

Southwest Airlines Co.
1995 Annual Report

OUR 6 SECRETS OF SUCCESS

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Consolidated Highlights

(dollars in thousands except per share amounts)

	1995	1994	Percent Change	
Operating revenues _____	\$2,872,751	\$2,591,933	10.8	
Operating expenses _____	\$2,559,220	\$2,275,224	12.5	
Operating income _____	\$313,531	\$316,709	(1.0)	
Operating margin _____	10.9%	12.2%	(1.3) pts.	
Net income _____	\$182,626	\$179,331	1.8	
Net margin _____	6.4%	6.9%	(0.5) pts.	
Net income per common and common equivalent share _____	\$1.23	\$1.22	0.8	
Stockholders' equity _____		\$1,427,318	\$1,238,706	15.2
Return on average stockholders' equity _____	13.7%	15.6%	(1.9) pts.	
Debt as a percentage of invested capital _____	31.7%	32.0%	(0.3) pts.	
Stockholders' equity per common share outstanding _____	\$9.91	\$8.65	14.6	
Revenue passengers carried _____	44,785,573	42,742,602	4.8	
Revenue passenger miles (RPM) (000s) _____	23,327,804	21,611,266	7.9	
Available seat miles (ASM) (000s) _____	36,180,001	32,123,974	12.6	
Passenger load factor _____	64.5%	67.3%	(2.8) pts.	
Passenger revenue yield per RPM _____	11.83¢	11.56¢	2.3	
Operating revenue yield per ASM _____	7.94¢	8.07¢	(1.6)	
Operating expenses per ASM _____	7.07¢	7.08¢	(0.1)	
Number of Employees at yearend _____	19,933	16,818	18.5	

Net Income (in millions)

1991	1992	1993	1994	1995
\$33	\$97	\$154	\$179	\$183

Net Income Per Share

1991	1992	1993	1994	1995
\$.25	\$.68	\$1.05	\$1.22	\$1.23

Southwest Airlines Co. is the nation's low fare, high Customer Satisfaction airline. We primarily serve shorthaul city pairs, providing single class air transportation which targets the business commuter as well as leisure travelers. The Company, incorporated in Texas, commenced Customer Service on June 18, 1971 with three Boeing 737 aircraft serving three Texas cities—Dallas, Houston, and San Antonio. At yearend 1995, Southwest operated 224 Boeing 737 aircraft and provided service to 46 airports in 45 cities principally in the midwestern, southwestern, and western regions of the United States. Southwest has one of the lowest operating cost structures and consistently offers the lowest and simplest fares in the domestic airline industry. LUV is our stock exchange symbol, selected to represent our home at Dallas Love Field, as well as the theme of our Employee and Customer relationships.

Last year, our annual report was the blueprint for building a low fare airline. Two of our competitors, the United Shuttle and Continental Lite, sincerely flattered us with their imitations. But thanks to the 20,000 mavericks who work for us, our 24-year record of success remained intact.

This year, for the first time in our history, we've decided to share our Six Secrets of Success. Now there's simply no reason why every airline can't be just as successful as Southwest Airlines. Except for this: If you want to be THE Low Fare Airline, you'll need our remarkable Employees and their unwavering Southwest Spirit.

Hey, we never said it would be easy!

To Our Shareholders:

In fourth quarter 1994 and first quarter 1995, our year over year earnings were down substantially as the proud and beloved People of Southwest Airlines defended themselves against simultaneous assaults from Continental Lite and the United Shuttle. Because of my supreme confidence in the dedication, martial vigor, and extreme valor of our People, I predicted in our 1994 Annual Report that Southwest's fortunes would begin to recover in the second quarter of 1995. I also said that:

"While a number of other airlines may attempt to imitate Southwest, none of them can duplicate the spirit, unity, 'can do' attitudes, and marvelous *esprit de corps* of the Southwest Employees, who continually provide superb Customer Service to each other and to the traveling public. Just as the past has belonged to Southwest because of our People's goodwill, dedication, and energy, so shall Southwest seize the future!"

As of today, Continental Lite has ceased to exist and the United Shuttle has substantially receded from Southwest's Oakland, California, markets. Because of our Employees' indefatigable efforts, a 72 percent year over year decline in first quarter 1995 profits has been transmogrified into a 1995 record annual profit of \$182,626,000 (\$1.23 per share), a two percent increase over the \$179,331,000 (\$1.22 per share) of 1994.

Our fourth quarter 1995 earnings of \$43,359,000 (\$.29 per share) made a very substantial contribution to our 1995 "turnaround," as they exceeded 1994's \$20,343,000 (\$.14 per share) by 113 percent.

Despite the adverse cost impact of the recently effective 4.3 cents per gallon federal jet fuel tax, accompanied, as well, by thus far moderate increases in jet fuel prices, from this early vantage point we presently anticipate, barring any unforeseen and deleterious external events, that our first quarter 1996 earnings will substantially exceed those of first quarter 1995.

During 1996, we anticipate adding 20 new Boeing 737-300s to our fleet and removing three older 737-200s therefrom. Our net increase in available seat mile capacity is expected to be approximately 13 percent.

As of this writing, our just inaugurated service to Tampa and Ft. Lauderdale is already producing average daily load factors in excess of our system averages, and we are, therefore, optimistic that Florida will be a successful addition to our growing route system. We will inaugurate service to Orlando in April 1996, and we currently plan to devote at least eleven of our twenty 1996 aircraft deliveries to our new Florida markets.

As American Airlines has “dehubbed” Nashville, we have been steadily adding replacement service, and Southwest is now the largest Nashville air carrier in terms of daily flight departures. In 1996, we will inaugurate nonstop service from Nashville to Tampa and Orlando and one-stop service to Ft. Lauderdale.

After beginning 1995 with a truly dismal first quarter earnings performance, I am especially pleased and extremely happy to be able to report to our Shareholders 1995 annual financial results slightly improved over those for 1994. How was this “miracle” of 1995 accomplished? It was achieved through the fighting spirit of the marvelous People of Southwest Airlines. They never give in and they never give up; that is why they are my heroines and my heroes!

Most sincerely,
Herbert D. Kelleher
Chairman, President, and
Chief Executive Officer
January 27, 1996

P.S. Our People are also a heck of a lot of fun to be with!

SECRET NUMBER 1

Stick to what you're good at.

Since 1971, Southwest Airlines has offered single class service on lots of short-to-medium range flights to convenient airports. It's an idea that has propelled us to new heights.

"Our focus is, and has always been, shorthaul, point-to-point travel. That's why 80 percent of our Customers fly nonstop."

Gary C. Kelly
Vice President-Finance,
Chief Financial Officer

Since Southwest's inception, we have fundamentally adhered to our shorthaul, high frequency, low-fare, point-to-point market niche. As a consequence, Southwest provides service only to communities that have ample local traffic to profitably support our high-frequency operation. Since our focus is on local, not connecting, shorthaul traffic, we do not interline with other jet carriers or have any commuter feeder relationships. As a consequence, approximately 80 percent of our Customers fly nonstop.

Southwest schedules its aircraft on a point-to-point as opposed to a hub-and-spoke basis. Our extensive point-to-point routing system provides more direct nonstop routings to better serve the needs of the business as well as the leisure shorthaul passenger. By avoiding hubs, we minimize connections, delays, and our Customers' total travel time. In addition, many of the airports we serve are conveniently located satellite or downtown airports such as Dallas Love Field, Houston Hobby, Chicago Midway, Oakland, Burbank, Ft. Lauderdale, and Baltimore. These airports are typically less congested than hub airports and, therefore, improve our ability to maintain our outstanding ontime performance record.

Although we served only 46 airports at the end of 1995, we had over 2,000 flights per day. The average number of daily departures per airport was approximately 45. Our largest airports are Phoenix Sky Harbor, Dallas Love

Field, Houston Hobby, and Las Vegas McCarran with 168, 137, 136, and 128 daily flights, respectively. At the airports we serve, we consistently have among the largest number of Customers boarded of all airlines. We ranked first or second in terms of Customers boarded in the majority of our 46 airports served in 1995.

As a result of the combination of low fares, high frequencies, convenience, and outstanding Customer Service, we dominate the majority of the shorthaul markets we serve. We consistently rank first in market share in approximately 80 to 90 percent of our top 100 city-pair markets, and, in the aggregate, 60 to 70 percent of the total market share. Southwest also carries the most passengers in the top 100 U.S. markets despite serving only 41 of them.

Operating Revenue Per Available Seat Mile

1991	1992	1993	1994	1995
7.10¢	7.89¢	8.35¢	8.07¢	7.94¢

Scheduled Service Only

Operating Expense Per Available Seat Mile

1991	1992	1993	1994	1995
6.76¢	7.03¢	7.25¢	7.08¢	7.07¢

Scheduled Service Only

SECRET NUMBER 2

Keep it simple.

Southwest Airlines honors some simple no-nos: No assigned seats. No meals. No hassles. No problems. Do our Customers like the way we do business? You could say they're simply nuts about it!

"We believe simpler is always better. Most people's lives are complicated enough. Why add to their problems?"

Gary A. Barron
Executive Vice

President-

Chief Operations Officer

Simplicity is a basic philosophy at Southwest Airlines. Southwest was built to meet the needs of the shorthaul, point-to-point traveler, and this is our focus. We fly only one aircraft type, the Boeing 737. This drastically simplifies scheduling, maintenance, flight operations, and training activities.

At yearend 1995, we had 224 Boeing 737 aircraft in our fleet, consisting of 149 -300s; 50 -200s; and 25 -500s. In 1994, Southwest agreed to be the launch customer with The Boeing Company for the third time and will add the new -700 model to our fleet beginning in fourth quarter 1997. Our agreement with Boeing allows for a comparatively lower capital cost, and the -700 is expected to be quieter, more fuel-efficient and more easily maintainable than its -300 counterpart. The new aircraft model should also have the capability to fly faster, longer, and higher. The -700 is expected to carry the same type rating as the rest of the 737 family, thereby allowing for the same simplified scheduling, training, and maintenance as today. Operating a single aircraft type has proven to be efficient and safe for our high frequency, shorthaul, point-to-point market focus.

From an operational perspective, we utilize simple, quick, and efficient ticketing and boarding procedures to minimize our Customers' total trip time. We also avoid costly and complicated interlining arrangements with other carriers.

