The Company Plane is on call.

Be there.

SOUTHWEST AIRLINES CO. 1987 ANNUAL REPORT

Southwest is not in the airline business, we're in the service business. *Our mission is to serve the needs of business and leisure travelers who understand that there is simply no substitute for being there. ■ To these valued Customers, Southwest has become The Company Plane®, providing consistently low fares, frequent flights, and genuine Southwest hospitality. ■ This year, in addition to frequent flights, we began providing the frequent rewards our Customers deserve: The Company Club™ is a short route to free trips. ■ To ensure hassle-free reservations, we added a Houston Reservations Center and a Phoenix Reservations Center, effectively doubling our reservations capacity. ■ Fun Fares Too, our new one-day advance purchase fares, accommodated Customers whose plans change on short notice. ■ To remain on the leading edge of aviation technology, we placed a substantial order for the new generation Boeing 737-500. ■ "Together," our internal cost reduction program, will help us keep fares low for years to come. ■ Our continuing support of our primary charity, Ronald McDonald House, earned us the President's Citation for Private Sector Initiative. ■ For the seventh year in a row, we received the fewest complaints per Customer carried of any airline serving the continental U.S. ■ Of the 14 airlines reported in all categories of Customer Service Quality by the Department of Transportation in 1987, Southwest garnered the best cumulative score. ■ Sea World of Texas, the largest marine life showplace in the world, selected Southwest as its official airline. ■ In mid 1988, we will re-open Detroit City Airport for commercial service, in the tradition of Dallas Love Field, Houston Hobby, and Chicago Midway Airport.*

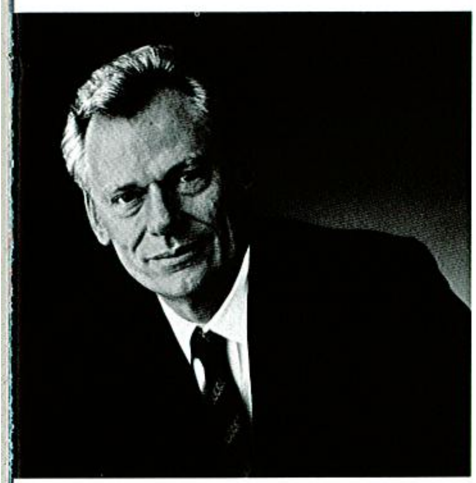
The Company Plane is on call. Be there.

TABLE OF CONTENTS

CONSOLIDATED HIGHLIGHTS

	1987	1986	Percent Change
INCOME DATA			
Operating revenues	$778,328,000	$768,790,000	1.2
Operating expenses	747,881,000	679,827,000	10.0
Operating income	30,447,000	88,963,000	(65.8)
Net income — Amount	$ 20,155,000	$ 50,035,000	(59.7)
Per share	$.63	$1.55	(59.4)
Average shares outstanding	32,091,000	32,254,000	—
FINANCIAL DATA			
Working capital	$ 88,737,000	$ 45,206,000	96.3
Property and equipment — net	824,358,000	925,174,000	(10.9)
Capital expenditures	232,940,000	181,763,000	28.2
Stockholders' equity	514,278,000	511,850,000	—
Return on stockholders' equity	4.0%	10.3%	n/a
Long-term debt as a % of total invested capital	32.8%	39.8%	n/a
Book value per outstanding share	$16.43	$15.87	—
OPERATING DATA			
Trips operated	270,559	262,082	3.2
Passengers carried	13,503,242	13,637,515	(1.0)
Revenue passenger miles (000)	7,789,376	7,388,401	5.4
Available seat miles (000)	13,331,055	12,574,484	6.0
Passenger load factor	58.4%	58.8%	n/a
Average revenue per available seat mile	5.8¢	6.1¢	(4.5)
Number of employees at year-end	5,765	5,819	(1.0)

Note: Operating income and related operating data include the results of TranStar through June 30, 1987. After that date, TranStar decided to cease its operations and liquidate its assets and liabilities. For further discussion, see Note 2 to the Consolidated Financial Statements.



Herbert D. Kelleher
Chairman, President and CEO
Southwest Airlines Co.

LETTER TO STOCKHOLDERS In the fourth quarter of 1987 Southwest earned $8,922,000, or $.28 per share, which, in light of a 40% increase in the average cost per gallon of jet fuel between fourth quarter 1986 and fourth quarter 1987, compares favorably with the $9,027,000, or $.28 per share, earned in fourth quarter 1986. Approximately $646,000 of the fourth quarter 1987 earnings resulted from disposition of the assets of TranStar, Southwest's subsidiary which ceased operations on August 9, 1987.

In the first half of 1987, Southwest lost $9,199,000. In the second half of 1987, Southwest made $29,354,000. I believe that the continuum of progress towards recovery of Southwest's earning power, as portrayed to you in my letters in our First, Second and Third Quarter 1987 Reports, will again be manifest in first quarter 1988 as our financial results improve over those of first quarter 1987.

Our net profit of $20,155,000 ($.63 per share) for 1987 is, of course, a keen disappointment as compared to our record net profit of $50,035,000 ($1.55 per share) for 1986. This disappointment is allayed, however, by the knowledge that we have now conquered the three principal problems that beset our earnings in the first half of 1987: the losses of TranStar; Southwest's own time lag in integrating its new and more flexible reservations system; and unacceptable operating revenue per available seat mile. We now feel that we are prepared to cope very ably with whatever exigencies might afflict our kaleidoscopic industry in 1988.

Our confidence in our future is reflected in our recent repurchase of almost 1,000,000 shares of our common stock. It is also reflected in our expansion plans for 1988: (1) the delivery of 13 new 737-300s (three of them to replace leased 737-200s), which will enhance Southwest's (excluding TranStar) available seat mile capacity by approximately 16-17%; our reopening of Detroit's downtown City Airport to commercial air service in hopes that it might become another Love Field or Hobby Airport for Southwest in the longer term; and our adding at least one new city to our route system.

We are grateful for our new three-year contract with our Mechanics and Aircraft Cleaners. We are also elated by our new status as the official airline of Sea World of Texas, the world's largest marine life showplace opening in San Antonio on May 28, 1988, and by the joint venture marketing plan we will jointly execute with Sea World of Texas. We feel that both Southwest's San Antonio Customer traffic and Sea World's attendance will be significantly strengthened by this exciting and novel "partnership" arrangement.

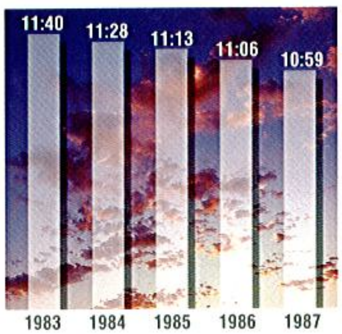
With low costs permitting low fares; a strong balance sheet fostering endurance in adversity; one of the best customer service records according to DOT statistics; and, most importantly, the very finest and most admirable people working for any company in our industry and perhaps for any company in any other industry, I believe we can assure our shareholders that our financial results for 1987 do not typify our position in our industry.

Most sincerely,

Herbert D. Kelleher

Herbert D. Kelleher
Chairman, President and CEO

Nobody wins at telephone tag. In the time it takes to trade messages, you can be there in person. Because The Company Plane is on call.



Aircraft Utilization
(Hours and Minutes per Day, Southwest Only)

OVERVIEW OF OPERATIONS

History Southwest Airlines Co. provides single class air transportation at affordable prices while emphasizing the highest standards of Customer service. The Company was incorporated in Texas and, after overcoming many legal and financial impediments, commenced passenger service operations on June 18, 1971 with four Boeing 737 aircraft serving three Texas destinations, Dallas, Houston and San Antonio. At present, Southwest serves 27 cities primarily in the midwestern and southwestern regions of the United States. The Company prides itself on having the best overall Customer service record in the U.S. airline industry while maintaining the lowest cost structure of any carrier operating at comparable stage lengths. It is this unique combination that has allowed Southwest to remain one of the most profitable carriers in the country over the last ten years. Further, it has provided its Customers with a refreshing and unique "transportation experience," one that is relaxed and fun and at the same time professional.

Operating Strategy Southwest offers a point-to-point method of scheduling its aircraft through connecting airport locations, a strategy which is designed to serve the local short-haul business traveler best and one which is more convenient than the hub and

spoke strategy employed by the other large U.S. air carriers. This point-to-point approach, together with its highly productive and cost conscious employee group, enables the Company to offer its short-haul Customers a large number of convenient daily departures while reducing total flight and ground time. The Company's attention to cost control has enabled it to consistently offer Customers the lowest fares available in its markets over the last sixteen years. Customers enjoy a low cost and relatively simple fare structure, quick ticketing, and boarding and seating procedures which have been designed to expedite all aspects of a Customer's trip. Further, the Company provides its Customers access in many cities to more convenient downtown airports, which are close to downtown business centers and, for many business travelers, keep total travel time to a minimum. Inflight

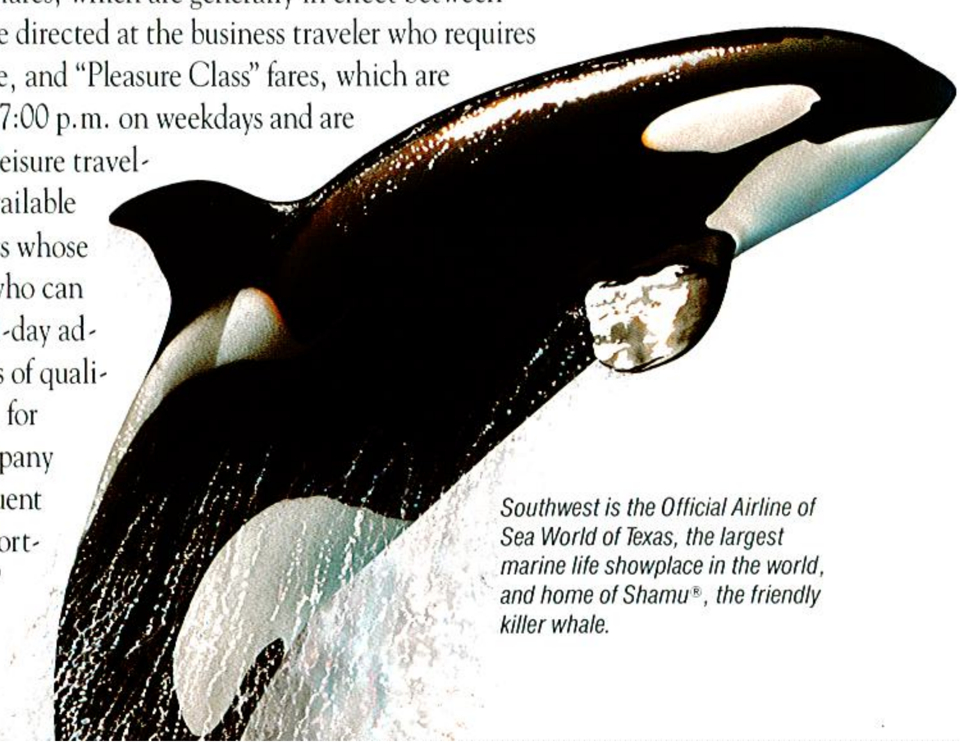
In mid 1988, Southwest will re-open commercial service to Detroit City Airport, in the tradition of Dallas Love Field, Houston Hobby, and Chicago Midway Airport.

services are also designed to fit smoothly within Southwest's expedited service approach and include efficient and pleasant beverage service on even the shortest Southwest flights.

