



Independent Analyses of Aviation Issues.

April, 2009

## Southwest & New York/LGA Not What The Consensus Is Predicting

Write it down: Southwest's expansion into New York/LaGuardia is not about what Southwest will do for New York.

It's about what NYC will do for Southwest. The real story is that LGA is yet another indication of how Southwest is successfully and aggressively responding and evolving to adjust to the new airline industry, not the other way around.

### On The Surface: Not A Lot Of Market-Share Potential

The consensus-following analysts will inject that there's the "Southwest effect," that will stimulate the market based on lower fares. Memo to analysts: You are wrong. You're assuming, not analyzing.

Let's look at some raw numbers. If Southwest is to get a 70% load factor at LGA, that means it will need to carry about 325,000 annual passengers on the Chicago/MDW-LGA leg. Based on current local O&D between LaGuardia and Chicago, that would equate to a 24% market stimulation, and with Southwest having just five flights and only 11% of the total capacity, not to mention being up against much stronger frequent flyer program loyalty, that's not going to happen.

True, they may try lowering fares. But United and AA will match. In a business market like CHI-NYC, that'll result mostly in decimated yields, not stimulated traffic. So, on first pass, this LGA expansion looks problematic for Southwest.

Other challenges abound. One is enormously strong brand loyalty at the competition. United's Mileage Plus and American's AAdvantage programs can deliver a freebie to London. The Southwest program, despite its simplicity and customer-friendly structure, can deliver complimentary travel to Lubbock. (A bit of hyperbole, but it makes the point.) Furthermore, the local Chicago-NYC market is mainly business travel, where things like advance seat selection is - denials notwithstanding - incredibly important. Southwest's "bingo boarding" system may not be competitive with AA, where the business traveler knows immediately at the time of booking that 14D is his.

### It's The Smart Move. Southwest Has Always Been Smarter.

We'll start with this: all of the apparent challenges notwithstanding, Southwest's LGA move is brilliant. It's going to throw off enormous amounts of long green to the carrier's bottom line. But it's not because they're entering the NYC-Chicago market, or the NYC-Washington/BWI market. The fact is, they really aren't entering either one in a material way. Let's look at a few hard data points - items that "the consensus" may have a hard time grasping, but will put this supposedly earth-shaking event into the context of reality:

- **WN LGA Capacity: A Drop In The Bucket.** Southwest hits the LGA runways on June 28 with slots for 8 daily flights. That's 1.4% of total LGA daily departures. That's not the low-fare invasion of New York that some are predicting. Additional slots may come down the line, but by nature, slots are not geared to what the airline might need in terms of flight timing. Nor are there a lot of them out there to be had.
- **Low Frequency In the LGA-Chicago Market.** Another fact is that Southwest will have only about 11% of the total daily Chicago departures from LGA - 5 out of 49. Every weekday, they'll be up against 35 UA and AA nonstops to ORD, plus 9 - count them, *nine* - DL-branded LGA-MDW flights. And, the Delta system flights are with E-175s. While more ASM-costly, these are true mainline-cabin aircraft. They also have wider seats than Southwest's 737s.

*Forget the predictions  
of WN causing major  
stimulation in travel at  
the Big Apple.*

*Eight daily departures  
out of LGA's 550+  
simply don't have the  
horsepower to change  
much of anything.*

- Product Differences.** In the LGA-MDW market (as with AA and UA in the ORD market) Delta offers advanced seat selection (yes, this is a big deal), and these flights have the brand and frequent flyer program power of Delta. What Delta ultimately may do with these LaGuardia-Midway flights is uncertain because it has no real connectivity at either end of the route. What is certain is that these E-Jets are not necessarily easy meat for WN. (Prediction: watch for the consensus-dwellers to sneer-off the DL service as being non-competitive "regional jets.")
- LGA-BWI: Perfect For Turboprops. Less So For 737s.** Southwest's three BWI flights will be up against eight to nine (depending on the day) US Airways flights, all but one operated with turboprops. No question that a Southwest 737 may be a lot more attractive. But there's no question, either, that the local O&D component is business-commuter, and that means frequency will count, not type of aircraft. Throw in the NYC brand identity of US Airways (buttressed by the presence of its Shuttle), and there's no guarantee that US Airways is in trouble. They may or may not have to fully match WN local fares.

