SOUTHWEST AIRLINES CO.

ANNUAL 1992 REPORT

Net Income*
(in millions)

*1992 excludes cumulative effect of change in accounting principle of $12.5 million

Net Income Per Share*

* 1992 excludes cumulative effect of change in accounting principle of $.13 per share

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Consolidated Highlights

(dollars in thousands except per share amounts)

	1992	1991	Percent change
Operating revenues	$1,685,178	$1,313,605	28.3
Operating expenses	$1,502,542	$1,250,669	20.1
Operating income	$182,636	$62,936	190.2
Operating margin	10.8%	4.8%	6.0 pts.
Net income*	$91,021	$26,919	238.1
Net margin*	5.4%	2.0%	3.4 pts.
Net income per common and common equivalent share*	$.97	$.31	212.9
Stockholders' equity	$854,253	$628,521	35.9
Return on average stockholders' equity*	11.7%	4.4%	7.3 pts.
Debt as a percentage of invested capital	45.0%	49.5%	(4.5) pts.
Stockholders' equity per common share outstanding	$9.24	$7.44	24.2
Revenue passengers carried	27,839,284	22,669,942	22.8
Revenue passenger miles (RPM) (000s)	13,787,005	11,296,183	22.1
Available seat miles (ASM) (000s)	21,366,642	18,491,003	15.6
Passenger load factor	64.5%	61.1%	3.4 pts.
Passenger revenue yield per RPM	11.78¢	11.22¢	5.0
Operating revenue yield per ASM	7.89¢	7.10¢	11.1
Operating expenses per ASM	7.03¢	6.76¢	4.0
Number of employees at yearend	11,397	9,778	16.6

* 1992 excludes cumulative effect of change in accounting principle of $12.5 million ($.13 per share)

The Triple Crown. Won by the airline with the combination of Best Ontime Performance; Best Baggage Handling; and Highest Customer Satisfaction in a single month, as reported by the U.S. Department of Transportation. Only one airline has ever won it – Southwest Airlines. And we've won it eleven times.

1992 marks the first time ever that a major airline – Southwest – has won the *annual* Triple Crown – Number One in Ontime Performance; Number One in Baggage Handling; and Number One in Customer Satisfaction – *for the entire year.*

Our 12,000 Employees now proudly wear the Triple Crown Medal for Distinguished Customer Service. This annual report is a tribute to them, and to the co-winners, our Customers.

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 1992, Southwest operated 141 Boeing 737 aircraft and provided service to 36 airports in 34 cities in the midwestern, southwestern, and western regions of the United States. The Company has one of the best overall Customer Service records, the lowest operating cost structure, 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.

To Our Shareholders

The three years 1990-92 presented the gravest financial crisis in the history of the airline industry. During this relatively brief period, approximately 40 percent of the total capacity of our nation's largest carriers either ceased operations or began operating in Chapter 11. And the massive losses incurred by our industry as a whole changed its cumulative financial results – stemming from its very inception – from an overall industry profit to an overall industry loss. For these reasons, 1990-92 will long and unhappily be remembered as a time of economic holocaust in the American airline industry.

Although Southwest was the only major carrier reporting both operating and net income in 1990 and 1991, its earnings were severely impaired in both years, falling substantially below those of 1989. In our Letter to Shareholders in our 1991 Annual Report, however, we prophesied that 1992 would be a "Year of Opportunity" for Southwest, and so it has proven to be, in terms of both market expansion and recuperation from financial malaise.

On behalf of the wondrous and valorous people of Southwest, I am happy to report fourth quarter 1992 earnings of $27,170,000 ($.29 per share), a 207.3 percent improvement over our fourth quarter 1991 profit of $8,842,000 ($.10 per share). These respectable results are primarily attributable to a revenue increase of 27.4 percent, accompanied by an operating cost increase of 20.0 percent on a capacity enhancement of 17.3 percent. A 2.3 percent rise in operating expenses per available seat mile (ASM), to $.0705 from $.0689, was substantially influenced by a $5,700,000 increase in quarterly Company contributions to employee profitsharing and savings plans.

Also on behalf of the splendid people of Southwest Airlines, I am very pleased to report year 1992 earnings of $91,021,000 ($.97 per share), a 238.1 percent improvement over our 1991 profit of $26,919,000 ($.31 per share). The 1992 earnings figure excludes the cumulative $12,538,000 one-time effect of an accounting change, both because it is an "accounting change" only and also because it will not recur in future years. Although below our target operating and net income margins, our relatively healthy 1992 profits are, again, principally attributable to a 28.3 percent increase in revenue, as compared to a 20.1 percent increase in operating costs. For the year, our operating expense per ASM increased 4.0 percent to $.0703 from $.0676, primarily due to increased annual profitsharing payments for our Employees; travel agency commissions; and airport terminal costs. Our net nonoperating expenses rose from $19,096,000 in 1991 to $35,799,000 in 1992 as a consequence of additional interest expense incurred from the 1991-92 issuances of $400,000,000 in senior unsecured debt, coupled with lower interest rates on invested cash during 1992 as compared to 1991. On January 20, 1993, we announced the early redemption, effective March 1, 1993, of $100,000,000 in 9 percent senior unsecured notes due 1996, to be funded from existing cash resources.

In 1992, Southwest became the largest carrier of intrastate passengers in California and also number one in originating passengers in Phoenix, Las Vegas, and Kansas City. As measured by daily flight departures, Phoenix is now the largest service point on our system, and we recently completed construction of our new maintenance facility at its Sky Harbor Airport. Additional California, Phoenix, Las Vegas, and Kansas City service will be provided in 1993.

Our 1992 expansion at Chicago's Midway Airport has proven to be successful, and we will inaugurate service to at least one new city from Midway in 1993, as well as augment service on existing Midway routes. A Midway reservations center and pilot domicile were opened in 1992.

Under our present plan, we will place in service 13 new Boeing 737-300s and one leased Boeing 737-300 in 1993, increasing ASM capacity by approximately 13 percent. We will also open our new Albuquerque reservations center; move to a larger reservations facility in Houston; complete the renovation of our gates at Dallas Love Field and Houston's Hobby Airport; and expand our Dallas Flight Training Center to accommodate a new Reflectone flight simulator.

Southwest has always striven to provide "more for less"– superior Customer Service quality for a lower fare – rather than "less for less." We have been successful in achieving this goal, as evidenced by our capture of 11 "Triple Crowns": best ontime performance; fewest mishandled bags; and lowest ratio of Customer complaints to Customers carried, all in a single month. No other major carrier has won even a single monthly Triple Crown, which is why Delta and Northwest have petitioned the Department of Transportation to declassify Southwest as a "major" carrier, despite the fact that we will transport roughly 30,000,000 originating Customers in 1993. Although DOT has not yet released its final 1992 statistics, as of this

writing it appears that our extraordinarily warm, welcoming, and Customer Service-oriented people have accomplished a "moon landing" in the field of Customer Service by winning the first **annual** Triple Crown attained by a major air carrier: best ontime performance; best baggage handling record; and best Customer complaint record – **for the entire year 1992.**

Our people are not only my heroines and heroes; they are the heroes and heroines of airline Customers and airline Customer Service quality throughout our land!

Southwest's people are, indeed, very special. During the past three years, they have worked assiduously and well to avoid and to avert the economic afflictions that have beset many other carriers and many other companies in the United States. In a material sense, they have been rewarded with job security rather than layoffs and furloughs; with pay increases rather than pay reductions; with profitsharing of $50,492,000 rather than shared privation; and with an increase in the value of their Employee owned, but Company contributed, stock to $246,232,000 at yearend 1992. Material rewards are important – to a point – but they also prove hollow unless accompanied by the psychic satisfactions of pride, excitement, fun, and collective fulfillment. Our people also provide <u>these</u> essential intangibles: to each other and to our Customers. That is why I am especially gratified that Messrs. Robert Levering and Milton Moskowitz, in their 1993 edition of *The 100 Best Companies to Work For in America*, chose Southwest as one of the **ten** best companies to work for – in all of America. Southwest received either four or five stars in the six rating categories of: Pay/Benefits; Opportunities; Job Security; Pride in Work/Company; Openness/Fairness; and Camaraderie/Friendliness. If our Employees' minds, hearts, and souls had been rated, they would each have received <u>ten</u> stars!

