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Southwest Airlines Co. NYSE:LUV

FQ3 2026 Earnings Call Transcripts

Thursday, October 22, 2026 2:00 PM GMT

S&P Global Market Intelligence Estimates

	-FQ3 2026-			-FQ4 2026-	-FY 2026-	-FY 2027-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.58	0.66	▲13.79	0.79	2.71	NA
Revenue (mm)	8244.36	8422.00	▲2.15	9118.23	33528.70	NA

Currency: USD
Consensus as of Oct-22-2026 4:27 PM GMT

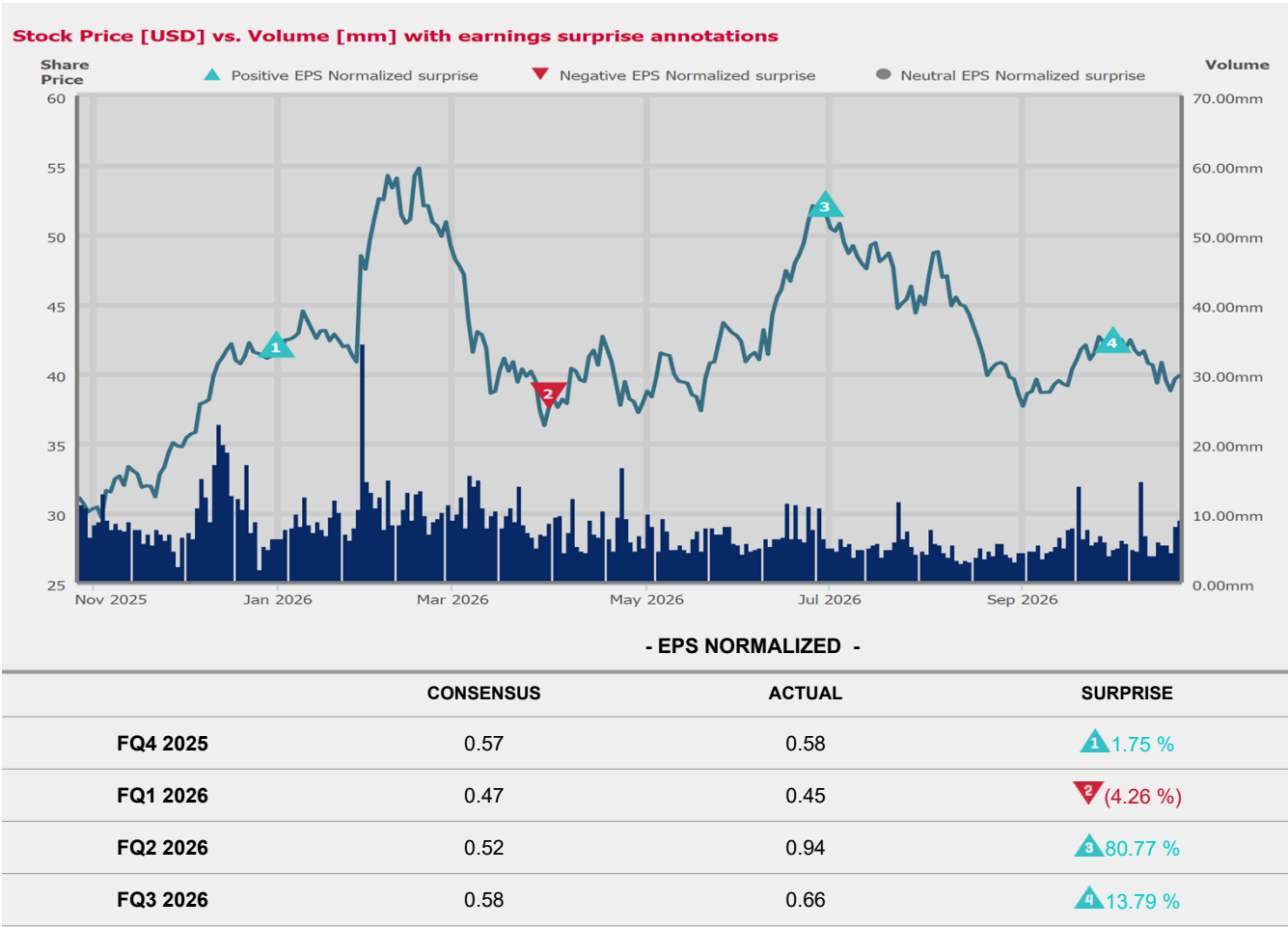


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Presentation

Operator

Hello, everyone, and welcome to the Southwest Airlines Third Quarter 2026 Earnings Conference Call. My name is Gary, and I'll be moderating today's call. Please note that this call is being recorded. A replay of today's call will be available in the Investor Relations section of southwest.com. [Operator Instructions]

At this time, I would like to turn the call over to Danielle Collins, Managing Director of Investor Relations. Danielle, please go ahead.

Danielle Collins

Managing Director of Investor Relations

Thank you. Hello, everyone, and welcome to Southwest Airlines Third Quarter 2026 Earnings Call. In just a moment, we'll share our prepared remarks, after which we'll move into Q&A. Joining me today are Bob Jordan, our President and Chief Executive Officer; Justin Jones, our Chief Commercial Officer; and rounding that out, Tom Doxey, our Chief Financial Officer.

Before we begin, a reminder that we'll be making forward-looking statements, which are based on our current expectations of future performance, and our actual results could differ materially from expectations. Also, we will reference our non-GAAP results, which exclude special items that are called out and reconciled to GAAP results in our earnings release.

With that, I'll turn the call over to Bob.

Robert E. Jordan

President, CEO & Vice Chairman of the Board

Thank you, Danielle, and good morning, everybody. Last quarter, we talked about the transformation reaching an important milestone with all of our major initiatives contributing throughout the entire quarter for the first time. Our third quarter performance and fourth quarter outlook both demonstrate that the earnings power we have built is durable.

In the third quarter, we delivered an adjusted operating margin of 5.4%, up 4.8 points year-over-year, and that's despite an \$820 million (sic) [\$821 million] year-over-year headwind from higher fuel prices. We expect to be the only major U.S. carrier to deliver year-over-year margin expansion here in the third quarter. After-tax return on invested capital was 11.3%, and we generated a third quarter record of \$8.4 billion of operating revenue. Adjusted earnings per share were \$0.66, representing a 500% increase year-over-year and above the midpoint of our guidance range despite a less favorable fuel environment than we anticipated at the time of our last earnings call.