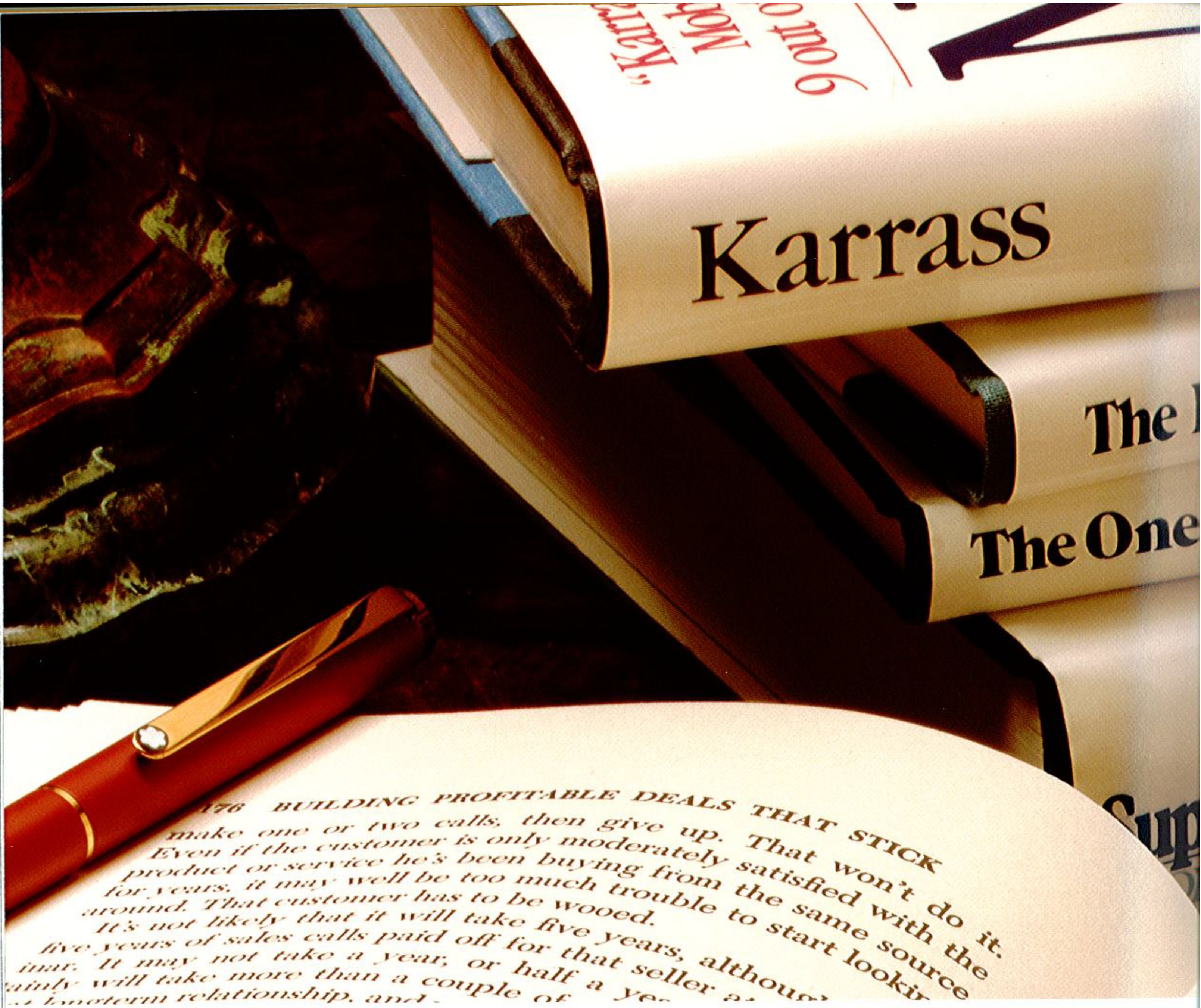
"The Flight of The Bumblebee" premieres at 6 tonight. Your busy day may include a mid-afternoon meeting out of town, but you can still savor sweet moments with your family this evening. Just buzz The Company Plane.

Route System Southwest's efficient and convenient scheduling focuses primarily on short-haul city pairs targeted at the business commuter as well as vacationing travelers. The Company currently serves 28 airports in 27 cities in 13 states with Dallas Love Field, Houston Hobby Airport and Phoenix Sky Harbor International being three of its primary airport locations. Southwest initiated new service in 1987 to Birmingham, Alabama and Metropolitan Airport in Detroit, Michigan and plans to add at least one more destination in 1988, in addition to downtown Detroit City Airport which is presently scheduled to open in summer 1988. Where possible, the Company serves airport locations in large cities which are close to the downtown business community, such as the Dallas Love Field, Chicago Midway, Houston Hobby, and Detroit City airports. Further, it attempts to identify markets that are underserved, where demand can be stimulated by lower fares and more frequent, high quality service. Southwest expanded its route system beyond the energy belt region beginning with the addition of Las Vegas, Phoenix and San Diego in January 1982 and, as a result of a continuation of such expansion, presently operates a route system with only 40-45% of its available seat mile capacity flown totally within the energy belt.

Customer Service The Company has consistently been among the industry's leaders in all facets of Customer service as attested to by annually receiving the fewest complaints filed with the Department of Transportation per Customer carried of any air carrier in the continental United States, by achieving high levels of ontime aircraft arrival performance as compared to its competitors within the industry and by efficiently handling Customer baggage. Although the Company does not offer an extensive food service because of its short-haul strategy and commitment to maintaining a low operating cost structure, it initiated a new snack service on certain longer-haul flight segments to complement its innovative inflight beverage service. Southwest's philosophy with respect to fares has historically been to offer Customers low fares in a simple to understand two-tier fare structure: "Executive Class" fares, which are generally in effect between 6:30 a.m. and 6:59 p.m. weekdays and are directed at the business traveler who requires the convenience of high frequency service, and "Pleasure Class" fares, which are generally in effect on weekends and after 7:00 p.m. on weekdays and are directed toward the more price-sensitive leisure traveler. The Company also generally makes available special restricted fares for those Customers whose itineraries meet certain restrictions and who can plan their travel in advance (14-day and 1-day advance purchase fares) or who are members of qualifying special groups (Senior Citizen fares, for example). Further, in June 1987 the Company implemented a simple and appealing frequent flyer program directed primarily at the short-haul frequent flyer. "The Company Club" program has an award structure based upon trips taken, rather than mileage



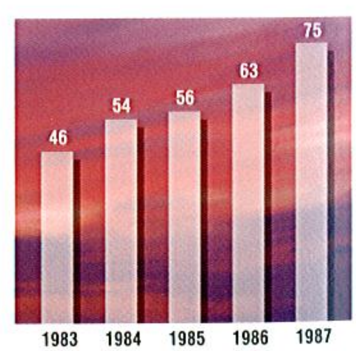
Southwest is the Official Airline of Sea World of Texas, the largest marine life showplace in the world, and home of Shamu®, the friendly killer whale.



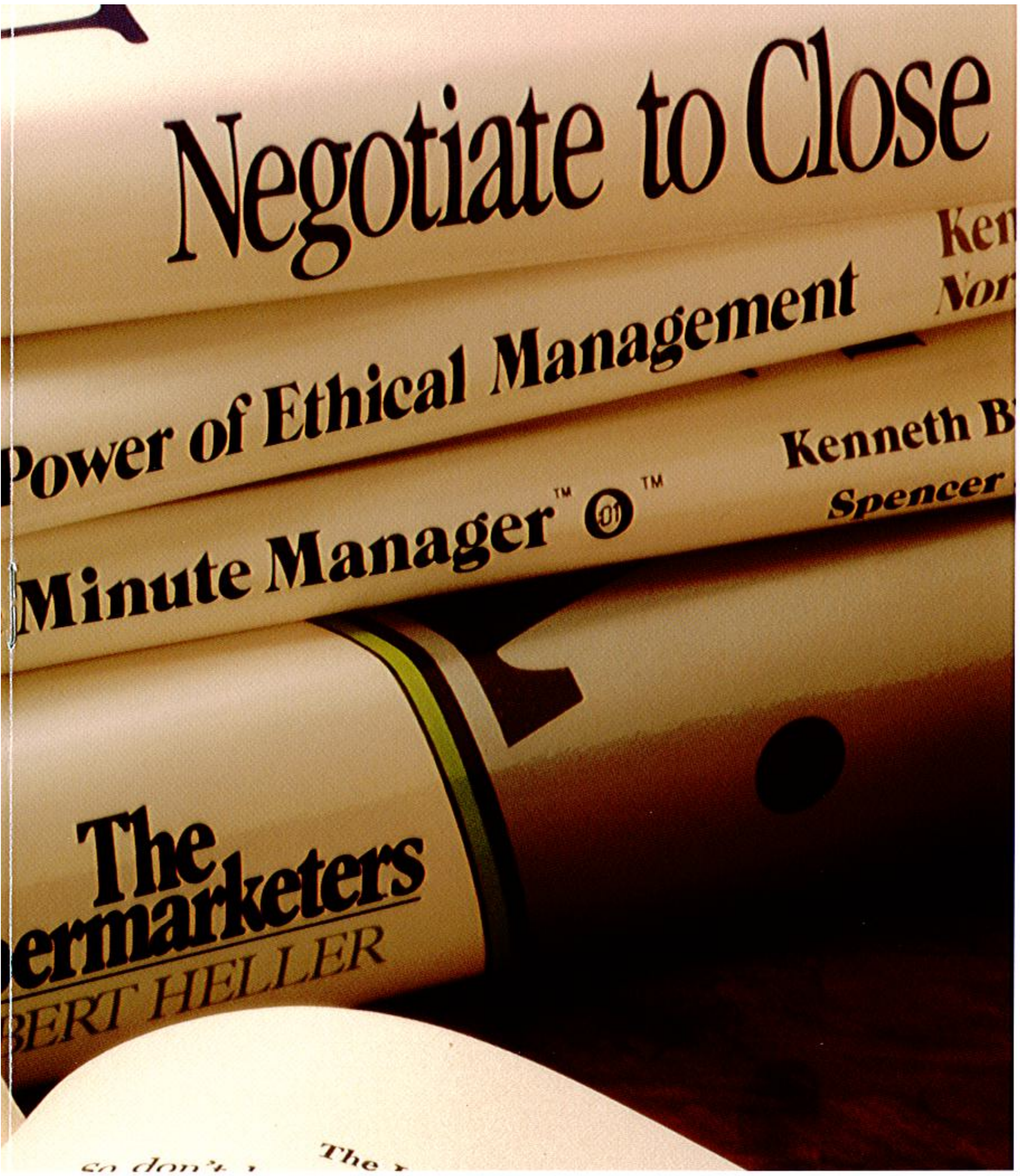
flown, which is intended to reward Southwest's short-haul Customers and enhance its market share.