Most sincerely,

Herbert D. Kelleher

Herbert D. Kelleher
Chairman, President, and
Chief Executive Officer
January 21, 1993

Best Ontime Record

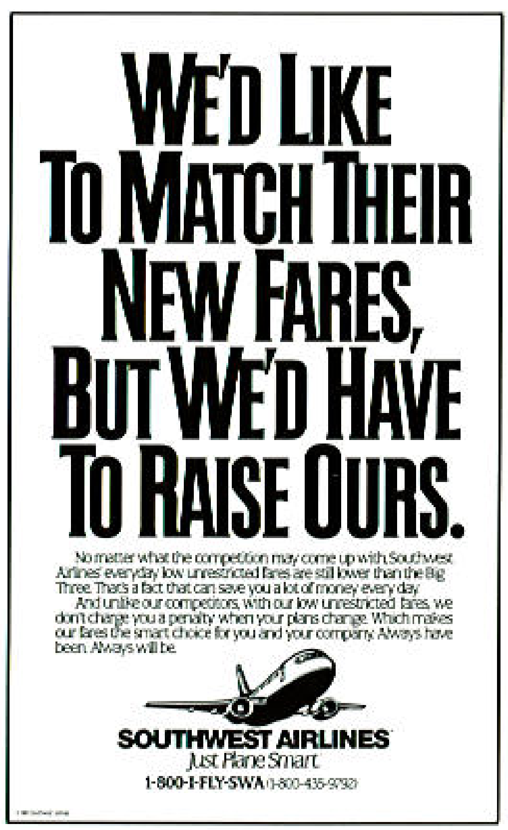
Southwest was specifically built to meet the needs of our Customers. It's no wonder we were on time 92.1 percent of the time in 1992, the best among the major U.S. airlines. In fact, we set an all-time monthly record in September 1992 with 94.9 percent of our more than 1,300 daily flights arriving on time.

Southwest's point-to-point route system, as compared to hub-and-spoke, provides for more direct nonstop routings for shorthaul Customers and, therefore, minimizes connections, delays, and total trip time. In addition, Southwest serves many conveniently-located satellite or downtown airports such as Dallas Love Field, Houston Hobby, Chicago Midway, Detroit City, Burbank, and Oakland airports, which are typically less congested than other airlines' hub airports and enhance our ability to achieve reliable, high ontime performance.

As a result of our focus on the shorthaul, point-to-point market, and the dedicated efforts of our Employees, Southwest is continually able to achieve the highest asset utilization and employee productivity of any major U.S. airline. Aircraft are scheduled to minimize the amount of time the aircraft is at the gate, generally less than 20 minutes, thereby reducing the number of aircraft and gate facilities that would otherwise be required. Avoiding high-cost, congested airports contributes significantly to our ability to achieve high asset utilization. So we don't have to sacrifice aircraft utilization to achieve high ontime performance.

Average Revenue Per Passenger Mile

The point-to-point route system, high aircraft utilization, and high employee productivity produce a very efficient operation with exceptional ontime performance. Also, we still operate only one aircraft type, the Boeing 737. At December 31, 1992, we had 141 in our fleet. This commitment to a single aircraft type significantly simplifies scheduling, maintenance, flight operations, and training activities. The 737 has proven to be one of aviation's most successful aircraft – it is attractive and comfortable for our Customers and is cost-effective to operate in the short- to medium-range markets.



When the Big Three airlines boasted they were lowering their fares, Southwest responded with characteristic humility.

Southwest Airlines Mechanic Robert Williams, First Officer Sherri Phillips, and Dispatcher Carla Beck helped us win the Best Ontime Record in America for 1992.

VISUAL: BUILDING A BOEING 737.
VOICE: All airlines were built to fly you places. But only one airline was built to save you money. Southwest.

VISUAL: FUELING A BOEING 737.
VOICE: That's why we fly one of the newest, most fuel-efficient jet fleets.

VISUAL: HAND LAYING MONEY ON COUNTER.
VOICE: We save on fuel. You save on fares.

VISUAL: SOUTHWEST JET.
VOICE: Southwest Airlines. It's Just Plane Smart.SM

Only one airline was built to save you money. In today's times, why would you fly anyone but Southwest Airlines?

Best Baggage Handling

Southwest was specifically built to meet the needs of our Customers. It's no wonder we don't lose many bags. In 1992, we had the fewest mishandled Customer bags of any major U.S. airline.

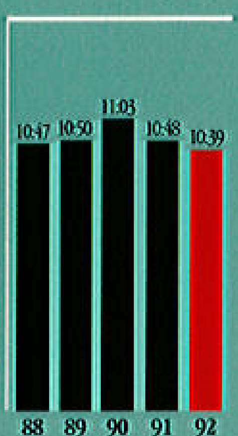
Southwest's marketing strategy is directed to communities that benefit by high-frequency, low-cost air transportation and that have sufficient local traffic to support our operations profitably. Because our focus is on local, not connecting, traffic, we do not interline with other jet airlines or have any commuter feeder relationships. As a consequence, approximately 80 percent of our Customers fly on us on a nonstop basis.

Our superior baggage handling is achieved despite our quick aircraft turns at the gate. So aircraft utilization is not impaired. In addition, this record has been compiled at a time when Southwest is carrying record and ever-increasing amounts of cargo and U.S. mail. Combined, freight revenues grew faster than capacity in 1992, or 25.2 percent.

Our streamlined approach, coupled with the caring and dedicated attitudes of our Ground Operations Employees, enables us to control and handle our Customers' baggage efficiently with minimal loss.