### A Southwest NYC Shuttle? Wake Up & Smell The Cost Structure.

Some are opining that Southwest would be a great player in the BOS-NYC-WAS shuttle market. (Via whatever mechanism – buying one of the two existing operators would likely be the only real opportunity.) A review of the yields in these markets (BOS and DCA) would at first pass indicate that WN might have some interest.

Airports:USA® DATA MINER					
Rank	Market	P'sgr	PDEV	Net OW Fare	Ticket Yield
1	BOS	201,362	1,094.4	\$160.80	<b>86.82¢</b>
2	DCA	175,815	955.5	\$155.90	<b>72.59¢</b>
	<b>Shuttle Average</b>	<b>377,177</b>	<b>2,049.9</b>	<b>\$158.53</b>	<b>79.70¢</b>
	<b>LGA AVG</b>	<b>5,122,334</b>	<b>27,838.8</b>	<b>\$177.78</b>	<b>18.48¢</b>

Source: Airports:USA® DataMiner, Boyd Group International, Inc.

Average fare yields for full year 2008 were in the 80 cent range. These are numbers that airline CFOs generally only dare dream about after a couple of adult beverages – literally over 400% higher than LGA's already-respectable average of 18.5 cents.

But this silver yield lining has a ton of lead in it. Actually, any basic understanding of the scheduling mechanics of an hourly shuttle operation would reveal that not only would Southwest not have any significant cost advantage, but it could be just the opposite.

Remember, Southwest's low system ASM costs are dependent on being able to fly the proverbial pantaloons off their airplanes to offset their labor costs. An East Coast shuttle operation is the poster child for low fleet utilization.

Not only that, but an hourly shuttle guarantees load factors that are abominable. Boyd Group International's Airports:USA® DataMiner reveals that for the full year 2008, the LGA-Boston shuttle operations only filled 45.3% of seats offered. The Washington flights were worse – 41.6%.

Again, however, the yields on the shuttle flights are just short of astronomical, and when one applies the load factor to the average yields, the RASM is still respectable. But they are dependent on the yields staying high and the traffic base not declining. Neither can be relied upon. Also not reliable is what may come out of Washington in the near future. Make no mistake: the current administration is fundamentally anti-aviation and anti-air travel. Just ask business aviation.

Southwest will focus on where it can increase system flow revenues with its LGA entry.

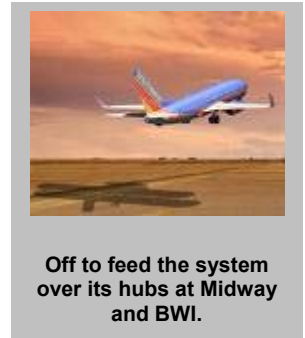
They aren't out to dominate or materially change the New York marketplace.

The reality is that they couldn't even if they wanted to.

# Research Review

The political tea leaves certainly would tell Southwest that buying a shuttle operation at LGA is the aviation equivalent of a pig in a poke. There have been official statements from inside the Beltway about finding "environmentally sustainable alternatives to air travel" (whatever that kind of idiot babble might mean is unclear, but be advised none of it's good). At the least, it would indicate that short-haul shuttle market operations would be the first in the regulatory cross-hairs.

Airports: USA, DATA MINER						
Load Factor By Segment In & Out						
2008M1 to 2008M12		Segments:	Carriers: All	Minimum Operations: 15		
City	Operator	Airline System	Total Psgr	Total Seats	Load Factor	Total Ops
<b>BOS</b>			<b>1,121,103</b>	<b>2,474,622</b>	<b>45.3%</b>	<b>22,421</b>
	American Eagle Airlines Inc.	AA	127,320	196,330	64.8%	4,832
	US Airways Inc.	US	528,091	1,129,608	46.7%	9,109
	Delta Air Lines Inc.	DL	465,692	1,148,684	40.5%	8,480
<b>DCA</b>			<b>1,009,795</b>	<b>2,428,741</b>	<b>41.6%</b>	<b>21,250</b>
	Delta Air Lines Inc.	DL	381,324	1,106,256	34.5%	8,164
	American Eagle Airlines Inc.	AA	61,461	120,580	51.0%	3,136
	Shuttle America Corp.	DL	12,501	43,348	28.8%	610
	US Airways Inc.	US	554,509	1,158,557	47.9%	9,340
<b>Totals</b>			<b>2,130,898</b>	<b>4,903,363</b>	<b>43.5%</b>	<b>43,671</b>



## So, What's The Play For Southwest? Plenty

Recently, some investment firm issued an "analysis paper" gloriously rating Southwest stock a "buy." (No word on whether the authors had a position in WN, by the way.) A good suggestion, probably, but for all the wrong reasons.