Demand for the Southwest product remained strong throughout the quarter. Broad-based demand strength was evident across all geographies and products, including managed business, leisure, loyalty and co-brand. We generated record third quarter passenger revenue and achieved the highest passenger yield in our history, providing further evidence that our strategy is resonating with customers. We also delivered an all-time record RASM performance, exceeding the high end of our guidance range and costs that came in within expectations. Justin and Tom will take you through the underlying revenue and cost drivers in more detail in a moment.

With the transformation complete, our work has shifted from building to optimizing the business and delivering the next set of customer experience improvements. Both are focused on unlocking the next phase of value creation through stronger earnings, higher returns and continued margin expansion. We are already making meaningful progress, and I'm particularly excited about the investments we continue to introduce across our product offering as well as our recently announced loyalty program enhancements that will further strengthen the value proposition of Rapid Rewards.

As we announced at Media Day last week, we're evolving Rapid Rewards from a program that primarily rewards customers for flying with Southwest into one that delivers value throughout the travel journey. Beginning January 1, we'll introduce new ways for members to earn recognition and rewards, including a new platinum tier, enhanced benefits along the path of status and additional opportunities to engage through our co-brand credit card.

We're expanding how members can use their points with international loyalty partnerships and partner redemption launching next spring and the ability to redeem points for ancillary purchases, including seat selection to follow later in 2027. Together, these enhancements make Rapid Rewards more engaging, more flexible and more valuable for our members while strengthening the role

that loyalty plays across the Southwest experience. In addition, we continue the installation of Starlink ultra-fast Wi-Fi on all of our aircraft, available free to Rapid Rewards members with the fleet-wide rollout expected to be complete by this time next year.

Additionally, we recently introduced the Southwest Icon Lounge network. The name Icon celebrates Southwest's 55-year legacy in the people, moments and ideas that have made the airline what it is today from Herb Kelleher's Maverick, People-First hospitality to the customers and employees who continue to shape our story. Lounges are already under construction in Austin, Baltimore, Honolulu and Nashville with at least 7 additional locations planned as we expect to welcome our first lounge guests in fourth quarter next year.

The Southwest Icon Lounge network will serve as the foundation for a new premium credit card launching in 2027. Premium cards have been among the strongest performing products in the co-brand market, and this gives Southwest an opportunity to participate in that segment for the first time.

On the digital front, we recently became the first U.S. airline to make flight shopping available through ChatGPT. As more customers use AI tools to research, plan and ultimately book their travel, this allows Southwest to engage earlier in the decision-making process and create a more seamless path from trip planning to booking.

Collectively, we continue to make a huge investment in our customer experience. And less than a year from now, we expect to complete our fleet-wide Starlink rollout, finish key cabin retrofit initiatives, including in-seat power, open our first premium Icon Lounges, launch a new premium co-brand credit card, expand Rapid Rewards with a new platinum tier and introduce new airline loyalty partnerships and redemption opportunities. We don't view these as stand-alone products. They are designed to work together as a connected loyalty ecosystem that expands the value of Rapid Rewards, strengthens customer engagement and creates additional opportunities to grow both loyalty and the economics of the program over time.

While our efforts to optimize the business and invest in the customer experience are already producing encouraging results, they represent only a fraction of the opportunity we see ahead. I am pleased to announce that we will host a Capital Markets Day in New York on March 2, 2027. We look forward to sharing our multiyear financial framework, the targets we are managing towards and the actions we are taking to achieve them. We will also discuss plans to further strengthen Southwest's competitive position and unlock additional long-term value for our employees, customers and shareholders.

Finally, none of what we have accomplished would be possible without our people. They are and always will be the heart of the Southwest brand. We have accrued approximately \$165 million in profit sharing year-to-date, reflecting our long-standing belief that when Southwest succeeds, our people share in that success. To our employees across the system, thank you for everything that you do for our customers and for each other.

And with that, I will turn it over to Justin.

Justin Jones
Executive VP & Chief Commercial Officer

Thank you, Bob. To build on Bob's comments, RASM increased 21.6% year-over-year, exceeding the high end of our 17.5% to 19.5% guidance range and setting an all-time record. Notably, this performance was achieved while lapping the 2025 implementation of bag fees and other initiatives, a headwind we flagged last quarter.

Passenger yields and volumes both exceeded our expectations during the quarter. September produced record RASM and passenger yield, reflecting strong customer demand and sustained travel activity beyond the traditional summer travel season. Our performance provides tangible evidence that the actions we've taken to strengthen our network and product offering are working.

On the network, we're concentrating capacity in our strongest markets, including Nashville, Las Vegas, Orlando, Austin and San Diego, while reallocating capacity from lower-performing markets. These changes are further supported from improved connectivity through redesigned banks in all our major airports, expanded red-eye flying and partnerships that bring more customers into the Southwest network. At the same time, assigned seating, extra legroom offerings, more tailored offers and dynamic pricing are helping us serve a broader range of customers while better capturing the value of the network we have built.

Importantly, these initiatives work together. By concentrating our network where we can win and giving customers more choice in how they travel with us, we're attracting more customers, increasing engagement and improving the economics of those markets. The progress we're making is also evident among business customers. This quarter included 20 of the top 50 corporate booking days in company history, and 2 of the quarter's 3 months set records for unique managed business travelers flown. Year-over-year managed business passenger revenue growth improved sequentially in every quarter of 2026, and we've seen double-digit growth in both new and reactivated travelers, reflecting strong adoption of our enhanced offerings.

Turning to our outlook. The strength we saw in the third quarter continues to support our expectations for the fourth quarter. We expect fourth quarter RASM to increase 19% to 21% year-over-year. As in the third quarter, our outlook reflects lapping bag fees and other initiatives. With approximately 65% of fourth quarter revenue already booked, demand remains healthy and broad-based. Corporate demand continues to perform well, and the pricing environment remains constructive.

With that, I'll turn it over to Tom.

