journal's CEO of the year for 2011 and received the 2013 Father of the Year Award. Moreover, Gary was named to Fortune magazine's list of the Top 20 People in Business in 2014, and was twice named D CEO Magazine's CEO of the Year. Today, he is the recipient of the prestigious 2016 Tony Jannus Award.

2. SECTOR

Before starting the study of the industry, we find essential to define the market niche and the benchmark of Southwest, in order to make an appropriate analysis.

Although since 2014 Southwest Airlines is operating flights to international destinations in Mexico, Latin America and the Caribbean, the truth is that its principal market is the national, as flights in U.S represent the 98,5% of their flights. Therefore, we consider that our study's centre has to be the domestic flights.

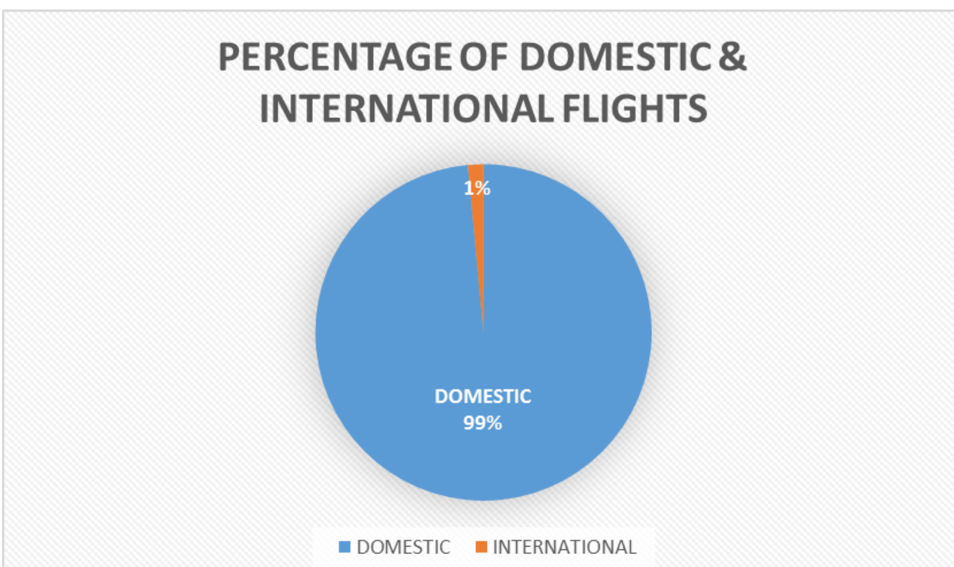

Figure 2: Source: United States Department of Transportation

2.1. SWOT ANALYSIS

In order to acquire a general vision and understanding the sector, we believe it is appropriate to make a SWOT analysis, an acronym of strengths, weaknesses, opportunities and threats. It is useful to identify the internal and external factors that are favourable and unfavourable in the sector. Southwest compete with firms that are operating in the same industry, providing similar products to similar costumers and undergo similar process of manufacturing. Therefore, the key for a successful strategic plan lays in gathering information from firms operating in the same industry.

STRENGTHS	WEAKNESSES
Acceptance of air travel as a fast and a safe way to travel. Possibility to segment the market and establish different levels of service and make associated Strong brand recognition as a low fare leader in the industry enables the company to expand its market Use of the tecgnologies. Direct sales through Internet. Facilities to the clients. The staff of the airlines is highly qualified and very experienced.	Airlines have a high ''spoliage'' rate compared to most other industries. An empty seat is lost and non-revenue producing. Infrastructural development is very slow. Aircrafts expensive and running an arline requires a very huge capital outlay. Ineficciency. There are number of instances of flight being cancelled. Cyclical economic downturns. A downsturn means that less people are likely to travel for pleasure and to do business. Seasonal demand specially with those who travel for leisure.

OPPORTUNITIES	THREATS
Airline market grwoth offers continual expansion opportunities for both leisure and business destinations. Recovery of U.S tourism and airline industry. UNWTO predicts growth between 3%-4% in tourism in 2016. Technology advances can result in cost savings. Expected investment. The aviation sector is ever growing and there is a increasing number of stakeholders in the industry willing to invest in air travel. Linkin up with other carriers in the industry to increase the passenger volume greatly. Longer flights are being introduced trhough fuel efficiency and aerodynamics. United States of America is the largest single market in the world. 33% of Revenue passenger mile.	In recent times, air travel has been a target to terrorists and frequent fliers have been scared away. High fuel prices. A huge upward surge in fuel prices can destabilize an investment in the aviation With the increasing number of airlines and aircrafts, there is likely to be a marked shortage of airports and airport facilities. Increasing impact of the governmental regultions to the industry operations. Failure to meet shareholders expectations can cause the market value of the company's stock to Increasing impact of the governmental regultions to the industry operations.

2.2. *AIRLINE'S INDUSTRY IMPORTANCE IN THE UNITED STATES*

Undoubtedly, not only for its contribution to the GDP, but also for the connectivity that it provides in the U.S, the airline industry is a key factor in increasing the nation's economic productivity and prosperity.

One of the reasons is the productivity in this industry. Although being ranked 41st in size among the 63 industries in the U.S economy, air transportation- driven by the forces of productivity and innovation- was found to be the 7th leading contributor to overall productivity in the U.S as we see in this graph:

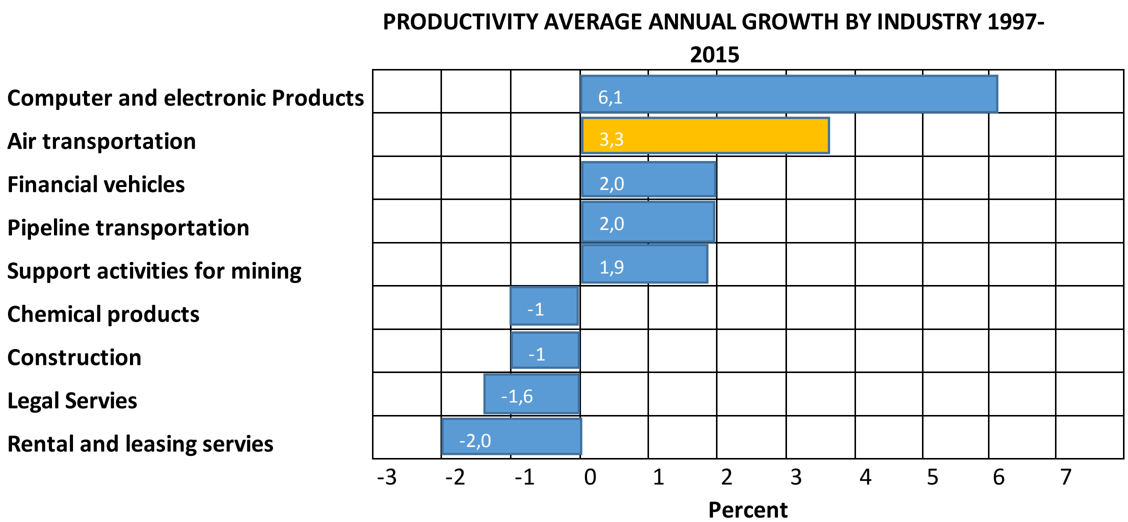

Figure 3: Source: *The Economic Impact of Civil Aviation on the U.S.Economy. Federal Aviation Administration*

Nowadays, as a consequence of this outstanding productivity, the total impact on the GDP, according to *The Economic Impact of Civil Aviation on the U.S economy*, is of 5,3% and is expected to keep growing as it has happened during the pasts years. Furthermore, it is important to point out that, in 2015, the civil aviation generated 10,6 million jobs.

2.3. *EVOLUTION OF THE SECTOR AND ITS FUTURE*

Now that we have seen the importance the airline industry, we analyse the evolution of the sector through:

i) The total number of passengers that have done domestic flights in the U.S

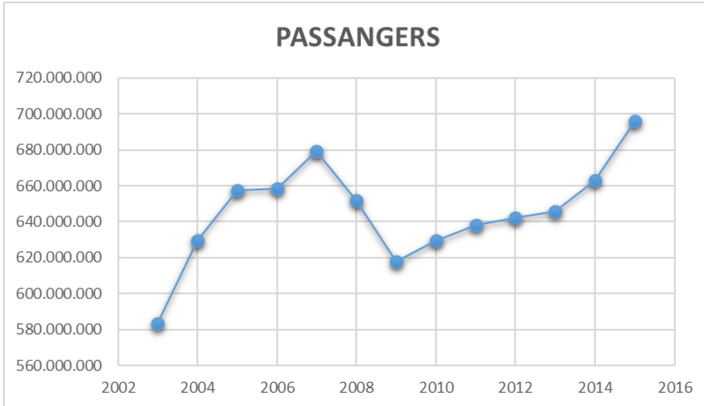

Figure 4: Annex B – Source: [United States Department of Transportation]

ii) The progression of the income of all the U.S. carriera

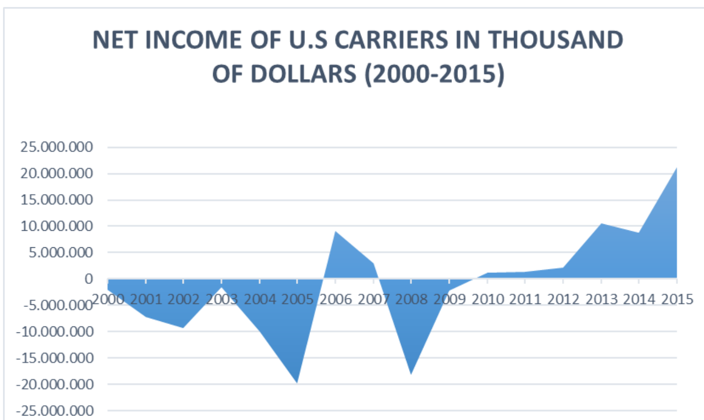

Figure 5: Source: [United States Department of Transportation]