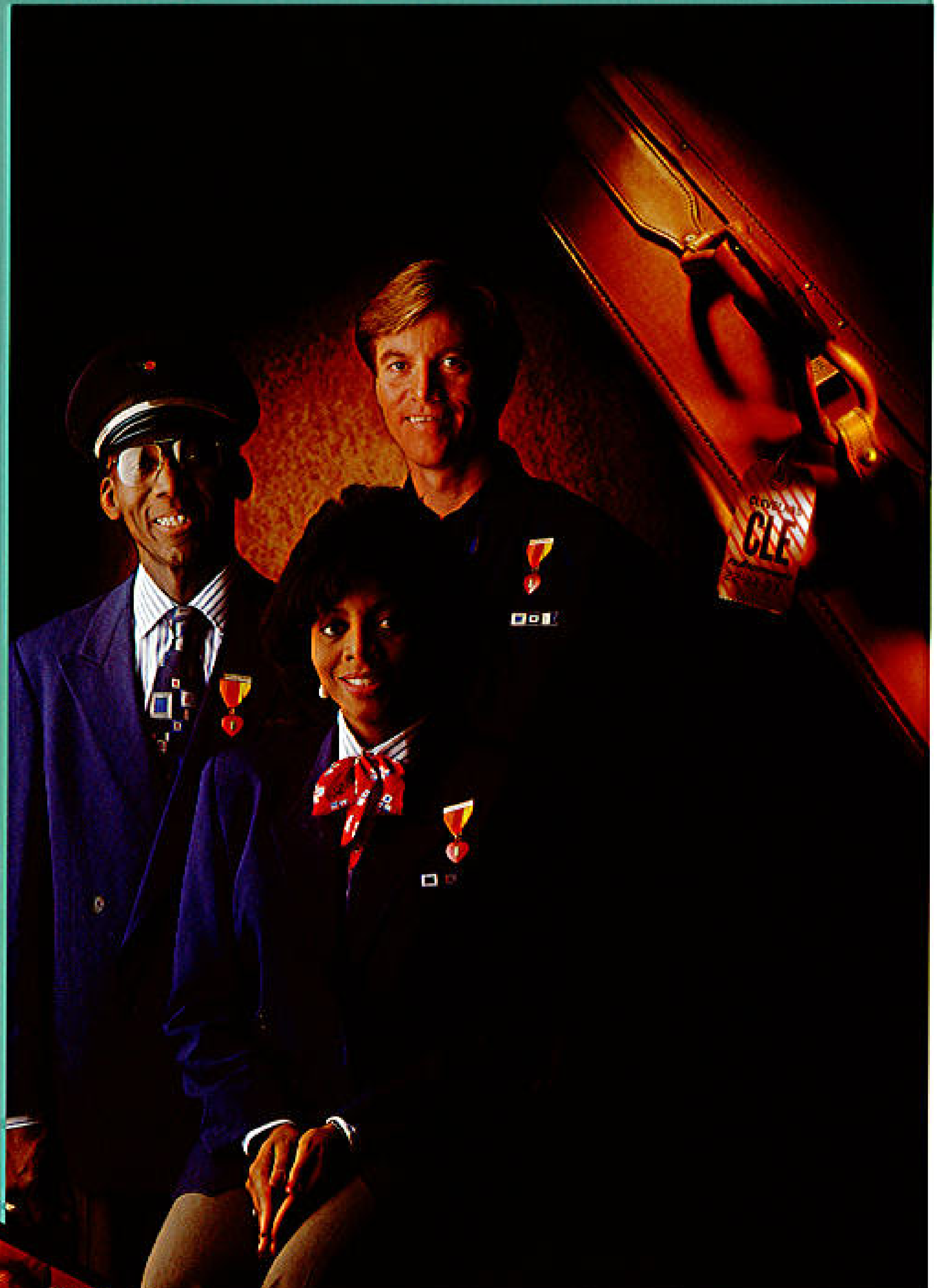
Although outstanding baggage handling along with outstanding Customer Service are objectives of our marketing strategy, the net result of our approach is that we dominate our markets in terms of passenger traffic. We consistently rank first in market share in more than 90 percent of our top 100 city-pair markets and, in the aggregate, hold a market share exceeding 50 percent.

Aircraft Utilization
(hours and minutes per day)



As part of Southwest's wildly successful "Friends Fly Free" program in 1992, we invited kids to fly free during the summer, when accompanied by an adult paying our regular low fare.

Southwest Airlines Ramp Agent Don Sargent, Skycap Charles Wilson, and Customer Service Agent Kathy Nelson make sure that your luggage is treated with the same respect we show all our Customers.



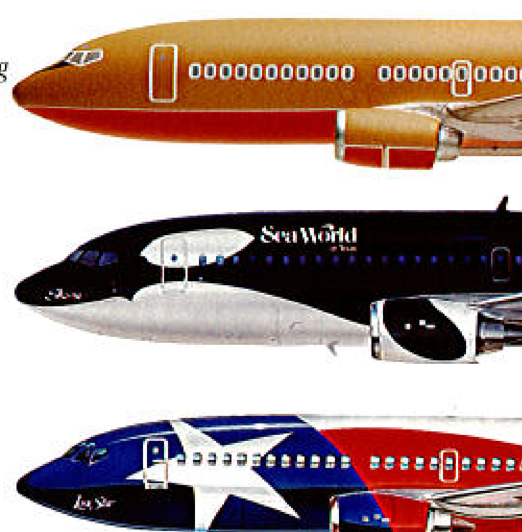
VISUAL: MOM SERVING DAD BREAKFAST IN BED.
VOICE: It's time for Friends Fly Free again on Southwest Airlines. And people are friendlier than ever.

VISUAL: DAUGHTER COMPLIMENTS DAD'S TIE.
VOICE: Just make reservations in advance, buy a roundtrip ticket, and a friend flies with you free.

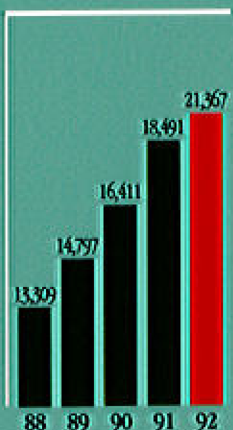
VISUAL: SON TRIMS HEDGE CREATIVELY.
VOICE: Yo, Dad. Whaddya think?

VISUAL: SOUTHWEST JET.
VOICE: Friends Fly Free on Southwest Airlines. It's Just Plane Smart.[SM]

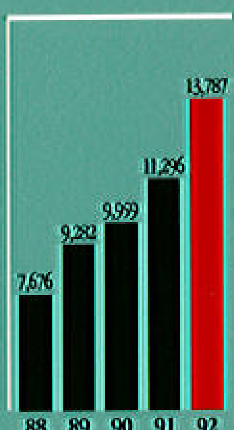
Southwest's fleet of 141 Boeing 737s includes three flying whales – Shamu® One, Two, and Three – in celebration of our partnership with Sea Worlds of Texas and California. Plus, Lone Star One,® a high-flying tribute to our home state of Texas.



Available Seat Miles
(in millions)



Revenue Passenger Miles
(in millions)



Highest Customer Satisfaction

Southwest was specifically built to meet the needs of our Customers. It's no wonder we get few complaints. In 1992, we had the best Customer complaint record of any major U.S. airline. Our outstanding Customer Satisfaction rating is a testament to the Positively Outrageous Service provided by our Employees on a daily basis.

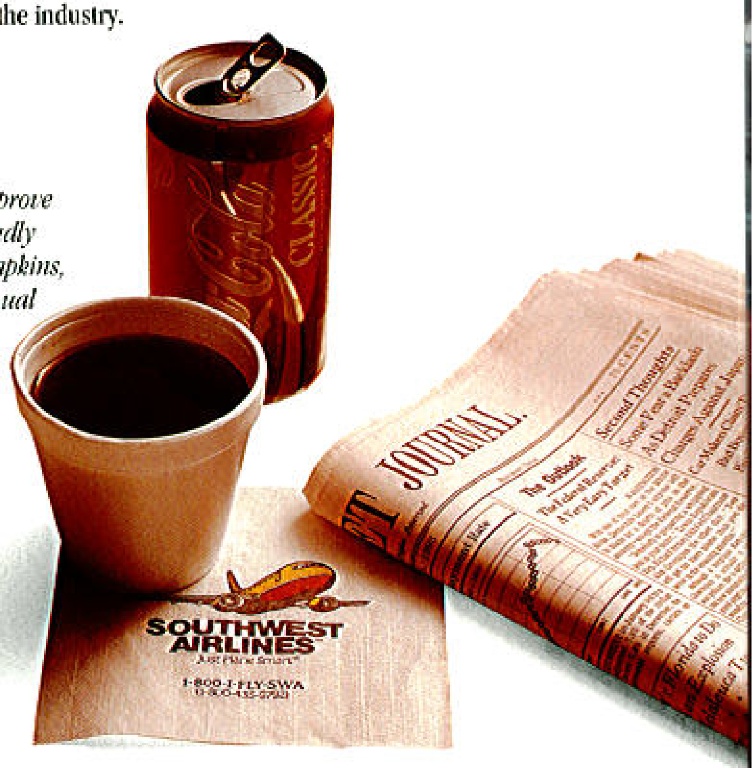
While our Employees deliver our high-quality Customer Service in a caring and enthusiastic manner, our unique marketing and operating strategy, designed with our Customers' needs in mind, facilitates this exceptional service. Since our inception, Southwest has adhered to our point-to-point service in shorthaul markets with the lowest fares; frequent, conveniently-timed flights; and friendly, reliable Customer Service. We are unique in the airline industry as the nation's only shorthaul, point-to-point, low-fare, high-frequency airline.