Tom Doxey
Executive VP & CFO

Thanks, Justin. Our cost performance continues to be a key differentiator. Third quarter CASM-X increased 3.8% year-over-year on capacity down 0.4%, within the guidance range that we provided in July. As Bob noted, we delivered a 5.4% adjusted operating margin and adjusted earnings per share of \$0.66, above the midpoint of our guidance. Those results came despite fuel costs that were \$109 million, or \$0.14 of EPS, higher than the assumptions underlying our guidance 3 months ago.

To me, that is a clear signal of how much our business has changed and the strength of Southwest's positioning within the industry. Even with a significant fuel headwind, strong revenue execution and disciplined cost performance allowed us to expand adjusted operating margin by 4.8 points year-over-year and deliver earnings growth. The initiatives we've implemented across the business are creating a more resilient earnings profile and helping us perform through a wider range of operating environments.

We ended the quarter with liquidity of \$5.6 billion and a gross leverage ratio of 1.9x, within our stated range of 1 to 2.5x. We also entered into a new \$2 billion revolving credit facility maturing in 2031, replacing our previous \$1.5 billion facility. Our investment-grade balance sheet remains a key strength, particularly during periods of volatility. The management of the fleet is also a strategic competency and a differentiator for Southwest Airlines.

We generated \$285 million in cash proceeds and recognized \$96 million of gains on the sale of retiring aircraft and engines in the third quarter. With a large fleet and an ongoing retirement schedule, aircraft sales are a recurring part of our business. These assets are generally unencumbered and generate cash that allows us to reinvest in the business, such as purchasing new and more efficient aircraft, which is a highly accretive use of capital.

As part of our annual review process, we have updated salvage value assumptions for portions of the fleet to better reflect anticipated values at the end of their respective useful lives, which will reduce depreciation expense by a bit more than 10%. More detail on this topic is included in our third quarter 10-Q.

We completed sale-leaseback transactions in the third quarter, which resulted in cash proceeds of \$212 million and \$118 million in gains. While we expect the majority of our future financing needs will be covered with unsecured or secured debt, maintaining a small portion of leased aircraft provides us additional flexibility and allows us to monetize aircraft in a strong market. We continue to anticipate total gains on sale from retiring assets and sale-leasebacks in the fourth quarter to be broadly similar to those in the first and second quarters of this year.

We expect fourth quarter CASM-X to increase 4% to 4.5% year-over-year on capacity of 3% to 4%. Unique cost drivers in the fourth quarter include the timing of 737-800 heavy maintenance events, costs relating to frontline labor, including health care, costs relating to on-time performance being lower than our targets, and a strategic decision to overweight advertising expense to the fourth quarter. Gains from sale are also forecast to be lower sequentially in the fourth quarter.

We are anticipating year-over-year unit cost growth to moderate from fourth quarter levels as we move into Q1 and next year. We expect fourth quarter adjusted earnings per share of \$0.55 to \$0.80, based on an average fuel price of approximately \$4.55 per gallon using the forward curve as of October 15. Full-year 2026 adjusted earnings per share is now projected to be \$2.60 to \$2.85.

For the year, we are planning for approximately 67 new aircraft deliveries and 60 retirements, with net capital spending of \$2.5 billion to \$2.75 billion. The underlying trends in the business remain strong, and we continue to expect earnings growth as we move into 2027.

And with that, I will turn it back to Danielle for Q&A.

Danielle Collins
Managing Director of Investor Relations

Thanks so much, Tom. This concludes our prepared remarks. We'll now open the line for analyst questions. Joining us today are numerous Southwest executives, including Tony Roach, our Executive Vice President and Chief Customer and Brand Officer, who

will be available to address questions on our customer offering, product enhancements and Rapid Rewards initiatives. To help us manage time efficiently, well, please ask your 1 and 2 questions back to back at the outset. All right, Gary, we're ready for the first question.

Question and Answer

Operator

[Operator Instructions] Our first question today is from Jamie Baker with JPMorgan.

Jamie Nathaniel Baker

JPMorgan Chase & Co, Research Division

I didn't realize Tony was there. So I think I'll ask a loyalty question. So -- or 2 loyalty questions. Obviously, there's speculation about international expansion and a potential wide-body order, that sort of thing. I'm curious how to frame that from loyalty's perspective. And we can keep this in the hypothetical.

But is there any data that you've seen in terms of how loyalty economics improve when long-haul awards become part of the consumer equation? I suppose the other way to ask it is when you compare your current loyalty economics against those of the Big 3, do you think you take a hit based on the fact that you don't currently offer the same type of long-haul destinations?

And then as a follow-up and maybe others will want to jump in, a question that's being asked on every call this season so far, if we look at Aeroplan's valuation and what Air Canada is doing, we can easily argue that your loyalty program is worth a figure that would at least rival, if not modestly exceed, your current enterprise value. Bob has said nothing is sacred. Actually, maybe he hasn't used those words. But clearly, Southwest is turning over certain rocks that we thought you'd never touch. Am I wasting my time in at least pondering the idea that you could do something creative or Air Canada-ish or -esque with loyalty?

Robert E. Jordan

President, CEO & Vice Chairman of the Board

Jamie, it's Bob. Yes, Tony has led all of our work on the Rapid Rewards, the changes we've had in loyalty and take that. And then I'll take the second one about the -- just the value of the program.

Anthony Roach

Executive VP and Chief Customer & Brand Officer

Jamie, and thanks for the question. I think, in short, we see a tremendous amount of upside to loyalty based on the initiatives and products that we've already announced and we see coming online. So if you think about them all individually, they have value, but collectively is really where you see that accelerate. And so the improvements to the day-of-travel experience that we're making, those are huge retention and acquisition levers for us.

And then the hooks that we've just made into the Rapid Rewards program really engage members on the more infrequent side of the scale all the way up to our most engaged customers. And so we're really attacking the loyalty equation on both sides of the spectrum there and have confidence that it's going to drive meaningful upside. And we know there's an opportunity for us with co-brand spend before us.

The way that I think about them is you really see an acceleration as they all kind of come online and kind of form a puzzle together. And these program changes are happening between now through the end of next year with our kind of initial set of lounge openings happening at the back of next year. So the way we see that is we think there's certainly traction as you get into that territory and beyond in terms of upside.