Fleet Southwest's fleet consists entirely of Boeing 737 aircraft, an aircraft type which is attractive and comfortable for our Customers and can be operated cost effectively in Southwest's short to medium stage length markets. This commitment to a single aircraft type allows for the most efficient and cost effective maintenance and flight operations. The Company added nine Boeing 737-300s and three Boeing 737-200s to its fleet in 1987; seven Boeing 737-300s in 1986; and is committed to add 13 more Boeing 737-300s in 1988. All of TranStar's aircraft were disposed of in 1987, as part of its shut-down, as they were aircraft types incompatible with Southwest's maintenance and flight operations' objectives. At December 31, 1987, the Company operated the following fleet:

Type of aircraft	Seats	Owned	Leased	Total
Boeing 737-200	122	43	6	49
Boeing 737-300	137	13	13	26
Total		56	19	75



Fleet Size (at Year-End, Southwest Only)



All the experts agree, the best way to see eye-to-eye is face-to-face. Now you can afford to take their advice more often, when you take The Company Plane.

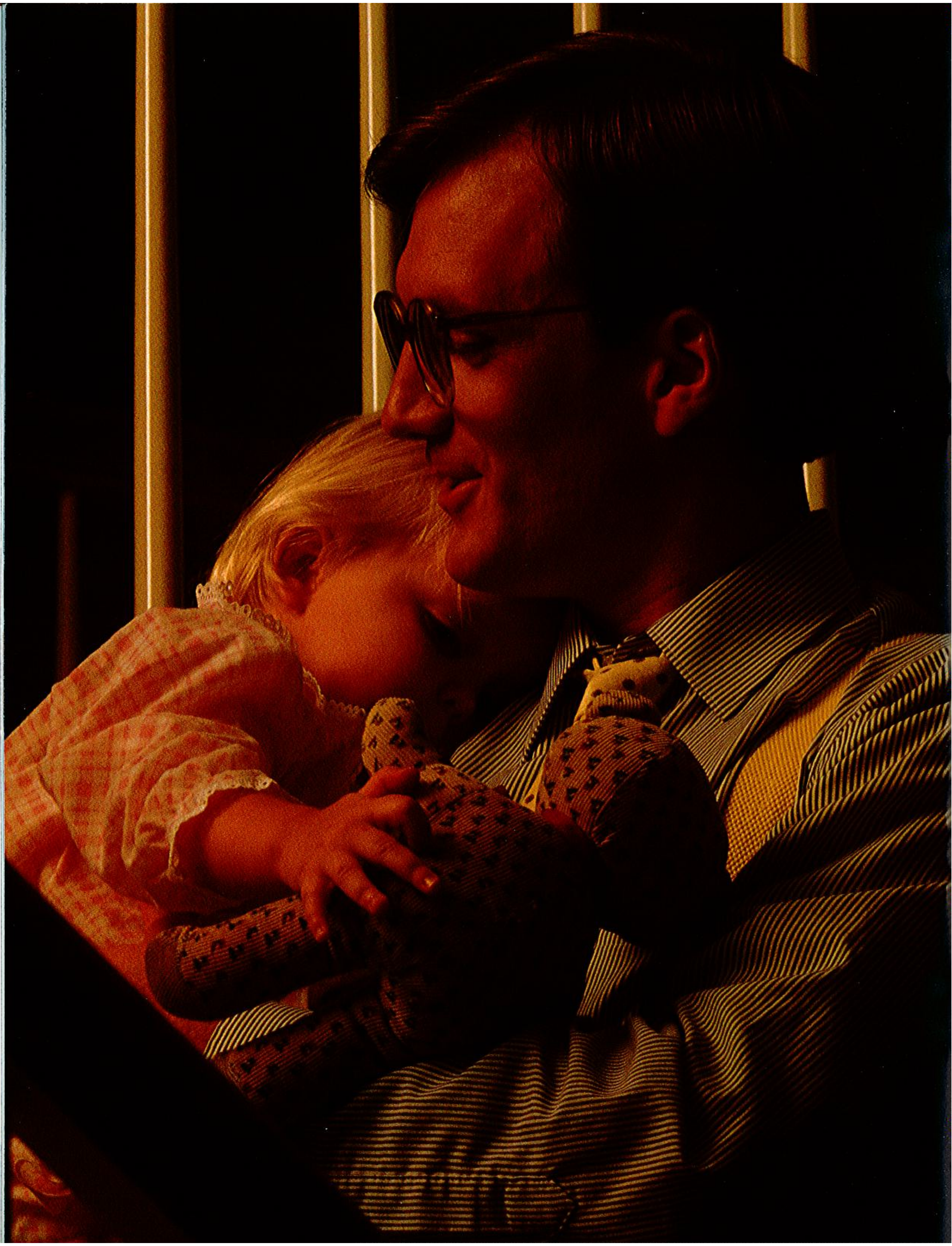
Of the 19 leased aircraft, 16 are subject to long-term leases (five are accounted for as capital leases and 11 are operating). The three 737-200s added in 1987 are leased on a short-term basis and may be returned to the lessor in 1988. For a complete analysis of the Company's aircraft purchase commitments, please refer to Note 3 to the Consolidated Financial Statements.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF RESULTS OF OPERATIONS AND FINANCIAL CONDITION

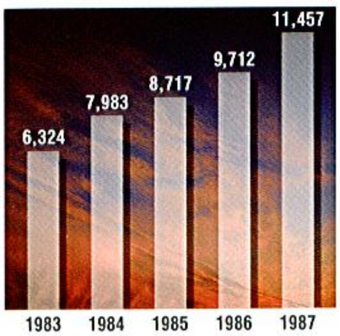
1987 COMPARED WITH 1986 The Company's consolidated net income was $20.1 million in 1987 compared with $50.0 million in 1986, a decrease of 59.7%. This reduction in net income was primarily attributable to a 4.5% decrease in consolidated operating revenue per available seat mile (ASM) from 6.1¢ in 1986 to 5.8¢ in 1987 as a result of intense fare competition in the first half of 1987. The Company's discontinued airline operation, TranStar, accounted for losses after the effect of income taxes of $6.1 million during 1987.

Operating Revenues Consolidated passenger revenues, which accounted for more than 96% of total consolidated operating revenues, increased by only 1% in 1987 to $751.6

For the seventh year in a row, Southwest received the fewest complaints per Customer carried of any airline serving the continental U.S.



The Sandman shows up at 8:30 tonight. Even if there's a late afternoon meeting out of town, you can still send your youngster off to dreamland tonight. Pleasant dreams, courtesy of The Company Plane.



Available Seat Miles
(in Millions, Southwest Only)

million due to the discontinuance of TranStar in July 1987 and the 4.5% decline in operating revenue per ASM mentioned above.

Southwest operating revenues, excluding TranStar, accounted for $698.7 million or 90% of total operating revenues in 1987 versus $619.7 million in 1986, an increase of 12.7%. Southwest alone added 12 aircraft or 1.7 billion ASM's in 1987, an increase of approximately 18.0% compared to 1986 levels. In addition, the system load factor increased .6 points in 1987 resulting in an increase of approximately 70 million RPM's. However, as a result of pricing actions taken to meet competitive fare pressures, operating revenue per ASM decreased 4.4% during 1987 to 6.1¢ compared to 6.4¢ in 1986 which partially offset the effect of the 18.0% increase in ASM's and the .6 point increase in the system load factor. Southwest was able to reverse the downward trend in yields, which began in 1986, and achieved meaningful gains in yields during the last half of 1987 that contributed significantly to the improved third and fourth quarter performances.

TranStar accounted for $80.5 million of total consolidated operating revenues in 1987, which represented six months of operations as compared to a full year of operations in 1986 which generated revenues of $149.9 million. TranStar had 1 billion RPM's with a 55.5% load factor for 1987 as compared to 1.7 billion RPM's and a load factor of 60.2% in 1986.

Operating Expenses Consolidated operating expenses increased 10.0% in 1987 primarily as a result of increases in ASM's of 6% and operating expense per ASM of 3.7%. The Company's two largest cost categories, "Salaries, wages and benefits" and "Fuel and oil" increased over 1986 levels by 7.4% and 8.3%, respectively, consistent with the 6% increase in consolidated ASM's. The Company's salaries and benefits costs, including profit sharing, remain among the lowest in the airline industry. This is principally attributable to the Company's high productivity per employee in comparison to other airlines (2,331 passengers carried in 1987 per employee). The cost per ASM for fuel and

Consolidated Operating Expenses

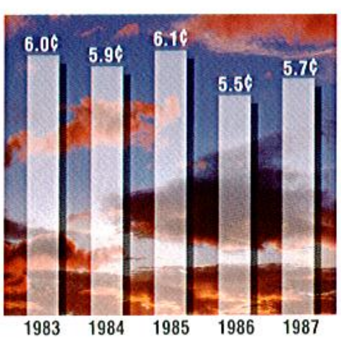
	1987 Per ASM	Increase (Decrease)	1986 Per ASM	Increase (Decrease)	1985 Per ASM
Salaries, wages and benefits	1.7¢	.1¢	1.6¢	(.1)¢	1.7¢
Fuel and oil	1.0	—	1.0	(.7)	1.7
Maintenance materials and repairs	.4	—	.4	—	.4
Agency commissions	.4	—	.4	.1	.3
Aircraft rentals	.2	.1	.1	—	.1
Landing fees and other rentals	.3	—	.3	—	.3
Depreciation	.5	—	.5	—	.5
Other	1.1	—	1.1	—	1.1
Total	5.6¢	.2¢	5.4¢	(.7)¢	6.1¢

You can't shake hands over the phone. Besides, sealing a deal is easier in person. And inexpensive, thanks to The Company Plane.

oil increased modestly in 1987 to 1.05¢ per ASM compared to 1.03¢ in 1986, only a 2.2% increase despite a 5.6% increase in the average price of jet fuel in 1987 compared to 1986. The largest percentage increase in a single cost category occurred in "Aircraft rentals." Southwest financed seven aircraft in 1987 pursuant to long-term operating leases, bringing Southwest's total to 11 financed in this fashion since fourth quarter 1986. TranStar had ten aircraft subject to long-term operating leases, two of which were added in 1987, that were acquired by a third party in late 1987 as described in Note 2 to the Consolidated Financial Statements. This increase is offset, however, by decreases in depreciation and interest expense and an increase in interest income. The table on the preceding page depicts the components of consolidated operating expenses per ASM compared to the previous two years.