Since our average flight approximates just one hour, we offer reserved but open seating in our comfortable single class 737 cabin. Additionally, our in-flight service is simplified because meals are neither practical nor necessary.

Our fare structure is the simplest in the domestic airline industry, and our Company Club frequent flyer program is also simple, generously rewarding our frequent flyers with free trips.

Consistent with our “keep it simple” approach, Southwest was the first major airline to introduce Ticketless Travel, which makes “ticketing” on Southwest even easier. Southwest’s unique Ticketless system, which was fully implemented in January 1995, eliminates the inconvenience of acquiring a paper ticket. Currently, 35 percent of our Customers use Ticketless Travel, and we believe this percentage will grow as our Customers experience its ease and convenience. Our Customers will soon be able to book Southwest Ticketless Travel directly using our Home Page on the Internet (<http://www.iflyswa.com>). When it comes to technology and streamlining our operations, our Employees are on the leading edge.

While our approach may be simple, our Customer Satisfaction consistently ranks best in the industry because we deliver what the Customer wants in shorthaul markets.

Passengers Carried Per Employee

1991	1992	1993	1994	1995
2,450	2,597	2,633	2,676	2,379

Scheduled Service Only

Passenger Revenue Per Passenger Mile

1991	1992	1993	1994	1995
11.22¢	11.78¢	11.77¢	11.56¢	11.83¢

Scheduled Service Only

SECRET NUMBER 3

Keep fares low, costs lower.

Southwest Airlines believes in low fares by philosophy. The only way to keep our fares low is to keep our costs even lower. It's our primary goal. And you can take that to the bank!

“Southwest is THE Low Fare Airline because we are THE Low Cost Airline. You can't have one without the other.”

John G. Denison
Executive Vice

President-

Corporate Services

Since our inaugural flight almost 25 years ago, Southwest has provided low fares to our Customers. After all, low fares are what the shorthaul traveler wants most from safe air transportation. Low fares are an integral part of our strategy, and Southwest is THE Low Fare Airline every day, everywhere we fly. To offer low fares profitably, we must keep our costs even lower—and we do! Southwest is also THE Low Cost Airline, with the lowest cost structure in the domestic airline industry.

The key to maintaining our low costs is our high productivity. Southwest continually achieves the highest asset utilization and Employee productivity of any U.S. airline. We schedule our aircraft to minimize the amount of time the aircraft is at the gate, approximately 20 minutes, thereby allowing each Southwest Employee to consistently handle an average of approximately 2,500 Customers per year. Even though we pay our Employees at or above industry levels, we achieve competitive unit labor costs due to their high productivity.

As a consequence of our quick turns, we require fewer aircraft and aircraft facilities than would otherwise be necessary. Additionally, our commitment to one aircraft type significantly simplifies our operation, which improves our overall productivity and lowers our costs.

Our Employees' dedication and efforts enabled us to reduce our unit costs for the second year in a row. Lowering our distribution costs was one of the leading factors in this notable accomplishment. As a result of our dominant market presence, reliable low fares, and the ease of dealing with us directly, our distribution costs have always been lower than the other major carriers; however, with the successful implementation of Ticketless Travel (reducing annual operating expense by approximately \$25 million), and our entry into Basic SABRE, we lowered our distribution costs even further.

Thanks to the Culture at Southwest Airlines, we do not have to motivate our Employees with programs to reduce costs; rather, it is their goal each and every day. The unprecedented ten-year agreement with our superb Pilot group, exchanging stock options for pay rate increases, is just one example of how our Employees' interests are aligned with those of our Customers and the Shareholders of Southwest Airlines. Our focus on low costs has always been paramount, and 1996 will be no exception. We are currently undertaking numerous major cost reduction initiatives, which we hope will result in even lower costs over the next several years. Keeping costs low is simply a way of life at Southwest Airlines.

Aircraft Utilization (hours and minutes per day)

1991	1992	1993	1994	1995
10:48	10:39	10:56	11:10	11:03

Scheduled Service Only

Fleet Size (at year end)

1991	1992	1993	1994	1995
124	141	178	199	224

Scheduled Service Only

SECRET NUMBER 4

Treat Customers like guests.

Southwest Airlines has won the annual Triple Crown four times: Highest Customer Satisfaction. Best Ontime Record. Best Baggage Handling. That should wake up those other guys.

“The secret is so simple, most companies overlook it. Treat your Customers like you’d like to be treated.”

Colleen C. Barrett

Executive Vice

President-

Customers

In 1995, Southwest Airlines won the annual Triple Crown for our fourth consecutive year: Highest Customer Satisfaction, Best Ontime Record, and Best Baggage Handling. Southwest was specifically built to meet the needs of our shorthaul Customers, and that’s exactly what our Employees do! We provide affordable, safe air travel, and Positively Outrageous Service.

In 1995, for the fourth straight year, we had the best Customer complaint record of any major U.S. airline. Our Employees consistently deliver high-quality Customer Service in a friendly, caring, and enthusiastic manner. In short, we treat our Customers like guests. Southwest was built with the shorthaul Customers’ needs in mind, and our unique marketing and operating strategy facilitates this exceptional service. Our quick and simple ticketing and boarding procedures, as well as our inflight services, were designed to deliver what the shorthaul Customer wants: the lowest fares; frequent, conveniently timed flights; and outstanding Customer Service. In addition, we offer a generous Company Club program that rewards our frequent flyers with free trips. Our Customers simply luv it!

Our unique operating strategy also facilitates our number one ranking in ontime performance. The combination of efficient aircraft scheduling; careful selection of airports served; quick and efficient ticketing and boarding procedures; and our

highly productive Employees consistently rank us at the top in terms of ontime performance.

For the fourth straight year, we also had the fewest mishandled Customer bags of any major U.S. airline. This was achieved despite our quick aircraft turns at the gate and the fact that we are carrying ever-increasing amounts of cargo and U.S. mail. Combined, freight revenues grew faster than capacity in 1995, or 21.0 percent. Our streamlined approach and the caring and dedicated attitudes of our Ground Operations Employees enable us to control and handle our Customers' baggage efficiently with minimal loss.

While the amenities may be "low frills," our Triple Crown Customer Service rankings are a testament to the fact that we deliver what the Customer wants in shorthaul markets.

Department of Transportation Rankings for 1995

<u>Customer Satisfaction</u>	<u>Ontime Performance</u>	<u>Baggage Handling</u>
1. Southwest	1. Southwest	1. Southwest
2. Northwest	2. Northwest	2. Continental
3. Alaska	3. USAir	3. America West
4. Delta	4. Continental	4. USAir
5. American	5. United	5. American
6. USAir	6. America West	6. United
7. United	7. American	7. Delta
8. America West	8. Alaska	8. Alaska
9. Continental	9. Delta	9. Northwest
10. TWA	10. TWA	10. TWA

SECRET NUMBER 5

Never stand still.

Southwest Airlines provides quick turnarounds at our gates. We also respond quickly to changes in the business environment. Which helps keep us one step ahead of our competition.

“One thing is for certain: Things will change. How well you anticipate and how quickly you deal with change determines your success.”

Herbert D. Kelleher
Chairman, President, &
Chief Executive Officer

In the rough and tumble airline industry, we must be able to react quickly to competitive challenges. Our low costs and energetic Employees allow Southwest to do just that!

Only the remarkable People of Southwest could have responded to the multitude of challenges we have recently faced and “turned around” our disappointing first quarter 1995 results so quickly. Our Employees effectively defended themselves from simultaneous assaults from Continental Lite and the United Shuttle. By mid-1995, Continental completely dismantled Continental Lite; and by January 1996, the United Shuttle had substantially reduced service in our Oakland, California, markets. We now compete against the United Shuttle in only six markets.

Our Employees swiftly corrected the technological Reservations System problem we encountered during fourth quarter 1994 and first quarter 1995. In addition, we opened two reservations centers in Little Rock and Oklahoma City during 1995 to ensure adequate reservations capacity for future growth.

We enhanced our fare structure, which led to dramatic improvements in our yields, from fourth quarter 1994 and first quarter 1995 levels. We ended 1995 with record revenue per RPM.

In January 1995, we were the first major airline to fully implement Ticketless Travel. Consequently, we are even less dependent on our competitors' computer reservations systems to distribute Southwest travel. In addition, our People are also in the process of developing our own internal reservations system which will further improve our productivity.

These accomplishments, along with our entry into Basic SABRE, resulted in permanent reductions in our distribution costs and demonstrate how our Employees never lose sight of Southwest's number one competitive advantage—the lowest cost structure in the airline industry.

Despite the intense competitive pressures we faced in 1995, our People remained focused on growing our market niche. We added 25 aircraft and increased our capacity by 12.6 percent. Although this was aggressive in the face of significantly increased competition, our Employees effectively managed the growth. We added only one new city, Omaha, which allowed our Employees to further develop our route system, including the seven cities we added in 1994. We also increased the number of our daily flights in Nashville to 35 by the end of the year and are now Nashville's largest carrier in terms of daily departures.

In 1996, we will take delivery of 20 new Boeing 737-300 aircraft, of which 11 will be deployed in Florida service. We inaugurated service from Tampa and Ft. Lauderdale on January 22, 1996 and will begin service from Orlando in April 1996.

Our Employees made an enormous investment in Southwest during 1995 and thanks to their Southwest Spirit and "never stand still" attitude, Southwest is positioned stronger than ever to meet the challenges of our extremely competitive airline industry.

Revenue Passengers Carried (in thousands)

<u>1991</u>	<u>1992</u>	<u>1993</u>	<u>1994</u>	<u>1995</u>
22,670	27,839	36,955	42,743	44,786

Scheduled Service Only

Revenue Passenger Miles (in millions)

<u>1991</u>	<u>1992</u>	<u>1993</u>	<u>1994</u>	<u>1995</u>
11,296	13,787	18,827	21,611	23,328

Scheduled Service Only

SECRET NUMBER 6

Hire great People.

Southwest Airlines is a People Company. Spirited, altruistic, fun-loving Employees who work hard, follow The Golden Rule, and provide the best Customer Service in America. It's how we earn our wings.

“We hire People who color outside the lines—creative, caring People who provide Positively Outrageous Service.”