Our fares are purposely low, as our principal competition in shorthaul markets is often ground transportation. Southwest is clearly the low-fare leader in the U.S. airline industry. We have a very simple fare structure, maintaining low, unrestricted, unlimited everyday coach fares, which our Customers can depend upon to be the lowest available.

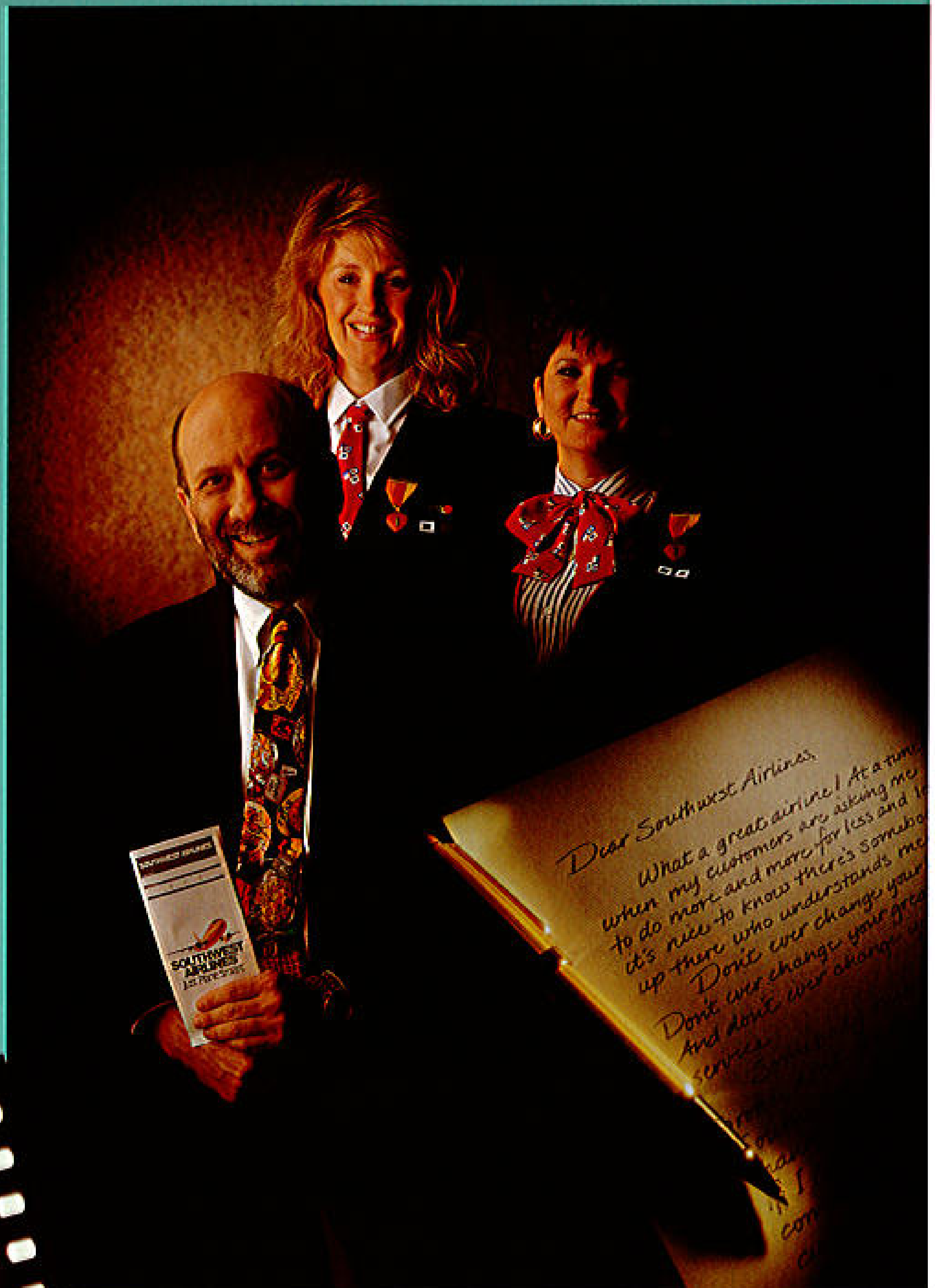
As a consequence of our low-fare approach, we tend to grow our own markets, often stimulating traffic three- and four-fold versus traffic levels existing prior to our service – with few complaints. Of course, our low operating costs enable us to offer these low fares, which are vital to the shorthaul Customer, and still be profitable.

Finally, our ticketing and boarding procedures, as well as our in-flight services, are designed and built to meet the needs of shorthaul Customers. Quick and efficient ticketing and boarding procedures are important to minimize the total trip time. Therefore, we offer confirmed but open seating in our all-coach cabin. Because the trips are short, no meals are practical or necessary, but superior beverage service is provided. While the services are "low frills," the Customer Satisfaction rating is the best in the industry.

In a continuing effort to help improve the environment, Southwest proudly recycles our coffee cups, cans, napkins, and newspapers. This entire annual report was printed on recycled paper.



Southwest Flight Attendant Laurel Miller and Reservations Agent Elsie Rice share our special brand of Southwest hospitality with Michael Levy, loyal Customer and Texas Monthly *magazine publisher.*



VISUAL: OFFICE COPY MACHINE.
VOICE: Flying to Houston on business?

VISUAL: COPIES SHOW MULTIPLE FLIGHTS.
VOICE: Southwest Airlines has 38 convenient flights from Dallas Love Field every business day.

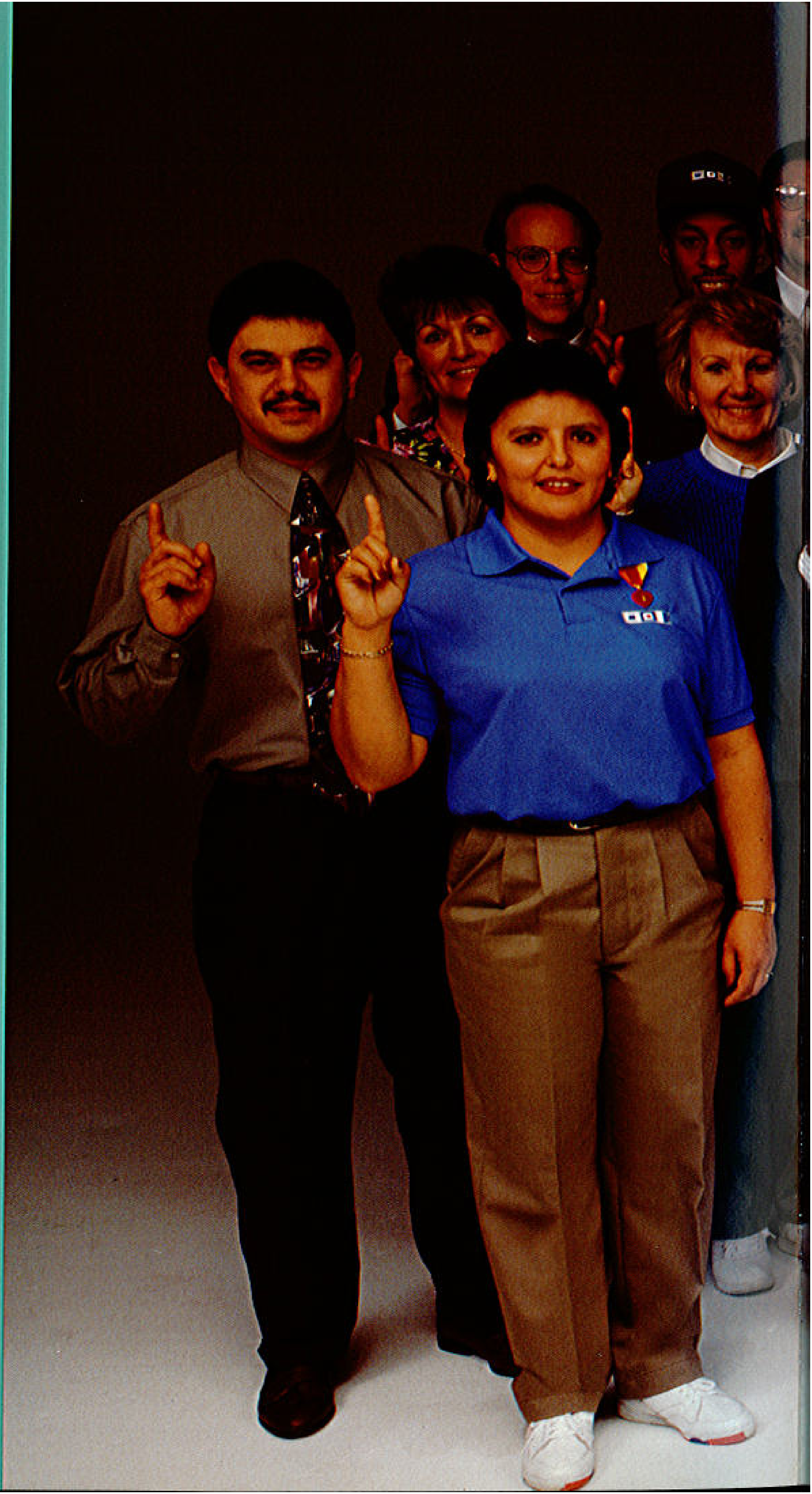
VISUAL: SCREEN READS "38 FLIGHTS TO HOUSTON."
VOICE: And that's something nobody else can copy.