iii) The evolution of the oil price

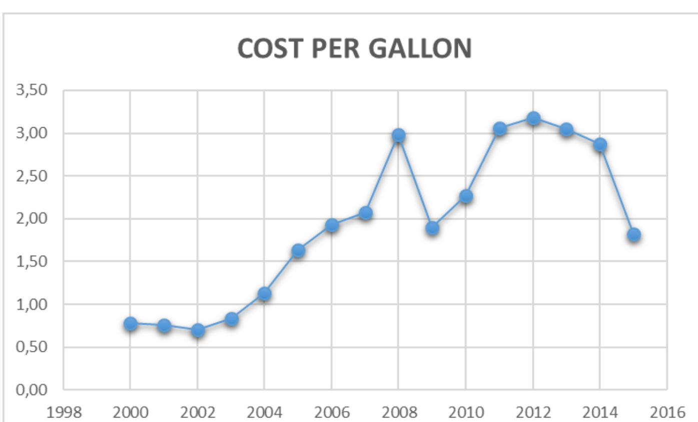

Figure 6: Source: [United States Department of Transportation]

iv) The growth of the GDP per Capita

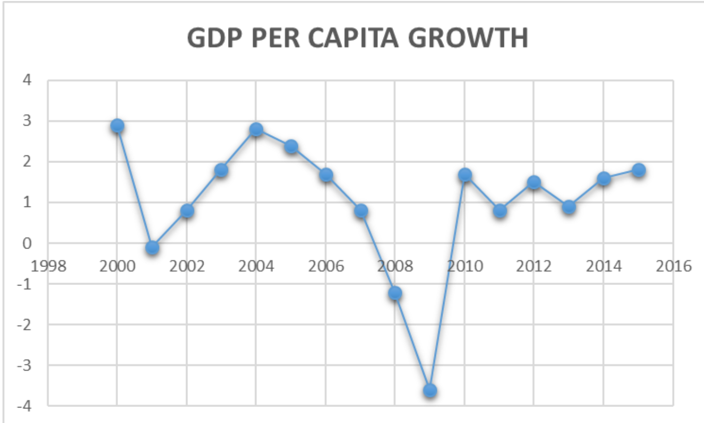

Figure 7: Source: [United States Department of Transportation]

As we have seen in the SWOT, the airline industry has historically been extremely volatile, subjected to numerous challenges. Futhermore, the airline industry has also been particularly susceptible to detrimental events such as terrorism attacks. Studying the three graphs, we can see that it is completely true.

On a global scale and, specially in the United States, the airline industry has suffered a financial crisis through almost all of this new century.

The problems that began with the economic downturn at the beginning of 2001 reached almost catastrophic proportions after the terror attacks of September 11, 2001. As a consequence, the airline industry in that year, experimented an enormous decrease in the net, as we can see it in the graph due to the the safety concerns of air travel. However, the airlines were in serious trouble before the 9/11, as the start of an economic downturm had already negatively affected the global air traffic demand, especially in premium class products because airlines were faced with deteriorating labor/management relations, aviation infraestructure constraints that led to increasing congestion and flights delays and dissatified custormers due to perceptions of poor service in general.

So big was the impact of the 9/11 that, although in 2002 there was a little recovery in the number of passengers, the airlines encountered a serious revenue problem in the serveral yeats after 2001. As a result, the total US airline industry passenger revenues dropped by over 20% between 2000 and 2002, and led four of the U.S principal carriers (U.S Airways, United, Delta and Northwest) into banckruptcy between 2001 and 2005.

During 2004 and 2005 there was a 12% increase in the total number of passengers compared to 2003, and the carriers were able to focus on down-sizing operating costs and improving productivity as a part of their re-structuring efforts. Much of their cost-cutting strategy focused on labor: employment was reduced by 30% in just five years. Notwithstandig, it was not enough to offset the increases of fuel prices that is the largest single component of airlines costs. The cost per gallon pass fromm 0,83 in the 2003 to 1,64 in 2005 representing a growth of a 97%. Consequently, american airlines entered in a profund crisis that it was even more servere than the 9/11, having the highest losses in their history as we see in the data.

In 2006, the airline sector became profitable as a consequence of the large increase in the number of passengers due to the improvemente in the economy before the crisis.

As we have said, the nature of the industry makes it vulnerable to global economic developments. In 2007, the global financial crisis led the industry into recessionary environment for a second time within a decade as a consequence of the general decrease in the GDP per capita as we can see in the graph and the permanent icnrease in the oil prices. Therefore, this economic crisis was the deepest experienced by the comercial airline industry since 1930s because the air travel demand dropped, as consumers experienced the impact of unemployment growth and expenses for basic necessities rised affected by petroleum prices.

As a consequence of the tremendous crisis and the quick increase in fuel costs, the airline industry during 2009 and 2015 experienced significant changes by U.S airlines in order to restore profitability that led to six consecutive beneficious years.

The main changes have been: firtsly, the airlines adaptation and development of new means when managing excees capacity, reducing the number of available fligts, airlines have been able to increase the fares for the seats that remain.

1st Quarter Average Fares, 2009-2015	
Year	Year-to-Year Percent Change in Average Fare (1Q to 1Q) (%)
2009	-5,84
2010	4,56
2011	8,41
2012	4,81
2013	1,37
2014	1,12
2015	1,61

Figure 8: Source- United States Department of Transportation

Secondly, airlines' income has also increased by implementing additional fees for services that previously were included in the basic ticket price. If we compare the revenue that proceeds of baggage fees before and after the crisis, we can see that there has been a 719% of growth.

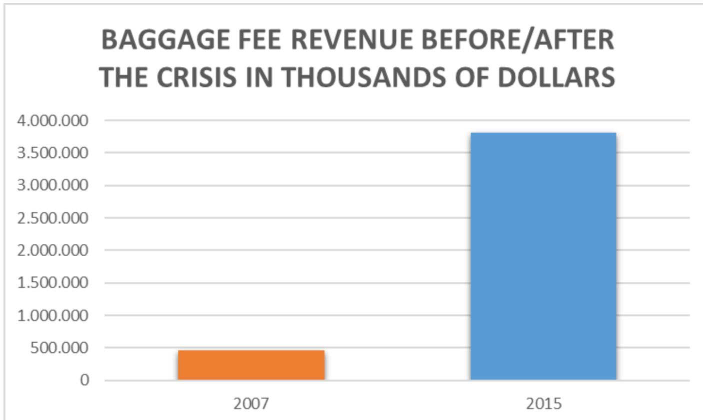

Figure 9: Source- [United States Department of Transportation]

Thirdly, the nation's airline industry has undergone so many mergers since the crisis that only four airlines (and their regional carriers) control almost the 70% of all domestic air traffic. These mergers have enabled the newly combined airlines to cut costs by reducing previously competing flights and redundant hub opertations, as well as consolidating operations. For instance, in the Delta/Northesmerger, hub operations at Cincinnati and Menphis airports have been reduced by 63 and 36 percent. Furthermore, a merger not only enables the firm to be more profitable and have greater funds for research and development, but also arises potential economies of scale.

Fourthly, the use of new technologies. In air transportation, technical progress includes the use of advandced or improved equipment used in the inspection of airplanes. This significantly reduced the amount of time needed to carry out airplane's inspections and, consequently, the amount of airplane's out-of-service time. This, in turn, leads to an increase of its output.

Last but not least, the airline industry remains as one of the most important in the American economy, with wide-reaching impacts on consumers and workforce. However, significant and frequent challenges to the economic and operating environment appear to be the new norm for the airline industry. Additionally, according to Boeing, one of the largest aircraft manufacturers, the new aircrafts such as Boeing-786, 747-8 and 737 reduces fuel consumption by double-digit percentages, compared to older ones.

2.4. MAIN COMPANIES IN THE U.S. MARKET

The American airline industry is a market where four companies have almost the 70% of the market.

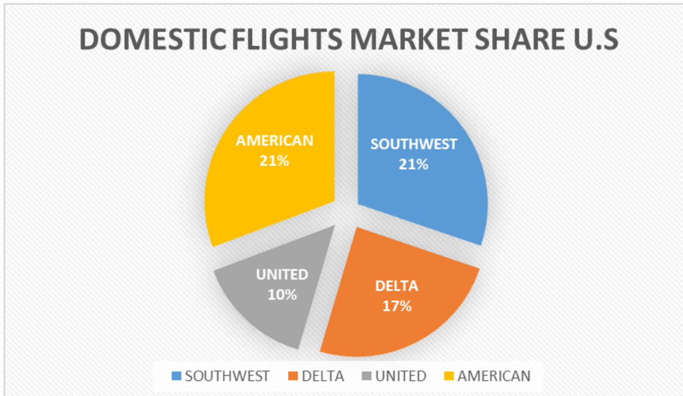

Figure 10: Source: [United States Department of Transportation]

We have calculated it, dividing the total number of passengers by the passengers of each company.