Elizabeth P. Sartain
Vice President-People

Southwest Airlines believes our number one asset is our People; therefore, we devote a significant amount of time and effort hiring, training, and retaining our Employees.

At Southwest, we are not interested in hiring clones. We target individuals from diverse backgrounds who will support and enhance our Culture. Regardless of the job, we hire People with attitudes that are outrageously positive. Our Employees enjoy working together as a team and take pleasure in team results, rather than emphasizing individual accomplishments.

Southwest Employees are not afraid to “color outside the lines.” We encourage our Employees to be creative and have fun on the job. As a result, our Employees tend to go out of their way to ensure our Customers have an enjoyable and memorable flight. Although our Employees take our Customers very seriously, they do not take themselves seriously. They are warm, caring, compassionate, and always willing to go the extra mile to deliver Positively Outrageous Service to our Customers as well as the communities we serve.

Finding a person who fits that bill is not an easy task! In fact, we accepted approximately 124,000 external job applications in 1995 and interviewed 38,000 individuals for 5,473 positions.

Once Southwest hires someone to join our Family, we focus on nurturing and developing that Employee. We provide exceptional training programs which are specifically designed to help our Employees excel and succeed in an extremely competitive and dynamic environment.

Without sufficient retention of our incredibly talented Employees, our recruiting, hiring, and training efforts would be in vain. What is our secret? Although we offer competitive compensation packages, including, among other things, competitive wages and generous profitsharing, it is the psychic satisfaction of pride, excitement, fun, and collective fulfillment that is the key to our Culture and retaining the best Employees in America.

It is Southwest's philosophy that Employees with a sense of ownership in the Company will focus more on longterm versus shortterm goals. Empowerment to each and every Employee not only provides high spirit but avoids complacency and prevents a hierarchy or bureaucracy from slowing down creativity and innovation. In other words, the Southwest Spirit and Culture enhance job satisfaction which translates into thousands and thousands of longterm dedicated Employees.

In every respect, our Employees are the best. And even though our competition may try to imitate Southwest, they cannot duplicate the most important element of our success—the Southwest Spirit inherent in each and every one of our 20,000 Employees.

Available Seat Miles (in millions)

1991	1992	1993	1994	1995
18,491	21,367	27,511	32,124	36,180

Scheduled Service Only

Passenger Load Factor

1991	1992	1993	1994	1995
61.1%	64.5%	68.4%	67.3%	64.5%

Scheduled Service Only

Looking ahead.

As we enter our 25th Anniversary of operations in 1996, we believe we are positioned strategically stronger than ever to meet the many challenges we will undoubtedly face over the next 25 years. Competitive pressures have somewhat stabilized as the industry consolidates hubs and limits capacity growth. We have significantly enhanced our distribution capabilities, thereby reducing our dependence on our competitors' computer reservations systems. Although we have been adversely impacted by the recent airline industry fuel tax, we remain the low cost producer in the industry and will continue our ongoing, intense efforts to maintain our position as THE Low Cost Airline.

We are well positioned to take advantage of shorthaul, point-to-point opportunities as our competitors consolidate their operations and will continue our strategy of controlled growth, operating cost control, and outstanding Customer Service.

We have been profitable for 23 consecutive years. We have the lowest operating costs in the industry and the best net profit margin among the major carriers. Our balance sheet remains strong and our "A" credit rating on our unsecured debt assures adequate access to the capital market to meet our expansion needs cost-effectively.

With our recent entry into the Florida market, we diversify our robust route system even further, serving 48 cities in 23 states by April 1996. Eleven of our 1996 aircraft deliveries, or approximately four percent of our ASM capacity, will be dedicated to our start-up of service in Tampa, Ft. Lauderdale, and Orlando. At the end of 1995, 14 percent of our ASMs were deployed intra-California; ten percent in the northwest region of our system; 36 percent in the remaining part of the western region (west of Texas); 21 percent in the heartland region (Texas, Oklahoma, Arkansas, and Louisiana); 16 percent in the midwest region; and three percent in the eastern region (Baltimore).

We are THE Low Fare Airline and, in our opinion, the airline of choice for the shorthaul passenger. We consistently have the dominant market share in our

niche, and we offer the best Customer Service according to U.S. Department of Transportation statistics.

We boast one of the youngest fleets in the airline industry, with an average age of 7.8 years at the end of 1995. This enables us to keep our maintenance costs low and our aircraft consistently in service. Since 78 percent of our fleet have newer Stage 3 engines, fuel consumption is lower and noise is reduced.

At yearend 1995, we owned 111 of the 224 aircraft in our fleet. Of the remaining 113 aircraft, 83 were operated pursuant to longterm leases with various renewal and purchase options at the end of the lease periods, and 30 of the older 737-200s were under shortterm leases expiring over the next several years.

We currently plan to acquire 20 new -300 aircraft from The Boeing Company and retire three of our older -200 aircraft in 1996, resulting in an available seat mile increase of approximately 12.8 percent. Including our recent conversion of four 1997 -300 options to four 1999 -700 options, we currently have 100 firm orders and 67 options for Boeing 737 aircraft.

Boeing 737 Jet Fleet Expansion

TYPE	SEATS	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
737-200	122	50	-	-	-	-	-	-	-	-	-
737-300	137	149	20	17	-	-	-	-	-	-	-
737-500	122	25	-	-	-	-	-	-	-	-	-
737-700	137	-	-	4	21	25	21	18	18	18	5
TOTAL		224	20	21	21	25	21	18	18	18	5

Southwest Airlines Destinations.

Albuquerque (ABQ)	Indianapolis (IND)	Reno/Tahoe (RNO)
Amarillo (AMA)	Kansas City (MCI)	Sacramento (SMF)
Austin (AUS)	Las Vegas (LAS)	St. Louis (STL)
Baltimore (BWI)	Little Rock (LIT)	Salt Lake City (SLC)
Birmingham (BHM)	Los Angeles (LAX)	San Antonio (SAT)
Boise (BOI)	Louisville (SDF)	San Diego (SAN)
Burbank (BUR)	Lubbock (LBB)	San Francisco (SFO)
Chicago Midway (MDW)	Midland/Odessa (MAF)	San Jose (SJC)
Cleveland (CLE)	Nashville (BNA)	Seattle (SEA)
Columbus (CMH)	New Orleans (MSY)	Spokane (GEG)
Corpus Christi (CRP)	Oakland (OAK)	Tampa (TPA)*
Dallas Love Field (DAL)	Oklahoma City (OKC)	Tucson (TUS)
Detroit Metro (DTW)	Omaha (OMA)	Tulsa (TUL)
El Paso (ELP)	Ontario (ONT)	*Effective January 22, 1996
Ft. Lauderdale (FLL)*	Orange County (SNA)	**Effective April 7, 1996
Harlingen (HRL)	Orlando (MCO)**	
Houston Hobby (HOU)	Phoenix (PHX)	
Houston Intercontinental (IAH)	Portland (PDX)	

Southwest Airlines added Omaha (OMA) to our rapidly expanding coast-to-coast system in 1995. *California One*, our newest Southwest flagship, was proudly unveiled in Sacramento in August. At yearend 1995, Southwest provided service to 46 airports in 45 cities. Ft. Lauderdale (FLL) and Tampa (TPA) were added in January 1996. Orlando (MCO) begins service in April 1996.

Management's Discussion And Analysis Of Financial Condition And Results Of Operations

Year In Review

Southwest and the airline industry posted their highest profits ever in 1995. Southwest began 1995 with first quarter earnings substantially below first quarter 1994. This beginning of 1995 followed a 47 percent decline in fourth quarter 1994 earnings compared to fourth quarter 1993. In early 1995, we addressed many of the challenges that surfaced during fourth quarter 1994, and we finished the year strong, reporting record earnings for 1995.

Competitive pressures eased in 1995 with most carriers pulling back to their hubs and routes where they dominate. Continental Lite ceased to exist, American substantially decreased its presence in Nashville, and the United Shuttle reduced head-to-head competition with Southwest by approximately 50 percent. Southwest, however, continued to expand, adding service to Omaha, Nebraska, and increasing service in many under-served markets, particularly those experiencing reductions in service by other carriers.

In 1995, capacity and traffic for the domestic airline industry grew approximately three percent and four percent, respectively, and load factor increased versus 1994 due to modest capacity growth and a steady economy. Southwest, however, grew capacity aggressively at 12.6 percent. For most of 1995 and in January 1996, Southwest's monthly load factors were below year-ago levels. While it is too early to determine if this trend will continue in 1996, thus far the lower load factors have been offset by strong passenger revenue yield performances. Our passenger revenue yield for January 1996 exceeded January 1995 by more than ten percent aided, in large measure, by the lapse of the ten percent federal ticket tax on January 1, 1996.

The early results of our 1996 expansion into Florida look promising as our load factors for our initial two markets, Tampa and Ft. Lauderdale, have exceeded our systemwide averages. We will begin service to Orlando in April 1996.

After years of horrendous losses, most carriers reduced costs in 1995 by closing hubs, reducing their work force, contracting high-cost work, and obtaining concessions from union workers. For the second consecutive year, our operating expenses per available seat mile (ASM) also declined year-over-year, down .1 percent in 1995 primarily due to the significant reduction in the Company's distribution costs. While our goal is to continue this overall cost trend, recent increases in jet fuel prices, and the October 1, 1995 implementation of a 4.3 cents per gallon transportation fuel tax for commercial aviation, make near-term reductions in total operating expenses on a per-ASM basis much more difficult.

The national budget impasse, lapse of the ten percent ticket tax and its presumed reinstatement, proposed deferral of the jet fuel tax, and looming prospect of FAA reform present uncertainty for 1996 and future periods. At the current time, Southwest is unable to predict how these issues will be resolved and what impact, if any, resolution of these uncertainties will have on future operating results or financial condition.

During 1996, we plan to add a net of seventeen aircraft to our fleet, which will be used primarily in our Florida expansion and to strengthen our existing route system.

RESULTS OF OPERATIONS

1995 COMPARED WITH 1994 The Company's consolidated net income for 1995 was \$182.6 million (\$1.23 per share), as compared to the corresponding 1994 amount of \$179.3 million (\$1.22 per share), an increase of 1.8 percent.