Southwest, excluding TranStar, accounted for $657.5 million of total consolidated operating expenses, or 5.7¢ per ASM in 1987 as compared to 5.5¢ in 1986. In 1987, operating expenses increased 22% over 1986 operating expenses, primarily as a result of the 18% increase in Southwest's ASM's.

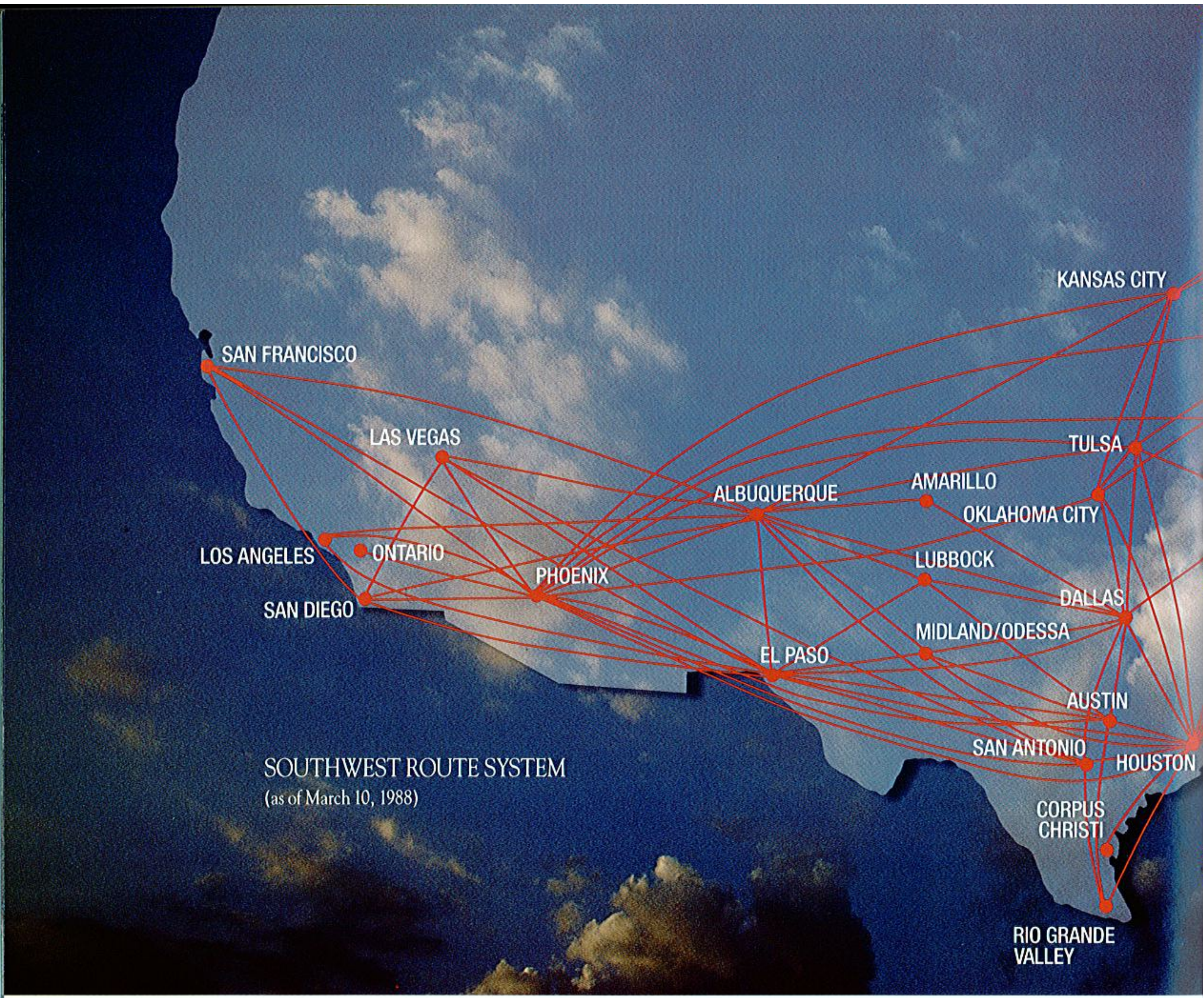
Other "Other expenses (income)" decreased substantially in 1987 from $23.5 million in



Operating Expense
(Per Available Seat Mile, Southwest Only)

1986 to $1.4 million primarily as a result of large gains realized on the sales of TranStar assets, net of reserves for operating losses during the shut-down period. For further discussion regarding the TranStar shut-down, refer to Note 2 to the Consolidated Financial Statements. Interest expense declined in 1987 primarily due to the assumption by a third party of all of TranStar's long-term debt during the third quarter of 1987. Interest income was up dramatically in 1987 as compared to prior periods. Cash balances available for investment were up in 1987 due to $77 million in cash generated from the sale of TranStar assets and $178.0 million generated from the sale and leaseback of seven aircraft. Both years included nonoperating gains of approximately $4 million as described in Note 9 to the Consolidated Financial Statements.

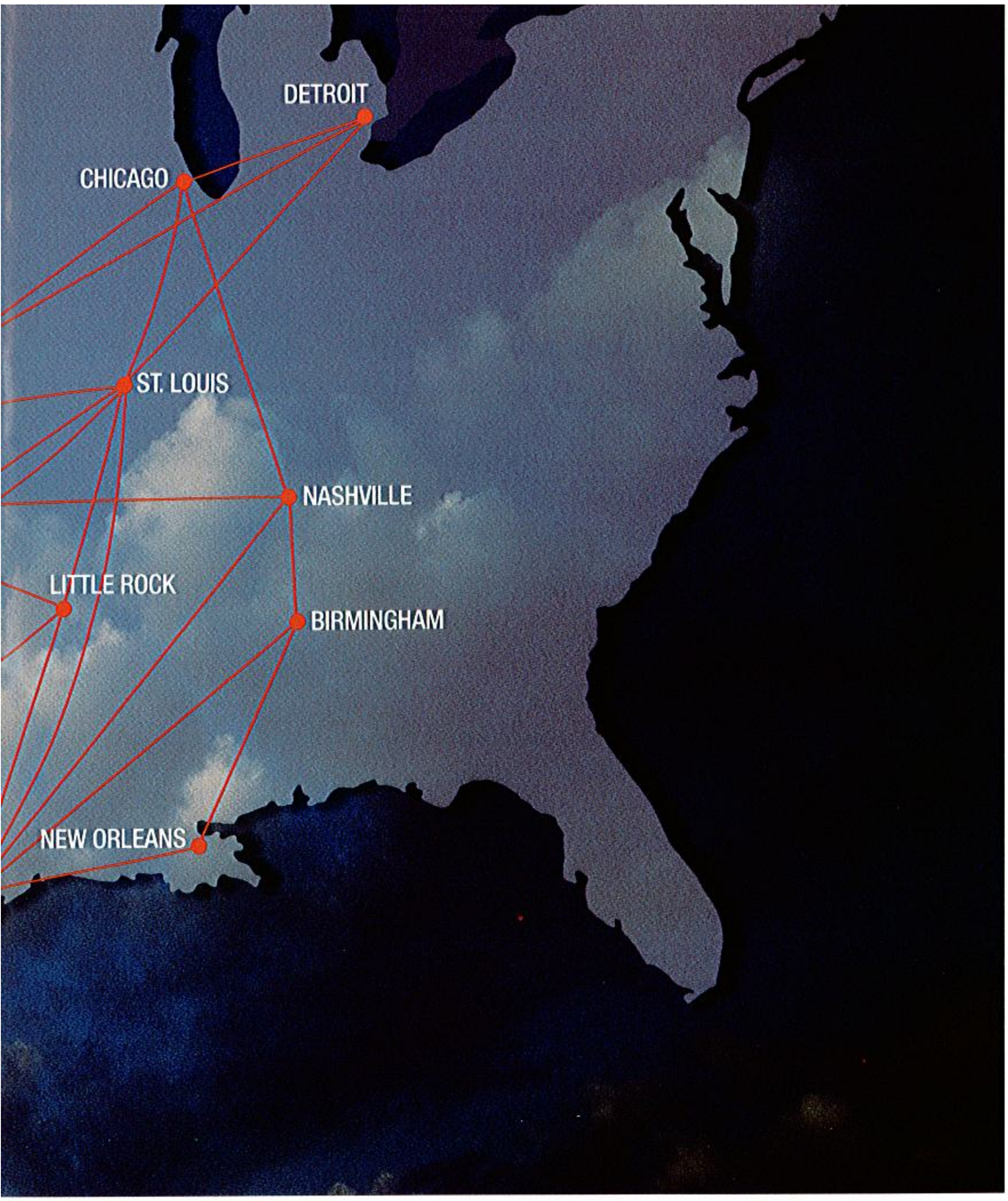
The "Provision for income taxes" increased in 1987 as a percentage of income before income taxes to 30.7% from 23.5% in 1986, despite a decrease in the federal statutory rate from 46% to 40%. The increase is primarily due to basis differences in the TranStar assets sold for financial versus income tax reporting purposes resulting in much larger gains for tax reporting purposes, as more fully described in Note 10 to the Consolidated Financial Statements. Investment tax credits (ITC), which were available in 1987 as a

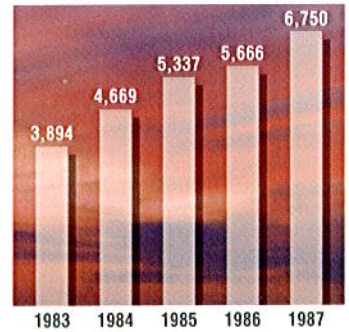


SOUTHWEST ROUTE SYSTEM
(as of March 10, 1988)

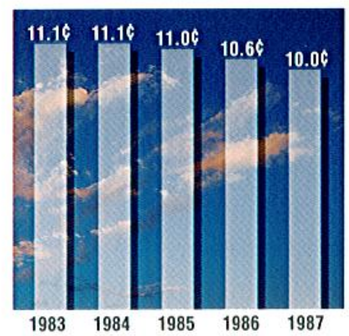
The Company Club, Southwest's new frequent flyer program, is a short route to free trips.

result of certain transitional rules contained in the Tax Reform Act of 1986, were $8.2 million in 1987 versus $11.1 million in 1986 after providing deferred taxes for reduction in the tax basis of the related assets for ITC. In December 1987, the Financial Accounting Standards Board (FASB) issued Statement No. 96, "Accounting For Income Taxes," which significantly modified what is currently generally accepted accounting for income taxes. The effect of the Company's anticipated change to this new Statement cannot be accurately estimated at this date but is expected to be material primarily as a result of reducing net deferred tax credits for reductions in income tax rates promulgated by the Tax Reform Act of 1986 (46% and 40% to 34%). The Statement is required by the FASB to be implemented no later than fiscal year 1989 although earlier adoption is permitted. The Company has not determined which year it will adopt the new Statement.