VISUAL: SOUTHWEST JET.
VOICE: Southwest Airlines. It's Just Plane Smart.SM

The Company Club,® our frequent flyer program that rewards Customers for short trips instead of long mileage, remains the shortest route to free trips.

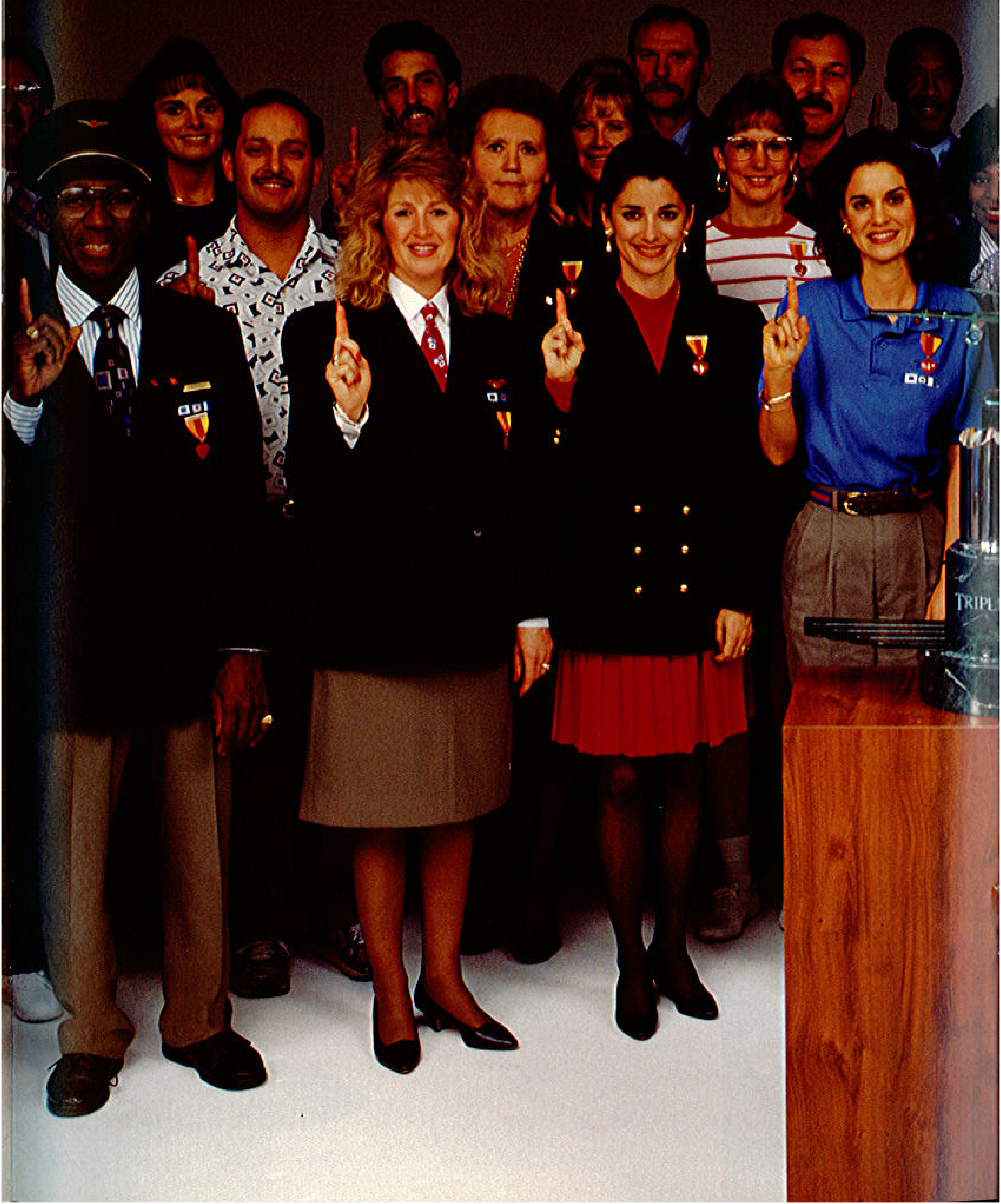
It takes teamwork to win the airline industry's first annual Triple Crown ever: Number One in Ontime Performance; Number One in Baggage Handling; and Number One in Customer Satisfaction for all of 1992. Representing the Southwest Team here are people from every department. Thanks to each and every one of our 12,000 Employees, Southwest Airlines has won what no other major airline has ever won before: The Annual Triple Crown.

But we've only just begun. Hats off to the past. Coats off to the future. Southwest Airlines is Number One and still climbing!



The first annual Triple Crown trophy ever. Polished green marble. Leaded jade crystal. An exquisite reminder of the hard work, dedication, and esprit de corps that made Southwest Number One in overall Customer Service in 1992.

SOUTHWEST AIRLINES. NUMB



ER ONE AND STILL CLIMBING.