3. FINANCIAL STATEMENTS

3.1. BALANCE SHEET

ASSETS	31/12/15	%	31/12/14	%	31/12/13	%
CURRENT ASSETS	**$ 4.024,0**	**18,9%**	**$ 3.927,0**	**19,9%**	**$ 4.456,0**	**23,0%**
TOTAL CASH & CASH EQUIVALENTS	**$ 3.051,0**	**14,3%**	**$ 2.988,0**	**15,1%**	**$ 3.152,0**	**16,3%**
a) Cash and equivalents	1.583,0	7,4%	1.282,0	6,5%	1.355,0	7,0%
b) Short term investments	1.468,0	6,9%	1.706,0	8,6%	1.797,0	9,3%
TOTAL RECEIVABLES	**$ 474,0**	**2,2%**	**$ 365,0**	**1,9%**	**$ 362,0**	**1,9%**
a) Accounts and other receivables	474,0	2,2%	365,0	1,9%	362,0	1,9%
TOTAL STOCK	**$ 311,0**	**1,5%**	**$ 342,0**	**1,7%**	**467,0**	**2,4%**
a) Inventories	311,0	1,5%	342,0	1,7%	467,0	2,4%
TOTAL OTHER CURRENT ASSETS	**$ 188,0**	0,9%	**$ 232,0**	1,2%	$ 475,0	2,5%
NON CURRENT ASSETS	**$ 17.288,0**	**81,1%**	**$ 15.796,0**	**80,1%**	**$ 14.889,0**	**77,0%**
TOTAL TANGIBLE ASSETS	**$ 15.601,0**	**73,2%**	**$ 14.292,0**	**72,5%**	**$ 13.389,0**	**69,2%**
a) Flight equipment	19.462,0	91,3%	18.473,0	93,7%	16.937,0	87,6%
b) Ground property and equipment	3.219,0	15,1%	2.853,0	14,5%	2.666,0	13,8%
c) Deposits on flight equipment purchase contracts	1.089,0	5,1%	566,0	2,9%	764,0	3,9%
d) Assets constructed for others	915,0	4,3%	621,0	3,1%	453,0	2,3%
e) Less allowance for depreciation and amortization	-9.084,0	-42,6%	-8.221,0	-41,7%	-7.431,0	-38,4%
TOTAL INTANGIBLE ASSETS	**$ 970,0**	**4,6%**	**$ 970,0**	**4,9%**	**$ 970,0**	**5,0%**
a) Goodwill	970,0	4,6%	970,0	4,9%	970,0	5,0%
TOTAL OTHER NON CURRENT ASSETS	**$ 717,0**	**3,4%**	**$ 534,0**	**2,7%**	**$ 530,0**	**2,7%**
ASSETS	**$ 21.312,0**	**100,0%**	**$ 19.723,0**	**100,0%**	**$ 19.345,0**	**100,0%**
CURRENT LIABILITIES	**$ 7.406,0**	**34,8%**	**$ 5.923,0**	**30,0%**	**$ 5.676,0**	**29,3%**
a) Accounts payable	1.188,0	5,6%	1.203,0	6,1%	1.247,0	6,4%
b) Accrued liabilities	2.591,0	12,2%	1.565,0	7,9%	1.229,0	6,4%
c) Air traffic liability	2.990,0	14,0%	2.897,0	14,7%	2.571,0	13,3%
d) Current maturities	637,0	3,0%	258,0	1,3%	629,0	3,3%
NON CURRENT LIABILITIES	**$ 6.548,0**	**30,7%**	**$ 7.025,0**	**35,6%**	**$ 6.333,0**	**32,7%**
a) Long-term debt less current maturities	2.541,0	11,9%	2.434,0	12,3%	2.191,0	11,3%
b) Deferred income taxes	2.490,0	11,7%	2.782,0	14,1%	2.934,0	15,2%
c) Construction obligation	757,0	3,6%	554,0	2,8%	437,0	2,3%
d) Other non current liabilities	760,0	3,6%	1.255,0	6,4%	771,0	4,0%
EQUITY	**$ 7.358,0**	**34,5%**	**$ 6.775,0**	**34,4%**	**$ 7.336,0**	**37,9%**
a) Common stock	808,0	3,8%	808,0	4,1%	808,0	4,2%
b) Capital in excess of par value	1.374,0	6,4%	1.315,0	6,7%	1.231,0	6,4%
c) Retained earnings	9.409,0	44,1%	7.416,0	37,6%	6.431,0	33,2%
d) Accumulated other comprehensive loss	-1.051,0	-4,9%	-738,0	-3,7%	-3,0	-0,02%
e) Treasury stock	-3.182,0	-14,9%	-2.026,0	-10,3%	-1.131,0	-5,8%
EQUITY + LIABILITIES	**$ 21.312,0**	**100,0%**	**$ 19.723,0**	**100,0%**	**$ 19.345,0**	**100,0%**

3.2. INCOME STATEMENT

ACCOUNTING ITEMS	31/12/15	%	31/12/13	%	31/12/13	%
OPERATING REVENUES	**$ 19.820,0**	**100%**	**$ 18.605,0**	**100,0%**	**$ 17.699,0**	**100,0%**
a) Passenger	18.299,0	92%	17.658,0	94,9%	16.721,0	94,5%
b) Freight	179,0	1%	175,0	0,9%	164,0	0,9%
c) Special revenue adjustment	172,0	1%	-	-	-	-
d) Other operating revenues	1.170,0	6%	772,0	4,1%	814,0	4,6%
OPERATING EXPENSES:	**$ 14.689,0**	**74%**	**$ 15.442,0**	**83,0%**	**$ 15.554,0**	**87,9%**
a) Salaries and wages	6.383,0	32%	5.434,0	29,2%	5.035,0	28,4%
b) Fuel and oil	3.616,0	18%	5.293,0	28,4%	5.763,0	32,6%
c) Maintenance materials and repairs	1.005,0	5%	978,0	5,3%	1.080,0	6,1%
d) Aircraft rentals	238,0	1%	295,0	1,6%	361,0	2,0%
e) Landing fees and other rentals	1.166,0	6%	1.111,0	6,0%	1.103,0	6,2%
f) Adquisition and integration	39,0	0,2%	126,0	0,7%	86,0	0,5%
g) Other operating expenses	2.242,0	11%	2.205,0	11,9%	2.126,0	12,0%
GROSS MARGIN	**$ 5.131,0**	**26%**	**$ 3.163,0**	**17,0%**	**$ 2.145,0**	**12,1%**
Depreciation	1.015,0	5%	938,0	5,0%	867,0	4,9%
EBIT	**$ 4.116,0**	**21%**	**$ 2.225,0**	**12,0%**	**$ 1.278,0**	**7,2%**
OTHER REVENUES	**$ 637,0**	**3%**	**$ 409,0**	**2,2%**	**$ 69,0**	**0,4%**
a) Interest expense	121,0	1%	130,0	0,7%	131,0	0,7%
b) Capitalized interest	-31,0	-0,2%	-23,0	-0,1%	-24,0	-0,1%
c) Interest income	-9,0	-0,05%	-7,0	-0,04%	-6,0	-0,03%
d) Other (gains) losses, net	556,0	2,8%	309,0	1,7%	-32,0	-0,2%
EBT	**$ 3.479,0**	**18%**	**$ 1.816,0**	**9,8%**	**$ 1.209,0**	**6,8%**
Provision for income taxes	1.298,0	7%	680,0	3,7%	455,0	2,6%
NET INCOME	**$ 2.181,0**	**11%**	**$ 1.136,0**	**6,1%**	**$ 754,0**	**4,3%**

3.3. CASH FLOW

ACCOUNTING ITEMS	31/12/15	31/12/14	31/12/13
CASH FLOWS FROM OPERATING ACTIVITIES	**$ 3.238,0**	**$ 2.902,0**	**$ 2.022,0**
a) Earning before taxes	3.479,0	1.816,0	754,0
TOTAL ADJUSMENTS TO RECONCILE NET INCOME	**$ 1.019,0**	**$ 1.718,0**	**$ 912,0**
a) Depreciation and amortization	1.015,0	938,0	867,0
b) Unrealized (gain) loss on fuel derivative instruments	113,0	279,0	-5,0
c) Deferred income taxes	-109,0	501,0	50,0
TOTAL CHANGES IN CERTAIN ASSETS AND LIABILITIES	**$ 38,0**	**$ 48,0**	**$ 811,0**
a) Accounts and other receivables	-88,0	54,0	-17,0
b) Other assets	103,0	142,0	-46,0
c) Accounts payable and acrrued liabilities	961,0	36,0	343,0
d) Air traffic liability	94,0	326,0	400,0
e) Cash collateral received (provided to) derivative counterparties	-570,0	-233,0	57,0
f) Other, net	-462,0	-277,0	74,0
TOTAL OTHER CASH FLOWS FROM OPERATING ACTIVITIES	**$ 1.298,0**	**$ 680,0**	**$ 455,0**
a) Provision for income taxes	1.298,0	680,0	455,0
CASH FLOWS FROM INVESTING ACTIVITIES	**-$ 1.913,0**	**-$ 1.727,0**	**-$ 1.384,0**
a) Capital expenditures	-2.041,0	-1.748,0	-1.433,0
b) Assets constructed for others	-102,0	-80,0	-14,0
c) Purchases of short-term investments	-1.986,0	-3.080,0	-3.135,0
d) Proceeds from sales of short-term and other investments	2.223,0	3.185,0	3.198,0
e) Other, net	-7,0	-4,0	-
CASH FLOWS FROM FINANCING ACTIVITIES	**-$ 1.024,0**	**-$ 1.248,0**	**-$ 851,0**
a) Proceeds from issuance of long-term debt	500,0	300,0	-
b) Proceed from employee stock plans	46,0	110,0	96,0
c) Reimbursement for assets constructed for others	24,0	27,0	-
d) Proceeds from termination of interest rate derivative instrument	12,0	-	-
e) Payments of long-term debt and capital lease obligations	-213,0	-561,0	-313,0
f) Payments of cash dividends	-180,0	-139,0	-71,0
g) Payments of construction obligation	-10,0	-11,0	-5,0
h) Repurchase of common stock	-1.180,0	-955,0	-540,0
i) Other, net	-23,0	-19,0	-18,0
NET CHANGE IN CASH AN CASH EQUIVALENTS	**$ 301,0**	**-$ 73,0**	**$ 242,0**
CASH AND CASH EQUIVALENTS AT BEGGINING OF PERIOD	**$ 1.282,0**	**$ 1.355,0**	**$ 1.113,0**
CASH AND EQUIVALENTS AT END OF PERIOD	**$ 1.583,0**	**$ 1.282,0**	**$ 1.355,0**

3.4. SOUTHTWEST RATIOS

RATIOS	**Average sector 2015**	**2015**	**2014**	**2013**
CAPITALIZATION AND DEBT				
Debt = Liabilities / Assets	0,77	0,65	0,65	0,62
Debt's quality = Current liabilities / total liabilities	0,41	0,53	0,47	0,47
Repayment capacity = Cash Flow / Loans	0,57	1,27	1,19	1,13
Cost of debt = Financial expenses / Loans	0,11	0,25	0,16	0,03
Financial expenses = Financial expenses = / Sales	0,025	0,03	0,02	0,003
LIQUIDITY				
Liquidity = Current assets / Current liabilities	0,6	0,54	0,66	0,78
Treasury = Receivable + Available / Current liabilities	0,48	0,47	0,56	0,61
Acid Test = Available / current liabilities	0,19	0,41	0,50	0,55
Apparent working capital (real) ($) = Current assets - Current liabilities	-5.014,5	- 3.382	- 1.996	-1.220
Required working capital ($) = Operating Current assets – Operating Current liabilities	-6.744,75	-4850	- 3.702	- 3.017
Operating CA = Stock+ Clients + Other Operating CA + Least Available (10%PC)	6.250,3	3296,6	2.813,3	3.226,6
Operating CL= Suppliers + Other Operating CL + Accruals	11.483,25	7.406	5.923	5.676
Working Capital Deficit ($)	1.730,25	1.468	1.706	1797
ASSET MANAGEMENT				
Non-Current Assets Turnover = Sales / Non-Current Assets**	1,12	1,39	1,41	1,41
Current Assets turnover = Sales / Current Assets**	4,58	4,92	4,73	3,97
TERMS				
Average Days Inventory Out = stocks / Daily Cost of Sales	11,61	9,86	11,26	12,8
Average Days Sales Out = Clients / Daily Sales	12,69	8,28	7,43	7,5
Average Day Payable Out= Suppliers / Daily Buys	28,5	36,23	34,45	32,2
SALES				
Sales growth from last year = Sales / Last year's Sales	0,99	1,06	1,05	0,93
RETURN, SELF-FINANCING AND GROWTH				
Assets Return = EBIT/ Assets	0,11	0,19	0,11	0,06
Return on Equity = Dominant society's attributable result / Equity	0,63	0,29	0,16	0,1
Cash flows / Sales	0,15	0,16	0,15	0,14
Cash flows / Assets	0,1	0,15	0,14	0,55
Dividends / Net Income	0,05	0,082	0,12	0,09
Dividends / Equity	0,021	0,024	0,02	0,009

