LUV 2Q25 Earnings Write-Up

Earnings came in **almost identical to the Base case scenario projection**. The Base case had projected 192mm in net income and Shareholders' Equity of 8.08bn. Actual results had 213mm in net income and Shareholders' Equity of 8bn flat. **Worth noting, the base case scenario value of the stock is 10.52 per share.** Notable changes in the quarter include a large downgrade to EBIT from prior guidance due to macro conditions and the implementation of checked bag fees and basic economy seating.

The downgrade to EBIT was to 0.6-0.8bn from a prior guide of 1.7bn. The large downgrade they state is a result of macro weakness that all peers are seeing. They emphasize that there is no issue with the core business and are expecting improvement in demand as we move into 4Q. I see this as a fair explanation and am not overly focused on their short-term EBIT guidance in terms of my overall view. They do state that they expect EBIT to see improvement going into 4Q as macro improves and they receive benefits from bag fees and basic economy.

They mention the implementation of their new programs has led to some noise in terms of bookings. They saw bookings decline after the implementation of basic economy and went in to make changes to the language in order to try and rectify the situation. They are saying bookings have returned to normal, but we will see how it shows up in 3Q. One concerning thing already showing up in the numbers is their weakened load factor % (the seats that actually have passengers in them). 2Q is normally strong for them seasonally, but they were down more than 4 percentage points in load factor to 78.5% from 82.6% YoY. For reference, 2Q23 was 83.4%, so a further decline from that. They claim they will be focusing on load factor in the back half of the year, but similar to the general bookings trend, I am skeptical and will wait to see numbers come in.

Not a ton to add as the quarter came in so close to projections. The watch-out-for's are going to be: will they actually start seeing incremental improvement from their bag fees and tiered seat pricing, will they turn load factor around and start seeing bookings return to previous year's levels, and will the macro headwinds dissipate over the next few quarters. All in all, this was a good quarter to be short LUV. Nothing came back particularly impressive, and "impressive" was baked into the stock price. As of writing, the stock price has come down to 29.80 from an entry of 33.71 for a return of 11.6%. To reiterate, my target exit price is between $24-26 per share. I will keep my eye on the above metrics, but we could see the stock reach the target price by year end or sooner depending on both specific company dynamics and how the overall macro environment shapes up.