Your question on do -- our opportunity to extract value from members who are wanting to go international beyond where our network takes us today is exactly the thesis behind the recent partnerships that we've announced. It's giving those members the opportunity to take those aspirational trips, and we're just getting started from a partnership standpoint there. So again, I kind of take your question as the things we're talking about and some of the things that will be coming online, in particular with international options related to our partnerships, we see it as all upside. And I think you'll see that reflected in the time to come.

Robert E. Jordan

President, CEO & Vice Chairman of the Board

And Jamie, on the second piece, I just want to say, maybe a congrats to Air Canada on their deal. And then I like the fact that it does illustrate the value of these programs, which everybody already knew. We're focused on creating value, period. We have -- as you've seen us continue to pursue the customer, we have a long list of things that will be in place this time next year between full fleet -- first

airline with full fleet Starlink to a first icon -- Southwest Icon Lounges to full fleet retrofits and power on and on and on. We have a lot of customer enhancements in place in addition to continuing to optimize all of the things that we put in place, all intended to drive value. And we have more beyond that.

So the way I would look at this is we've got a lot of opportunity to drive value with what we have and the things that are on the table today and continue to expand margins even in an environment of high fuel. We have, obviously, plenty of liquidity here at Southwest. So it's not something that we need to look at. But -- so it's not on the radar for us at all, but I do like the fact that it illustrates what we all know, which is these programs are extremely valuable.

Operator

The next question is from Catherine O'Brien with Goldman Sachs.

Catherine Maureen O'Brien
Goldman Sachs Group, Inc., Research Division

So my first question, I think, probably goes to Tom. Gains on aircraft sales have been a notable unit cost tailwind this year on top of solid cost control. Going forward, what's your view on secondary market aircraft values and how that will impact cost performance? And just to be sure, gains have been included and will keep being included in guidance?

And then second question, maybe to Justin, you beat the high end of your 3Q RASM guide. Can you talk through what maybe some of the key drivers of this better-than-expected guidance is? Was there some level of conservatism just given kind of unprecedented pushes on fares here? Or were there markets or trends that just really accelerated versus what you were seeing back in July? And I'll stop there.

Tom Doxey
Executive VP & CFO

Thanks, Catie. Yes, so first, I appreciate the recognition on cost. I do think the team has done a really good job there. And then as you pointed out, the aircraft sales are a nice supplement to that. And I think the management of the fleet continues really to be a strategic differentiator for us here at Southwest.

Maybe first and foremost, I think aircraft sales are a cash story. So we've got a ton of embedded value in the existing fleet in the order book. Most of the assets are fully paid for as well. So what that means is that really the entirety of the purchase price is flowing through as an offset to CapEx. And then that gives us the ability to offset the purchase of new airplanes, which creates a pretty short payback really for buying those long-term assets. We go from 137 to either 175 or soon to be 150 seats, the fuel burn reduction and those sorts of things. It becomes a really quick payback when you take all that into account.

And as you know, we've got north of 400 737 NGs that are still in the fleet that will ultimately replace with MAXs. So this is something -- this fleet-related cash flow is something that will be with us for a lot of years to come. You'd asked about secondary values. So my view is that those will remain strong, barring some sort of significant macro change, whether it's supply chain constraints related to engines or parts, new aircraft production, those sorts of things, I think those will keep the market strong there, and those issues are likely to be fully resolved for a little while.

And maybe just to finish up on the accounting side. So we mentioned in our last call that we anticipated that the gains from sales would be higher in third quarter and that in fourth quarter, it would look more like the first and second. We're still, as you heard in my prepared remarks, still anticipating that to be the case.

And then maybe finally on the depreciation side, just to kind of round out accounting, you also heard us say that we've made some adjustments as we went through our annual salvage value review and really. And really, the thinking there is just to try to match those up as best we can with where we think the anticipated values will be at the end of those respective useful lives. And you've heard me talk about depreciation, maintenance expense and gain/loss that all those 3 things work together. Ideally, you want to have that in the depreciation line. So what this will do is ultimately reduce gains as we move into the future.

Justin Jones
Executive VP & Chief Commercial Officer

Yes, I'll take the second one. Always appreciate being able to speak to the outperformance of the RASM guide for sure. So thank you for the question. Largely, I'd say the upside is pretty broad-based. Passenger fares came in about \$3 above what our forecast was. And the more important thing is that passenger volumes also exceeded our expectations.

September was particularly strong. Rather than seeing kind of that post-summer slowdown that you would normally experience, we delivered record RASM and passenger year in the month of September. We continue to see strength in managed business travel. And it's not the result of one isolated item. It was basically a combination of a very constructive pricing environment, super strong demand and then stronger business travel. And we saw really good customer adoption of our new products.

And so I'd say that the beat was not because we misunderstood the comparison. It was because the underlying business performed better than we anticipated, and we continue to see that strength in the fourth quarter.

Operator

The next question is from Duane Pfennigwerth with Evercore ISI.

Duane Thomas Pfennigwerth
Evercore ISI Institutional Equities, Research Division

I wonder if you could provide some early thoughts on 2027 total deliveries and retirements. I guess, this year, you've been pretty consistent on like the net fleet growth messaging. I wonder how that looks for next year. And then, Tom, just on the depreciation expense that you flagged, when does that or when did that start?

Tom Doxey
Executive VP & CFO

Thanks, Duane. Yes. So we'll -- 3 months from now, when we guide the year, we'll give more specifics, but we've just had the MAX 7 certified. And so I think the way you can think of 2027 is that we're likely to have more deliveries coming out of the factory than we had in 2026. And then we've also talked -- you've heard us talk in the past that there are 27 MAX 7s that were previously built that will start to deliver at the tail end of this year. We'll put them into service next year. So yes, you should think of 2027 total deliveries to be higher than 2026, and we'll give you more specifics in 3 months.

And then on depreciation, there was a bit of an impact this quarter, but really it starts for the full quarter in the fourth quarter. And you'll see more details. We'll have our 10-Q out tonight. You'll see more details about the depreciation in the 10-Q.

Operator

The next question is from Conor Cunningham with Melius Research.

Conor T. Cunningham
Melius Research LLC

Maybe, Justin, jumping back to kind of Catie's question or piggybacking on that. Just on 4Q, you're obviously lapping a lot of the initiatives and you're moving more towards optimization. I was hoping you'd be able to split out what you view as actual core blocking and tackling versus your optimization efforts that you're doing as well?