3.5. MAIN COMPETITORS RATIOS

RATIOS	Average sector 2015	Delta	American	Continental
CAPITALIZATION AND DEBT				
Debt = Liabilities / Assets	0,77	0,79	0,88	0,78
Debt's quality = Current liabilities / total liabilities	0,41	0,41	0,31	0,39
Repayment capacity = Cash Flow / Loans	0,57	0,17	0,3	0,57
Cost of debt = Financial expenses / Loans	0,11	0,05	0,07	0,09
Financial expenses = Financial expenses = / Sales	0,025	0.01	0,03	0,03
LIQUIDITY				
Liquidity = Current assets / Current liabilities	0,6	0,51	0,73	0,63
Treasury = Receivable + Available / Current liabilities	0,48	0,47	0,67	0,33
Acid Test = Available / current liabilities	0,19	0,11	0,02	0,24
Apparent working capital (real) ($) = Current assets - Current liabilities	-5.014,5	-8.470	-3.620	-4.586
Required working capital ($) = Operating Current assets – Operating Current liabilities	-6.744,75	-8.629	-7.948	-5.552
Operating CA = Stock+ Clients + Other Operating CA + Least Available (10%CL)	6.250,3	9.343,6	5.481,5	6.879,4
Operating CL= Suppliers + Other Operating CL + Accruals	11.483,25	15.963	11.374	11.190
Working Capital Deficit ($)	1.730,25	159	4.328	966
ASSET MANAGEMENT				
Non-Current Assets Turnover = Sales / Non-Current Assets	1,12	0,92	1,06	1,14
Current Assets turnover = Sales / Current Assets	4,58	4.49	4,1	4,83
TERMS				
Average Days Inventory Out = stocks / Daily Cost of Sales	11,61	13,2	12,8	10,6
Average Days Sales Out = Clients / Daily Sales	12,69	14,1	16,1	12,3
Average Day Payable Out= Suppliers / Daily Buys	28,5	29,2	20,3	28,3
SALES				
Sales growth from last year = Sales / Last year's Sales	0,99	0,98	0,96	0,97
RETURN, SELF-FINANCING AND GROWTH				
Assets Return = EBIT/ Assets	0,11	0,03	0,13	0,12
Return on Equity = Dominant society's attributable result / Equity	0,63	0,09	1,35	0,81
Cash flows / Sales	0,15	0,15	0,15	0,15
Cash flows / Assets	0,1	0,02	0,12	0,14
Dividends / Net Income	0,05	0,1	0,03	0,01
Dividends / Equity	0,021	0,002	0,05	0,01

B. ANALYSIS OF SOUTHWEST

4. HOW DOES SOUTHWEST FACE DIFFICULTIES?

4.1. HOW DID THE 9/11 IMPACT ON THE AIRLINE SECTOR?

The terrorist attacks on September 11, 2001 affected the United States in a profoundly way, deeply upsetting the national perception of safety within U.S. borders. However, airline industry was the sector of the economy that felt those impacts the most. Directly after the terrorist attacks on 9/11, the federal government closed airports, cancelling thousands of flights at a direct cost to airlines. Even when the airports reopened, passengers were worried of air travel, and airlines experienced at least a 30% reduction in demand during the initial shock period immediately following the reopening and had to reduce considerately the number of passengers as we can see in the following graph:

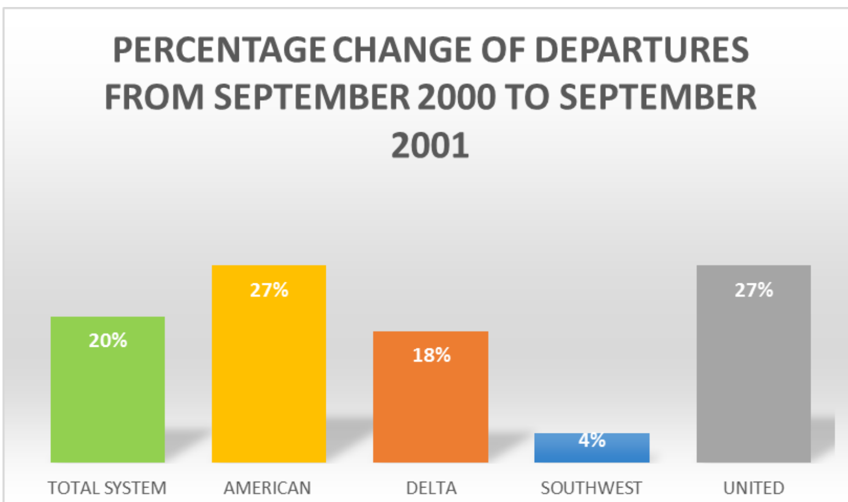

Figure 11: Source: United States Department of Transportation

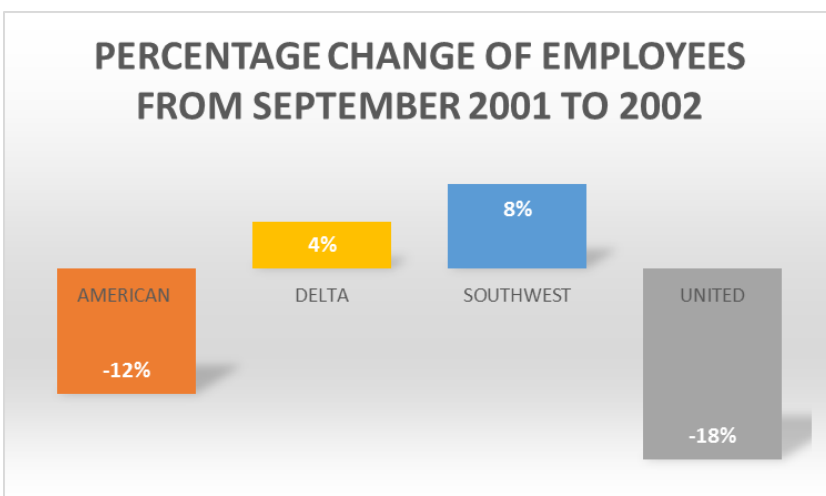

Figure 12: Source: United States Department of Transportation

Because of this fall in the demand, almost every airline carrier had profound loses.

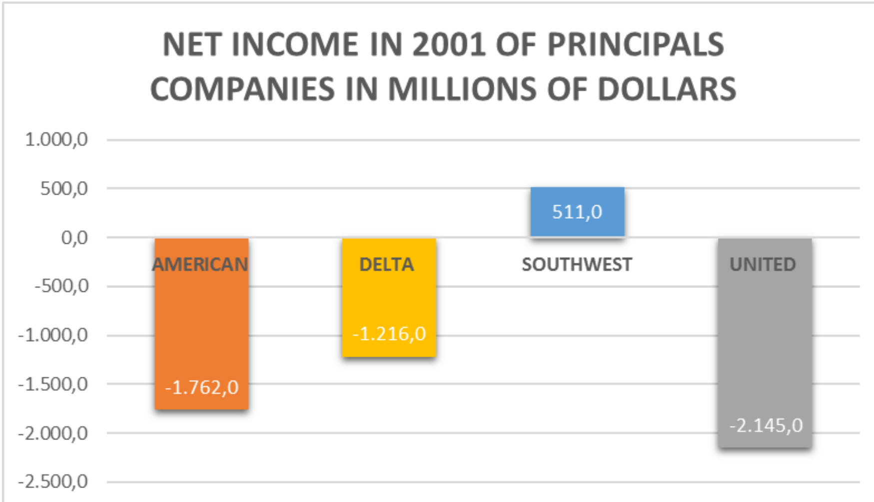

Figure 13: Source: United States Department of Transportation

4.2. HOW DID THE ECONOMIC CRISIS IMPACT ON THE AIRLINE SECTOR?

As we have seen in the industry analysis, the economic crisis had a brutal effect in the airline industry because of the massive financial losses (due to lack of passenger demand, cancelled flights and increased expenditures for security). The airline industry had to slowly emerge from one of its worst recessions ever.