OPERATING REVENUES Consolidated operating revenues increased by 10.8 percent in 1995 to \$2,872.8 million, compared to \$2,591.9 million for 1994. This increase in 1995 operating revenues was derived from a 10.5 percent increase in passenger revenues. Revenue passenger miles (RPMs) increased 7.9 percent in 1995, compared to a 12.6 percent increase in ASMs, resulting in a decrease in load factor from 67.3 percent in 1994 to 64.5 percent in 1995. The 1995 ASM growth resulted from the addition of 25 aircraft during the year.

Freight revenues in 1995 were \$65.8 million, compared to \$54.4 million in 1994. The 21.0 percent increase in freight revenues exceeded the 12.6 percent increase in ASMs for the same period primarily due to increased air freight volumes and United States mail services primarily resulting from the development of new markets added in 1994.

OPERATING EXPENSES Consolidated operating expenses for 1995 were \$2,559.2 million, compared to \$2,275.2 million in 1994, an increase of 12.5 percent, compared to the 12.6 percent increase in ASMs. For the second consecutive year, operating expenses on a per-ASM basis decreased year-over-year, down .1 percent in 1995.

Operating expenses per ASM for 1995 and 1994 were as follows:

OPERATING EXPENSES PER ASM

	<u>1995</u>	<u>1994</u>	<u>Increase (decrease)</u>	<u>Percent Change</u>
Salaries, wages, and benefits	2.17¢	2.13¢	.04¢	1.9%
Employee profitsharing and savings plans	.23	.22	.01	4.5
Fuel and oil	1.01	1.00	.01	1.0
Maintenance materials and repairs	.60	.59	.01	1.7
Agency commissions	.34	.41	(.07)	(17.1)
Aircraft rentals	.47	.42	.05	11.9
Landing fees and other rentals	.44	.46	(.02)	(4.3)
Depreciation	.43	.43	-	-
Other	<u>1.38</u>	<u>1.42</u>	<u>(.04)</u>	<u>(2.8)</u>
Total	7.07¢	7.08¢	(.01)¢	(0.1)%

Salaries, wages, and benefits per ASM increased 1.9 percent in 1995. This increase resulted primarily from a 17.8 percent increase in 1995 average headcount, which outpaced the 1995 capacity (ASM) increase of 12.6 percent, and offset a 2.6 percent decrease in average salary and benefits cost per Employee. The 17.8 percent increase in average headcount was primarily the result of a 44.6 percent increase in Reservations Sales Agents in 1995. Excluding Reservations Sales Agents, total average headcount increased only 11.4 percent. The Reservations Sales Agent increase coincided with increased demand for reservations capacity following 1994 enhancements to Southwest's ticket delivery systems for direct Customers.

Fleet Service Employees are subject to an agreement with the Ramp, Operations and Provisioning Association (ROPA), which became amendable in December 1994. The Company reached an agreement with ROPA which was ratified by its membership in November 1995. Southwest's mechanics are subject to an agreement with the International Brotherhood of Teamsters, Chauffeurs, Warehousemen and Helpers of America (the Teamsters), which became

amendable August 16, 1995. Southwest is currently in negotiations with the Teamsters for a new contract.

Employee profitsharing and savings plans expense per ASM increased 4.5 percent in 1995. The increase is primarily the result of increased matching contributions to Employee savings plans resulting from increased Employee participation and higher matching rates in 1995 for non-contract Employees and certain Employee groups covered by collective bargaining agreements.

Fuel and oil expenses per ASM increased 1.0 percent in 1995, primarily due to a 2.4 percent increase in the average jet fuel cost per gallon from 1994. Jet fuel prices remained relatively stable throughout most of 1995, with quarterly averages through the first three quarters ranging from \$.53 to \$.55 per gallon. During fourth quarter 1995, the average cost per gallon increased to \$.59 and, in January 1996, has averaged approximately \$.62 per gallon.

Maintenance materials and repairs per ASM increased 1.7 percent in 1995 compared to 1994 primarily as a result of performing more engine overhauls during 1995.

Agency commissions per ASM decreased 17.1 percent in 1995 compared to 1994, due to a lower mix of travel agency sales in 1995. The lower travel agency sales mix resulted from 1994 enhancements to Southwest's ticket delivery systems for direct Customers, as described below.

In response to actions taken by our competitor-owned reservations systems in 1994, we reduced our operating costs and enhanced our ticket delivery systems by developing our own Southwest Airlines Air Travel ("SWAT") system allowing high-volume travel agents direct access to reservations; introduced overnight ticket delivery for travel agents; reduced to three the number of advance days reservations required for overnight delivery of tickets to consumers (Ticket By Mail); developed our own Ticketless system, which was rolled out system-wide on January 31, 1995; and effective March 30, 1995 subscribed to a new level of service with SABRE that automates the booking process for SABRE travel agencies. We also continue to actively pursue other cost-effective solutions for automating non-SABRE travel agency bookings.

Aircraft rentals per ASM increased 11.9 percent in 1995. The increase primarily resulted from second and third quarter 1995 sale/leaseback transactions involving ten new 737-300 aircraft and a higher percentage of the fleet consisting of leased aircraft.

Other operating expenses per ASM decreased 2.8 percent in 1995 compared to 1994. This decrease was primarily due to operating efficiencies resulting from the transition of Morris operational functions to Southwest commencing first quarter 1994, and lower communications costs. Communications costs decreased approximately 15 percent per ASM primarily due to lower negotiated rates, increased reservations operations efficiencies, and enhancements to the Company's ticket delivery system.

In August 1993, the Revenue Reconciliation Act of 1993 was enacted, which, among other things, included an assessment of 4.3 cents per gallon in federal jet fuel tax, which became effective September 30, 1995, for commercial aviation. This additional fuel tax increased 1995 "other operating expenses" by \$7.4 million.

OTHER "Other expenses (income)" included interest expense, interest income, and nonoperating gains and losses. Interest expense increased \$5.4 million in 1995 due to the March 1995 issuance of \$100 million senior unsecured 8% Notes due 2005. Capitalized interest increased \$5.0 million in 1995 as a result of higher levels of progress payments on aircraft compared to 1994. Interest income for 1995 increased \$10.9 million primarily due to higher invested cash balances and higher short-term interest rates.

INCOME TAXES The provision for income taxes as a percentage of income before taxes was relatively unchanged year-over-year.

1994 COMPARED WITH 1993 The Company's consolidated net income for 1994 was \$179.3 million (\$1.22 per share), as compared to the corresponding 1993 amount (before the cumulative effect of accounting changes) of \$154.3 million (\$1.05 per share), an increase of 16.2 percent. The increase in earnings was primarily attributable to an increase in operating income of 8.5 percent and a decrease in other expenses (nonoperating) of 46.9 percent.

OPERATING REVENUES Consolidated operating revenues increased by 12.9 percent in 1994 to \$2,591.9 million, compared to \$2,296.7 million for 1993. This increase in 1994 operating revenues was derived from a 12.7 percent increase in passenger revenues. RPMs increased 14.8 percent in 1994, compared to a 16.8 percent increase in ASMs, resulting in a decrease in load factor from 68.4 percent in 1993 to 67.3 percent in 1994. The 1994 ASM growth resulted from the addition of 21 aircraft during 1994.

Freight revenues in 1994 were \$54.4 million, compared to \$42.9 million in 1993. The 26.9 percent increase in freight revenues exceeded the 16.8 percent increase in ASMs for the same period primarily due to increased air freight volumes and United States mail services.

OPERATING EXPENSES Consolidated operating expenses for 1994 were \$2,275.2 million, compared to \$2,004.7 million in 1993, an increase of 13.5 percent, compared to the 16.8 percent increase in ASMs. On a per-ASM basis, operating expenses (excluding 1993 merger expenses) decreased 2.3 percent in 1994. The primary factors contributing to this decrease were an 8.8 percent decrease in average jet fuel cost per gallon and lower agency commission costs, offset by increased aircraft rentals.

Salaries, wages, and benefits per ASM increased only .5 percent in 1994. This increase resulted from a 3.0 percent increase in average salary and benefits cost per Employee, partially offset by slower average headcount growth, which increased only 13.8 percent in 1994 versus the 1994 capacity (ASM) increase of 16.8 percent. The majority of the increase in average salary and benefits cost related to increased health benefits and workers' compensation costs. Employee productivity improved from 2,633 passengers handled per Employee in 1993 to 2,676 in 1994.

Employee profitsharing and savings plans expense per ASM increased 4.8 percent in 1994. The increase is primarily the result of increased matching contributions to Employee savings plans resulting from increased Employee participation and higher matching rates in 1994 for Flight Attendants and Customer Service Employees under their respective collective bargaining agreements.

Fuel and oil expenses per ASM decreased 9.9 percent in 1994, primarily due to an 8.8 percent reduction in the average jet fuel cost per gallon from 1993. Jet fuel prices remained relatively stable throughout 1994, with quarterly averages ranging from \$.51 to \$.56 per gallon.

Maintenance materials and repairs per ASM was unchanged in 1994 compared to 1993.

Agency commissions per ASM decreased 12.8 percent due to a lower mix of travel agency sales and lower 1994 passenger revenue per ASM. The lower travel agency sales mix resulted from 1994 enhancements to Southwest's ticket delivery systems for direct Customers.

Aircraft rentals per ASM increased 7.7 percent in 1994. The increase primarily resulted from a third quarter 1994 sale/leaseback transaction involving ten new 737-300 aircraft and a lease of three used aircraft under long-term operating leases. At December 31, 1994, 44.7 percent of the Company's fleet was subject to operating leases, compared to 43.3 percent at December 31, 1993.

Other operating expenses per ASM decreased 1.4 percent in 1994 compared to 1993. The overall decrease is primarily attributable to operating efficiencies resulting from the transition of

Morris operational functions to Southwest, primarily contract services which decreased \$8.8 million (24.4 percent per ASM), offset by an increase in advertising costs of \$24.1 million (22.9 percent per ASM) primarily associated with the start-up of seven new cities and new competitive pressures in 1994.