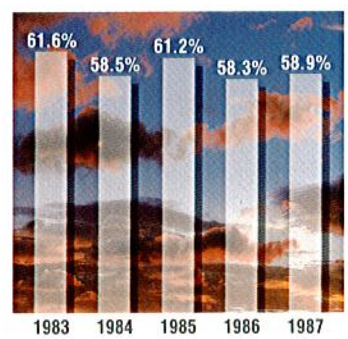




Revenue Passenger Miles
(in Millions, Southwest Only)



Average Revenue Per Passenger Mile
(Southwest Only)



Passenger Load Factor
(Southwest Only)

1986 COMPARED WITH 1985 The Company's consolidated net income was $50 million in 1986 compared with $47.3 million in 1985, an increase of 5.8%. This growth in earnings was primarily attributable to an increase in operating income to $89 million, an increase of 13.3%, partially offset by an increase in interest expense of 38.6% and federal income tax of 14%.

Operating Revenues Consolidated passenger revenues, which accounted for more than 96% of total consolidated operating revenues, increased by $86 million in 1986, or 13%, to $742 million. RPM's increased 1.4 billion and accounted for $156 million of the increase offset by a decrease in the yield of 8.6%, or $70 million. The growth in RPM's was primarily attributable to the inclusion of TranStar for a full year in 1986 (approximately 1.1 billion RPM's) and additional ASM's of Southwest (net of the decline in Southwest's load factor) of approximately 1 billion which generated another 300 million RPM's. The passenger load factor declined in 1986 to 58.8%, reflecting a softening in the Texas economy offset by an increase in other markets. The decrease in yield was due to an increase in the average passenger trip length from 472 in 1985 to 542 in 1986 and an increase in discounted fare traffic.

Operating Expenses Consolidated operating expenses increased in proportion to operating revenues in 1986, by 13.1%. This is primarily attributable to a 27.2% growth in ASM's offset by a decline in the cost per ASM to 5.4¢, a decrease of 11%. The principal contributor to this decrease was fuel which, in total, decreased 39% in 1986 as a result of the decline in crude oil prices. For 1986, the average cost of fuel per gallon was 51.4¢ versus 78.2¢ in 1985.

Other "Other expenses (income)" increased $5.8 million in 1986, principally as a result of higher interest expense from borrowings by TranStar ($10.8 million). Offsetting the increase from interest expense was a $4 million gain from the sale of certain aircraft delivery positions, included in "Other income."

The "Provision for income taxes" increased as a percentage of income before income taxes from 22.2% in 1985 to 23.5% in 1986 principally due to a reduction in ITC. Federal income tax was provided at the current 46% rate in effect for 1986, of which $14 million was deferred and $1.4 million was currently payable.

LIQUIDITY AND CAPITAL RESOURCES The Company had $88.7 million in working capital at December 31, 1987 as compared to $45.2 million at December 31, 1986 and $46.0 million at the end of 1985. Funds provided by operations were $49.7 million in 1987, down from the $133.3 million and $114 million generated in 1986 and 1985, respectively. Additional funds of $178 million were generated in 1987 through the sale and leaseback of seven Boeing 737-300 aircraft with another $163.1 million from the sale of TranStar assets, which included the assignment to a third party of all TranStar long-term debt. These proceeds were utilized to finance aircraft-related capital expenditures and provide working capital. TranStar's aircraft operating leases were also assumed by a third party as more fully described in Note 2 to the Consolidated Financial Statements. As a result of the sale and leaseback transactions, commitments for operating leases increased in 1987 by $336.3 million.

Additional funds were provided in 1986 through the sale of $100 million of public debt, which represented one-half of the $200 million shelf registration of debt securities that was completed in December 1985. The proceeds were used primarily to retire certain debt and finance aircraft acquisitions. The Company completed approximately $100 million of financings in the fourth quarter of 1986 via the sale and leaseback of four aircraft, the proceeds of which were used to retire debt and provide working capital.

During 1985, the Company generated additional working capital through the issuance of $34 million of Southwest common stock upon the conversion of its 10% Convertible Subordinated Debentures and $27 million of common stock and warrants in the acquisition of TranStar. After its acquisition by Southwest, TranStar renegotiated $33 million of its notes to banks and, with $55 million in proceeds from the sale and leaseback of five aircraft, retired this debt. Southwest borrowed a net $107 million under its Bank Credit Agreements, $23 million under its Euro Note Programme and $18 million under the French Credit Export Agreement. In addition, Southwest generated $40 million through a capital lease of two aircraft. Southwest used $75 million of the proceeds from these borrowings to acquire the net non-current assets of TranStar and the remainder for aircraft acquisitions and working capital.

Capital expenditures were $232.9 million in 1987 versus $181.8 million in 1986 and $214.5 million in 1985. The majority of these expenditures were for aircraft delivery or progress payments.

Capital commitments for the Company consisted primarily of scheduled aircraft acquisitions. At year-end, Southwest had 20 Boeing 737-300s and 15 Boeing 737-500s on order. Aggregate future funding required for these commitments was $513 million at year-end. See Note 3 to the Consolidated Financial Statements for further information.

The Company has various financing options available to it to meet its capital and operating commitments, including internally generated funds and revolving credit lines with banks of approximately $200 million. In addition, the Company will consider various borrowing or leasing options in order to maximize earnings and cash flow.

In December 1987, the FASB issued Statement No. 95, "Statement of Cash Flows," which supercedes APB 19 and will replace the statement of changes in financial position. The Company will be required to implement this new Statement in 1988.

Consolidated Net Income (in Millions)

QUARTERLY FINANCIAL DATA (UNAUDITED)

(in thousands except per share amounts)

	Three months ended			
1987	March 31	June 30	Sept. 30	Dec. 31
Revenues	$178,383	$205,302	$200,743	$193,900
Operating income (loss)	(7,021)	2,796	24,247	10,425
Income (loss) before income taxes	(13,089)	846	30,506	10,810
Net income (loss)	(9,834)	635	20,432	8,922
Net income (loss) per common share	(.30)	.02	.63	.28

	Three months ended			
1986	March 31	June 30	Sept. 30	Dec. 31
Revenues	$173,256	$193,916	$207,628	$193,990
Operating income	7,111	28,171	34,699	18,982
Income before income taxes	3,219	21,275	27,873	13,079
Net income	2,727	17,100	21,181	9,027
Net income per common share	.08	.53	.66	.28

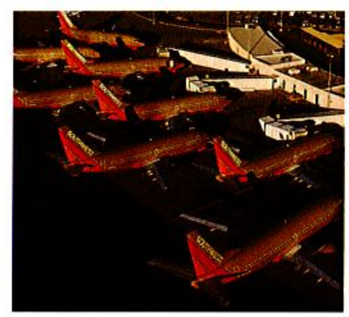
Primary Earnings Per Share

COMMON STOCK PRICE RANGES AND DIVIDENDS

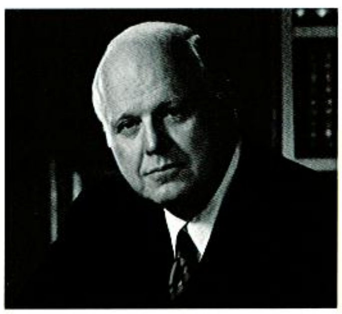
Southwest's common stock is listed on the New York Stock Exchange and trades under the symbol "LUV." The high and low sales prices of the common stock on the Composite Tape and the quarterly dividends per share paid on the common stock were:

Period	Dividend	High	Low
1987			
1st Qtr.	$.032	$25.13	$20.50
2nd Qtr.	.032	23.13	18.00
3rd Qtr.	.032	23.25	19.38
4th Qtr.	.032	21.25	11.75
1986			
1st Qtr.	.032	27.50	20.00
2nd Qtr.	.032	22.50	18.25
3rd Qtr.	.032	24.00	19.00
4th Qtr.	.032	26.13	19.75

As of January 31, 1988, there were 6,513 holders of record of the Company's common stock.



Southwest is credited with bringing lower fares to Phoenix, plus keeping fares low and service high at convenient Terminal 1.



Dedicated to
Sidney A. Adger
Retired Director
Southwest Airlines Co.

DIRECTORS

SAMUEL E. BARSHOP
Chairman of the Board and President, La Quinta Motor Inns, Inc., San Antonio, Texas; Audit and Compensation Committees

GENE H. BISHOP
Chairman of the Board and Chief Executive Officer, MCorp, Dallas, Texas; Audit, Compensation, and Executive Committees

TRAVIS C. JOHNSON
Partner, Johnson & Bowen, Attorneys at Law, El Paso, Texas; Audit Committee

HERBERT D. KELLEHER
Chairman of the Board and President of Southwest Airlines Co., Dallas, Texas; Executive Committee

ROLLIN W. KING
Managing Director, Russell Reynolds Associates, Inc., Dallas, Texas; Executive Recruiting Consultants; Audit and Executive Committees

WALTER M. MISCHER, SR.
Chairman of the Board and Chief Executive Officer of The Mischer Corporation, Houston, Texas; Audit and Compensation Committees

OFFICERS

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ROBERT W. LAWLESS
Executive Vice President, Chief Operations Officer

GARY A. BARRON
Executive Vice President – Corporate Services

JAMES G. AMOS
Vice President – Flight Operations

COLLEEN C. BARRETT
Vice President – Administration & Secretary

JOHN G. DENISON
Vice President – Finance, Chief Financial Officer

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Vice President – Systems

J. L. HERRING
Vice President – Energy & Provisioning

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Vice President – Special Marketing

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Vice President – Personnel

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Vice President – Inflight Service

JAMES F. PARKER
Vice President – General Counsel

PAUL J. QUINN
Vice President – Schedule Planning

RON RICKS
Vice President – Governmental Affairs

DONALD G. VALENTINE
Vice President – Marketing

JOHN A. VIDAL
Vice President – Maintenance

JAMES C. WIMBERLY
Vice President – Ground Operations

GARY C. KELLY
Controller

JOHN D. OWEN
Treasurer

SOUTHWEST AIRLINES CO.
1987 ANNUAL REPORT
CONSOLIDATED FINANCIAL STATEMENTS

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SOUTHWEST AIRLINES CO.
CONSOLIDATED BALANCE SHEET
(in thousands except share and per share amounts)

	December 31, 1987	December 31, 1986
ASSETS		
Current assets:		
Cash and cash equivalents	$ 142,734	$ 74,861
Accounts receivable	44,116	33,513
Inventories of parts and supplies, at cost	7,693	11,201
Prepaid expenses and other current assets	6,577	8,443
Total current assets	201,120	128,018
Property and equipment, at cost (Notes 3, 5 and 6):		
Flight equipment	858,713	955,716
Ground property and equipment	106,465	103,295
Deposits on flight equipment purchase contracts	134,726	100,924
	1,099,904	1,159,935
Less allowance for depreciation	275,546	234,761
	824,358	925,174
Other assets	17,162	8,227
	$1,042,640	$1,061,419
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 26,877	$ 18,280
Accrued liabilities (Note 4)	56,993	43,765
Air traffic liability	11,540	7,868
Federal income tax payable	7,230	1,353
Current maturities of long-term debt	9,743	11,546
Total current liabilities	112,383	82,812
Long-term debt less current maturities (Note 5)	251,130	339,069
Deferred income taxes	85,918	92,187
Deferred gains from sale and leaseback of aircraft	77,668	29,424
Other deferred liabilities	1,263	6,077
Commitments and contingencies (Notes 2, 3 and 6)		
Stockholders' equity (Note 7):		
Common stock, $1.00 par value; 75,000,000 shares authorized; 32,254,269 shares issued in 1987 and 1986	32,254	32,254
Capital in excess of par value	175,170	175,170
Retained earnings	320,402	304,426
	527,826	511,850
Less treasury stock, at cost (950,700 shares in 1987)	13,548	—
Total stockholders' equity	514,278	511,850
	$1,042,640	$1,061,419

See accompanying notes.