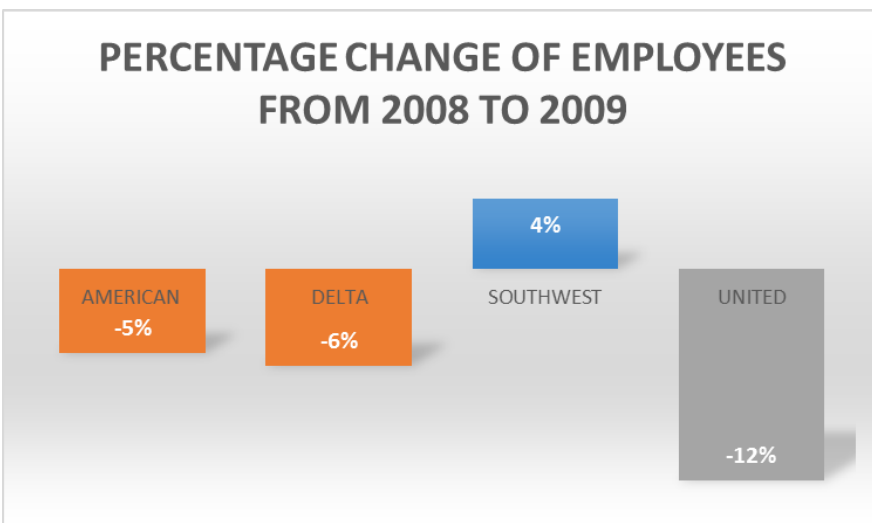

Figure 13: Annex C – Source: United States Department of Transportation

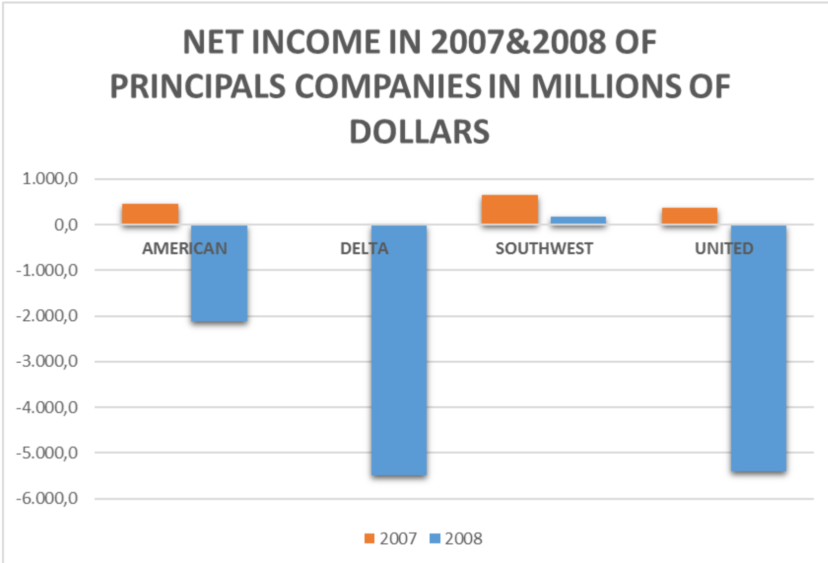

Figure 14: Annex C – Source: United States Department of Transportation

5. WHAT ARE THE REASONS FOR SOUTHWEST SUCCESS?

While many airlines, as a consequence of the 9/11 and the economic crisis, were forced to tight their belts, renegotiate labor contracts and lay off high numbers of employees, Southwest Airlines came through the storm almost intact, with its ambitions undiminished not cancelling any flight nor did fire any employees, and without having loses as all the principal competitors.

La compañía es conocida por su atención al cliente.

Los vuelos baratos de la compañía se llenan pese a la turbulencia del sector.

Southwest Airlines se eleva sobre la crisis

Escribe AMPARO POLO

SOUTHWEST Airlines vale hoy en bolsa lo mismo que American Airlines, United Airlines, Delta, Continental, Northwest Airlines y US Airways juntas. La compañía de vuelos baratos, fundada hace treinta años por el carismático Herbert Kelleher, tenía ayer una capitalización bursátil de 12.230 millones de dólares, un 6,5 por ciento menos que en enero de 2001. El sector ejemplo, según Salomon Smith Barney). La compañía ha aumentado su beneficio en los últimos nueve años y ha conseguido una reducción de costes progresiva, lo que le permite ofrecer vuelos directos muy baratos entre 58 ciudades americanas. Uno de sus puntos fuertes es la extraordinaria motivación de su plantilla y el compromiso de los empleados con la cultura de la compañía. De hecho, el lema de

James Parker, consejero delegado de la aerolínea. / B. N.

El beneficio creció un doce por ciento

Southwest se confirma como la aerolínea más rentable de EEUU

AGENCIAS. Dallas

Southwest Airlines ha vuelto a confirmar que es la única de las grandes aerolíneas norteamericanas que siguen siendo rentables después de los ataques terroristas del 11 de septiembre. La empresa, que sólo realiza vuelos dentro de Estados Unidos, aumentó su beneficio un doce por ciento entre enero y marzo, gracias a la mayor ocupación derivada de las ofertas de vuelos baratos. La situa-

La empresa ofrece vuelos baratos y no tiene destinos internacionales

7,5 por ciento hasta 1.350 millones de dólares.

La aerolínea prevé aumentar su capacidad un cuatro por ciento este año y sumar a su flota otros cuatro aparatos Boeing 737, que tiene previsto poner en servicio a lo lar-

Figure 15: Source: Expansion newspaper

How could that be possible? Well, in Kelleher's view, Southwest could afford to do it because of three main reasons: firstly, because it had the lowest costs, secondly, due to the treatment of its employees and finally for its outstanding treatment to their clients. So, the secret of Southwest's success has always been keeping costs down and treating their workers right, as well as their commitment to manage the company during boom periods with an eye on the recession that will inevitably come then. If you do this, "said Kelleher," everything else will work for itself. *"To be successful in business requires a certain historical and futuristic sense. Be prepared because the bad times will come''.* [7]

[7] "El éxito de Southwest, un secreto a voces", Wharton University of Pennsylvania, 4th of June 2003.

We proceed to analyse the reasons and the policy implemented in those years, which are the same ones that permit Southwest have the highest number of passengers nowadays. Although time passes, nothing changes. The several awards Southwest has received is a prove of it.

Figure 16: Source: [Awards and accolades]

5.1. COST OF STRUCTURE

Extreme attention to costs has been the key to achieve these results, as we can see in their website. *´´Even in the best times we kept our costs low and we questioned every expense. For years, I had the habit of approving all expenses above $1,000. Why? To encourage a culture of awareness of expenses. Obviously, it was impossible for me to supervise the whole world. But from time to time I asked questions, which made everyone continue to pay attention to the subject´´.*

Southwest has always done an amazing job controlling its costs. As a Barclays analyst, David Fintzen says, this company is a *"cost leader and revenue laggard"*.[8] One of its strategies to make

[8] David Fintzen, "Southwest bets big on business travelers", Fortune, September 23, 2015.

that possible is flying primarily with one basic type of plane, the Boeing 737, producing big savings in pilot training and maintenance.

The business also gets extra efficacy of each plane than other major airlines because they minimize the time they are on the ground. Southwest principally flies nonstop "point to point" routes regularly through the day. That way, Southwest maintains its planes and crews in the air nine hours a day on average, beating its rivals' airtime by two hours. "That's like getting one airplane in five for free," says Randy Babbitt, Southwest's chief of labour relations.[9]

Southwest also has faced the oscillations in the oil price perfectly. When prices were at high levels, Kelly sharply reduced purchases in the futures market. So when prices began to plummet in 2014, Southwest took only minor losses on hedges and pocketed most of the cost savings. In the first six months of 2015 it spent just $1.88 billion on jet fuel, compared with $3.1 billion over the same period in 2012, a savings of 39%.[10] Furthermore, Southwest is improving their efficiency through fleet modernization and other fuel initiatives. *``For example, during 2015, the company took delivery of 19 Boeing 737-800 and 24 Boeing 737-700 aircraft. In 2016, the Company currently expects to take delivery of an additional 36 Boeing 737-800 and 17 Boeing 737-700 aircraft''*[11]. As a consequence, Southwest has reduced considerately the percentage of operating expenses since 2011.

Finally, Southwest reduces costs because it does not offer lunch service in their flights. Although these measure seems insignificantly, a study made by the Economist explain that lunches can add 40 dollars per passenger to the cost of the flight. ''*In an industry that serves fussy customers and operates on thin margins, how else do modern airlines cut costs without cutting corners? Southwest, for example, followed the suggestion of a flight attendant and removed the company's logo from rubbish bags, saving the carrier 300.000 a year in printing costs".*

5.2. EMPLOYEES

Southwest's focus on employees is a smart move. Your employees bring the customer experience to life. If employees are treated well, they treat clients well. If customers are treated well, they will return, and shareholders will be satisfied. The company is a comfortable and fun place to work. *"If you're comfortable, you smile more and give a better service,"*[12] For the company, treating employees well does not mean offering them big salaries. In fact, the salaries of the company are lower than those of the competitors. But the airline distributes stock options among

[9] Randy Babbitt, "Southwest bets big on business travelers", Fortune, September 23, 2015.
[10] "Southwest bets big on business travelers", Fortune, September 23, 2015.

[11] Southwest airlines CO. 2015 annual report to shareholders, page 12.
[12] Pelline, Jeff, "Southwest Air's Driving Force," San Francisco Chronicle, June 10, 1993.

all its employees (not just the executives) so that they can participate in the financial successes of the company. Southwest even has the policy of increasing the salaries of managers in an amount proportionally no higher than the increase for other employees. And, in the bad times, they also reduce them.

Harold Sirkin, an airline specialist at BGC, said, *"Southwest works because people collaborate to do whatever it takes to get the plane back on the ground. It is part of the Southwest culture. And if the pilots have to carry suitcases, they will''.* [13] Those who join the company are made to feel like part of a family. You can perceive this family spirit in many areas of the company. A few examples of it are:

- ❖ $ 500,000 was collected of voluntary contributions to distribute among other needy Southwest employees.
- ❖ During the last oil crisis, unbeknownst to management, the employees contributed $ 130,000 to cover fuel costs.
- ❖ When a former employee had problems with the drug, the company paid for their medical care following their stay in the rehabilitation program.

Southwest employees also volunteer to help clients in difficult situations. Once a customer arrived at the airport to go on vacation accompanied by his dog, where he was told that the animal could not travel with him. Instead of forcing him to cancel the flight, the gate agent took care of the dog for two weeks so that the client could enjoy his vacation. Another employee escorted an elderly passenger to the next scale to make sure he could change planes without problems. These efforts bear fruit in the form of productivity. "There's no question that the glory of Southwest Airlines is its productivity," said Edward J. Starkman, airline analyst with PaineWebber. *"The work force is dedicated to the company. They're Moonies basically. That's the way they operate."* [14]

Years ago, the human resources function in Southwest was renamed, replacing it with "the people department". While in many companies, human resources are considered a secondary function, the Southwest people department is "like the keeper of the flame" says the treasurer John Owen.[15] To make sure that only the right people comes in, Southwest is very selective when hiring. Teamwork is the key. As noted by Ann Rhoades, "if they say ‘I’ too often in the interview, they are not admitted." Southwest even invites clients to take part in the interviews for flight attendants sometimes. The company believes that attitude is what counts. According to

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[13] Scott Reckard, E., "Shuttle dogfight good news for air travelers," San Francisco Chronicle, October 2, 1994.

[14] Elsworth, Peter, "Southwest Air's new push west," the New York Times, June 16, 1991.
[15] Zellner, Wendy "Go-go goliaths", business week, February 13 Of 1995.

Kelleher *"we look for out-of-the-way attitudes. We can perfect skills through information. We can not change the attitude''.* [16] So, first of all, the company looks up for those who have an outstanding attitude and, later on, the worker will get experience on the sector. Gary C. Kelly is a clear example of it: he transformed himself from a buttoned-down C.P.A. to one of Corporate America's most colorful bosses.