And then maybe on the cadence of product enhancements, I mean you're obviously -- maybe I'll ask you like this. The -- how important are the lounges to further product segmentation in the years to come? Like do you need those in place before you maybe push more into first class or something like that? That is being talked about a fair bit. So just -- I know everything is on the table. So just any thoughts around the importance of the investment in the infrastructure to product enhancements.

Robert E. Jordan
President, CEO & Vice Chairman of the Board

Yes, Conor, I think Justin, maybe take the first one, Tony, take the second piece on just thinking about lounges and co-brand, the new premium card.

Justin Jones
Executive VP & Chief Commercial Officer

Yes, happy to. So yes, fourth quarter, I just kind of talked a little bit about the trends from Q3 into Q4 and the fourth quarter outlook remains exceptionally strong from a unit revenue growth. Basically, we have about 65% of the fourth quarter revenue booked and demand remains healthy across the board. Corporate demand continues to perform well, and the pricing environment remains very constructive.

And so when we think about our guide, it's continued strength against kind of the different capacity and year-over-year comparison. You asked specifically about kind of how much of it is coming from the core business versus optimization. And I would say it's probably around 2/3 core business and then 1/3 of it on the optimization side of things.

Anthony Roach

Executive VP and Chief Customer & Brand Officer

And to take your second question on the role of the Southwest Icon Lounge network. The way we think about that is, obviously, we're going to be launching a new premium credit card that provides access into those lounges. And what the premium card does for our co-brand portfolio is kind of twofold. One, we have existing members in our card member base today that have a heavy amount of spend that this is just going to be a better product for them that will continue to consolidate their spend with our Southwest card.

And so it's essentially extracting more value out of the customers who are already that deeply engaged. It also just helps us be more relevant for customers that are looking for that type of experience on trips that they can't get from Southwest today. So we see that the Lounge network provides that halo benefit certainly there, but really benefits and drives the co-brand portfolio as it stands today, separate apart from any additional changes to the product that we can make.

Robert E. Jordan

President, CEO & Vice Chairman of the Board

And Conor, I think the only thing I would add to is that the majority of folks who are in have the card and are in the lounges, they're not flying first class. They're in the lounge with the card because they want to be in the lounge. And each of the things that we're doing, while they stack on top of each other to build a better and better experience and offering for our customer, each one is additive. So you add full fleet Starlink installation.

Again, by this time next year, we expect a tailwind from that from all customers, certainly business customers. The retrofits, every seat having power, the larger bins, the ability to have the beginnings of the lounge network. And as a reminder, we have lounges under construction in Austin, Baltimore, Nashville, Honolulu with more to come. So they're under construction right now.

And the loyalty enhancements changes that we put into place, a new platinum tier that comes with a Companion Pass, which is super popular, new reward and redemption opportunities, the ability to redeem on loyalty airline partners to long-haul international spots in the world. They all -- every time we add something, they stack together to build an overall better product offering and loyalty ecosystem for our customers. So we're not building to any one thing like first class.

So the way we look at that is, is that something that makes sense for Southwest Airlines and our customers? Is that the next best way to ensure that we can offer our customers something that they want and give them another reason not to travel on a competitor simply because we don't offer it. So while these things all stack together to build a better ecosystem for our customers, I don't see them as all building necessarily towards one thing.

Operator

The next question is from Sheila Kahyaoglu with Jefferies.

Sheila Karin Kahyaoglu

Jefferies LLC, Research Division

I wanted to ask about just what's going on with your initiatives. It's resulted in average fares up 27% in Q3 with load factors flat, implying pretty strong demand for your product. Flat load factors as a contrast to some other people who reported this morning. I guess what do you attribute that strong performance to? Is it Southwest attracting new customers following the introduction of extra legroom and assigned? And maybe as a quick follow-up to that, could you talk about the buy-up trends from basic to choice products and choice to extra legroom?

Robert E. Jordan

President, CEO & Vice Chairman of the Board

Yes, I'll start with the first. And then, Justin, if you want to take the second piece there. I really think it is all of that. So while fares have accelerated certainly a lot here in 2026. And you've got to remember that while they're up, they remain below 2019 in real terms. Our customers are continuing to respond, and we're seeing -- Justin said this, we're seeing that both in higher passenger volumes and in yield. So it's not -- those higher fares are not causing an erosion of volumes.

Certainly, a piece of that is just broad-based demand strength. Again, we're seeing demand strong across every geography, every product across the board, business leisure. But without a doubt, a piece of the demand that we're seeing is incremental and unique to Southwest Airlines because of the product set that we've introduced and this continuation of additional products that we've announced. Certainly, I'm convinced we are seeing outsized demand because of that.

And we will continue to see outsized demand in 2027 as we implement the list that I just went through. So we don't see any sign at this point that fares coming up are eroding customer demand in any way, shape or form.

Justin Jones

Executive VP & Chief Commercial Officer

Yes. To the buy-up question, obviously, buy-up is dramatically above our historical levels. But overall, the way we look at it is we're optimizing the total customer revenue, just not a single buy-up percentage. Fare upsells plus stand-alone seating is a better way to think about the opportunity. And what matters to us is the total revenue production across fares and seating.

I'll give you a few examples. You might have some holiday dates where we've -- we've added more basic fares on there. So you might see a basic fare mix go up. But also on those days, you'll have more upsell because you're pushing higher into your fare structure. So it's really about just optimizing the entire customer value, not just optimizing the basic fare itself.

Operator

The next question is from Michael Linenberg with Deutsche Bank.

Michael John Linenberg

Deutsche Bank AG, Research Division

Just in the context of some of the press reports about potentially bringing on wide-body airplanes, presumably that would need a reopening of a pilot contract. But maybe more specifically, would that also be required to bring on the MAX 10? And I'm highlighting the MAX 10 because you're obviously very proficient in flying the MAX 8. You're bringing on the MAX 7s. The fact that there's been a focus to increase connectivity, maybe the MAX 10 would make sense in the Southwest fleet. So number one, do you have to go back and reopen? Or would that be -- could that be added by merely through an amendment of the contracts?

