

## ***The Motley Fool***

### **“The Reason Southwest Airlines Will Beat the Market The low-cost carrier makes sure passengers feel the LUV”**

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More than anything else, managers determine returns. They set strategy, hire key team members, oversee operations -- and cash big paychecks for it all. Every move they make either enhances or destroys shareholder capital.

It pays to know who these men and women are, how they're paid, whether they, too, are owners, and how they perform versus competitors in certain key metrics. In this regular column, I'll examine all that and more with the goal of enhancing our understanding of some of the top stocks in Fooldom.

Next up: **Southwest Airlines** (NYSE: LUV). Is this discount airline's executive team doing all it can to earn you outsized returns?

Last month, a still-anonymous Southwest pilot held his plane for a late passenger rushing to make a flight to see his dying grandson. Rather than criticize an employee for costing the carrier money -- delays always do -- management applauded the pilot's actions.

"You can't hold a plane for every late customer, but I think we would all agree that these were extenuating circumstances and the pilot absolutely made the right decision," Southwest spokeswoman Marilee McInnis told CNN in an interview. "I don't think you could ask for a better example of great service for our customers."

I agree. But what makes this story interesting is that it isn't unusual. A Kansas City baggage service worker named Mina helped marketing consultant Lisa Chapman retrieve her misplaced luggage in time for a family reunion last July. In 2007, Southwest gave free flights to customers unfairly delayed by icy weather in St. Louis.

Now contrast that with a 2008 incident in which United Airlines employees were accused of breaking a guitar. The carrier refused to take responsibility until an insanely catchy music video caught fire on YouTube, unleashing a wave of public criticism. The new **United Continental Holdings** (NYSE: UAL) shows some signs of improving its service record from those days, though its financial disclosures still need work.

At Southwest, exceptional acts of service explain why J.D. Power named the carrier as one of its 2011 "Customer Service Champions." Peers **Westjet** and **JetBlue** (Nasdaq: JBLU) also made the list, but Fool co-founder David Gardner loves Southwest the most. He cited the airline's service record as a sustainable competitive advantage in recommending the stock to our *Motley Fool Stock Advisor* members.

Many Fools agree with his thesis. As Foolish investor bikodoggy wrote in pitching the stock earlier this month:

As economy starts to improve, travel will increase. [Southwest] is a diamond that is customer and service driven, unlike other industry players. They will benefit from efficiencies and economic improvements proportionally higher than competition because they have [a] better [management team] and business model.

Source: Capital IQ, a division of Standard & Poor's. (Data current as of Feb. 17.)

Years refers to time as employee, not necessarily in current position.

\*Includes time representing Southwest as an attorney with a private law firm.

Southwest stands apart from peers in that it has an executive on staff responsible for "proactive" customer service: **Fred Taylor, Jr.** In a bio, Taylor describes his job as embodying the "Golden Rule." When the airline suffers disruptions, Taylor's team ensures that customers are informed and reach their destinations as quickly as possible.

I love how Taylor has broad authority to make customers happy. I also love how experienced his bosses are. Three of Southwest's top executives have more than 20 years on the job, while COO Michael Van de Ven is closing in on that mark.

All four know how to manage to the numbers, having worked in finance at various times during their careers. CEO Kelly joined the carrier in 1986 as Controller, and served as CFO before taking over the top job. Jordan held the same title at Hewlett-Packard.

Southwest's cost management reveals its financial efficiency. Despite having a lower load factor than Delta or JetBlue, the carrier outperforms its most comparable peer, JetBlue, in terms of returns on capital and equity. Southwest also earns more per dollar than Delta after subtracting direct costs.

In short: Kelly and team have found a system that works. Over the long term, it should lead to progressively higher margins, higher earnings, higher returns on capital, and ultimately richer shareholders.

Do you agree? Disagree? Let us know what you think about Southwest's service record, valuation, and the airline industry as a whole using the comments box below. You can also rate Southwest Airlines in Motley Fool CAPS.

*Interested in more info on the stocks mentioned in this story? Add Allegiant Travel, Delta Air Lines, JetBlue Airways, or Southwest Airlines to your Fool watchlist*