When hiring, the company implies a brilliant interview group tactic. One by one, applicants are asked to tell everyone their most embarrassing moment. Here's the key of the tactic. The interviewers spend the majority of their focus on the audience. They are looking at the faces of the other interviewees. And they are looking for one thing: empathy. Specifically, Southwest looks for three characteristics: a warrior spirit, a servant's heart and a fun-luving attitude[17].

When facing the future, Kelly did not wrong believe that Southwest would remain on top, by deploying its traditional advantages in the big-city business market. *"Our service levels are the best in the business, our costs are the lowest of the majors, and our beloved brand puts us in a prime position. We'll grow faster than they will."*[18]

5.3. CLIENTS

As we can read in the Southwest website:

Our Customers mean everything to us. We like to think of ourselves as a Customer Service company that happens to fly airplanes. From booking your trip to the moment you deplane, it's our mission to make your travel experience a great one.

Southwest wins loyal costumers because of the service that offers. Abigail Johnson, co-founder of Silicon Valley frequently flies with Southwest airlines. *"What I like best is the attitude of the flight attendants," says Johnson. "I've taken 1,100 flights on Southwest and maybe met two or three flight attendants who were unpleasant. On other airlines you hear them complaining all the time."*[19]

They achieve the satisfaction of their clients through:

5.3.1. The Triple Crown

What does an airline have to do to give an outstanding service and to achieve the satisfaction of

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[16] Chakravaty, subrata, Hit "em hardest with the mostest", Forbes, September 16, 1991".

[17] Stan Phelps, "Southwest Airlines understands the heart of Marketing is experience", Forbes, September 14, 2014.
[18] Gary C. Kelly, "Southwest bets big on business travelers", Fortune, September 23, 2015.
[19] Abigail Johnson, "Southwest bets big on business travelers", Fortune, September 23, 2015.

their clients? In the airline sector, the service is measured by what is known as the *Triple Crown:* punctuality, having the least number of lost luggage and having the least number of customer complaints".

In Southwest, one of the main reasons of its success is that is the one who performs better with regard to punctuality, complaints and mishandled baggage.

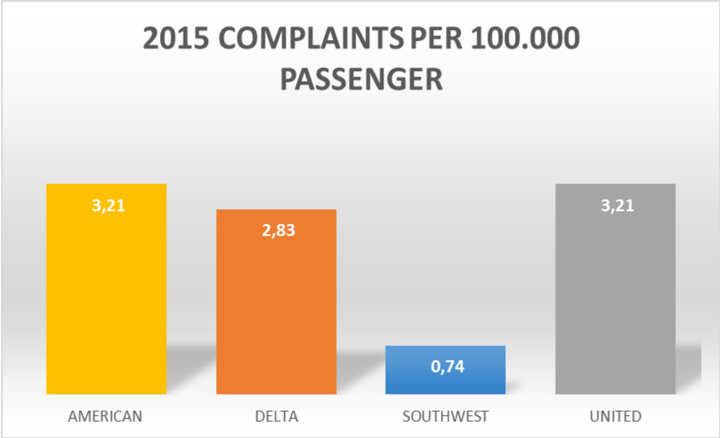


Figure 17: Source: [Report of Airline Quality Rating 2016]()

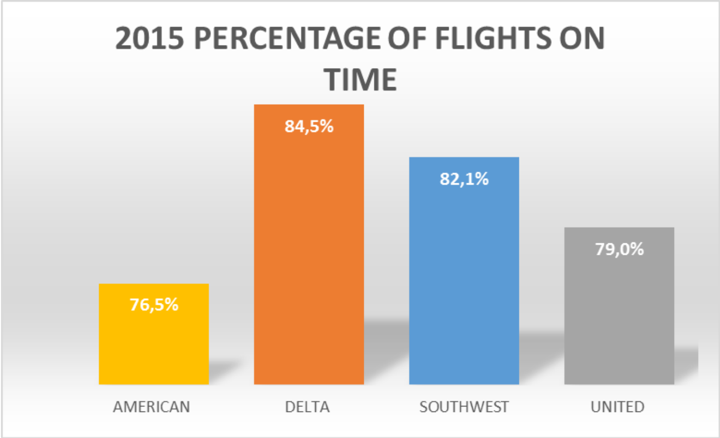


Figure 18: Source: [Report of Airline Quality Rating 2016]()

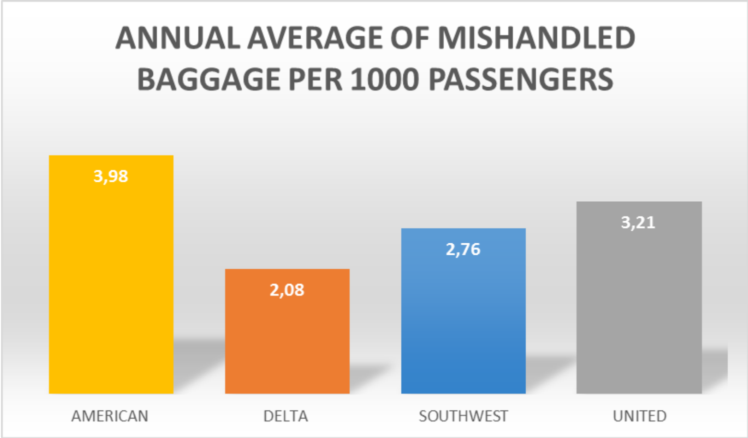


Figure 19: Source: [Report of Airline Quality Rating 2016]()

5.3.2. FEES

Southwest, compared to other companies, has the lowest fees and includes in the base ticket price the first and second cheked baggage. While bag fees have become the norm amongst their principals competitors, that has not happened in Southwest.

BAGGAGE FEES			
AIRLINES	**CARRY-ON BAG**	**1ST CHECKED BAG**	**2ND CHECKED BAG**
AMERICAN	$ 0,0	$ 25,0	$ 35,0
DELTA	$ 0,0	$ 25,0	$ 35,0
SOUTHWEST	$ 0,0	$ 0,0	$ 0,0
UNITED	$ 0,0	$ 25,0	$ 35,0

This can be seen in the last offer made by Southwest:

Figure 20: Source: Southwest website

6. ANALYSIS OF FINANCIAL STATEMENTS

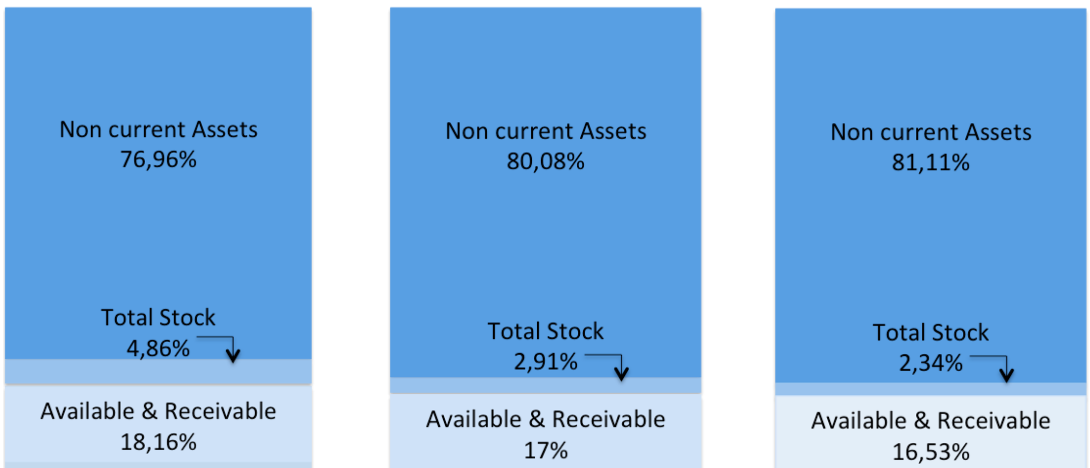
6.1. BALANCE SHEET

The first step when analysing the financial statements of a company is to begin with the analysis of the balance sheet, which allows us to evaluate aspects such as liquidity situation, ability to pay, business indebtedness, financial independence, capitalization, equity guarantees or their asset management.

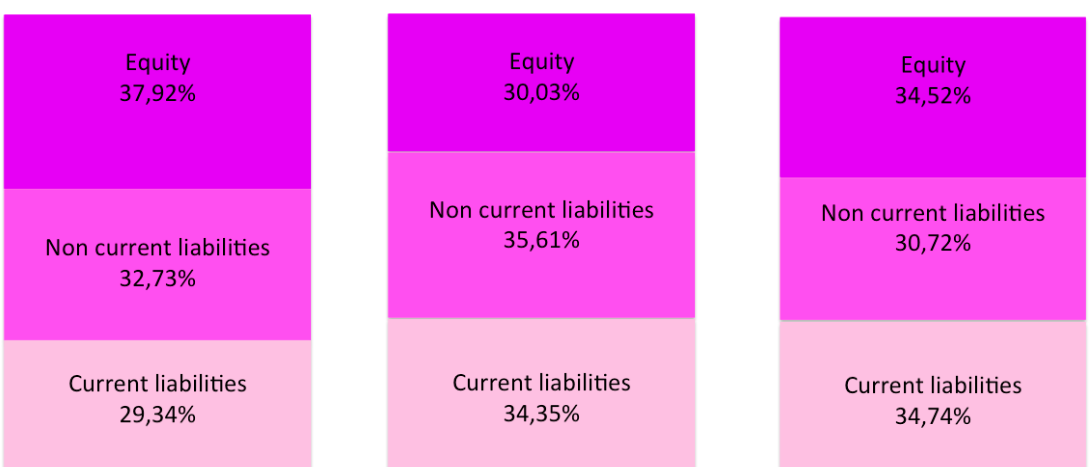
To understand in a better way the evolution of the company balances, it is preferable to do what is called a "dynamic" or "horizontal" analyse, which consists in calculating the percentages of every patrimonial mass and creating a graphic with them. Thus, we can check out the evolution of different patrimonial groups over the past years.

Here we have now the assets, the liabilities and the equity of Southwest from 2013 to 2015.

SOUTHWEST ASSETS FROM 2013 – 2014 – 2015



SOUTHWEST LIABILITIES AND EQUITY FROM 2013 – 2014 – 2015



RELATION BETWEEN ASSETS AND LIABILITIES

The situation is optimal when the current assets are higher than what is demandable in the short term and, if it is possible, almost the double. This is necessary for the company to not have liquidity difficulties and be able to pay all the bills.