And then my second question is actually with respect to connectivity. The fact that your load factors were flat. We've been hearing from other carriers this willingness to trade yield for volume. I realize that your capacity growth was somewhat flat, so that may have helped it. But then we may have seen an increase in connections. So maybe, Justin, if you can talk about your success on the connection front because I know that's been a real initiative for the company.

Robert E. Jordan

President, CEO & Vice Chairman of the Board

Yes. And I'll take the first one and Justin can take the second. Just -- I just want to make sure that draw a distinction between -- I've been very, very specific and direct that we are going to continue to follow the customer and the customer's choice and demand and give our customers more reasons to buy Southwest Airlines and fewer reasons to not buy Southwest Airlines when they would actually prefer us. We just don't offer the product. So that's the guiding light here is the customer, not a fascination with any one thing.

So yes, the recent reports about Southwest is close to ordering wide-body aircraft. There's no credibility to those. We -- again, we just continue to evaluate products to add to the mix to attract and retain more customers. But there's -- but that report was not correct. On the -- and Andrew, you check me here. On the other variants of the 737, specifically, it's really more of a seat. I believe it's a seat count cap than it is a different fleet type.

Andrew M. Watterson

Chief Operating Officer

Correct. In effect, if we want to operate more than 175 seats, we'd go back to the pilots. The contract does open up next year likely. So there's an opportunity there for the second line.

Robert E. Jordan

President, CEO & Vice Chairman of the Board

Yes. So it's really about the seats on the aircraft. It's not about the different variant of the 737. Obviously, we would have a big negotiation around a wide-body. But I suspect that adding another variant of the 737 is significantly easier. And then Justin, you've got a lot of -- as we think about our capacity, a lot of great examples of how we're strategically thinking about capacity investments. So...

Justin Jones

Executive VP & Chief Commercial Officer

Yes. Yes. Well, again, just like outperforming the quarter, I love also answering this question about connectivity. As you noted, we have increased fares significantly, and we've also increased load factor. And September is a great example of that. Yield was up more than 20% year-over-year and load factor also increased.

And now the composition of that has changed a little bit. We will see some local load factor decline, but that's offset by connecting traffic growth, which actually highlights a pretty distinctive advantage for Southwest Airlines. So often you talk -- often, you hear people talk about a point-to-point model versus a hub and spoke.

We're really unique in that we operate a point-to-point, which gives us an incredible utilization and operational efficiency advantage -- but commercially, we build more like a hub-and-spoke model, which gives us all the value coming in from being able to take advantage of connecting traffic on top of an extremely efficient operating model. And when you combine those 2, you see the exact trends we had, yields up, load factors up, really good RASM results.

Operator

The next question is from Tom Fitzgerald with TD Cowen.

Thomas John Fitzgerald

TD Cowen, Research Division

First question, just curious if you could level set and remind us on the incremental EBIT expected in '27 from the current initiatives announced at the last Investor Day. And then just a follow-up on loyalty, specifically as it relates to other revenue. I think that line item is up around 7.5%, call it, year-to-date. And it seems like you're going to have a lot of momentum next year with the new credit card product, presumably a big upgrade cycle. Is it fair to think that other revenue could accelerate further next year, maybe into the high-single digits or low-double digits? Any color on that would be really helpful.

Tom Doxey

Executive VP & CFO

Thanks, Tom. On the initiatives, I mean, the 2 really big ones, of course, were bag fees and then the seat assignments and the extra legroom seats. We've talked about going from \$1 billion of EBIT in 2026 to about \$1.5 billion in EBIT, again, for the seat side of it in 2027. We are still on track for that, if not ahead.

On the bag side, that \$1 billion that we had talked about for the bags, one -- that has tracked. And the one change, that's a positive change that we've had this year as bag fees increased a bit, it just stepped that up. So I would say we're tracking ahead for both of those. So those are probably the 2 big ones that we'd want to update on now.

The second question we'll maybe answer just a little more generally. We'll get into the detail of 2027 in about 3 months. But the things that you heard really all of us talking about today, but specifically, a lot of what you've heard Tony talk about, the focus on continuing to build on what is already a very strong loyalty program and a very strong partnership with Chase. A lot of the initiatives that we are now moving to and are in the process of executing on now relate to improving that loyalty revenue. And so yes, the focus will be there. But for specific numbers, we'll talk a little bit more at the Capital Markets Day and as we guide the year.

Operator

The next question is from John Godyn with Citigroup.

John David Godyn

Citigroup Inc., Research Division

Clearly, you guys are making a number of improvements domestically. As you rub up against the network carriers, the lack of international, both for loyalty, for frequent flyer plan, but it's also for corporate travel, premium travel, et cetera, is kind of like a point of differentiation and maybe a gap. I see that you're adding alliance members, Air Portugal, Polish Airlines. But maybe we can just

take a second to review the international strategy at large. And does a more meaningful push of some sort have to happen? What would be the bottlenecks to making that happen?

Robert E. Jordan
President, CEO & Vice Chairman of the Board

Yes. Let me just start just with some general comments and then Justin can add specifically around the international. I mean, let's just talk about head-to-head competition here. Yes, we don't have 2x2 premium. We don't haul long haul. We don't have long haul international. But just -- let's just look at performance. I mean, we're on a many, many quarter trend of beating -- outgrowing our peer competitors in unit revenue growth year-over-year. And I expect exactly the same thing in Q4.

Despite the fact that fuel prices are up, and we're planning against fuel prices staying up in 2027, despite that backdrop, we see opportunities to significantly expand margins even in that environment. And you look at our demand performance, look at our loyalty program performance, we're seeing very large increases in new members, record tier qualifications, remuneration growth in the, I think, Tony, the 12% range. And this is all without, again, this outperforming premium and long-haul international.

So our revenue performance and certainly, our overall performance, expanding margins 5 points year-over-year in an environment where we had an \$820 million (sic) [\$821 million] headwind from fuel. It's hard to argue we are somehow underperforming because we don't have those products. Let's see all of that as upside in the future if we decide to pursue that.

Operator

The next question is from Savi Syth with Raymond James.