SOUTHWEST AIRLINES CO.
CONSOLIDATED STATEMENT OF INCOME

(in thousands except per share amounts)

	Years ended December 31, 1987	1986	1985
Operating revenues:			
Passenger	$ 751,649	$ 742,287	$ 656,689
Freight	13,428	13,621	13,643
Other	13,251	12,882	9,340
Total operating revenues	778,328	768,790	679,672
Operating expenses:			
Salaries, wages and benefits	222,461	207,158	164,668
Fuel and oil	140,334	129,522	165,008
Maintenance materials and repairs	59,469	49,181	38,272
Agency commissions	47,444	44,209	33,342
Aircraft rentals	22,001	7,976	6,259
Landing fees and other rentals	38,860	36,617	30,675
Depreciation	65,484	67,465	53,633
Other operating expenses	151,828	137,699	109,291
Total operating expenses	747,881	679,827	601,148
Operating income	30,447	88,963	78,524
Other expenses (income):			
Interest expense	30,682	37,310	26,914
Capitalized interest	(8,066)	(7,069)	(7,410)
Interest income	(6,764)	(2,765)	(1,764)
Other income (Note 9)	(4,297)	(3,959)	—
Net gains of $31,824 on disposals of TranStar assets less provision of $21,643 for operating losses during shut-down period (Note 2)	(10,181)	—	—
	1,374	23,517	17,740
Income before income taxes	29,073	65,446	60,784
Provision for income taxes (Note 10)	8,918	15,411	13,506
Net income	$ 20,155	$ 50,035	$ 47,278
Net income per common share (Note 11):			
Primary	$.63	$1.55	$1.54
Fully diluted	$.63	$1.55	$1.51

See accompanying notes.

SOUTHWEST AIRLINES CO.
CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY

(in thousands except per share amounts)
Three years ended December 31, 1987

	Common stock	Capital in excess of par value	Retained earnings	Treasury stock	Total
Balance at December 31, 1984	$ 29,570	$117,643	$215,322	$ (767)	$361,768
Issuance of common stock and warrants for acquisition of TranStar (Note 2)	793	25,365	—	767	26,925
Issuance of common stock upon conversion of debentures	1,891	32,158	—	—	34,049
Cash dividends, $.13 per share	—	—	(4,016)	—	(4,016)
Net income — 1985	—	—	47,278	—	47,278
Balance at December 31, 1985	32,254	175,166	258,584	—	466,004
Proceeds from issuance of common stock	—	4	—	—	4
Cash dividends, $.13 per share	—	—	(4,193)	—	(4,193)
Net income — 1986	—	—	50,035	—	50,035
Balance at December 31, 1986	32,254	175,170	304,426	—	511,850
Purchase of treasury stock	—	—	—	(13,627)	(13,627)
Issuance of treasury stock upon exercise of stock options	—	—	(14)	79	65
Cash dividends, $.13 per share	—	—	(4,165)	—	(4,165)
Net income — 1987	—	—	20,155	—	20,155
Balance at December 31, 1987	$ 32,254	$175,170	$320,402	$(13,548)	$514,278

See accompanying notes.

SOUTHWEST AIRLINES CO.
CONSOLIDATED STATEMENT OF CHANGES IN FINANCIAL POSITION
(in thousands)

	Years ended December 31, 1987	1986	1985
Sources of working capital:			
Operations:			
Net income	$ 20,155	$ 50,035	$ 47,278
Items not affecting working capital:			
Depreciation	65,484	67,465	53,633
Deferred income taxes	(2,725)	14,058	12,535
Gains from sales of TranStar assets (Note 2)	(31,824)	—	—
Other	(1,376)	1,791	606
Total from operations	49,714	133,349	114,052
Issuance of common stock and warrants	—	4	60,974
Issuance of long-term debt:			
Due to acquisition of TranStar	—	—	41,230
Other	—	101,043	121,302
Proceeds from sale and leaseback of aircraft under operating leases	178,000	99,387	54,865
Proceeds from sales of TranStar assets (Note 2)	163,102	—	—
Total sources of working capital	390,816	333,783	392,423
Applications of working capital:			
Net additions to property and equipment	232,940	181,763	214,516
Net non-current assets of TranStar acquired (Note 2)	—	—	74,943
Acquisition of note receivable	9,533	—	—
Cash dividends	4,165	4,193	4,016
Reduction of long-term debt:			
From the disposal of TranStar assets (Note 2)	74,600	—	—
Other	9,450	142,235	72,560
Purchase of treasury stock	13,627	—	—
Other	2,970	6,405	(4,172)
Total applications of working capital	347,285	334,596	361,863
Increase (decrease) in working capital	$ 43,531	$ (813)	$ 30,560
Changes in components of working capital:			
Working capital deficiency of TranStar acquired	$ —	$ —	$ (7,213)
Increase (decrease) in current assets:			
Cash and cash equivalents	67,873	5,562	39,021
Accounts receivable	10,603	1,649	2,681
Inventories of parts and supplies	(3,508)	2,620	3,308
Refundable federal income tax	—	—	(5,460)
Prepaid expenses and other current assets	(1,866)	290	731
	73,102	10,121	40,281
Increase (decrease) in current liabilities:			
Accounts payable	8,597	(608)	3,000
Accrued liabilities	13,228	7,481	1,051
Air traffic liability	3,672	3,640	200
Federal income tax payable	5,877	1,353	—
Current maturities of long-term debt	(1,803)	(932)	(1,743)
	29,571	10,934	2,508
Increase (decrease) in working capital	$ 43,531	$ (813)	$ 30,560

See accompanying notes.

SOUTHWEST AIRLINES CO.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 1987

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of presentation The consolidated financial statements include the accounts of Southwest Airlines Co. (Southwest) and its wholly owned subsidiaries, TranStar Airlines Corporation (TranStar), formerly Muse Air Corporation, and Southwest Airlines Eurofinance N.V. (collectively referred to as the Company). All significant intercompany balances and transactions have been eliminated. The decision was made to discontinue TranStar's operations effective July 1987 as described in Note 2. Accordingly, the results of TranStar's operations subsequent to that date were included in "Other expenses (income)" in the caption "Net gains on disposals of TranStar assets less provision for operating losses during shut-down period." Further, as a result of the discontinuance of TranStar's operations, a pre-acquisition net operating loss carryforward was realized, requiring a restatement of the 1985 purchase price allocation. Thus, adjustments of amounts previously reported in the financial statements at December 31, 1986 and 1985 have been made as described in Note 10. Certain reclassifications of amounts previously reported in the financial statements at December 31, 1986 and 1985, have also been made to conform to the presentation at December 31, 1987.

Inventories Inventories of flight equipment expendable parts, materials and supplies are valued at cost. These parts 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 18 years for flight equipment and three to 30 years on ground property and equipment. The Company charges aircraft maintenance costs to operations as incurred. 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 lessee's incremental borrowing rate or, when known, the interest rate implicit in the lease. Property under capital leases is amortized on a straight-line basis over the lease term.

Investment tax credits Investment tax credits are accounted for by the flow-through method.

Revenue recognition Passenger revenue is recognized when the transportation is provided. Tickets sold but not yet used are included in "Air traffic liability."

2. TRANSTAR

Effective June 30, 1985, Southwest acquired the stock of Muse Air Corporation, which was subsequently renamed TranStar, for approximately $68 million consisting of approximately $40.5 million in cash; 830,320 shares of Southwest common stock; and 1,080,320 warrants to purchase Southwest common stock at $35 per share, subject to adjustment, expiring on June 25, 1990. The acquisition was accounted for as a purchase and, accordingly, the results of operations of TranStar were included in the consolidated financial statements from the date of acquisition.

Due to substantial operating losses, TranStar's management decided in July 1987 to cease operations and liquidate TranStar's assets and liabilities. Accordingly, the effects of this decision were recorded as of July 1. Since July, the following events have taken place: TranStar discontinued its scheduled airline operations; sold all its owned aircraft and related spare parts and equipment; assigned its rights and obligations as lessee with respect to all leased aircraft; and effected a nontaxable liquidating dividend of remaining net assets to its parent at December 31, 1987 and thus, ceased all operations. Proceeds pursuant to these aircraft sale agreements were approximately $77 million in cash (subject to adjustment for a fair market value appraisal of the spare parts and equipment) and assumption of all aircraft-related debt ($26 million face value of notes and $50 million face value of Equipment Trust Certificates) and all aircraft related lease obligations (approximately $238 million at June 30, 1987). TranStar also sold its delivery positions for two MD-80 aircraft for cash and assumption of debt equivalent to progress payments made by TranStar on the positions ($8 million). TranStar remains secondarily liable on the Equipment Trust Certificates and certain of the lease agreements assigned. Ultimately, aircraft should be available, if necessary, to satisfy a substantial portion of the Company's secondary liabilities. TranStar also disposed of approximately $2 million (net book value) of ground property and equipment.

Operating results for TranStar included in the Company's consolidated financial statements were (in thousands):

	Years ended December 31, 1987	1986	1985
Operating revenues	**$ 80,499**	$ 149,943	$ 73,863
Operating expenses	**(91,233)**	(142,216)	(65,539)
Other, net	**(4,451)**	(6,061)	(8,021)
Net gains on asset disposals	**31,824**	—	—
Provision for operating losses during shut-down period	**(21,643)**	—	—
Income (loss) before income taxes	**$ (5,004)**	$ 1,666	$ 303

3. COMMITMENTS

At December 31, 1987, the Company's contractual commitments consisted primarily of scheduled aircraft acquisitions. Thirteen Boeing 737-300s were scheduled for delivery in 1988 and seven in 1989. Ten Boeing 737-500 aircraft were scheduled for delivery in 1990 and five in 1991. In addition, the Company had options to purchase two Boeing 737-300 aircraft in 1989 and 25 Boeing 737-500s in 1991-1993. (Subsequent to December 31, 1987, the Company exercised one of its options to purchase a Boeing 737-300 aircraft.) Aggregate funding needed for these commitments was approximately $513 million at December 31, 1987, due as follows: $202 million in 1988, $112 million in 1989, $138 million in 1990 and $61 million in 1991. The Company had paid a total of $675,000 to obtain the 27 purchase options.