As we see in this case, the current liabilities (29,34% – 34,35% - 34,74%) are higher than the current assets (23,02% – 19,91% - 18,87%). This could mean that the company is in temporary receivership, which can cause liquidity problems and eventually an administrative receivership.

In addition, the available plus the receivable should be equal to the current liabilities, since it is possible that the company has a very high amount of current assets but in the form of stocks, which would mean that it would not be able to meet its short-term debts. As we can see, this does not happen in our case either.

This would be the case in any usual company, but as Southwest is a company with really short average collecting terms and higher average payment terms, it can manage to survive with a negative working capital. Therefore, this situation does not affect its normal activity.

RELATION BETWEEN LIABILITIES AND EQUITY

The equity capital should be at least the 40% or 50% of the total equity plus liabilities. This percentage is necessary so that the company is sufficiently capitalized and its indebtedness is not excessive.

In 2013 the amount of equity capital was almost 40% of the total. However, the following year, it declined considerably, although in the last accounting year, in 2015, this situation improved slightly, reaching a 34.52% of equity.

This situation is not optimal but does not represent alarming levels of decapitalization in which the company is excessively indebted. In addition, a line of recovery of own resources is being followed, so there is no cause for concern.

Also, it should be noted that we are talking about a publicly traded company, so getting finance is not one of its main problems.

6.2. STATEMENT OF SOURCES AND APPLICATION OF FUNDS

ASSETS 2014

Non current assets	15,796,00
Stock	342,00
Receivables	365,00
Cash	2.988,00
Other non current assets	232,00

EQUITY AND LIABILITIES 2014

Equity	6.775,00
Long term liabilities	7.025,00
Short term liabilities	5.923,00

ASSETS 2015

Non current assets	17.288,00
Stock	311,00
Receivables	474,00
Cash	3.051,00
Other non current assets	188,00

EQUITY AND LIABILITIES 2015

Equity	7.358,00
Long-term liabilities	6.548,00
Short-term liabilities	7.406,00

INCREASES AND DECREASES

ASSETS		EQUITY + LIABILITIES	
Non current assets	1.492,00	Equity	583,00
Stock	-31,00	Long-term liabilities	-477,00
Receivables	109,00	Short-term liabilities	1.483,00
Cash	63,00	-	-
Other non current assets	-44,00	-	-
	1.589,00		1.589,00

STATEMENT OF SOURCE AND APPLICATION OF FUNDS

APPLICATIONS		SOURCES	
Non current assets	1.492,00	Equity	583,00
Long-term liabilities	477,00	Stock	31,00
Receivables	109,00	Short-term liabilities	1.483,00
Cash	63,00	Other non current assets	44,00
	2.141,00		2.141,00

To finish analysing the balance sheet, we have calculated the state of origin and application of funds, since it is a very useful method that shows the variations that have occurred during the last two accounting periods of the Company.

It allows us to answer questions such as what investments have been made and what funding has been used to do so. How to distribute the financing among shareholders, undistributed profit and debt and what part of the financing obtained is long or short term. Finally, it is used to see if there is a reasonable balance between the investments made and the financing used.

We see then that Southwest has basically invested in fixed assets that have been financed in part by shareholders' equity but mostly by short-term debt. This, as a general rule, is negative, since the fixed asset has to be financed by own capital or long-term debt.

This analysis helps to determine if the growth of the company is balanced or not. Generally speaking, the increases in current assets and short-term debt are expected to be similar, with a tendency for the former to be higher than the latter. At the same time, increases in fixed liabilities should be similar to increases in fixed assets, with the first ones tending to be higher, in order to have sufficient working capital.

As mentioned before, this company has the peculiarity of being able to operate without problems with a negative working capital, in addition to being little capitalized. It is possible that these two aspects are the cause that the state of origin and application of funds does not fit the theoretical ideals.

6.3. INCOME STATEMENT

The economic analysis of the profit and loss account helps us to verify how the company generates its result and how it can be improved.

That said, we will analyse the accounts of the last three years, so that, as has been done with the balance sheet, we can have a historical view on the evolution of Southwest's expenses.

For this, the first step is to find the percentages of ordinary results. To achieve this, we calculated the percentage of expenses and profits on sales. Another way to analyse the evolution of the different items in the profit and loss account is to consider as a basis one hundred each of the first year items, so that the growth or decrease of each item can be compared. However, the latter is very useful when we talk about a company with losses, as it is not the case, the first way is more appropriate.

To begin with, before looking at the percentage of each item, it should be noted that during the last three years there has been an increase both in operating income and net final result.

As can be seen, practically all operating revenues come from passengers. However, in the last year the proportion of this item has slightly dropped and increased another operating income, but nothing important enough to take into account.

All operating expenses have been reduced during this three years except for the salaries and wages, which have increased from 28.4% in 2013 to 32% in the last year. The increase in this expense does not necessarily have a negative effect on the company, since it may have increased due to a rise in wages or an increase in the workforce.

It is important to note, however, that the gross margin has not increased in the last three years, so we understand that the company continues to maintain the same profitability of its products.

Regarding the operating result, before interest and taxes, we see it represents a larger proportion of the sales in the last accounting year (21%) than in the previous two years (12% in 2014 and 7.2% in 2013). This is understood to be due to a better management of the ordinary and operating expenses that the company has. With regard to financial expenses, it is important to note that they have increased slightly in recent years.

Finally, it should be noted that the final net profit of the last year accounts for 11% of the operating income of the company, which is a strong increase compared to previous years.

6.4. CASH FLOW

As we have seen in class, the cash flow informs about the transactions than affect the cash of the company. It is useful to evaluate the company capacity to generate treasury. Furthermore, the cash flow is useful to analyse the financial independence of the company.

In accounting, cash flow is the difference in amount of cash available at the beginning of a period (opening balance) and the amount at the end of that period (closing balance). It is called positive if the closing balance is higher than the opening balance, otherwise called negative.

We can affirm that Southwest has an extraordinary cash flow because, has a positive net change in cash although it has used a large part of their cash to do investments and finance them. We procced to analyse the sections of cash flow:

A) CASH FLOW FROM OPERATING ACTIVITIES

The cash flow from operating activities reflects money coming into and leaving the business associated with ordinary company activities. This part is the most important section because it reflects if the business model is profitable or not and has the capacity to achieve enough cash to finance the other activities of the company.

We observe that the cash flow from operating activities, not only is positive but also high in the three years. Is important to point out, that from 2013 to 2015, it has increase a 160%. Consequently, we can affirm that the business model of Southwest generates cash.

B) CASH FLOW FROM INVESTMENT ACTIVITIES

The cash flow from investing activities reflects how much money is being expended in investment. We can observe, that Southwest use the cash flow generated from operating activities to invest. Is that a problem?

We consider that for a company is essential to innovate and more in a industry, such as the airline, where companies must maintain and strengthen a set of competitive advantages that differentiates it from its competitors to reduce costs. Southwest, knows that. The proof is the plaque embossed in the principal wall of the company: *''If you rest on you laurels, you'll get a thorn in your butt''*.

Following this statement, Southwest is investing in new airplanes that are reducing considerately their costs (explained in 5.1) and has added, in the last year, its first three destinations in Central America and commenced Southwest service to a fourth destination in Mexico.

In conclusion, although Southwest has a negative cash flow from investing activities, we believe that is following a good strategy because is financing the innovation of their aircraft and the expansion of the business model with the cash generated with the operating activities.

C) CASH FLOW FROM FINANCING ACTIVITIES

The cash flow from financing activities reflects how the company is financing its operations, whether through debt or equity**.**

Southwest has a negative cash flow from financing activities because is returning debt and paying dividends to their shareholders. Furthermore, as Southwest has generated enough money from its operating activities, not only is it capable of returning the debt, but also repurchase common stock.

6.5. LIQUIDITY

LIQUIDITY

As a general rule, for a company, not having liquidity problems involves having a liquidity ratio close to 2, approximately between 1.5 and 2. If it is less than 1.5, that indicates that the company may be more likely to suspend payments. In the case of Southwest, the ratio has gone from 0'78 in 2013 to 0'54 in 2015. Therefore, there is a decrease, apparently not positive for the company.

Even so, the sector average for 2015 is 0.6, a little bit higher than the value of the company, but not so much. In addition, current assets are higher than current liabilities, so the working capital is still positive, letting the company deal with its short-term debt from a conservative perspective. It is important, also, to keep in mind that the value of the southwest ratio in 2015 does not go far beyond the competition, since Delta had a value of 0.50, American 0.73 and continental 0.63.

TREASURY

Regarding the treasury ratio, in order to avoid liquidity's problems, the value of this ratio must be 1. In case it's smaller, there's a chance that the company suspends payments because it may not have enough liquid assets to deal with the payments. And, If the ratio is much higher than 1, there's a chance of having an excess of liquid assets and, therefore, the company is losing profitability. The value of the ratio for Southwest was of 0'61 in 2013, 0'50 in 2014 and 0'47 in 2015. That could seem like bad news. However, we can notice that the average sector in 2015 was of 0'48, almost like Southwest's ratio. Besides, Delta got the same value than the company. American, however got a much higher value and, Continental, smaller, leaving them in a lower position, because, even though Continental is closer to the 1, which, as a general rule would be the best, we must always give greater importance to the ideal value of the sector, in this case, of 0'48.

ACID TEST

It is difficult to estimate an ideal value for the acid test, since the available (excluding those bank accounts that are not freely available because they are subject to safeguards) usually fluctuate throughout the year and, therefore, an average must be taken. However, it should be well-known that if the value of the ratio is low, the company may be having difficulties to deal with payments. Conversely, if the ratio increases, availability may be valueless and therefore the business may be losing profitability. The average value for this ratio is of 0.3, approximately, as it provides information on whether they can manage important payments or not. This value changed from 0'55 in 2013 to 0'41 in 2015. It is clearly an improvement, although, the value is not close enough to the 0'19, the average sector's value in 2015. If we take a look to the competition, we can see that Continental is the closest to the average value of the sector, with a difference of only 0.05, and followed by Delta, and American.