Savanthi Nipunika Prelis-Syth
Raymond James & Associates, Inc., Research Division

Maybe a first question, just kind of during one of the Air Show podcast, Andrew kind of detailed what has impacted Southwest on-time performance, which I think Tom mentioned hurt CASM-X. Just curious -- and he had detailed -- Andrew had detailed kind of the plan to address it. I know that some of those steps go into kind of 2027, but wondering if you can kind of provide an assessment of how -- and if the solutions are having kind of the hoped-for results here. And then just for the second question, just a follow-up from kind of Duane's question. As you think to 2027 and growth, how are you thinking about retirements next year?

Robert E. Jordan
President, CEO & Vice Chairman of the Board

Let me just -- I'll just start and pitch to Andrew on the cost question and then thinking about on-time performance. The -- our fourth quarter cost performance is up a little bit. It's really an outlier. We've got some maintenance events. They're really timing. And to some extent, we've got some pressure from on-time performance that is -- I'll just admit, it is lower than what we would like.

We're performing well overall. We've got our best baggage numbers ever. We've got terrific completion factor, but OTP is not where we want it to be. And on cost from the fourth quarter, those will absolutely step down into the first quarter '27, and it will step down into the full year 2027.

But we are highly focused on on-time performance. There are improvements built into schedules next year, beginning with the January schedule, that will improve on time, and that will have an improvement impact on our costs in 2027 as well. But just thinking about the specifics of all that we're doing to improve OTP. Andrew?

Andrew M. Watterson
Chief Operating Officer

Yes. Thanks, Bob. As you mentioned, the Wall Street Journal overall, the 7 metrics, we're doing well on all of them except for the A14. The extreme delays, which is the A45, we're also doing well. So it shows you the difference in our performance is in between that kind of 14 to 45. So it's a handful of minutes we need to move back, not any problem with like larger disruptions, we continue to do very well compared to our competitors.

And so some of the schedule, as Bob talked about, will be rolled out in January and beyond. But between now and then, we've made some smaller changes like report time for crews and other ways we manage the interior cabin. But 2 of the bigger ones that are actually going live in November is a change to our gate check process and our flight close process.

And those are both process changes, and we have some technology changes for our ops agents to help them close the flight with the iPad down the aircraft not at the podium, so to speak, so they can problem solve and be able to manage the last part of the turn because we start turn extraordinarily well better than ever, but it [lags] a little bit. So these changes will start going out in November and then also ramp up through when those schedules go live. So we've got a broad range of efforts we think will bear fruit here November, December and into the first quarter.

Tom Doxey
Executive VP & CFO

Thanks, Andrew. And Savi, on your retirement question, again, we'll give specifics and guide deliveries and retirements in 3 months. But you should anticipate that going along with what I said to Duane earlier about a higher level of deliveries, we will also have an increased level of retirements next year, but we'll give you the specific numbers in 3 months.

Operator

The next question is from Chris Wetherbee with Wells Fargo.

Christian F. Wetherbee
Wells Fargo Securities, LLC, Research Division

You've talked about loyalty, I think, here on the call a couple of times, but maybe you could frame sort of where you think you are relative to peers in the space, if there's an opportunity to kind of close the gap or bigger opportunities as you expand your services. And then I guess maybe on the corporate demand side, sounds like it's quite strong. You've had a couple of quarters here with a lot of the initiatives. You kind of get a sense, maybe expand a little bit on what you're hearing in terms of feedback and what you think it might mean for growth rates going forward.

Anthony Roach
Executive VP and Chief Customer & Brand Officer

Yes, I'll take the loyalty question. We -- as mentioned before, we think that relative to what the opportunity is, there's upside to what we're seeing. The initiatives that we are rolling out lays out the plan for that. And again, it's really a matter of attracting certainly more customers into the program.

Bob talked about the strength that we're seeing in the Rapid Rewards program as a whole. I mean, new record growth numbers there. That provides a great base of acquisition into the co-brand portfolio. And really, as you get into the Lounge network, the new premium card, we really see that as a way to accelerate the growth as we get towards the back half of next year. So we've -- we're clear and have been clear that there's upside here, and we think the initiatives really gives us a great plan to go and achieve that.

Robert E. Jordan
President, CEO & Vice Chairman of the Board

And on your managed business, I mean yes, we're seeing strong continued demand and managed business customers and that segment has continued to outperform the overall business on essentially flat capacity, business passengers were up roughly 9% in the quarter. Business revenues were up 29%. And it's a combination of a whole series of things. I mean, obviously, it is our product enhancements.

Our business customers are responding very, very well to the product options and changes. And I expect that to continue given, again, the fact that we've got full fleet Starlink coming here by this time next year. We've got our lounges opening. So things that are important to all customers, but certainly important to our business customers will continue to come online at a very rapid pace in 2027. And I expect that to continue to fuel the growth in managed business.

Operator

The next question is from Scott Group with Wolfe Research.

Scott H. Group
Wolfe Research, LLC

So Tom, I guess just I have like a very big picture sort of question. Like, obviously, like tons of changes this year, [seats, bags, gains and depreciation], like it's obviously working like really outperforming RASM, you're outperforming CASM. Like I know we're not getting guidance today, but like just directionally, as we think about next year, like do you think we can outperform like industry again on these -- on RASM, CASM?

Do you think it's more sort of -- we're more in line with sort of whatever the industry is going to do? Or do we need to, in any way, be cognizant of, oh, we've got tough comps, maybe we underperform. I don't think that's the message. But I don't know, how would you think about like one of those 3 sort of outcomes?

Tom Doxey
Executive VP & CFO

I'll reiterate what Bob said a minute ago. We feel that even in a high-fuel environment, given all the things that we're doing with continued discipline on the cost side, all the great initiatives we have that are building revenue, yes, we absolutely see a path to expanding margins meaningfully year-over-year even if fuel is high. And yes, I do think we can beat everybody else.

Operator

The next question is from Brandon Oglenski with Barclays.

Brandon Robert Oglenski
Barclays Bank PLC, Research Division

So -- and Tom, maybe we can elaborate on that. How optimized do you guys feel you are in offering value for your products, meaning like the walk up from basic to a main fare. I'm sorry if that's not what you call your main fare. But -- and then thinking about like dynamic pricing of seat assignments and extra legroom, has that all been optimized in this environment? Or is there more to go there?