4. ACCRUED LIABILITIES

(in thousands)	1987	1986
Aircraft rentals	$ 13,313	$ 1,780
Taxes, other than income	8,764	6,758
Interest	8,040	8,949
Vacation pay	8,147	7,371
Profit sharing (Note 8)	1,596	4,972
Other	17,133	13,935
	$ 56,993	$ 43,765

5. LONG-TERM DEBT

(in thousands)	1987	1986
Southwest:		
9% Notes due 1996	$100,000	$100,000
6¾% Convertible Subordinated Debentures due 1998	35,000	35,000
French Export Credit Agreement	15,151	17,676
10.4% ETC's due July 1, 1994	12,539	14,329
10.3% ETC's due January 1, 1995	10,501	11,901
10.3% ETC's due July 1, 1995	11,834	13,313
Capital leases (Note 6)	70,891	71,642
Industrial Revenue Bonds	4,025	4,300
Other	1,626	2,199
TranStar:		
Notes payable to banks due December 31, 1991	—	27,060
16⅞% ETC's due June 15, 1999	—	50,000
	261,567	347,420
Less current portion	9,743	11,546
Debt discount	(694)	(2,597)
Debt premium	—	5,792
	$251,130	$339,069

In March 1986, Southwest issued $100 million of unsecured 9% Notes due March 1, 1996. Interest is payable semi-annually on March 1 and September 1 and the entire principal balance is payable at maturity. The Notes are redeemable at the issuer's option on or after March 1, 1993 at par plus accrued interest.

The 6¾% Convertible Subordinated Debentures were issued by Southwest Airlines Eurofinance N.V. and are convertible into common stock at any time on or before July 1, 1998, unless previously redeemed, at a conversion price of $38.30 per share, subject to adjustment in certain events. Interest is payable on July 1 of each year. The debentures are redeemable at the issuer's option at prices beginning at 103% of face value after July 1, 1986, and declining by 1% per year to 100% in 1989 and thereafter.

The French Export Credit Agreement requires 16 semi-annual installments of principal and interest beginning in June 1986. The debt is secured by one Boeing 737-300 and one Boeing 737-200 aircraft and bears interest at 10.5% per annum.

The 10.3% and 10.4% Equipment Trust Certificates require semi-annual principal and interest payments and are secured by ten Boeing 737-200 advanced series aircraft with a net book value of approximately $45 million at December 31, 1987.

The Industrial Revenue Bonds mature in series annually through 1994. Interest is payable semi-annually on January 1 and July 1 at an effective rate of 60% of prime but not less than 7½% or more than 15%. The Bonds are secured by Southwest's Reservations Center in San Antonio.

The notes payable to banks due December 31, 1991 were TranStar obligations secured by two MD-80 aircraft. These notes were assumed by a third party in 1987 as part of TranStar's aircraft sales as described in Note 2. The FAA guaranteed 90% of the principal and all of the interest on the notes. The aircraft manufacturer guaranteed the remaining principal payments. The notes accrued interest on 90% of the principal balance at the greater of a certificate of deposit rate plus ½% per annum or 115% of a 90-day treasury bill rate (as defined in the loan participation agreement) and at prime rate on the remainder.

The 16⅞% Equipment Trust Certificates due June 15, 1999 were TranStar obligations secured by three MD-80 aircraft. These ETC's were assumed by a third party in 1987 as part of TranStar's aircraft sales as described in Note 2. Interest was payable December 15 and June 15 of each year. The Certificates were entitled to an annual sinking fund of $5 million beginning June 15, 1991, calculated to retire 80% of the certificates prior to maturity. The Certificates were redeemable, at TranStar's option, at any time on or after June 15, 1989 at prices beginning at 109.15% of face value and declining to 100% in years 1997 and thereafter.

The Company had several other credit facilities available to it as of December 31, 1987: Bank Credit Agreement, Transferable Advances Facility Agreement and Euro Note Programme.

The Bank Credit Agreement with a group of domestic banks permits Southwest to borrow through December 18, 1988 on a revolving credit basis up to the primary commitment ($40 million at December 31, 1987). The primary commitment can be increased to as much as $150 million at Southwest's option. Interest rates on borrowings under the Credit Agreement can be, at the option of Southwest, the agent bank's prime rate, ½% over LIBOR or ½% over domestic certificate of deposit rates. The commitment fee is ⅜% per annum on the unused portion of the primary commitment and ⅛% per annum on the difference between $150 million and the amount of the primary commitment. There were no outstanding borrowings under this agreement at December 31, 1987 and 1986.

The Transferable Advances Facility Agreement with a group of European banks permits Southwest to borrow on a revolving credit basis up to $50 million through June 21, 1990. Borrowings bear interest from 0.15% to 0.35% over LIBOR. The agreement provides for commitment fees of (i) 0.15% per annum on the unused portion of the Available Commitment, as defined, (ii) 0.10% per annum on the Reserve Commitment, as defined, and (iii) 0.10% per annum on the Available Commitment, whether or not used. At Southwest's option, the Available Commitment can be increased to as much as $50 million or decreased to as little as $10 million. As of December 31, 1987 and 1986, there were no outstanding borrowings under the agreement.

The Euro Note Programme allows Southwest to issue up to $50 million of unsecured short-term notes in the European market. The notes are sold through a single dealer on a best efforts basis. At December 31, 1987 and 1986 there were no outstanding borrowings under this program.

Long-term debt principal payments, exclusive of capital leases, due in the next five years are (in thousands):

1988	$ 7,878
1989	7,878
1990	9,130
1991	7,820
1992	7,845

6. LEASES

Excluding landing fees, total rental expense for operating leases charged to operations in 1987, 1986 and 1985, was $41,713,000, $27,851,000 and $23,717,000. The majority of the Company's corporate office and terminal operations space and 14 aircraft are under operating leases. The following amounts applicable to capital leases are included in property and equipment (in thousands):

	1987	1986
Flight equipment	**$72,382**	$72,382
Less accumulated amortization	**12,451**	8,456
	$59,931	$63,926

At December 31, 1987, obligations under capital leases and noncancelable operating leases for future minimum lease payments were as follows (in thousands):

	Capital leases	Operating leases
1988	$8,931	$ 27,373
1989	8,931	28,865
1990	8,931	28,604
1991	8,931	28,797
1992	8,931	27,703
After 1992	95,447	411,556
Total minimum lease payments	140,102	$552,898
Less amount representing interest	69,211	
Present value of minimum lease payments	70,891	
Less current portion	1,865	
Long-term portion	$69,026	

7. CAPITAL STOCK

At December 31, 1987, the Company had 36,515,712 shares of common stock reserved for issuance upon the conversion of convertible securities and pursuant to employee profit sharing and stock option plans and upon exercise of rights pursuant to the Common Share Purchase Rights Plan (the Plan), described below.

On July 14, 1986, the Board of Directors of the Company adopted the Plan which was effected by a dividend of one common share purchase right (Right) for each outstanding share of the Company's common stock. Each Right entitles its holder to purchase one share of common stock for $75 and is exercisable only in the event of a proposed takeover, as defined by the Plan. The Company may redeem the Rights at $.05 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 Plan, each Right will entitle its holder to purchase for $75 that number of the acquiring company's or the Company's common shares, as provided in the Plan, having a market value of $150. The Rights will expire no later than July 30, 1996.

8. EMPLOYEE PROFIT SHARING AND STOCK OWNERSHIP PLANS

Substantially all of the Company's employees are members of a profit sharing plan. Total profit sharing expense charged to operations in 1987, 1986 and 1985 was $1,596,000, $8,469,000 and $8,329,000, respectively.

Southwest's plan provides that Southwest may contribute, as determined by the Board of Directors, the lesser of 15% of its adjusted pretax income (as defined by the plan) or the maximum amount deductible for federal income tax purposes.

Southwest also had an Employee Stock Ownership Plan which, under Internal Revenue Service regulations, allowed a tax credit equal to 1/2% of salary and wage expense if this amount was invested in Southwest stock on behalf of its employees. The tax credit was repealed effective December 31, 1986 by the Tax Reform Act of 1986 and, as a result, the Plan was terminated effective July 1, 1987.

9. OTHER INCOME

In 1987, a gain of $4,297,000 was realized from the sale of certain financial assets. The Company sold aircraft delivery positions during 1986, realizing a gain of $3,959,000.

10. INCOME TAXES

The provision for income taxes included deferred tax resulting from timing differences in the recognition of revenue and expense for financial and tax reporting purposes. The provision for income taxes consisted of (in thousands):

	1987	1986	1985
Current	**$11,703**	$ 1,353	$ 971
Deferred:			
Depreciation	**7,769**	33,598	27,318
Deferred gain on sale/leaseback	**(17,635)**	(9,424)	—
Operating loss carryforward	**10,015**	3,753	(3,753)
Investment tax credits	**1,671**	(8,251)	(15,693)
Capitalized interest	—	1,269	2,845
Capital leases	**(1,428)**	(1,587)	(925)
Tax benefit transfer	**(741)**	(2,996)	(1,030)
Other	**(2,436)**	(2,304)	3,773
Total deferred provision (benefit)	**(2,785)**	14,058	12,535
Total	**$8,918**	$15,411	$13,506

The provision for income taxes differed from the amount which resulted from applying the statutory rates (40% in 1987, 46% in 1986 and 1985 for federal income tax) to pretax income as follows (in thousands):

	1987	1986	1985
Federal income tax provision at statutory rate	**$11,629**	$30,105	$27,961
Investment tax credit	**(8,193)**	(11,089)	(14,001)
Effect of TranStar basis differences that resulted from purchase accounting adjustments	**4,008**	(1,554)	(120)
Nondeductible expenses	**785**	—	—
State income tax provision at statutory rates	**360**	—	—
Other tax credits	—	(754)	(618)
Capital gains	—	(740)	—
Other	**329**	(557)	284
	$8,918	$15,411	$13,506

The effect of the discontinuance of TranStar's operations (described in Note 2) was to increase the provision for income taxes for the year ended December 31, 1987 by $7 million. As a result of the application of Accounting Principles Board Opinion No. 16 (APB 16) upon the acquisition of TranStar in 1985, large permanent differences existed between the bases of the aircraft for federal income tax purposes versus the net book values for financial reporting purposes. Therefore, the gains on sales of these assets for federal income tax purposes were significantly greater than the corresponding gains for financial reporting purposes and thus, the provision for income taxes applicable to TranStar's pretax earnings of $10,181,000 derived during the shut-down period was approximately 69%.