OTHER "Other expenses (income)" included interest expense, interest income, and nonoperating gains and losses. Interest expense decreased \$5.1 million in 1994 due to the March 1, 1993 redemption of \$100 million senior unsecured 9% Notes due 1996 and the repayment of approximately \$54.0 million of Morris long-term debt during first quarter 1994. Capitalized interest increased \$8.6 million in 1994 as a result of higher levels of advance payments on aircraft compared to 1993. Interest income for 1994 decreased \$1.9 million primarily due to lower cash balances available for short-term investment.

INCOME TAXES The provision for income taxes decreased in 1994 as a percentage of income before taxes, excluding cumulative effect of accounting changes, to 40.1 percent from 40.6 percent in 1993. The 1993 rate was higher due to deferred tax adjustments in 1993 related to the 1993 increase in the federal corporate income tax rate from 34 percent to 35 percent (see Note 11 to the Consolidated Financial Statements). This was offset by increased 1994 effective state income tax rates.

LIQUIDITY AND CAPITAL RESOURCES

Cash provided from operations was \$456.4 million in 1995, compared to \$412.7 million in 1994. During 1995, additional funds of \$321.7 million were generated from the sale and leaseback of ten new 737-300 aircraft subject to long-term operating leases (increasing total commitments for operating leases by \$607.9 million). In addition, \$98.8 million was generated from the March 1995 issuance of \$100 million in senior unsecured 8% Notes due in 2005.

During 1995, capital expenditures of \$728.6 million primarily were for the purchase of 23 new 737-300 aircraft, one used 737-300 aircraft previously leased by Morris, and progress payments for future aircraft deliveries. At December 31, 1995, capital commitments of the Company consisted primarily of scheduled aircraft acquisitions.

As of January 1996, Southwest had one hundred 737s on firm order, including twenty to be delivered in 1996, with options to purchase another sixty-seven. Aggregate funding required for firm commitments approximated \$2,614.0 million through the year 2001 of which \$461.5 million related to 1996. See Note 4 to the Consolidated Financial Statements for further information.

As of December 31, 1995 and since 1990, the Company had authority from its Board of Directors to purchase 3,750,000 shares of its common stock from time-to-time on the open market. No shares have been purchased since 1990.

The Company has various options available to meet its capital and operating commitments, including cash on hand at December 31, 1995 of \$317.4 million, internally generated funds, and a revolving credit line with a group of banks of up to \$460 million (none of which had been drawn at December 31, 1995). In addition, the Company will also consider various borrowing or leasing options to maximize earnings and supplement cash requirements.

The Company currently has outstanding shelf registrations for the issuance of \$260.6 million public debt securities.

Cash provided from operations was \$412.7 million in 1994 as compared to \$392.7 million in 1993. During 1994, additional funds of \$315.0 million were generated from the sale and leaseback of ten new 737-300 aircraft subject to long-term operating leases (increasing total commitments for operating leases by \$619.0 million). These proceeds were primarily used to finance aircraft-related capital expenditures and to provide working capital.

CONSOLIDATED BALANCE SHEET

(in thousands except share and per share amounts)	December 31, 1995	1994
ASSETS		
Current assets:		
Cash and cash equivalents	\$317,363	\$174,538
Accounts receivable	79,781	75,692
Inventories of parts and supplies, at cost	41,032	37,565
Deferred income taxes (Note 11)	10,476	9,822
Prepaid expenses and other current assets	<u>24,484</u>	<u>17,281</u>
Total current assets	473,136	314,898
Property and equipment, at cost (Notes 4 and 7):		
Flight equipment	3,024,702	2,564,551
Ground property and equipment	435,822	384,501
Deposits on flight equipment purchase contracts	323,864	393,749
	3,784,388	3,342,801
Less allowance for depreciation	<u>1,005,081</u>	<u>837,838</u>
	2,779,307	2,504,963
Other assets	<u>3,679</u>	<u>3,210</u>
	<u>\$3,256,122</u>	<u>\$2,823,071</u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$117,473	\$117,599
Accrued liabilities (Note 5)	348,476	288,979
Air traffic liability	131,156	106,139
Current maturities of long-term debt	<u>13,516</u>	<u>9,553</u>
Total current liabilities	610,621	522,270
Long-term debt less current maturities (Note 6)	661,010	583,071
Deferred income taxes (Note 11)	281,650	232,850
Deferred gains from sale and leaseback of aircraft	245,154	217,677
Other deferred liabilities	30,369	28,497
Commitments and contingencies (Notes 4, 7, and 11)		
Stockholders' equity (Notes 8 and 9):		
Common stock, \$1.00 par value: 500,000,000 shares authorized;		
144,033,273 shares issued and outstanding in 1995 and	144,033	143,256
143,255,795 shares in 1994		
Capital in excess of par value	162,704	151,746
Retained earnings	<u>1,120,581</u>	<u>943,704</u>
Total stockholders' equity	<u>1,427,318</u>	<u>1,238,706</u>
	<u>\$3,256,122</u>	<u>\$2,823,071</u>

CONSOLIDATED STATEMENT OF INCOME

(in thousands except per share amounts)

	Years ended December 31,		
	1995	1994	1993
OPERATING REVENUES:			
Passenger	\$2,760,756	\$2,497,765	\$2,216,342
Freight	65,825	54,419	42,897
Other	<u>46,170</u>	<u>39,749</u>	<u>37,434</u>
Total operating revenues	2,872,751	2,591,933	2,296,673
OPERATING EXPENSES:			
Salaries, wages, and benefits (Note 10)	867,984	756,023	641,747
Fuel and oil	365,670	319,552	304,424
Maintenance materials and repairs	217,259	190,308	163,395
Agency commissions	123,380	133,081	130,445
Aircraft rentals	169,461	132,992	107,885
Landing fees and other rentals	160,322	148,107	129,222
Depreciation	156,771	139,045	119,338
Other operating expenses	498,373	456,116	397,441
Merger expenses (Note 2)	=	=	<u>10,803</u>
Total operating expenses	<u>2,559,220</u>	<u>2,275,224</u>	<u>2,004,700</u>
OPERATING INCOME	313,531	316,709	291,973
OTHER EXPENSES (INCOME):			
Interest expense	58,810	53,368	58,460
Capitalized interest	(31,371)	(26,323)	(17,770)
Interest income	(20,095)	(9,166)	(11,093)
Nonoperating (gains) losses, net	<u>1,047</u>	<u>(693)</u>	<u>2,739</u>
Total other expenses	<u>8,391</u>	<u>17,186</u>	<u>32,336</u>
INCOME BEFORE INCOME TAXES AND CUMULATIVE EFFECT OF ACCOUNTING CHANGES	305,140	299,523	259,637
PROVISION FOR INCOME TAXES (NOTE 11)	<u>122,514</u>	<u>120,192</u>	<u>105,353</u>
INCOME BEFORE CUMULATIVE EFFECT OF ACCOUNTING CHANGES	182,626	179,331	154,284
CUMULATIVE EFFECT OF ACCOUNTING CHANGES (NOTE 3)	=	=	<u>15,259</u>
NET INCOME	<u>\$182,626</u>	<u>\$179,331</u>	<u>\$169,543</u>
PER SHARE AMOUNTS (NOTES 3, 8, AND 12):			
Income before cumulative effect of accounting changes	\$1.23	\$ 1.22	\$1.05
Cumulative effect of accounting changes	=	=	<u>.10</u>
Net income	<u>\$1.23</u>	<u>\$1.22</u>	<u>\$1.15</u>

CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY

(in thousands except per share amounts)	Years Ended December 31, 1995, 1994, And 1993			
	Common stock	Capital in excess of par value	Retained earnings	Total
Balance at December 31, 1992	\$96,047	\$177,561	\$605,928	\$879,536
Three-for-two stock split (Note 8)	46,325	(46,325)	-	-
Issuance of common stock upon exercise of executive stock options and pursuant to Employee stock option and purchase plans and related tax benefit (Note 9)	384	9,932	-	10,316
Cash dividends, \$.03867 per share	-	-	(5,376)	(5,376)
Net income - 1993	-	-	<u>169,543</u>	<u>169,543</u>
Balance at December 31, 1993	142,756	141,168	<u>770,095</u>	1,054,019
Issuance of common stock upon exercise of executive stock options and pursuant to Employee stock option and purchase plans and related tax benefit (Note 9)	500	10,578	-	11,078
Cash dividends, \$.04 per share	-	-	(5,722)	(5,722)
Net income - 1994	-	-	<u>179,331</u>	<u>179,331</u>
Balance at December 31, 1994	143,256	151,746	943,704	1,238,706
Issuance of common stock upon exercise of executive stock options and pursuant to Employee stock option and purchase plans and related tax benefit (Note 9)	777	10,958	-	11,735
Cash dividends, \$.04 per share	-	-	(5,749)	(5,749)
Net income - 1995	-	-	<u>182,626</u>	<u>182,626</u>
Balance at December 31, 1995	<u>\$144,033</u>	<u>\$162,704</u>	<u>\$1,120,581</u>	<u>\$1,427,318</u>

CONSOLIDATED STATEMENT OF CASH FLOWS

(in thousands)	Years ended December 31,		
	1995	1994	1993
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net income	\$182,626	\$179,331	\$169,543
Cumulative effect of accounting changes (Note 3)	-	-	<u>(15,259)</u>
Income before cumulative effect of accounting changes	182,626	179,331	154,284
Adjustments to reconcile net income to cash provided by operating activities:			
Depreciation	156,771	139,045	119,338
Deferred income taxes	48,147	49,887	53,200
Amortization of deferred gains on sale and leaseback of aircraft	(24,286)	(30,341)	(32,509)
Amortization of scheduled airframe overhauls	17,337	14,216	11,630
Changes in certain assets and liabilities:			
Increase in accounts receivable	(4,089)	(5,208)	(14,253)
(Increase) decrease in other current assets	(11,857)	648	(9,641)
Increase in accounts payable and accrued liabilities	61,937	52,679	67,585
Increase in air traffic liability	25,017	9,993	30,212
Increase (decrease) in other current liabilities	1,050	(4,690)	2,393
Other	<u>3,789</u>	<u>7,106</u>	<u>10,440</u>
Net cash provided by operating activities	456,442	412,666	392,679
CASH FLOWS FROM INVESTING ACTIVITIES:			
Purchases of property and equipment	<u>(728,643)</u>	<u>(788,649)</u>	<u>(524,169)</u>
Net cash used in investing activities	(728,643)	(788,649)	(524,169)
CASH FLOWS FROM FINANCING ACTIVITIES:			
Issuance of long-term debt	98,811	-	17,810
Proceeds from aircraft sale and leaseback transactions	321,650	315,000	90,000
Payment of long-term debt and capital lease obligations	(10,379)	(63,071)	(120,098)
Payment of cash dividends	(5,749)	(5,722)	(5,376)
Proceeds from Employee stock plans	10,693	8,743	6,743
Other	-	-	<u>(7)</u>
Net cash provided by (used in) financing activities	<u>415,026</u>	<u>254,950</u>	<u>(10,928)</u>
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	142,825	(121,033)	(142,418)
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	<u>174,538</u>	<u>295,571</u>	<u>437,989</u>
CASH AND CASH EQUIVALENTS AT END OF PERIOD	<u>\$317,363</u>	<u>\$174,538</u>	<u>\$295,571</u>
CASH PAYMENTS FOR:			
Interest, net of amount capitalized	\$25,277	\$26,598	\$ 43,161
Income taxes	73,928	80,461	45,292

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 1995

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

BASIS OF PRESENTATION Southwest Airlines Co. (Southwest) is a major domestic airline that provides shorthaul, high frequency, point-to-point, low-fare service. The consolidated financial statements include the accounts of Southwest and its wholly owned subsidiaries (the Company). All significant intercompany balances and transactions have been eliminated. The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from these estimates. Certain prior year amounts have been reclassified for comparison purposes.