The financial house's supposed analysis was based on the usual mantra that "Southwest has retained its highly-efficient point-to-point model, and avoided hubs," which, aside from being accepted lore, is 100% inaccurate. Obviously this bunch didn't do much research before going out and trying to hawk wallpaper. (This is yet another reason a Sealy Posturpedic may be a better place for money than taking the advice of some of these "experts.")

The fact is just the opposite - Southwest is increasingly shifting away from point-to-point service. Boyd Group International estimates that over 30% of WN passengers are connecting, and linear routings, for example, MAF-ELP, are going away in favor of concentrating more aircraft time in hub and/or semi-hub roles. And that's the point: the LGA strategy is a part of this evolution at Southwest.

You can take it to the bank that Southwest has identified strong incremental flows LGA can generate over MDW and BWI from cities that have limited, or RJ-only, or no, nonstop service to New York, such as - TUL, OKC, OMA, ABQ, TUS, BHM, etc.

These incremental flow revenues that LGA attracts to/from existing WN points will almost all float to the bottom line. And they will be huge. Plan on the LGA flights having load factors significantly higher than the rest of the WN system. In short, the LGA service will deliver big time for Southwest. And, contrary to the all-knowing consensus, it will be connecting traffic that delivers much of it.

## The Name of The Game Is Revenues, Not Just Costs.

Yes, but what about the notoriously poor efficiency of operating at LGA? True, schedules at LGA must be heavily padded to accommodate the long taxi waits, both in and out, that can routinely add an otherwise unnecessary two or three tenths of a block hour. Yes, schedules must be padded even further to adjust to the FAA's incompetent and out-of-date ATC system. And finally, even with these margins added, there still can be huge delays, anyway.

At LGA, with a whopping 1.4% of daily departures, Southwest isn't going to turn traffic or fares upside down.

But they will feed enormous amounts of net-new revenue to their system from the Big Apple.

Southwest has limited ability to grow at LGA.

*But it has huge opportunities to flow net-new revenues across its MDW and BWI hubs.*

*In the absence of any near-term dumb taxes and legislation from the administration, it will be hard for WN not to succeed at LGA.*



**LGA is subject to some horrendous ATC and other delay issues.**

**Southwest will likely minimize system effects by isolating specific aircraft rotations to the market to minimize system disruptions.**

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All true, but it's a leadpipe cinch that the overall incremental system revenues that Southwest gains with LGA service will more than offset these costs. We can also assume that WN will isolate LGA flying to specific aircraft rotations, to minimize the system effects of what happens when NYC air traffic control goes into meltdown mode and turns LGA into a winged gulag.

**Conclusion: A Player. Not A Dominant Force At LGA.**

Barring the buying of another carrier (not likely), Southwest will probably not become a major player in the New York market. But the New York market will be a major player in Southwest's system revenues.



Lexington, Kentucky October 4-6, 2009

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# Research Review

The 14<sup>th</sup> Annual Boyd Group International

## Aviation Forecast Summit



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Venue is the Marriott Griffin Gate Resort, just ten minutes from Lexington Bluegrass Airport, the host of this year's Summit.

**Reserve Your Space Now For The Early Registration Rate – Deadline May 15<sup>th</sup>**

**Schedule:** Conference opens with a cocktail reception at 5:30 the evening of October 4 and wraps up about 12:30 on October 6. There are optional workshops on Sunday afternoon, and the formal sessions begin at 8:00AM sharp, Monday, October 4. **Fax this form to (303) 674-9995. Or, register on-line at [www.AviationForecastSummit.com](http://www.AviationForecastSummit.com)**, or call us at 303-674-2000. Announcement of Conference Workshops for Sunday Afternoon will be made in July.

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