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From Aw-Shucks to Cutthroat: Southwest's Ascent

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STILL think of **Southwest** Airlines as a folksy company whose employees dress in golf shirts and tell jokes? Don't tell its competitors.

Southwest's victory last week in the battle for some assets of a bankrupt rival, ATA Airlines, revealed an aggressive new stance at the airline. Already the largest low-fare airline in the United States, **Southwest** is on a path to becoming the industry's most influential company, something its traditional competitors might never have envisioned.

Leading the charge is **Southwest's** feisty new chief executive, Gary C. Kelly, a Porsche-driving accountant with a sharp strategic focus. In less than six months on the job, Mr. Kelly, 50, has shown the potential to put as great a stamp on **Southwest** as its flamboyant chairman and co-founder, Herbert D. Kelleher Jr.

"It's a good start for anybody," Mr. Kelleher said of Mr. Kelly's short tenure.

Besides winning his bid for ATA, Mr. Kelly has rapidly expanded **Southwest's** flights in Philadelphia, where it started service only last May but may have already driven a lethal stake into the heart of US Airways, which uses Philadelphia as one of its three hubs.

He also has decided to take on the industry's biggest airline, American, to try to do away with Congressional limits on the places that airlines may fly from Love Field in Dallas, **Southwest's** home base. American is based at the Dallas-Fort Worth International Airport, about 11 miles away.

Alfred E. Kahn, who ran the old Civil Aeronautics Board when it deregulated airlines in 1978, said he was impressed with **Southwest's** latest moves. The deal with ATA "makes them even more formidable," said Mr. Kahn, an emeritus professor at Cornell University. The expansion in Philadelphia, he added, moved US Airways from "the frying pan into the fire."

Southwest will carry the most passengers in the United States this year, eclipsing Delta Air Lines, and it is expected to be the only major airline to make money in 2004, with an anticipated profit of about \$335 million, rising to \$430 million in 2005. Over all, the industry is set to lose a collective \$5.5 billion this year.

Mr. Kelly says that all the moves are in line with a long-held strategy of constant growth at **Southwest**, the nation's sixth-largest airline, after American, United, Delta, Continental and Northwest. "Either you respond, or you miss the opportunity," he said, though he was quick to avoid taking too much credit. Since he took charge, he said, "I don't think there is anything different about **Southwest** or its leaders."

What is different about **Southwest**, compared with its rivals, is its balance sheet. It has \$2 billion in cash on hand, and debts totaling about \$1.9 billion; by comparison, Delta has about \$1.45 billion in cash and \$20 billion in debt. As a result, **Southwest's** \$12 billion market capitalization is five times greater than any other airline.

Financial nimbleness has also played a role. While this year's spike in jet fuel prices played havoc with earnings projections at other airlines, for example, **Southwest** has stayed in the black. An important reason is that Mr.

Kelly, in his previous job as chief financial officer, arranged hedging contracts to lock in lower prices.

With its debts and costs under control and its revenues recovering from the post-Sept. 11 slump, **Southwest** has the only investment-grade debt rating of any of the airlines tracked by Standard & Poor's. And it has 37.9 percent more cash than Delta, which used **Southwest** as a model for its recently drafted restructuring plan.

"**Southwest** never bleeds cash," said Delta's chief financial officer, Michael J. Palumbo. No matter the decision, he said, **Southwest** calculates the break-even point between its costs and its likely revenues. "They doggedly and with an incredible amount of discipline execute that, before they become the vicious competitor that they are" in any area, he said.

EASIER to do, perhaps, given that **Southwest** flies only one kind of aircraft, the Boeing 737, and does not serve destinations outside the United States, while Delta flies 12 kinds of aircraft made by four suppliers and has dozens of international routes.

But unlike Delta, which is still coming to grips with the high costs left from its past, Mr. Kelly need only worry about **Southwest's** future. The latest step came with the contest for the cream of ATA's assets, which **Southwest** won with its \$117 million bid, besting a \$90 million offer by AirTran Airways, another low-fare airline.

