



Partner Perspective: Andrew Watterson of Southwest Airlines

May 20, 2021

Introduction

Kevin Crissey: Hello and welcome, everyone. I'm Kevin Crissey, part of the Investor Relations team at Sabre. I'm thrilled to have Andrew Watterson, Chief Commercial Officer from Southwest Airlines, with me today. Welcome, Andrew.

Andrew Watterson: Thanks, Kevin, glad to be here.

KC: Before we get started, we have a lot to discuss today. I want to let everyone know, those watching, you can check out the questions that we're covering on the links below.

Question 1: How has Southwest managed through Covid?

KC: Andrew, maybe you could start by talking about how Southwest is dealing with the Covid, how you've managed through the Covid crisis. It's obviously been the biggest impact in the industry's history.

AW: Yeah, obviously we've had a lot of ups and downs with Covid, and so what we've been focused on is in the short term, managing our business in like 30-, 60-, 90-day chunks, we can understand where demand is, and what the right level of capacity we need to deploy against that demand, for, you know, the best financial outcome, with an eye towards getting to the cash-burn break-even, you know, as quickly as possible.

At the same time, we had to tamp down a lot of our expenses, discretionary expenses, during this time, but we were keen to make sure we didn't, kind of mortgage the futures or some of our big initiatives that we had undergoing. We kept them going like our work with Sabre.

Question 2: Where does corporate travel fit into Southwest's plans?

KC: To what extent does corporate travel fit into those plans? It seems, you know, difficult to position a corporate travel strategy into this type of pandemic.

AW: That's true, the corporate travel demand is extraordinarily low right now, even though leisure is coming back with gusto.

The corporate travel initiative we had was pre-pandemic, and so if you go back, you know, we're almost 50 years old--and will be next month--we started life as a business airline.

Sometimes, depending on where one is in the country, if you're to the west coast, you view us as a business airline, because we have a lot of business routes out there.

More towards the east, you'll view us more as a leisure airline—it's just a consequence of kind of, where our growth path took us, when, and what airports were able to get into. And so, as we grew up, we still maintained a decent amount of business traffic.

And so, as we saw what we had done with our direct distribution strategy over the years, we saw that we were leaving money on the table, and so we needed to, kind of, professionalize and change our corporate sales focus, so that we could kind of meet the customer where they were;

And so we set up an initiative which involved, you know, more head count, technology investments and new procedures to be able to tap into the corporate market—especially the largest corporations pre-pandemic, and since it was, we saw an opportunity, even post-pandemic, we continued that investment in the network.

KC: How long ago did that start, Andrew?

AW: It started about three or four years ago.

Dave Harvey, who's our Vice President Southwest Business, he's been a Mr. Fix-it in a lot of different areas of the company, and so we put him in charge of this and said—take what was there—which was quite successful, but it kind of reached its level of peak performance, given the investment we put into it, and we wanted him to bring the next level;

And so he set about, you know, surveying the marketplace, talking to our customers, and then came forward with a proposal for investment for people and resources and technology to execute on that, and he's been doing that for a couple years now, we've been really pleased with it.

Question 3: How does your expanded partnership with Sabre fit into your distribution strategy?

KC: Terrific. Can you talk about how your expanded partnership with Sabre fits into that, if it does?

AW: Yeah, so we've been doing business with Sabre for a while, and across multiple different product lines, and we had a basic participation in their in GDS, which served some purpose;

But it created a lot of friction and we felt like that, for the largest corporations, travel is, kind of, one of their purchase services, and they don't spend a lot of time thinking about it, and they have their standard processes and technology they want to use to book travel, and since we were doing our own way, they would only use us kind of, you know, when necessary.

When there's really no other choice, and when there was choice, that we were too much of a hassle to do business with.

And so what we want to do is work in an industry standard way, and since Sabre is the industry leader, it was a natural partnership for us to participate fully in their GDS systems, so we could put our product on the shelf for the largest corporations.

And we'll go live here, you know, not too distant future and we expect a good return from it.

Question 4: How has Southwest's distribution strategy changed?

KC: So Andrew, how has Southwest's distribution strategy changed, other than maybe the advancement with an increased participation with Sabre?

Oh, that's actually a really big change for us, we've been direct to consumer for quite a long time, and we were direct to business, as well, and that was a point of pride and a point of cost savings for us.

And so, this idea that we would distribute indirectly through the GDSs at full participation levels is a fundamental shift in our in our distribution strategy, and was really unanticipated by the marketplace, and so this, I think is a big opportunity for us and for the GDSs, because we're kind of going the opposite way from a lot of airlines.

A lot of airlines distribute indirectly, are then trying to push up their direct.

We've already had a substantial book of business doing direct business on a B2B basis and now, going towards indirect is really a landmark change, and counter to industry trends.

Question 5: How do you see the distribution landscape changing over the next few years?