Justin Jones
Executive VP & Chief Commercial Officer

Yes. I mean I would say that there's quite a bit more to go there, and that is exactly what we're focusing on to drive the value for 2027 that Tom just talked about. We've got a pretty unique combination at Southwest that doesn't exist anywhere in the industry. We have the leading position in many of America's largest travel markets, we have an incredible brand that customers know and trust and an incredible culture of hospitality.

And now we're adding a much more sophisticated commercial engine around those strengths, whether you think about how do we think about merchandising differently for the new products the lounges, how do we think about that? How do we think about the loyalty program changes we have? All of those things are going to work in a combination.

So again, going back to some of the things we're not trying to be one of the other airlines. We're taking things that have always made Southwest unique, and we're adding capabilities that we've never had before. And so we're just in the very early stages of that. And Tony and I probably have a list of 30 pretty quick hit things that we can do that can drive incremental value. Simple example is you can't even upgrade on some of the products yet using the Rapid Rewards points. So there's dozens of things like that, that we're going to look at to drive value in '27.

Operator

The next question is from Andrew Didora with Bank of America.

Andrew George Didora
BofA Securities, Research Division

I know sitting here in October, it's early to guide for '27, but just looking at 1Q, 2Q schedules currently set kind of like 5.5% growth you've been cutting about 1 point out of schedules the last few quarters. So is the right way to think about the beginning part of next year in that 4% to 5% range? Or should we expect more significant changes just given where fuel is right now?

And then my second question, just for Tom in terms of capital allocation. Are you still open to share repurchases here in this environment? I know you have \$450 million remaining. You're within your target leverage range and it seems like you have a pretty deep pipeline of asset sales. So just some thoughts around capital returns would be helpful.

Robert E. Jordan
President, CEO & Vice Chairman of the Board

Yes. I just take -- we're obviously not ready to guide capacity for 2027, but you've seen us be very disciplined here in 2026. Again, our full year is going to come in at about 1.2. And that discipline -- and that's well below our peers, and that discipline is at least a piece of why we are showing unit revenue and just revenue outperformance.

As you look at 2027, though, it's all going to come down to a combination of many factors. Demand is incredibly strong, but what does demand look like? What does competitor capacity look like? What's going on with fuel. So we'll continue to manage in a dynamic way. The one thing we are not going to do, though, we are not going to chase growth at the expense of returns or profitability. I promise you that.

And Justin, it might be helpful if you just give a few examples of where we are -- we're being incredibly intentional about where we are investing capacity. So just -- maybe just a minute on that.

Justin Jones

Executive VP & Chief Commercial Officer

Yes. I mean, to your point, we're not just going to grow. If you look at our fourth quarter capacity, and this is true for the vast majority of our capacity that's out and published, 95% of our year-over-year seat growth touches the Southwest point of strength, meaning that we're flying in and out of airports where we are the #1 carrier. And well over half of that growth is occurring in markets where the rest of the industry is actually reducing seats. So most importantly, we're seeing the economics support our strategy.

If you look at our 22 strategic focus markets, 18 of those improved operating margin year-over-year. So 18 of those improved. We had margin growth in those year-over-year. Two of them were essentially flat and only 2 declined. That's with the higher fuel environment. So for us, this isn't growth for growth's sake, as Bob just said, we're concentrating capacity behind our strongest market positions, which is improving the economics of those markets overall and it's building leadership positions that we believe can produce more durable earnings over time. So we're very, very disciplined in our approach to capacity moving forward.

Tom Doxey

Executive VP & CFO

And on the capital allocation side, we'll always go back to our framework. So we've talked about our liquidity target. That remains unchanged, the combination of the revolver and cash and then the 1 to 2.5x gross debt-to-EBITDA ratio, the debt ratio, we'll work within those guardrails.

And so -- maybe one other thing I'll mention is going back to the fleet comments, knowing that we have the MAX 7 that's now been certified, and we feel that will be a great asset for our network. We are anticipating that we will have more deliveries as we are taking both the MAX 8 and the MAX 7 over the next couple of years.

Operator

Next question is from Ravi Shanker with Morgan Stanley.

Ravi Shanker

Morgan Stanley, Research Division

Apologies if I missed this, but are you able to quantify the RASM uplift in 2027, specifically from the Rapid Rewards changes and the Starlink rollout? And second question is, interesting with the ChatGPT integration, can you share any initial takeaways there in terms of response from consumers? And Bob, how do you think AI agents will change how you distribute and your market position over time?

Tom Doxey

Executive VP & CFO

Ravi, I'll start with your first one. No, we haven't given specific numbers for 2027 RASM for those items. You've heard a lot of confidence from us about the benefits that these will bring getting to Starlink by this time next year, all the things that you've heard Tony talk about around lounges and all of that, all of that we see to be beneficial and accretive, but we have not given specific numbers.

Anthony Roach

Executive VP and Chief Customer & Brand Officer

And I'll just address the question on the ChatGPT plug-in that we installed. First of all, it is just fantastic work by our technology teams to really go and explore in this area. We look at this very much as kind of a way to explore how our customers are thinking about travel inspiration in that channel. It's very early.

And so the numbers are quite small today to talk about any trends. But where things may go from a distribution standpoint in AI agents, that's exactly why we put a plug-in in place so we can get an early read and early learnings and continue to adapt based off where customers are looking to consume Southwest Airlines and moving forward. So it's been a great exploration so far.

Operator

The next question is from Atul Maheswari with UBS.

Atul Maheswari

UBS Investment Bank, Research Division

Just one question in the interest of time. Tom, how are you thinking about free cash conversion and CapEx for '27 and beyond as earnings hopefully continue to expand from here?

Tom Doxey

Executive VP & CFO

We've seen -- on the operating cash flow side, we've seen meaningful improvements there as the overall profitability of the company has improved. And then the flow from operating cash flow to free cash flow will largely maybe stating the obvious, but largely depend on the quantity of aircraft that we're taking, offset by the proceeds that we have as we're selling assets from our fleet. So again, we haven't given specific guidance around the profitability for next year or any of the cash guidance, but that's the flow.

Danielle Collins

Managing Director of Investor Relations

All right. Well, that was our last question for today. Thank you, everyone, for joining us, and we'll see you next quarter.

Operator

The conference has now concluded. Thank you for attending today's presentation. You may now disconnect.

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