CASH AND CASH EQUIVALENTS Cash equivalents consist of certificates of deposit and investment grade commercial paper issued by major corporations and financial institutions that are highly liquid and have original maturity dates of three months or less. Cash and cash equivalents are carried at cost, which approximates market value.

INVENTORIES Inventories of flight equipment expendable parts, materials, and supplies are carried at average cost. These items are charged to expense when issued for use.

PROPERTY AND EQUIPMENT Depreciation is provided by the straight-line method to residual values over periods ranging from 15 to 20 years for flight equipment and 3 to 30 years for ground property and equipment. Property under capital leases and related obligations are recorded at an amount equal to the present value of future minimum lease payments computed on the basis of the Company's incremental borrowing rate or, when known, the interest rate implicit in the lease. Amortization of property under capital leases is on a straight-line basis over the lease term and is included in depreciation expense.

AIRCRAFT AND ENGINE MAINTENANCE The cost of engine overhauls and routine maintenance costs for aircraft and engine maintenance are charged to maintenance expense as incurred. Scheduled airframe overhaul costs are capitalized at amounts not to exceed the fair market value of the related aircraft and amortized over the estimated periods benefited, presently 8 years. Modifications that significantly enhance the operating performance or extend the useful lives of aircraft or engines are capitalized and amortized over the remaining life of the asset.

REVENUE RECOGNITION Passenger revenue is recognized when the transportation is provided. Tickets sold but not yet used are included in "Air traffic liability", which includes estimates that are evaluated and adjusted periodically. Any adjustments resulting therefrom are included in results of operations for the periods in which the evaluations are completed.

FREQUENT FLYER AWARDS The Company accrues the estimated incremental cost of providing free travel awards earned under its Company Club frequent flyer program.

ADVERTISING The Company expenses the production costs of advertising as incurred. Advertising expense for the years ended December 31, 1995, 1994, and 1993 was \$92,087,000, \$79,475,000, and \$55,344,000, respectively.

STOCK-BASED EMPLOYEE COMPENSATION The Company accounts for stock-based compensation plans utilizing the provisions of Accounting Principles Board Opinion No. 25 (APB 25), "Accounting for Stock Issued to Employees." In October of 1995, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 123 (SFAS 123), "Accounting for Stock-Based Compensation." The Company is not required to adopt the provisions of SFAS 123 until 1996. Under SFAS 123, companies are allowed to continue to apply the provisions of APB 25 to their stock-based employee compensation arrangements. As

such, the Company will only be required to supplement its financial statements with additional disclosures beginning in 1996.

2. ACQUISITION

On December 31, 1993, Southwest exchanged 3,574,656 newly issued shares of its common stock for all of the outstanding stock of Morris Air Corporation (Morris), a low-fare commercial/charter air carrier based in Salt Lake City. The acquisition was accounted for as a pooling of interests and, accordingly, the Company's consolidated financial statements were restated to include the accounts and operations of Morris for all periods prior to the acquisition.

Merger expenses of \$10,803,000 relating to the merger of Southwest and Morris have been included in 1993 operating expenses as required for financial reporting purposes; however, these expenses have been separately reported as "merger expenses" to reflect the impact of these nonrecurring expenses on operating results.

3. ACCOUNTING CHANGES

INCOME TAXES Effective January 1, 1993, the Company adopted Statement of Financial Accounting Standards No. 109 (SFAS 109), "Accounting for Income Taxes". As a result of adopting SFAS 109, the Company recorded deferred tax assets of \$6,977,000 and reduced deferred tax liabilities by \$9,048,000 at January 1, 1993, which resulted in an increase to the Company's 1993 net income of \$16,025,000 (\$.11 per share) for the cumulative effect of the accounting change.

POSTRETIREMENT BENEFITS Effective January 1, 1993, the Company adopted Statement of Financial Accounting Standards No. 106 (SFAS 106), "Employers' Accounting for Postretirement Benefits Other Than Pensions". The cumulative effect of this change in accounting method at January 1, 1993 reduced 1993 net income by \$766,000 (net of benefit from income taxes of \$469,000) or \$.01 per share. The effect of adopting SFAS 106 on 1993 income before cumulative effect of accounting changes was not material.

4. COMMITMENTS

The Company's contractual purchase commitments consist primarily of scheduled aircraft acquisitions. Timing of payments pursuant to contractual commitments was affected by third quarter 1995 amendments to certain aircraft purchase contracts, which modified future progress payment schedules. Twenty 737-300 aircraft are scheduled for delivery in 1996, and 17 in 1997. Four 737-700s are scheduled for delivery in 1997, 16 in 1998, 16 in 1999, 15 in 2000, and 12 in 2001. In addition, the Company has options to purchase up to sixty-seven 737-700s during 1998-2004. The Company has the option, which must be exercised two years prior to the contractual delivery date, to substitute 737-600s or 737-800s for the 737-700s delivered subsequent to 1999. Aggregate funding needed for these commitments is approximately \$2,614.0 million, subject to adjustments for inflation, due as follows: \$461.5 million in 1996, \$576.9 million in 1997, \$446.9 million in 1998, \$551.2 million in 1999, \$351.0 million in 2000, and \$226.5 million in 2001.

The Company uses jet fuel and heating oil fixed price swap arrangements to hedge its exposure to price fluctuations on approximately two percent of its annual fuel requirements. As of December 31, 1995, the Company had a heating oil swap agreement with a broker-dealer to exchange monthly payments on a notional quantity of 1,050,000 gallons during May 1996. Under the swap agreement, the Company pays or receives the difference between the daily average heating oil price and a fixed price of \$.46 per gallon. Gains and losses on such transactions are recorded as adjustments to fuel expense and have been insignificant. Although such agreements expose the Company to credit loss in the event of nonperformance by the other parties to the agreements, the Company does not anticipate such nonperformance.

5. ACCRUED LIABILITIES

(in thousands)	1995	1994
Aircraft rentals	\$105,534	\$67,407
Employee profitsharing and savings plans (Note 10)	55,253	53,512
Vacation pay	38,777	31,801
Aircraft maintenance costs	31,463	37,330
Taxes, other than income	22,478	25,001
Interest	22,326	20,270
Other	<u>72,645</u>	<u>53,658</u>
	<u>\$348,476</u>	<u>\$288,979</u>

6. LONG-TERM DEBT

(in thousands)	1995	1994
9 1/4% Notes due 1998	\$ 100,000	\$ 100,000
9.4% Notes due 2001	100,000	100,000
8 3/4% Notes due 2003	100,000	100,000
7 7/8% Notes due 2007	100,000	100,000
8% Notes due 2005	100,000	-
Capital leases (Note 7)	177,696	195,756
Other	<u>430</u>	<u>435</u>
	678,126	596,191
Less current maturities	13,516	9,553
Less debt discount	<u>3,600</u>	<u>3,567</u>
	<u>\$ 661,010</u>	<u>\$ 583,071</u>

On March 7, 1995, the Company issued \$100 million of senior unsecured 8% Notes due March 1, 2005. Interest is payable semi-annually on March 1 and September 1. The Notes are not redeemable prior to maturity.

On September 9, 1992, the Company issued \$100 million of senior unsecured 7 7/8% Notes due September 1, 2007. Interest is payable semi-annually on March 1 and September 1. The Notes are not redeemable prior to maturity.

During 1991, the Company issued \$100 million of senior unsecured 9 1/4% Notes, \$100 million of senior unsecured 9.4% Notes, and \$100 million of senior unsecured 8 3/4% Notes due February 15, 1998, July 1, 2001, and October 15, 2003, respectively. Interest on the Notes is payable semi-annually. The Notes are not redeemable by the Company prior to maturity.

The fair values, based on quoted market prices, of these Notes at December 31, 1995, were as follows (in thousands):

9 1/4% Notes due 1998	\$106,720
9.4% Notes due 2001	114,610
8 3/4% Notes due 2003	114,350
7 7/8% Notes due 2007	110,530
8% Notes due 2005	110,310

In addition to the credit facilities described above, Southwest has an unsecured Bank Credit Agreement with a group of banks that permits Southwest to borrow through December 14, 1999 on a revolving credit basis up to \$460 million. Interest rates on borrowings under the Credit Agreement can be, at the option of Southwest, the agent bank's prime rate, 0.275% over LIBOR, or 0.50% over domestic certificate of deposit rates. The commitment fee is 0.125% per annum. There were no outstanding borrowings under this agreement at December 31, 1995 or 1994.