Carla Beck, Dispatcher. **Rudy Bowling,** Courier, Mail and Warehouse Services Supervisor. **Keith Bradt,** Stock Clerk. **Jeff Brookhart,** Station Manager. **Zodie Christakos,** Cargo Administrative Analyst. **Mark Endriss,** Aircraft Cleaner. **Barri Fain,** Senior Customer Relations Representative. **Rocky Gonzalez,** Facilities Maintenance Specialist I. **Danny Goulas,** Crew Scheduler. **Johnny Guizar,** Offset Operator I. **Don Harbour,** Flight Crew Training Supervisor. **Hiram Harrison,** Senior Central Baggage Service Representative. **Charles Heinz,** Ground Operations Supervisor. **Terry Hornbaker,** Systems Application Support Manager. **Sandi Housouer,** Legal Assistant. **Joe Hughes,** Flight Information Agent. **Herb Kelleher,** Chairman. **Mike Kellogg,** Provisioning Manager. **Charlene Kostak,** Clerk. **Arlene Leonard,** Senior Company Club Writing Representative. **Jean Lewis,** Manager Ticket-By-Mail. **Tina Love,** Pass Bureau Coordinator. **Lidia Martinez,** Sales/Marketing Coordinator. **Laurel Miller,** Flight Attendant. **Dominique Missimo,** Revenue Management Analyst II. **Kathy Nelson,** Customer Service Agent. **Anne Norman,** Tax Accountant. **Sherri Phillips,** First Officer. **Robert Quintanilla,** Electronic Tech III. **Elsie Rice,** Reservations Sales Agent. **Jimmy Roybal,** Senior Internal Auditor. **Sandy Sambrano,** People Department Flight Ops Coordinator. **Don Sargent,** Ramp Agent. **Carol Sheff,** Executive Secretary. **Brook Sorem,** Schedule Analyst. **Ed Stewart,** Manager Public Relations. **Donna Swoverland,** Refunds Assistant Supervisor. **Irma Taube,** Inventory Control Specialist. **Dana Williams,** Manager Promotion/Event Marketing. **Robert Williams,** Mechanic. **Charles Wilson,** Skycap.


SOUTHW
DET
DTW
MDW
RNO
SMF
OAK
SFO
MCI
STL
IND
LAS
TUL
BUR
OKC
AMA
LIT
LAX
ONT
ABQ
SAN
PHX
LBB
DAL
MAF
ELP
AUS
HOU
MSY
SAT
IAH
CRP
HRL

Route Map – 1992 Expansion

1992 was another year in which Southwest capitalized on many of our available opportunities, despite America's sluggish economy. Our unique market niche, strong financial position, and wide Customer acceptance allowed us to accelerate our growth in shorthaul markets as our competitors contracted in 1991 and 1992.

Southwest's intra-California traffic surged in 1992 as compared to 1991. USAir's withdrawal from six California airports in 1991, along with reduced intra-California service in 1992 by United Airlines, Delta Air Lines, American Airlines, and USAir, allowed Southwest to accelerate our expansion in these markets with very satisfactory results. We serve seven California airports, all opened prior to 1992, and rank first in total passenger boardings at all of our California airports except Los Angeles International and San Francisco International. As of second quarter 1992, we had the highest share of intra-California traffic among the airlines, with 30.7 percent of the market, even though we do not serve all California airports and city pairs. Of the routes we served, however, we had the highest share of passenger traffic in every city pair with an aggregate 72.5 percent market share.

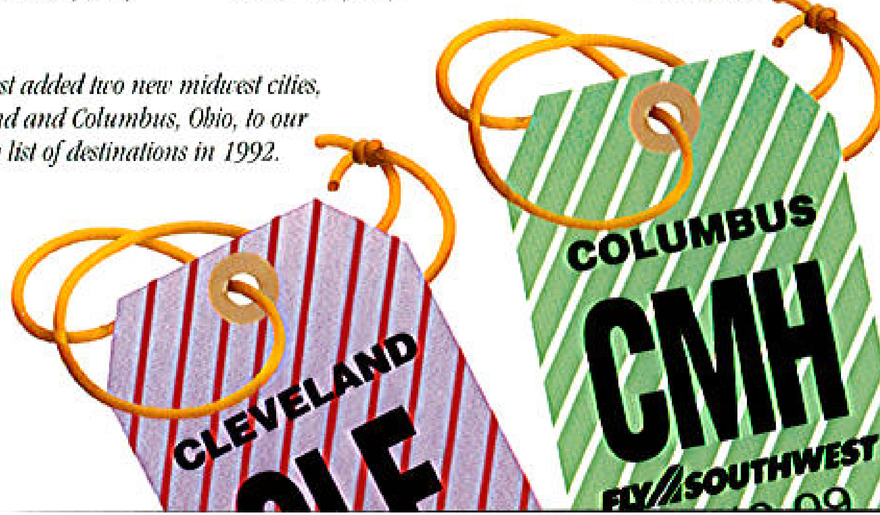
In contrast, our mature intra-Texas market grew a steady 4.8 percent in 1992, outpacing growth rates for the sluggish state economy, in general. Texas still well exceeds California in total traffic. Southwest ranks first in passenger boardings at ten of the 11 Texas airports served and had an intra-Texas traffic market share as of second quarter 1992 of 72.0 percent. We had the number one ranking in every intra-Texas city pair served.

Our Chicago Midway Airport development began in earnest in 1992 with the acquisition of 18 gates from Northwest Airlines. Southwest added service to Indianapolis and successfully opened two new cities in the midwest, Cleveland and Columbus, Ohio, each with nonstop service to Midway and St. Louis. Thus, our flight activity out of Midway was up almost 40 percent versus 1991, and traffic, partially as a result of the shutdown of Midway Airlines in November 1991, was up substantially in 1992. We were the largest carrier at Midway in 1992 by a wide margin.

In 1992, we also became the largest airline in Phoenix, Las Vegas, and Kansas City, in terms of originating traffic. Phoenix also became our largest operation with 137 daily departures.

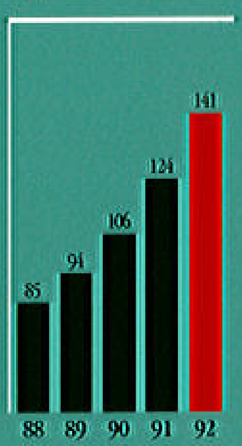
Southwest Airlines Destinations:

Albuquerque (ABQ)
Amarillo (AMA)
Austin (AUS)
Birmingham (BHM)
Burbank (BUR)
Chicago Midway (MDW)
Cleveland (CLE)
Columbus (CMH)
Corpus Christi (CRP)
Dallas Love Field (DAL)
Detroit City (DET)
Detroit Metro (DTW)
El Paso (ELP)
Harlingen (HRL)
Houston Hobby (HOU)
Houston Intercontinental (IAH)
Indianapolis (IND)
Kansas City (MCI)
Las Vegas (LAS)
Little Rock (LIT)
Los Angeles (LAX)
Lubbock (LBB)
Midland/Odessa (MAF)
Nashville (BNA)
New Orleans (MSY)
Oakland (OAK)
Oklahoma City (OKC)
Ontario (ONT)
Phoenix (PHX)
Reno/Tahoe (RNO)
Sacramento (SMF)
St. Louis (STL)
San Antonio (SAT)
San Diego (SAN)
San Francisco (SFO)
Tulsa (TUL)

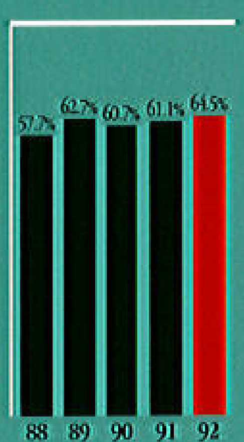


Southwest added two new midwest cities, Cleveland and Columbus, Ohio, to our growing list of destinations in 1992.

Fleet Size
(at yearend)



Passenger Load Factor



Outlook

While the last three years have been devastating for the airline industry and dismal, at best, for the economy as a whole, Southwest has remained profitable and financially strong. Our profit margins improved markedly in 1992. This was not only desirable but necessary for Southwest to maintain our financial stability. These results, while they represent a tremendous accomplishment, also are inadequate to support future growth, combat unrelenting competitive pressures, and protect against wide volatility in energy and capital markets. Therefore, we cannot be satisfied with these results, which still fall below our profit margin and return on investment goals. We are, however, well positioned to meet the challenges of the 1990s and will continue our strategy of controlled growth, operating cost control, and outstanding Customer Service.

We have achieved market dominance as the nation's only shorthaul, point-to-point, low-fare, high-frequency, high-quality airline.

From a Customer perspective, we believe Southwest is the best value for shorthaul transportation – *Just Plane Smart*SM – as Customers want low fares and high-quality service.