Under the deal, **Southwest** will get six of ATA's 14 gates at Chicago Midway Airport, giving it 25 of the airport's 43 gates. **Southwest** will set up a code sharing arrangement with ATA on some of its domestic flights, and will take a 27.5 percent stake in the airline once it emerges from bankruptcy.

J. George Mikelsons, the founder and chief executive of ATA, lauds the deal even though it means he will have to step aside. Because of its financial clout, "When **Southwest** picks up the phone, people listen," Mr. Mikelsons said.

That was painfully apparent to AirTran, which had agreed to buy all of ATA's Chicago gates, plus its operations in New York and Washington. AirTran said **Southwest's** efforts, particularly its lobbying of government officials in Washington, were "a clever trick" to win dominance at Midway.

David G. Neeleman, the chief executive at JetBlue Airways and a former executive with **Southwest**, said he saw nothing wrong with **Southwest's** tactics. "If I were **Southwest**, I would have done exactly the same thing," said Mr. Neeleman, whose airline did not bid on ATA.

MR. KELLY was appointed chief executive last July with no warning. His predecessor, James F. Parker, had hit an impasse in talks with the airline's flight attendants after two years. Mr. Kelleher stepped in and quickly reached a settlement. Soon after, Mr. Parker stepped down, replaced by Mr. Kelly, who had been the chief financial officer since 1989.

While the path from chief financial officer to chief executive has been common in the airline industry, Mr. Kelly's appointment raised some eyebrows. Promoting Mr. Kelly was "exactly the wrong move for **Southwest**," Marc Lewis, president of Morgan Howard Worldwide, an executive search firm, said at the time. He said the company needed a "marketing and strategy superstar" like Louis V. Gerstner, the former chief executive at I.B.M.

But Mr. Kelleher said **Southwest** had made sure that Mr. Kelly, the son of a San Antonio Porsche distributor, received assignments beyond finance. "If you're talking about getting a panoramic view of the company, Gary's had that," Mr. Kelleher said.

Mr. Kelly has already followed in Mr. Kelleher's footsteps in a couple of ways. Last Halloween, he dressed up as Gene Simmons from the rock band Kiss, updating Mr. Kelleher's affinity for Elvis. Mr. Kelleher also tutored him in government relations, lessons that Mr. Kelly recently put to good use.

Weeks before the auction for ATA's assets, Mr. Kelly led a **Southwest** team to Washington to meet with staff members and advisers of the federal Air Transportation Stabilization Board. Support from the loan board was vital, because ATA owes it \$140 million on a bailout package granted after the Sept. 11 terrorist attacks. Bypassing an elaborate presentation, Mr. Kelly spoke from his own notes, outlining the advantages of **Southwest's** case.

Once the auction began, Mr. Kelly spent three days at the offices of Baker & Daniel, ATA's Indianapolis law firm, and in the Canterbury Hotel across the street, breaking only for seafood dinners each night at 11 o'clock. His determination paid off when AirTran conceded to **Southwest** on Dec. 16. Mr. Kelly said he preferred not to delegate

such matters. "These deals take unusual twists and turns," he said.

That is bound to be the case in **Southwest's** battle next year to overturn the Wright Amendment, named for former House Speaker Jim Wright, a Texas Democrat, which imposes limits on passenger air travel out of Love Field. Originally meant to encourage airlines to relocate to the Dallas-Fort Worth International Airport after it opened in 1974, the law has become a noose around **Southwest**, which can fly to only eight states from Love Field.

American, backed by the cities of Dallas and Fort Worth, has already begun lobbying on Capitol Hill to keep the amendment in place. Industry experts say the matchup, which has gripped Dallas, could make the ATA tussle look like a schoolyard fist fight.

That could mean a different Christmas card choice next year for Mr. Kelly. This year he chose a white dove with an olive branch in its beak.

Photos: Gary Kelly, right, **Southwest's** new chief executive, has expanded flights in one of US Airways' hub cities, Philadelphia. Above, the two rivals' planes pass on a Philadelphia runway. (Photo by Ryan Donnell for The New York Times); (Photo by Tom Strattman for The New York Times)

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