7. LEASES

Total rental expense for operating leases charged to operations in 1995, 1994, and 1993 was \$247,033,000, \$198,987,000, and \$167,303,000, respectively. The majority of the Company's terminal operations space, as well as 100 aircraft, were under operating leases at December 31, 1995. The amounts applicable to capital leases included in property and equipment were (in thousands):

	1995	1994
Flight equipment	\$223,844	\$233,324
Less accumulated amortization	<u>101,641</u>	<u>88,656</u>
	<u>\$122,203</u>	<u>\$144,668</u>

Future minimum lease payments under capital leases and noncancelable operating leases, with initial or remaining terms in excess of one year, at December 31, 1995, were (in thousands):

	CAPITAL LEASES	OPERATING LEASES
1996	\$27,796	\$223,279
1997	25,858	207,875
1998	32,026	187,662
1999	20,245	173,846
2000	16,871	165,692
After 2000	<u>172,751</u>	<u>1,935,372</u>
Total minimum lease payments	295,547	<u>\$2,893,726</u>
Less amount representing interest	<u>117,851</u>	
Present value of minimum lease payments	177,696	
Less current portion	<u>13,505</u>	
Long-term portion	<u>\$164,191</u>	

The aircraft leases can generally be renewed at rates, based on fair market value at the end of the lease term, for one to five years. Most aircraft leases have purchase options at or near the end of the lease term at fair market value, but generally not to exceed a stated percentage of the lessor's defined cost of the aircraft.

8. COMMON STOCK

At December 31, 1995, the Company had common stock reserved for issuance pursuant to Employee stock benefit plans (29,202,885 shares) and upon exercise of rights pursuant to the Common Stock Rights Agreement (Agreement), as amended (173,236,158 shares).

Pursuant to the Agreement, each outstanding share of the Company's common stock is accompanied by one common share purchase right (Right). Each Right entitles its holder to purchase one share of common stock at an exercise price of \$16.67 and is exercisable only in the event of a proposed takeover, as defined by the Agreement. The Company may redeem the Rights at \$.0111 per Right prior to the time that 20 percent of the common stock has been acquired by a person or group. If the Company is acquired or if certain self-dealing transactions occur, as defined in the Agreement, each Right will entitle its holder to purchase for \$16.67 that number of the acquiring company's or the Company's common shares, as provided in the Agreement, having a market value of two times the exercise price of the Right. The Rights will expire no later than July 30, 1996.

On May 19, 1993, the Company's Board of Directors declared a three-for-two stock split, distributing 46,325,147 shares on July 15, 1993.

9. STOCK PLANS

In May 1991, the Company's stockholders approved the Incentive Stock Option Plan and the Non-Qualified Stock Option Plan. Under the Incentive Stock Option Plan, options to purchase a maximum of 9,000,000 shares of Southwest common stock may be granted to key Employees. Under the Non-Qualified Stock Option Plan, options to purchase up to 750,000 shares of Southwest common stock may be granted to key Employees and non-employee directors. Under each plan, the option price per share may not be less than the fair market value of a share on the date the option is granted and the maximum term of an option may not exceed ten years.

Effective January 12, 1995, the Company adopted, pursuant to a collective bargaining agreement between the Company and the Southwest Airlines Pilots' Association (SWAPA), the 1995 SWAPA Non-Qualified Stock Option Plan (SWAPA Plan). Under the terms of the SWAPA Plan, 18,000,000 common shares have been reserved for issuance. An initial grant of approximately 14.5 million shares was made on the effective date at an option price of \$20.00 per share. On September 1 of each year of the agreement, commencing September 1, 1996, additional options will be granted to Pilots that became eligible during that year at an option price equal to the fair market value of the common stock of the Company on the date of grant plus 5 percent. Options vest in ten annual increments of ten percent and must be exercised prior to January 31, 2007, or within a specified time upon retirement or termination. In the event that SWAPA exercises its option to make the collective bargaining agreement amendable on September 1, 1999, any unexercised options will be canceled on December 1, 1999.

Information regarding the stock option plans is summarized below:

	INCENTIVE PLAN	NON-QUALIFIED PLANS*
Outstanding December 31, 1992	4,016,904	374,625
Granted	724,646	22,512
Exercised	** (198,285)	*** (94,810)
Surrendered	<u>(230,978)</u>	<u>(1,050)</u>
Outstanding December 31, 1993	4,312,287	301,277
Granted	794,714	63,918
Exercised	(190,159)	(9,940)
Surrendered	<u>(104,880)</u>	-
Outstanding December 31, 1994	4,811,962	355,255
Granted	983,214	14,620,365
Exercised	(275,058)	(60,510)
Surrendered	<u>(308,239)</u>	<u>(61,041)</u>
Outstanding December 31, 1995	<u>5,211,879</u>	<u>14,854,069</u>
Exercisable December 31, 1995	889,499	2,892,969
Available for granting in future periods	2,772,719	3,719,841
Average price of exercised options:		
1995	\$8.50	\$15.12
1994	\$8.23	\$7.85
1993	\$7.14	\$7.37

* includes 1991 Non-Qualified Plan and SWAPA Plan.

** includes 108,113 pre-split shares and 36,115 post-split shares, of which 5,476 pre-split shares and 72 post-split shares were issued from treasury.

*** includes 12,740 pre-split shares and 75,000 post-split shares.

The exercise price of outstanding options ranged from \$6.02 to \$37.44 in 1995 and 1994, and \$6.02 to \$19.71 in 1993.

In 1991, the Company's stockholders also approved the Employee Stock Purchase Plan that provides for the sale of common stock to Employees of the Company at a price equal to 90% of the market value at the end of each purchase period. Common stock purchases are paid for through periodic payroll deductions. Participants under the plan received 388,339 shares in 1995, 290,054 shares in 1994, and 182,459 shares (59,442 pre-split shares and 93,296 post-split shares) in 1993 at average prices of \$19.18, \$24.98, and \$25.25, respectively.

At December 31, 1995, 1994, and 1993, 1,422,253, 1,489,753, and 1,504,753, options to purchase the Company's common stock were also outstanding related to employment contracts with the Company's president and chief executive officer. Exercise prices range from \$1.00 to \$11.33 per share. Options for 67,500 shares, 15,000 shares, and 7,500 shares (5,000 pre-split shares, of which 968 shares were issued from treasury), were exercised in 1995, 1994, and 1993, respectively.

10. EMPLOYEE PROFITSHARING AND SAVINGS PLANS

Substantially all of Southwest's Employees are members of the Southwest Airlines Co. Profitsharing Plan (the Plan). Total profitsharing expense charged to operations in 1995, 1994, and 1993, was \$54,033,000, \$52,782,000, and \$44,959,000, respectively.

The Company sponsors Employee savings plans under Section 401(k) of the Internal Revenue Code. The plans cover substantially all full-time Employees. The amount of matching contributions varies by Employee group. Company contributions generally vest over five years with credit for prior years' service granted. Company matching contributions expensed in 1995, 1994, and 1993 were \$28,954,000, \$19,817,000, and \$13,986,000, respectively.

11. INCOME TAXES

Effective January 1, 1993, the Company changed its method of accounting for income taxes from the deferred method to the liability method as required by SFAS 109 (see Note 3).

Under SFAS 109, deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. The components of deferred tax assets and liabilities at December 31, 1995 and 1994 are as follows (in thousands):

	1995	1994
Deferred tax liabilities:		
Accelerated depreciation	\$400,321	\$343,585
Scheduled airframe overhauls	27,129	23,966
Other	<u>68,458</u>	<u>55,953</u>
Total deferred tax liabilities	495,908	423,504
Deferred tax assets:		
Deferred gains from sale and leaseback of aircraft	106,119	95,602
Capital and operating leases	54,472	38,240
Alternative minimum tax credit carryforward	11,333	22,778
Other	<u>52,810</u>	<u>43,856</u>
Total deferred tax assets	<u>224,734</u>	<u>200,476</u>
Net deferred tax liability	<u>\$271,174</u>	<u>\$223,028</u>

In August 1993, the Revenue Reconciliation Act of 1993 was enacted, which contains numerous provision changes including an increase in the federal corporate income tax rate from 34 percent to 35 percent effective January 1, 1993. As a result, the Company recognized approximately \$4.0 million of additional expense in 1993 related to deferred tax liabilities existing on January 1, 1993.

The provision for income taxes before the cumulative effect of accounting changes is comprised of the following (in thousands):

	1995	1994	1993
Current:			
Federal	\$64,420	\$59,603	\$46,744
State	<u>9,947</u>	<u>10,702</u>	<u>5,409</u>
Total current	74,367	70,305	52,153
Deferred:			
Federal	44,580	46,470	48,524
State	<u>3,567</u>	<u>3,417</u>	<u>4,676</u>
Total deferred	<u>48,147</u>	<u>49,887</u>	<u>53,200</u>
	<u>\$122,514</u>	<u>\$120,192</u>	<u>\$105,353</u>

Southwest has received examination reports from the Internal Revenue Service proposing certain adjustments to Southwest's income tax returns for 1987 through 1991. The adjustments relate to certain types of aircraft financings consummated by Southwest, as well as other members of the aviation industry during that time period. Southwest intends to vigorously protest the adjustments proposed with which it does not agree. The industry's difference with the IRS involves complex issues of law and fact that are likely to take a substantial period of time to resolve. Management believes that final resolution of such protest will not have a materially adverse effect upon the results of operations of Southwest.

The effective tax rate on income before cumulative effect of accounting changes differed from the federal income tax statutory rate for the following reasons (in thousands):

	1995	1994	1993
Tax at statutory			
U.S. tax rates	\$106,799	\$104,833	\$90,873
Nondeductible items	4,488	3,689	1,361
State income taxes, net of federal benefit	8,784	9,177	6,632
Effect of increase in U.S. statutory rate	-	-	3,957
Other, net	<u>2,443</u>	<u>2,493</u>	<u>2,530</u>
Total income tax provision	<u>\$122,514</u>	<u>\$120,192</u>	<u>\$105,353</u>

12. NET INCOME PER COMMON AND COMMON EQUIVALENT SHARE

Net income per common and common equivalent share is computed based on the weighted average number of common and common equivalent shares outstanding (148,850,512 in 1995, 147,305,374 in 1994, and 147,144,568 in 1993). Fully diluted earnings per share have not been presented as the fully dilutive effect of shares issuable upon the exercise of options under the Company's Stock Option Plans is not material.

REPORT OF ERNST & YOUNG LLP INDEPENDENT AUDITORS
THE BOARD OF DIRECTORS AND SHAREHOLDERS
SOUTHWEST AIRLINES CO.