From an operating perspective, Southwest is uniquely positioned to expand in shorthaul markets because our services are specifically and uniquely designed to meet the needs of shorthaul Customers.

From a financial perspective, we have the lowest operating costs, best profit margins, strongest balance sheet, and highest credit ratings in the airline industry, enabling us to access the capital markets to acquire new aircraft, hire more Employees, expand our operations, and continue the patient development of new shorthaul city-pair markets.

Of course, our fleet is very young, too, with an average age at the end of 1992 of 6.9 years, one of the youngest in the airline industry. This enables us to keep our maintenance costs low and our aircraft in service. Since over 65 percent of the fleet have the newer Stage 3 engines, fuel consumption is lower and noise is reduced.

We will acquire 13 new 737 aircraft from Boeing in 1993. We have future delivery and option positions with Boeing for enough new 737 aircraft to adequately meet our expansion needs and maintain a young fleet. At yearend 1992, we had 141 aircraft on hand, of which 44 were subject to long-term leases and 23 of the -200s were subject to short-term leases expiring over the next several years. We have the flexibility with respect to these aircraft either to return them to the lessors or continue leasing them at the then-current fair market value.

We have 60 firm orders through 1997 and 53 options from 1997 through 1999, as follows:

Type	Seats	1992	1993	1994	1995	1996	1997	1998	1999
737-200	122	49	—	—	—	—	—	—	—
737-300	137	67	13	13	12	12	21	21	21
737-500	122	25	—	—	—	—	—	—	—
TOTAL		141	13	13	12	12	21	21	21

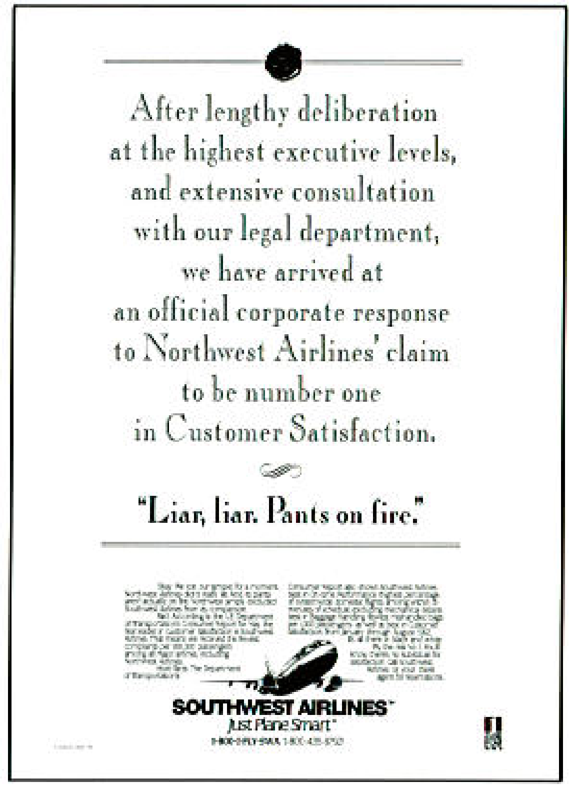
As we begin 1993, our traffic demand is strong, despite a relatively sluggish national economy. Whether this trend will continue or the economy will change course, we cannot predict.

Our unit costs (operating cost per available seat mile) increased 4.0 percent in 1992 as more fully explained in Management's Discussion and Analysis of Financial Condition and Results of Operations. We expect our unit costs to increase again in 1993 as we continue to experience pressure in several areas.

For 1993, salaries and wages, our largest cost component, will be primarily a function of headcount and should remain roughly consistent with aircraft capacity on an annual basis. Significant increases are expected from health care, however. Southwest's major labor contracts have five-year terms, with none scheduled for renegotiation until 1994.

Jet fuel represents the second highest cost component, which, on a cost-per-gallon basis, is extremely volatile and unpredictable. As our aircraft fleet continues to grow, however, it becomes more fuel-efficient with the addition of -300s. These aircraft are more expensive to maintain, though, which resulted in an increase in maintenance unit costs in previous years and is expected to continue in 1993.

Finally, airport unit costs will continue to rise if airports continue to expand or if other airlines reduce service at airports we serve.



Southwest's pithy response to Northwest Airlines' claim to be Number One in Customer Satisfaction. Northwest conveniently excluded Southwest from its comparison.

VISUAL: BOARDROOM TABLE SCATTERED WITH REPORTS.
VOICE: After lengthy discussions at the highest executive levels and exhaustive consultation with our legal department...

VISUAL: PENSIVE EXECUTIVE.
VOICE: We have arrived at an official response to Northwest Airlines' recent claim that they're Number One in Customer Satisfaction.

VISUAL: EXECUTIVE BRIGHTENS, SPEAKS.
VOICE: Liar, liar. Pants on fire.

VISUAL: SOUTHWEST JET.
VOICE: Southwest Airlines. Just Plane Smart.SM

Dedication

This 1992 Annual Report is dedicated to our 12,000 Employees. You will always be Number One in our hearts.

Directors

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

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

WILLIAM P. HOBBY, JR.
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
Consultant, Executive Education, Dallas, Texas;
Audit and Executive Committees

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

Officers

HERBERT D. KELLEHER*
Chairman of the Board, President,
and Chief Executive Officer

COLLEEN C. BARRETT*
Executive Vice President–
Customers and Corporate Secretary

GARY A. BARRON*
Executive Vice President,
Chief Operations Officer

JOHN G. DENISON*
Executive Vice President–
Corporate Services

ALAN S. DAVIS
Vice President–Internal Audit and
Special Projects

CAMILLE T. KEITH
Vice President–Special Marketing

GARY C. KELLY*
Vice President–Finance,
Chief Financial Officer

WILLIAM Q. MILLER
Vice President–Inflight Service

JAMES F. PARKER*
Vice President–General Counsel

ROBERT W. RAPP, JR.**
Vice President–Systems

MARGARET ANN RHOADES
Vice President–People

RON RICKS*
Vice President–Governmental Affairs

ROGER W. SAARI
Vice President–Fuel and
Administrative Purchasing

PAUL E. STERBENZ
Vice President–Flight Operations

JOHN A. VIDAL
Vice President–Maintenance

JAMES C. WIMBERLY*
Vice President–Ground Operations

WILLIAM D. LYONS
Controller

JOHN D. OWEN
Treasurer

*Member of Executive Planning Committee
**Effective March 1, 1993

SOUTHWEST AIRLINES CO.
ANNUAL 1992 REPORT

Financial Review

Management's Discussion and Analysis of Financial Condition and Results of Operations

INDUSTRY CONDITIONS

The recession in the airline industry continued in 1992, resulting in three of the most financially devastating years in the history of the airlines. The industry changed its overall financial position from a cumulative industry profit to an overall industry loss during this three year period. Domestic competition was characterized by heated fare wars in 1992, which exacerbated industry losses. However, despite these adverse industry conditions, Southwest reported a profit for its 20th consecutive year.

The Company's low operating costs and shorthaul, low-fare market niche have allowed the Company to profit during this period. Southwest has continued to maintain steady growth in its mature markets, such as Texas, and to expand in markets where other carriers are reducing service. In 1992, Southwest became the largest carrier of intrastate passengers in California and also number one in originating passengers in Phoenix, Las Vegas, and Kansas City. The Company's expansion efforts at Chicago Midway airport were successful in 1992. Southwest added service to Indianapolis and opened two new cities in the midwest, Cleveland and Columbus, Ohio, each with nonstop service to Midway and St. Louis. A reservation center and pilot domicile were also opened in 1992 at Chicago Midway. In May 1993, the Company will begin service to Louisville, Kentucky with nonstop flights to St. Louis, Chicago, and Birmingham. In February 1993, the Company began taking calls at the Company's new reservation center in Albuquerque.

