

## Taking Stock: Way to fly may not be way to buy

by Malcolm Berko

Dear Mr. Berko: I think I'd like to own 125 shares of Southwest Airlines. My nephew joined Southwest a year ago and after working at United, USAir and Delta between 1989 and 2005 he says that this is the most fantastic airline in the world. He has even met the founder and chief executive officer, who he says are "regular guys." My nephew owns some stock and he says I should own some stock, too. Please advise me.

B.E.

Fort Walton Beach, Fla.

Dear B.E.: Southwest Airlines Co. (LUV-\$15.10) is a no-frills - well, they have peanuts and Pepsi - short-haul (except to Honolulu), low-fare (that's for sure) carrier. LUV uses the efficient point-to-point system rather than that sloppy, articulated hub-and-spoke system with frequently clogged arteries. And while United, Delta, US Airways, Continental, Northwest, American, etc., were collectively losing billions, LUV was flying high and making hundreds of millions of dollars every year; yes, every year.

The reason LUV, with a fleet of 445 B-737s serving 61 cities, has remained profitable can be summed up in one word - management - or in seven words: veritably, indubitably, peerless, caring and talented management.

That speaks volumes about the management at competing carriers and the high-energy, pasty-skinned MBAs hired to make decisions using expertise in game theory mathematics. When I called LUV to make a reservation, I didn't have to press 2 for English, then 18 to enter the system, wait for a prompt to press 72 and then 16 to reach a menu requesting that I input my PIN, press "pound" to be followed by my Social Security number and my mother's maiden name before I made a reservation.

When I called LUV, a live human voice in unaccented English answered with a smile and an attitude as though she just finished baking a batch of chocolate chip cookies. I asked, "Do you fly to Colorado Springs?" "No," she replied, "but Delta and USAir do, and I have their numbers if you'd like to call them."

I nearly fell over. You gotta LOVE LUV and their happy employees, all of whom seem to have an infectious esprit de corps. I will go out of my way to fly LUV every time I can.

This management team and the folks working with them really know how to run an airline. Those yokels,

yahoos and bumpkins at Delta, US Airways, American, etc., who sit in their executive "snivel" chairs must be green with envy. LUV expects to book more than \$10 billion in revenues this year, nearly a threefold increase from a decade ago, and net income should come in at a buck and pennies a share - up more than 250 percent from 1997. The LUV boys are doing a yeoman's job. And these LUV lads were also wise enough to hedge their fuel costs, enabling them to pay 35 percent less than other carriers whose starchy MBAs were removing olives from martinis to reduce costs. Meanwhile, LUV has the lowest unit cost in the industry as well as the most productive work force - and they put two olives in their martinis!

As the legacy carriers emerge from bankruptcy with lower cost structures, they still won't be able to beat LUV's fares. Management's conservative approach to growth (most of which has been internally financed) has earned LUV a strong balance sheet. The LUV boys have more than \$2 billion in a "war chest," and hundreds of millions in available credit. So LUV can easily weather an industry downturn as well as a war of attrition waged by other low-cost carriers, who are leveraged to the scalp.

LUV is managed smart. Founder and CEO Herb Kelleher, President Colleen Barrett (yep, a lady), CEO Gary Kelly and other top jocks will tell you that LUV's most valuable assets are employees. And on any given day, you may find these top jocks and lesser top jocks loading baggage, selling tickets or hosing down a B-737 in the hangar.

Continental Airlines (CAL), which lost billions and is now in the black, has zoomed from \$3 a share to \$39.50. I'll wager a Continental that soon in the next decade, CAL will be in the red. United Air Lines Inc. (UAUA) emerged from bankruptcy last year. After cumulative losses exceeding \$16 billion, UAUA now trades at \$43.60, and I suspect UAUA will return to the red again. American Airlines - AMR Corp. (AMR) - lost \$10 billion between 2001 and 2005. Its share price zoomed from \$1.50 to \$34.95, and continued profitability would shock me!

But LUV, which has always made a profit, enjoys superb operating margins, impressive net profit margins and a hugely attractive cash flow, meandered between \$15 and \$18 during the last 12 months. What does this tell you about the motives and morals of the investment banking community?

LUV doesn't have much sex appeal and its share growth will probably follow the market over the next 12 months or so. And though LUV may inarguably be the best-run airline in the world, I don't feel that its share price has compelling appreciation potential this year. There's just nothing exciting about a well-run, on-time, consistently profitable airline that provides excellent service.

I wouldn't buy the stock, but Goldman Sachs, Citigroup, UBS, Credit Suisse, Value Line, Standard & Poor's and Calyon Securities all have a "buy" recommendation and I hope they know something I have missed.

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