We have audited the accompanying consolidated balance sheets of Southwest Airlines Co. as of December 31, 1995 and 1994, and the related consolidated statements of income, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 1995. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Southwest Airlines Co. at December 31, 1995 and 1994, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 1995, in conformity with generally accepted accounting principles.

As discussed in Note 3, during 1993, the Company changed its method of accounting for income taxes and postretirement benefits.

Ernst & Young LLP
Dallas, Texas
January 25, 1996

QUARTERLY FINANCIAL DATA (UNAUDITED)

(in thousands except per share amounts)	Three months ended			
	1995 March 31	June 30	Sept. 30	Dec. 31
Operating revenues	\$620,999	\$738,205	\$764,975	\$748,572
Operating income	23,409	103,425	114,098	72,599
Income before income taxes	20,034	100,801	114,215	70,090
Net income	11,826	59,724	67,717	43,359
Net income per common and common equivalent share	.08	.41	.45	.29

	Three months ended			
	1994 March 31	June 30	Sept. 30	Dec. 31
Operating revenues	\$619,412	\$661,056	\$685,289	\$626,176
Operating income	76,046	101,834	101,710	37,119
Income before income taxes	69,538	97,156	97,128	35,701
Net income	41,847	58,522	58,619	20,343
Net income per common and common equivalent share	.28	.40	.40	.14

COMMON STOCK PRICE RANGES AND DIVIDENDS

Southwest's common stock is listed on the New York Stock Exchange and is traded under the symbol LUV. The high and low sales prices of the common stock on the Composite Tape and the quarterly dividends per share were:

Period	Dividends	High	Low
1995			
1st Quarter	\$.01	\$19.63	\$16.38
2nd Quarter	.01	24.75	17.63
3rd Quarter	.01	28.38	23.63
4th Quarter	.01	26.88	19.75
1994			
1st Quarter	\$.01	\$39.00	\$31.25
2nd Quarter	.01	34.38	24.13
3rd Quarter	.01	29.63	21.63
4th Quarter	.01	23.63	15.50

Ten Year Summary

Selected Consolidated Financial Data (1)

(in thousands except per share amounts)	1995	1994	1993	1992	1991	1990	1989
Operating revenues:							
Passenger	\$2,760,756	\$2,497,765	\$1,144,421	\$973,568	\$1,267,897	\$1,144,421	\$973,568
Freight	65,825	54,419	42,897	33,088	26,428	22,196	18,750
Charter and other	46,170	39,749	37,434	146,063	84,961	70,659	65,300
Total operating revenues	2,872,751	2,591,933	2,296,673	1,802,979	1,379,286	1,237,276	1,057,018
Operating expenses	2,559,220	2,275,224	2,004,700	1,609,175	1,306,675	1,150,015	955,600
Operating income	313,531	316,709	291,973	193,804	72,611	87,261	102,418
Other expenses (income), net	8,391	17,186	32,336	36,361	18,725	(6,827) (6)	(13,696)
Income before income taxes	305,140	299,523	259,637	157,443	53,886	80,434	115,722
Provision for income taxes (3)	122,514	120,192	105,353	60,058	20,738	29,829	41,200
Net income (3)	\$182,626	\$179,331	\$154,284 (4)	\$97,385 (5)	\$33,148	\$50,605	\$74,522
Income per common and common equivalent share (3)	\$1.23	\$1.22	\$1.05 (4)	\$.68 (5)	\$.25	\$.39	\$.50
Cash dividends per common share	\$.04000	\$.04000	\$.03867	\$.03533	\$.03333	\$.03223	\$.03125
Total assets	\$3,256,122	\$2,823,071	\$2,576,037	\$2,368,856	\$1,854,331	\$1,480,813	\$1,423,000
Long-term debt	\$661,010	\$583,071	\$639,136	\$735,754	\$617,434	\$327,553	\$354,000
Stockholders' equity	\$1,427,318	\$1,238,706	\$1,054,019	\$879,536	\$635,793	\$607,294	\$591,000
Consolidated Financial Ratios (1)							
Return on average total assets	6.0%	6.6%	6.2% (4)	4.6% (5)	2.0%	3.5%	5.0%
Return on average stockholders' equity	13.7%	15.6%	16.0% (4)	12.9% (5)	5.3%	8.4%	12.0%
Debt as a percentage of invested capital	31.7%	32.0%	37.7%	45.5%	49.3%	35.0%	37.0%
Consolidated Operating Statistics (2)							
Revenue passengers carried	44,785,573	42,742,602 (12)	36,955,221 (12)	27,839,284	22,669,942	19,830,941	17,958,000
RPMs (000s)	23,327,804	21,611,266	18,827,288	13,787,005	11,296,183	9,958,940	9,281,000
ASMs (000s)	36,180,001	32,123,974	27,511,000	21,366,642	18,491,003	16,411,115	14,796,000
Load factor	64.5%	67.3%	68.4%	64.5%	61.1%	60.7%	62.0%
Average length of passenger haul	521	506	509	495	498	502	500
Trips flown	685,524	624,476	546,297	438,184	382,752	338,108	304,000
Average passenger fare	\$61.64	\$58.44	\$59.97	\$58.33	\$55.93	\$57.71	\$54.00
Passenger revenue yield per RPM	11.83¢	11.56¢	11.77¢	11.78¢	11.22¢	11.49¢	10.40¢
Operating revenue yield per ASM	7.94¢	8.07¢	8.35¢	7.89¢	7.10¢	7.23¢	6.80¢
Operating expenses per ASM	7.07¢	7.08¢	7.25¢ (13)	7.03¢	6.76¢	6.73¢	6.20¢
Fuel cost per gallon (average)	55.22¢	53.92¢	59.15¢	60.82¢	65.69¢	77.89¢	59.40¢
Number of Employees at yearend	19,933	16,818	15,175	11,397	9,778	8,620	7,700
Size of fleet at yearend (14)	224	199	178	141	124	106	100

(1) The Selected Consolidated Financial Data and Consolidated Financial Ratios for 1992 through 1989 have been restated to include the financial results of restatement purposes

(2) Prior to 1993, Morris operated as a charter carrier; therefore, no Morris statistics are included for these years

(3) Pro forma for 1992 through 1989 assuming Morris, an S-Corporation prior to 1993, was taxed at statutory rates

(4) Excludes cumulative effect of accounting changes of \$15.3 million (\$.10 per share)

(5) Excludes cumulative effect of accounting changes of \$12.5 million (\$.09 per share)

(6) Includes \$2.6 million gains on sales of aircraft and \$3.1 million from the sale of certain financial assets

(7) Includes \$10.8 million gains on sales of aircraft, \$5.9 million from the sale of certain financial assets, and \$2.3 million from the settlement of a contingency

(8) Includes \$5.6 million gains on sales of aircraft and \$3.6 million from the sale of certain financial assets

(9) Includes TranStar's results through June 30, 1987

(10) Includes \$10.1 million net gains from the discontinuance of TranStar's operations and \$4.3 million from the sale of certain financial assets

(11) Includes a gain of \$4 million from the sale of aircraft delivery positions

(12) Includes certain estimates for Morris

(13) Excludes merger expenses of \$10.8 million

(14) Includes leased aircraft

CORPORATE DATA

TRANSFER AGENT AND REGISTRAR
Continental Stock Transfer & Trust Company
2 Broadway
New York, New York 10004
(212) 509-4000

STOCK EXCHANGE LISTING
New York Stock Exchange
Ticker Symbol: LUV

AUDITORS
Ernst & Young LLP
Dallas, Texas

GENERAL OFFICES
P. O. Box 36611
Dallas, Texas 75235-1611

ANNUAL MEETING
The Annual Meeting of Shareholders of Southwest Airlines Co. will be held at 10:00 a.m. on May 16, 1996 at the Southwest Airlines Corporate Headquarters, 2702 Love Field Drive, Dallas, Texas.

FINANCIAL INFORMATION
A copy of the Company's Annual Report on Form 10-K as filed with the Securities and Exchange Commission may be obtained without charge, as well as other financial information, by writing or calling:

Investor Relations
Southwest Airlines Co.
P. O. Box 36611
Dallas, TX 75235-1611
Telephone (214) 904-4908

DEDICATION:

This Southwest Airlines Annual Report is dedicated to all of our spirited Employees. Your hard work, creativity, caring, and extra effort have won us our fourth annual Triple Crown for Highest Customer Satisfaction, Best Ontime Record, and Best Baggage Handling.

DIRECTORS

SAMUEL E. BARSHOP

Chairman of the Board,
Barshop & Oles Co., Inc.,
San Antonio, Texas; Audit and Compensation Committees

GENE H. BISHOP

Retired Chairman and Chief Executive Officer,
Life Partners Group, Inc., Dallas, Texas; Audit, Compensation, and Executive
Committees

C. WEBB CROCKETT

Shareholder and Director, Fennemore Craig,
Attorneys at Law, Phoenix, Arizona;
Audit Committee

WILLIAM P. HOBBY, JR.

Chancellor, University of Houston System;
Former Lieutenant Governor of Texas;
Chairman of the Board,
H&C Communications, Houston, Texas;
Audit and Compensation Committees

TRAVIS C. JOHNSON

Partner, Johnson & Bowen,
Attorneys at Law, El Paso, Texas;
Audit Committee

HERBERT D. KELLEHER

Chairman of the Board, President, and Chief Executive Officer of Southwest Airlines Co., Dallas, Texas; Executive Committee

ROLLIN W. KING

Retired, Dallas, Texas; Audit and Executive Committees

WALTER M. MISCHER, SR.

Chairman of the Board and Chief Executive Officer, Southern Investors Service Co., Inc., Houston, Texas (Real Estate Development); Audit and Compensation Committees

JUNE M. MORRIS

Founder and former Chief Executive Officer of Morris Air Corporation, Salt Lake City, Utah; Audit Committee

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Chairman of the Board, President,
and Chief Executive Officer

COLLEEN C. BARRETT*

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Customers and Corporate Secretary

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Executive Vice President–
Chief Operations Officer

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Corporate Services

CAROLYN R. BATES

Vice President–Reservations

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Vice President–Flight Operations

KEITH L. TAYLOR

Vice President–Revenue Management

JAMES C. WIMBERLY*

Vice President–Ground Operations

*Member of Executive Planning Committee

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