KC: Yeah, I can see that. How do you see the distribution landscape changing over the next few years, for both--for yourself, and maybe just more structurally?

AW: Well, we obviously will continue this play we have with going through the GDSs and working in a more you know, collaborative manner with the TMCs, but people have been predicting, you know, earthquakes and distribution business for a while, and really we see just incremental change.

You definitely see some more technology options coming into the marketplace, and you see the NDC came in with plans for, you know, our promises for big changes and really it looks like it's led to incremental changes for improvements on how to distribute you know, ancillary revenue and such.

So I would think we would see this continued you know, technology progress, but I don't anticipate kind of a fundamental shift in the industry in like a short period of time, just this continuous improvement if you will

Question 6: What is your view on the future of TMCs?

KC: Thanks. You mentioned Dave, and he did an interview a while back with Hunter Keay, and he mentioned that he thought there'd be fewer TMCs in the future, but they would have increased relevance. Is that your view? And if so, can you talk about that?

AW: Certainly. So what Dave was talking about, there's just two trends going on that lead to that answer.

The first trend is that TMC is consolidating. We see the largest TMCs buying regional, or technology based TMCs, and so a trend of consolidation would likely continue and that means, you know, fewer, larger ones, as Dave mentioned.

And then as far as being more important, I think that's a big learning we had from Covid.

Corporations count on their TMCs for duty of care, reporting, cost savings and lots of different mechanisms that are more relevant now than they were pre-Covid.

So the idea that TMC would go away seems to fly in the face of our recent experience, and the consolidation which continued during Covid, it seems like those two trends come together to Dave's point of view of, you know, fewer, bigger, more important TMCs.

Question 7: Where do you see personalization heading for retailing and distribution?

KC: Yeah, thank you. Maybe switching gears a little bit.

Can you talk about personalization in successful retailing and distribution and where that might be heading?

AW: Yeah certainly, you know, we are a bundled carrier, and so we don't make as big a use as perhaps some of our competitors do.

We have a bundled product, now we do look for personalization in our communication with our customers, both in, you know, offer management, as well as service delivery and service remediation;

But we only give a kind of handful of ancillaries that customers kind of want to buy, if you will.

We don't take the approach of pulling stuff away and then reselling it back to the customer.

And so, therefore, we're not pushing as hard for that personalization customization as some other carriers might, but knowing that we're the outlier; that certainly is a trend for a lot of distribution is to be able to manage add-ons better than, you know, was done 10 years ago.

So I think that trend will continue, you'll just see us as a kind of below-average number of ancillary items, but the ones we sell will be high quality and high adoption by customers.

We think that ends up to a higher revenue performance at the end of the day.

Question 8: How has the pandemic changed your tech budget?

KC: Terrific, thank you. How has the Covid-19 pandemic changed your tech budget generally-- if it has at all?

AW: Well certainly with all of our expenses, we had to, you know, manage them down very tightly during Covid, and that included technology.

A lot of it was we did not start efforts we had not yet begun.

We have, you know, a whole host of continuous improvement-type stuff we could kind of easily pause, but some of the more structural ones that we counted on for multi-year benefits and have been underway, it was actually, you know, lower cost over the horizon to keep doing them.

That included some work with ETOPS, some work with our maintenance systems, and our work with Sabre to put in place the GDS participation that will go live here in the near future.

And so, that was important to us, because we had the financial wherewithal to keep, to maintain that; that we not mortgage our future, and so I think that worked out well for us, but it certainly depressed our tech budget during Covid;

And then as we evaluate coming out of Covid, we'll look, and as we do every year, we rack and stack and look at what our budget can afford, and therefore, what initiatives will we fund for that year--that'll come up here in October, and we'll decide, you know, what we're going to do in 2022.

Question 9: Where does AI/ML fit in for the industry and with Southwest?

KC: And I guess as part of a tech budget these days, you have to talk about artificial intelligence and machine learning, or, at least many people are. Would you be able to talk about how that fits in for the industry and how Southwest may or may not use AI and ML today and in the future?

AW: Well, we view that as a tool in the toolbox of our business leaders and our tech leaders, and we have some departments who've been using them for a while, and so it's embedded in their departments.

You might think about a revenue management or marketing, and network planning and stuff, and we also have a centralized resource, and our strategy team provides kind of that service out departments who are newer to that, say an accounting department that may not have that embedded, and would like to use a central resource.

And that's the way we kind of roll out our continuous improvement, with black belts and such, we're doing the same thing with AI and machine learning.

We have a central pool of data scientists who do projects and kind of help teach departments

how to properly use it, and so this becomes a tool in every manager's toolbox to use the proper problem.

You know, I will say that you think of any initiative in our company, and probably in corporate America, it involves a technology aspect.

It's really hard to have an improvement initiative that doesn't have technology in it.

You've got technology, it's probably got AI and ML these days. So this is kind of part and parcel of doing business.