WORKING CAPITAL

The working capital ratios report the weight that represents working capital relative to assets. It is not possible to specify the appropriate value because it depends entirely on the sector in which the company operates. As a general rule, it must be positive because if not, the result would be financed with fixed assets required in the short term, which would increase the probability of suspending payments. The appropriate value for this ratio ranges between 0.5 and 1, to ensure the stability of the company. If the value of the ratio is negative, the company may be in danger of bankruptcy. However, there are cases of companies with negative working capital without risk of bankruptcy. This is the case of Southwest; it has had a negative working capital in the last three years, but that is perfectly fine. In fact, the average sector in 2015 was of -5.014’5. That is possible because the companies of the sector have a negative cash cycle, which means they charge before paying. So, they are financed by suppliers and, therefore, can have a negative working capital without becoming a problem for the business.

In fact, the working capital that a company needs to finance its operations, the one that matters to avoid liquidity problems is called the “required working capital”. The working capital that a company actually has in its latest balance sheet is denominated “apparent working capital”.

If the apparent working capital (which is, as we just explained, what the company really got) is less than the necessary working capital (what we should have) there is a working capital deficit and the company will have to look for additional funding. Otherwise, there is a surplus of working capital, as happens in Southwest, where the apparent working capital (real) in 2015 was of -3.382 and the required working capital of -4.850. So, we are in front of a case in which we have more than we need, so the company has no problems to deal with their debts. However, there may be underutilized current asset items. Therefore, we recommend the company to take either of these measures:

- Maximize investment in current assets
- Reduce permanent capital

If we take a look to the completion, Delta stands out, as it has very little difference between what it needs and what it has. That is really positive.

6.6. DEBT

DEBT

The optimum value of this ratio is between 0.4 and 0.6. If it is higher than 0.6, it means that the volume of debt is excessive and the company is losing financial autonomy against third parties and is running a risky financial structure. If the ratio is less than 0.4, the company may have an excess of equity. However, it is often profitable to have a certain proportion of debt. The average value of the sector is a bit higher, 0'77. In the past three years Southwest has kept almost the same value, it has gone from 0'62 in 2013 to 0'65 in 2015. Therefore, we can assume that the company does not have an excessive volume of debt. Delta, Continental and American have a ratio that exceeds the average, so they are in a much worse position than Southwest and should be careful, since it is highly probable that they are running a risky financial structure.

DEBT'S QUALITY

The smaller the value, the better quality of the debt regarding the term. Southwest has a higher value than the average value of the sector (0'41). Southwest's debt's quality ratio has increased from 0'47 to 0'53, so we assume that current liabilities have augmented compared to the total debt. In contrast, the other three airlines that make up the main competition for southwest, have a lower ratio than the average, being Delta the airline with a higher ratio, of 0.41, and American the one with the lowest ratio, of 0.31. So, in terms of debt's quality, Southwest is not way too far from the average, so the company is not so bad, but the airline should definitely try to make the short-term debts become long-term.

REPAYMENT CAPACITY

The higher the value of this ratio, the more capacity to repay the loans as the numerator reflects the cash flow generated by the company. This ratio is based on the belief that the loans should be returned with the cash flow generated by the company, while the debts with suppliers must be returned with payments to customers. Southwest's repayment's capacity, although it has grown from 2013 (1'13) to 2015 (1'27) is still very small compared to the average value of the sector, that reaches a value of 0'54. Except Continental (that has the same value than the average of the sector), the competition also has such a small value of the ratio (Delta with 0'17 and American with 0'3).

COST OF DEBT

The smaller the value of this ratio, the cheaper the debt that the company has paid, and will, therefore, be a reflection of a better situation. Southwest's ratio has grown from 0'03 in 2013 to 0'25 in 2015. This latest value is higher than the average value of the sector, which is 0'11. That is not a good sign, because it means that the debt that the company paid has become more expensive. The three other big airlines have a smaller value of the ratio, presenting, apparently, a better situation than Southwest. Delta is the one with the smallest value, of 0'05.

FINANCIAL EXPENSES

This ratio revises whether the company can withstand the debt that has or not. When the ratio is above 0.02 indicates that financial expenses are excessive. When the value is between 0.015 and 0.02, is indicative of caution, and when it is less than 0.015 means that the financial expenses are not excessive in relation to turnover. Southwest's latest value of the ratio has been 0'03. That would mean that the company's financial expenses are extreme; however, the average value of the sector is 0'025, so our company is not that far. Besides, both American and Continental have the same ratio's value than Southwest, being Delta the only one with a smaller value, of 0'01.

6.7. PROFITABILITY. ROI AND ROE

The analysis of profitability allows us to relate what is generated through the income statement with what is needed to develop the business activity.

The main ratios analyzed depend on four variables: assets, equity, sales and profit. From these, the ratios of yield, profitability, margin, leverage and rotation can be obtained.

RETURN ON INVESTMENTS (ROI)

	ROI	ROE	EBIT/Sales	Sales/Assets	Assets/Equity x EBT/EBIT	Net Income / EBT
Average Sector 2015	0,15	0,638	0,168	0,719	4,098	1,163
2015	0,19	0,296	0,207	0,929	1,29	0,626
2014	0,11	0,167	0,119	0,943	1,243	0,625
2013	0,06	0,102	0,072	0,914	1,523	0,616

The ROI, also known as economic profitability, is the ratio between the profit before interest and taxes and the assets. EBIT is usually taken to be able to get the benefit generated by the asset regardless of how it is financed, and therefore, without taking into account the financial expenses. The yield study allows us to know the evolution and the factors that affect the productivity of the company's assets.

The higher this obtanied value is, the better, as it will indicate there is a higher productyvity of the assets. The ROI is usually compared to the average cost of financing: average cost of liabilities plus equity.

As we see, ROI data is not very positive. If we compare the financing cost of the three years studied (shown in the table of ratios in section 3.4) with the value obtained, we see that in both 2013 and 2015 the latter is higher, which means that the company does not get enough profitability from their assets compared to its cost of financing.

On average, Southwest's financing cost ratio between 2013 and 2015 is 0.14, while its average economic return is 0.12.

It should also be noted that the company's profitability is lower than the average ROI of its main competitors and its financing cost is also higher.

MARGIN AND TURNOVER

If we multiply the ratio of sales/sales to economic performance, we can see that it can be divided into two ratios that better explain the causes of its evolution: the turnover of the asset and the margin that the company obtains from its sales. Through the evolution of these two ratios, we can see if the profitability has changed due to an asset turnover or a smaller margin of sales.

As we can see, the margin on sales starts to be very low in 2013 and improves during the next two years. In contrast, asset turnover increases from 2013 to 2014, but decreases again in 2015.

In this way, we understand that the ROI for 2014 is the highest because in both ratios we see an improvement and we appreciate that the value of 2013 is caused by a smaller margin in sales and its decrease in 2015 is due to the worsening of the rotation.

RETURN ON EQUITY (ROE)

Financial profitability is the relation between net profit and equity. It is the ratio that measures the net profit generated in relation to the investment of the owners of the company.

As this value gets higher, the better the financial profitability of the company is. In any case, at least, it must be positive and greater than the expectations of the shareholders.

These expectations are usually represented by the so-called opportunity cost, which indicates the profitability that the shareholders do not receive because they have not invested in other financial alternatives of similar risk.

That is why we find it particularly appropriate in this case to compare the values of Southwest with the average of its main competitors. As we can see, Southwest's ROE is significantly lower than other companies, which means that the profitability obtained by its shareholders is not very high for the sector where it operates.

LEVERAGE RATIO

Financial leverage is what is studied when evaluating the relationship between debt and equity on one side, and the effect of financial expenses on ordinary results, on the other.

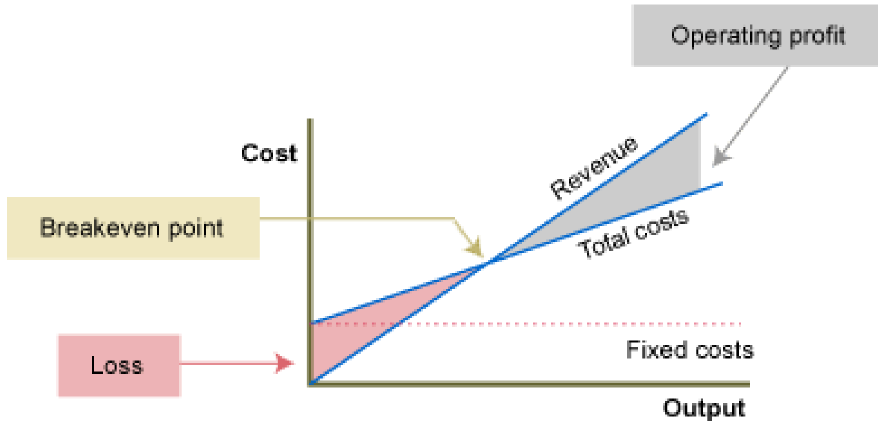
The financial leverage is positive when the use of the debt allows to increase the financial profitability of the company. In this case, the debt is convenient to raise the financial profitability.

The reference value at the time of studying this ratio is one. When the leverage is greater than one, its effect will be positive, that is, the debt will increase the profitability of the business. Being one is considered that the effect of leverage is neutral and if it is below this value is understood that greater leverage would decrease the profitability of the company.

In this case, Southwest has positive leverage in the three periods studied, which would mean, as has been said, that an increase in its debt would improve the financial return on capital. However, is quite lower than the average of the main competitors.

6.8. BREAK-EVEN POINT

In accounting, the break-even point refers to the revenues needed to cover a company's total amount of fixed and variable expenses during a specified period of time. Is the point, where a company have neither income nor losses.



Before calculating the break-even point we need to distinguish between the fix and variable costs.

FIX COSTS	VARIABLE COSTS
Salaries and wages. Aircraft rentals. Maintenance materials and repairs. I consider it is a fix cost as in the airline sector it is compulsory to maintain the airplanes in good conditions. As the airline sector is a business of fix costs, we consider a 85% of other operating expenses.	Fuel and oil. Landing fees. Acquisition and other integration. As the airline sector is a business of fix costs, we consider a 15% of other operating expenses.

$$Break - even\ point = \frac{Fixed\ costs}{1 - \left(\frac{Variable\ costs}{Sales}\right)} = 13.000\ millions\ of\ dollars$$

In order to have neither income nor losses, Southwest needs 13.000 millions of dollars of sales. We see that in 2015 Southwest has 19.820 millions of dollar. The higher the difference between the reality and the break-even point, the better for the company. Consequently, we can affirm that Southwest is in an optimal situation.