Further, the discontinuance of TranStar's operations and its subsequent liquidation enabled the Company to realize, for financial reporting purposes, the purchased TranStar net operating loss and investment tax credit carryforwards of approximately $52 million and $3 million, respectively. Accordingly, the purchase price allocation has been adjusted in accordance with APB 16 and the 1986 and 1985 balances included in the Consolidated Financial Statements have been restated to reflect the realization of the tax benefit derived from the realization of the net operating loss carryforward. Prior years' balance sheets have been restated to eliminate goodwill and reduce deferred income taxes by a comparable amount. The effects of the realization of the benefit from the net operating loss carryforward on each period's net income were not material and, therefore, no restatement of net incomes or retained earnings was made. The realization of the investment tax credit carryforward was accounted for as a reduction of noncurrent assets.

At December 31, 1987, the Company had available $27 million in pre-acquisition operating loss carryforwards and $3 million in pre-acquisition investment tax credit carryforwards for federal income tax purposes. The carryforwards can be used by Southwest as a result of the liquidation of TranStar and will expire in 1995 through 2000 if they remain unutilized.

In addition, at December 31, 1987, the Company had available $27.8 million in investment tax credit carryforwards for federal income tax purposes. The carryforwards will expire in 1999 through 2002 if not previously utilized.

11. NET INCOME PER COMMON SHARE

Net income per common share is computed based on the weighted average number of common and common equivalent shares outstanding (32,091,000 in 1987, 32,254,000 in 1986 and 30,766,000 in 1985).

Net income per common share assuming full dilution is computed based on shares issuable upon conversion of debentures (weighted for number of days outstanding) and the weighted average number of common and common equivalent shares outstanding (33,005,000 in 1987, 33,168,000 in 1986 and 32,757,000 in 1985). The computation includes adjustment of $1,418,000 in 1987, $1,276,000 in 1986 and $2,148,000 in 1985 for debenture interest expense, net of income tax effect.

AUDITOR'S REPORT

The Board of Directors
Southwest Airlines Co.

We have examined the accompanying consolidated balance sheet of Southwest Airlines Co. at December 31, 1987 and 1986, and the related consolidated statements of income, stockholders' equity and changes in financial position for each of the three years in the period ended December 31, 1987. Our examinations were made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the statements mentioned above present fairly the consolidated financial position of Southwest Airlines Co. at December 31, 1987 and 1986, and the consolidated results of operations and changes in financial position for each of the three years in the period ended December 31, 1987, in conformity with generally accepted accounting principles applied on a consistent basis during the period.

Arthur Young & Company

Dallas, Texas
January 29, 1988

SOUTHWEST AIRLINES CO.
SUPPLEMENTARY INFORMATION
PARENT COMPANY ONLY

SUMMARY OF OPERATIONS (in thousands)	Years ended December 31, 1987	1986	1985
Operating revenues:			
Passenger	$ 675,397	$ 599,440	$ 586,639
Freight	12,329	11,758	12,711
Other	10,937	8,501	6,729
Total operating revenues	698,663	619,699	606,079
Operating expenses:			
Salaries, wages and benefits	206,140	179,269	152,822
Fuel and oil	121,900	99,702	145,682
Maintenance materials and repairs	52,331	40,316	35,367
Agency commissions	40,498	32,520	28,805
Aircraft rentals	14,834	858	4,920
Landing fees and other rentals	33,593	27,569	27,413
Depreciation	59,139	55,644	45,624
Other operating expenses	129,047	102,585	95,246
Total operating expenses	657,482	538,463	535,879
Operating income	41,181	81,236	70,200
Other expenses	7,104	17,456	9,719
Equity in earnings (loss) of TranStar	(5,004)	1,666	303
Income before income taxes	29,073	65,446	60,784
Provision for income taxes	8,918	15,411	13,506
Net income	$ 20,155	$ 50,035	$ 47,278

OPERATING STATISTICS	1987	1986	1985
Passengers carried	12,313,114	11,333,893	11,595,602
Revenue passenger miles (RPM) (000's)	6,749,942	5,666,037	5,336,560
Available seat miles (ASM) (000's)	11,456,730	9,712,384	8,716,608
Load factor	58.9%	58.3%	61.2%
Average length of passenger haul	548	500	460
Trips flown	246,046	218,841	208,368
Average passenger fare	$54.85	$52.89	$50.60
Yield per RPM	10.0¢	10.6¢	11.0¢
Operating expense per ASM	5.7¢	5.5¢	6.1¢
Fuel cost per gallon (average)	54.9¢	51.6¢	78.4¢
Number of employees at period-end	5,765	4,610	4,228
Size of fleet at period-end*	75	63	56

*includes leased aircraft

SOUTHWEST AIRLINES CO.

Years ended December 31

SELECTED CONSOLIDATED FINANCIAL DATA

(in thousands except per share amounts)	1987	1986	1985 (4)	1984
Operating revenues:				
Passenger	$ 751,649	$ 742,287	$ 656,689	$ 519,106
Freight	13,428	13,621	13,643	12,115
Other	13,251	12,882	9,340	4,727
Total operating revenues	778,328	768,790	679,672	535,948
Operating expenses	747,881	679,827	601,148	467,451
Operating income	30,447 (1)	88,963	78,524	68,497
Other expense (income)	1,374 (2)	23,517 (3)	17,740	649
Income before income taxes	29,073	65,446	60,784	67,848
Provision for income taxes	8,918	15,411	13,506	18,124
Net income	$ 20,155	$ 50,035	$ 47,278	$ 49,724
Net income per common share:				
Primary	$ .63	$ 1.55	$ 1.54	$ 1.69
Fully diluted	$ .63	$ 1.55	$ 1.51	$ 1.64
Cash dividends per common share	$ .13	$ .13	$ .13	$ .13
Total assets	$ 1,042,640	$ 1,061,419	$ 1,002,403	$ 646,244
Long-term obligations	$ 251,130	$ 339,069	$ 381,308	$ 153,314
Stockholders' equity	$ 514,278	$ 511,850	$ 466,004	$ 361,768

CONSOLIDATED FINANCIAL RATIOS

Return on average total assets	1.9%	4.8%	5.6%	8.1%
Return on average stockholders' equity	4.0%	10.3%	11.4%	14.7%
Debt as a percentage of equity	32.8%	39.8%	45.0%	29.8%

CONSOLIDATED OPERATING STATISTICS

Passengers carried	13,503,242	13,637,515	12,651,239	10,697,544
Revenue passenger miles (RPM) (000's)	7,789,376	7,388,401	5,971,400	4,669,435
Available seat miles (ASM) (000's)	13,331,055	12,574,484	9,884,526	7,983,093
Load factor	58.4%	58.8%	60.4%	58.5%
Average length of passenger haul	577	542	472	436
Trips flown	270,559	262,082	230,227	200,124
Average passenger fare	$55.66	$54.43	$51.91	$48.53
Yield per RPM	9.7¢	10.1¢	11.0¢	11.1¢
Operating expense per ASM	5.6¢	5.4¢	6.1¢	5.9¢
Fuel cost per gallon (average)	54.3¢	51.4¢	78.2¢	82.4¢
Number of employees at period-end	5,765	5,819	5,271	3,934
Size of fleet at period-end (7)	75	79	70	54

(1) Includes TranStar's results through June 30, 1987
(2) Includes $10.1 million net gains from the discontinuance of TranStar's operations and $4.3 million from the sale of certain property rights
(3) Includes a gain of $4 million from the sale of aircraft delivery positions
(4) Includes the accounts of TranStar since June 30, 1985
(5) Includes a gain from the sale of tax benefits relating to three aircraft of $11 million
(6) Includes a gain of $8.5 million from the sale of aircraft and net cumulative effect of an accounting change of $735,000
(7) Includes leased aircraft

1983	1982	1981	1980	1979	1978
$ 433,388	$ 317,996	$ 258,612	$ 204,260	$ 130,507	$ 77,583
10,357	9,469	8,326	6,080	4,057	2,364
4,491	3,724	3,420	2,708	1,550	1,118
448,236	331,189	270,358	213,048	136,114	81,065
379,738	291,964	221,854	164,219	107,128	59,943
68,498	39,225	48,504	48,829	28,986	21,122
4,927	(5,165)(5)	239	7,539	8,272	(3,569)(6)
63,571	44,390	48,265	41,290	20,714	24,691
22,704	10,386	14,100	12,843	4,062	7,687
$ 40,867	$ 34,004	$ 34,165	$ 28,447	$ 16,652	$ 17,004
$ 1.40	$ 1.28	$ 1.35	$ 1.30	$ .79	$ .81
$ 1.38	$ 1.26	—	—	—	—
$ .13	$ .13	$ .11	$ .09	$ .06	$ .04
$ 587,258	$ 420,542	$ 291,823	$ 224,442	$ 172,495	$ 118,706
$ 158,701	$ 106,306	$ 58,934	$ 77,892	$ 87,374	$ 62,000
$ 314,556	$ 240,627	$ 176,503	$ 106,964	$ 58,412	$ 42,889
8.1%	9.6%	13.0%	14.1%	11.7%	17.2%
14.2%	16.7%	23.5%	36.0%	33.1%	50.3%
33.5%	30.6%	25.0%	42.1%	59.9%	59.1%
9,511,000	7,965,554	6,792,927	5,976,621	5,000,086	3,528,105
3,893,821	3,022,142	2,310,181	2,024,097	1,585,539	1,048,624
6,324,224	4,907,945	3,633,351	2,969,448	2,320,371	1,556,173
61.6%	61.6%	63.6%	68.2%	68.3%	67.4%
409	379	340	339	317	297
175,421	140,030	110,301	91,143	75,837	54,816
$45.57	$39.92	$38.07	$34.18	$26.10	$21.99
11.1¢	10.5¢	11.2¢	10.1¢	8.2¢	7.4¢
6.0¢	5.9¢	6.1¢	5.5¢	4.6¢	3.9¢
85.9¢	94.5¢	101.7¢	85.0¢	59.3¢	38.2¢
3,462	2,913	2,129	1,839	1,630	1,119
46	37	27	23	18	13

CORPORATE DATA

TRANSFER AGENT AND REGISTRAR

MTrust Corp., N.A.
P.O. Box 2320
Dallas, Texas 75221-2320

STOCK EXCHANGE LISTING

New York Stock Exchange
Ticker Symbol: LUV

AUDITORS

Arthur Young & Company
Dallas, Texas

GENERAL OFFICES

P.O. Box 37611
Love Field
Dallas, Texas 75235

ANNUAL MEETING

The Annual Meeting of Shareholders of Southwest Airlines Co. will be held at 10:00 a.m. on May 18, 1988 in the Auditorium of MBank Dallas on the fifth floor of Momentum Place, 1717 Main Street, Dallas, Texas.

SEC FORM 10-K

Stockholders may obtain free of charge a copy of the Company's Annual Report on Form 10-K as filed with the Securities and Exchange Commission by writing to the Chief Financial Officer, P.O. Box 37611, Love Field, Dallas, Texas 75235.