Question 10: Where do the benefits of AI/ML come in?

KC: If you were thinking about the benefit of AI and ML and how to kind of, put it into the revenue camp or the cost savings camp--is it 50 50? Where would you think that the benefit comes--is it more on the cost side or the revenue side?

AW: We expect managers, you know, in all areas to use it, so we have examples where you know routine back-office work can be now done with RPA, and on the other side we have, you know, our pricing and revenue management that humans can't, you know, handle every single flight, so they need assistance from AI and ML to manage flights that just human can't get to.

So we see, you know, across the board that it provides benefits, so it's more of an expectation that every leader properly use it than thinking it's just a revenue thing or cost thing.

Question 11: What is the value of data today and in the future?

KC: Gotcha. I guess it's quite related--airlines have always had lots of data, but it's probably more than ever. How is that value of that data--has it increased? Is AI and ML the only way that that is increasing value, or is data creating a lot of value for your company today, and will it create more in the future?

AW: You know, I've been at Southwest just shy of eight years and when I came here, I was impressed by how ubiquitous and easily available data is at Southwest Airlines, so for many years you know, people that came before me had the foresight to begin storing the data.

You know of course, technology evolves and you have to change the mechanism it was, you know, data cubes and data warehouses and now they're talking data lakes.

And so, you know, I don't master any of that, but I know the data's there and it's easily available, and we use it all the time, every single initiative, every single kind of management question comes down to a data exercise and you know, I can remember 15 years ago, people say--well we can't get the data or we have to merge the data--no one talks about the data not being available anymore.

Now they talk about simple techniques they use to evaluate the data.

So I think that's a huge improvement and it basically gives the fodder for almost anything you

want to do, because of that data being so good quality, such good history and readily available to our to our managers and individual contributors.

Question 12: How does your active participation in the managed corporate marketplace affect your cost structure?

KC: Terrific. Maybe switching gears backward a little bit, can you talk about being actively participating in the managed corporate travel marketplace, how that affects your cost structure, or your unit costs if at all?

AW: Yeah. Well I won't go into kind of, anything about unit cost per se, but I will say indirect distribution is more costly than direct distribution.

Indirect, a little more costly and a more variable component to it, whereas direct distribution has more of a fixed cost component to it as we build up kind of, the infrastructure for selling through our website and such, and our APIs.

And so, it doesn't mean you don't do it, it just means it has to have the right value equation in the right circumstance.

So, for indirect distribution with the TMCs and through the GDSs, we think it's a, you know, good value and an appropriate strategy to use that to sell to corporations and we're happy to do it.

Question 13: Does your route structure need to change to be more active in corporate travel?

KC: Do you need to change your route structure at all to be more active in the managed corporate travel?

AW: We've had a lot of business travel, as I mentioned earlier, from day one, and so we're already a business airline in many parts of the country.

And so, we don't need to change it necessarily. If those particular clients or particular markets that are requested we will certainly modify for that, but we already have, you know, lots of short, medium-haul, high frequency markets with convenient business traveler attributes, and so our approach to corporate travel is really putting more volume on to what already exists there, so it's really a great operating leverage play.

Question 14: Do you ever intend to become the low-fare corporate airline?

KC: We had an investor ask a question about whether your intention is to become the low-fare corporate airline. Is that something, how you would describe your intentions in that space?

AW: We, you know, I think of ourselves as a low-fare airline, regardless of the market which

we're selling, so we certainly expect that our fares today, which are lower, and we sell to corporations and businesses outside of these channels to continue.

I will say that we've been doing business with the TMCs for quite a while, so we're already present in this marketplace.

I just say underpenetrated because we didn't use Sabre and others to distribute, so I don't think this would, you know, affect how we price in these markets, it just makes us show up on the shelf better than we did before.

To the extent that it changes price in the market, so be it, but really, it's just making what we have today available on the shelf more broadly is really the play here.

Question 15: Would you consider using OTAs as part of your distribution strategy?

KC: And that, I guess related to that, another investor question that came in was, would you consider using OTAs as part of your distribution strategy?

AW: Well our world is too dynamic to, you know, globally use, you know, "always" and "never".

I will say, at this point in time, we have no interest in OTAs, I don't see that change in the near future.

Closing remarks

KC: Terrific. Andrew, is there anything you'd like to conclude with or any other messages, or should we just wrap it here?

AW: You know, I would say that I appreciate the invitation to be here and I appreciate what Sabre is doing in the marketplace.

You know, I think we've had through this, constructive relationship with Sabre, we find that valuable.

Negotiations can be tough, but we came to something that was mutually agreeable and I think it will help both of us in the marketplace, and we're looking forward to, you know, an airline and GDS partnership and going to market together this Fall.

KC: Terrific. Thank you so much for your time, Andrew.

AW: My pleasure, have a wonderful day.

The views expressed in the interview are not necessarily the views of Sabre.