During 1993, the Company plans to continue expanding its short-haul markets, particularly through added service to existing city-pair markets in California and the western region of its system. In addition, the Company will continue its focus on controlling costs and maintaining high quality Customer Service to protect its financial and competitive position within the industry.

RESULTS OF OPERATIONS

1992 COMPARED WITH 1991 The Company's consolidated net income for the year 1992 was $91.0 million ($.97 per share), before the cumulative effect of a change in accounting principle, compared to $26.9 million ($.31 per share) for 1991, an increase of 238.1 percent. The 1991 earnings per share has been restated for the 1992 two-for-one stock split (see Note 8 to the Consolidated Financial Statements). The increase in earnings was attributable to an increase in operating income of 190.2 percent.

Operating Revenues Operating revenues increased by 28.3 percent in 1992 to $1,685.2 million. Operating revenue per available seat mile (ASM) increased in 1992 to $.0789 from $.0710 in 1991. Operating revenues increased as follows: a 28.1 percent increase in passenger revenues; a 25.2 percent increase in freight revenues; and a 46.6 percent increase in other revenues. The increase in passenger revenues, which accounted for 96.4 percent of total operating revenues, resulted from a 22.1 percent increase in revenue passenger miles (RPMs) in 1992 and a 5.0 percent increase in revenue passenger yield per RPM.

The increase in RPMs of 22.1 percent in 1992 exceeded the increase in ASMs of 15.6 percent for the same period and resulted in an increase in the load factor from 61.1 percent to 64.5 percent. The 1992 ASM increase resulted from the addition of 17 aircraft, which were primarily used to expand California, Las Vegas, Phoenix, and Chicago markets.

Freight revenues increased in 1992 to $33.1 million from $26.4 million in 1991. The 25.2 percent increase in freight revenues exceeded the 15.6 percent ASM increase for the same period primarily due to further expansion of United States mail services and increased freight marketing programs. Other revenues increased 46.6 percent primarily as a result of charter revenues. Charter revenues increased 91.9 percent due to a significant increase in commercial charters.

Operating Expenses Consolidated operating expenses increased 20.1 percent to $1,502.5 million from $1,250.7 million in 1991. The primary factors contributing to the increase were the 15.6 percent increase in ASMs resulting from the addition of seventeen 737 aircraft; increased contributions to profit sharing and employee savings plans; higher agency commissions; higher aircraft rentals; and increased maintenance costs. On a per-ASM basis, operating expenses increased 4.0 percent in 1992 as follows:

Operating expenses per ASM

	1992	1991	Increase (decrease)	Percent change
Salaries, wages and benefits	2.17¢	2.12¢	.05¢	2.4%
Profit sharing and employee savings plans	.18	.09	.09	100.0
Fuel and oil	1.14	1.22	(.08)	(6.6)
Maintenance materials and repairs	.56	.53	.03	5.7
Agency commissions	.50	.44	.06	13.6
Aircraft rentals	.30	.26	.04	15.4
Landing fees and other rentals	.48	.44	.04	9.1
Depreciation	.47	.47	–	–
Other	1.23	1.19	.04	3.4
Total	7.03¢	6.76¢	.27¢	4.0%

The increase in salaries, wages and benefits per ASM in 1992 of 2.4 percent resulted from a 16.1 percent increase in employee benefits per ASM. Salaries and wages per ASM remained constant. The increase in employee benefits per ASM resulted from increases in workers' compensation and health benefit costs. Although the Company has implemented, and plans to continue implementing, various cost savings programs to attempt to control the annual increase in these benefit costs, these costs are expected to continue to increase in the near term. Headcount increased 16.6 percent in 1992, slightly more than the 15.6

percent increase in ASMs. However, employee productivity improved from 2,451 passengers handled per employee in 1991 to 2,597 in 1992. Average salary and benefit costs per employee increased 3.7 percent from 1991 to 1992.

In January 1992, the Company signed a new collective bargaining agreement with the Transportation Worker's Union of America, which represents the Company's flight attendants. The contract extends into 1996.

Profit sharing and employee savings plan expenses per ASM doubled in 1992. This significant increase was primarily the result of a significantly more profitable year. For additional information, see Note 10 to the Consolidated Financial Statements.

Fuel and oil expenses per ASM decreased 6.6 percent in 1992 due to a 7.4 percent reduction in the average jet fuel cost per gallon from 1991. The average price of jet fuel decreased from 65.69¢ in 1991 to 60.82¢ in 1992. A combination of a relatively mild winter and unusually high inventories at the end of 1991 precipitated a rapid decline of jet fuel prices beginning late fourth quarter 1991, which resulted in an average of 54.96¢ per gallon in first quarter 1992. Jet fuel prices rose in second quarter 1992 to an average of 60.68¢ per gallon as a result of unusually cold weather late in the season, a global firming of supply-demand fundamentals, and a recognition that the Iraq-UN situation would not produce immediate oil exports. Jet fuel prices remained relatively steady throughout the remainder of 1992 with an average of 64.46¢ and 62.44¢ per gallon in third and fourth quarter 1992, respectively.

Maintenance materials and repairs per ASM increased 5.7 percent in 1992. This increase was primarily the result of performing more airframe and engine overhaul work in 1992. The Company performed 13 scheduled airframe overhauls in 1992, as compared to three in 1991, as a result of the recent modification of its airframe overhaul maintenance program with the Federal Aviation Administration (FAA) and growth of the Company's fleet. In addition, the Company changed its method of accounting for scheduled airframe overhaul costs from the direct expense method to that of capitalizing and amortizing the costs over the periods benefited. See Note 2 to the Consolidated Financial Statements for further information. Airframe overhauls were also more costly in 1992 as compared to 1991. Consequently, amortization of 1992 capitalized airframe overhauls, along with amortization of the cumulative adjustment related to the accounting change, exceeded overhauls directly expensed in 1991. Engine overhauls were also more expensive in 1992 due to the higher cost to repair 737-300 and -500 high-bypass engines, which represent an increasing percentage of the fleet.

Agency commissions per ASM increased 13.6 percent in 1992 primarily due to passenger revenue growth exceeding ASM growth coupled with a higher mix of travel agency sales.

Aircraft rentals per ASM increased 15.4 percent in 1992. The increase was the result of the Company leasing four used 737-300 aircraft in 1992 under long-term operating leases, along with incurring a full year's rent on the 14 aircraft acquired, or converted to operating leases, in 1991 through various leasing arrangements. On December 31, 1992, the Company completed the financing through sale/leasebacks of four 737-300 aircraft delivered in 1992; however, no rent expense will be recorded on these leases until 1993.

The increase in landing fees and other rentals per ASM of 9.1 percent resulted from an increase of 12.1 percent in landing fees per ASM, or .03¢, and a 2.1 percent increase in other rentals per ASM, or .01¢. The increase in landing fees per ASM is primarily attributable to overall rate increases, with significant increases in New Orleans and Chicago. The increase in other rentals per ASM is also primarily due to rate increases.

Depreciation expense per ASM remained constant in 1992. However, had the Company not changed the estimated remaining useful lives of its 737-200 aircraft as discussed in Note 2 to the Consolidated Financial Statements, depreciation expense per ASM would have increased 4.3 percent, or $.02 per ASM in 1992. The increase is primarily the result of acquiring more aircraft and certain leasehold interests as described in Note 7 to the Consolidated Financial Statements.

Other operating expenses per ASM increased 3.4 percent primarily due to increases in ad valorem tax rates and passenger-related costs. Passenger-related costs increased per ASM due to the 22.8 percent increase in passengers carried, which exceeded ASM capacity growth for 1992.

Other "Other expenses (income)" included interest expense, interest income and nonoperating gains and losses. Interest expense, net of capitalized interest, increased 52.2 percent in 1992 due to 1991-92 issuances of $400 million in senior unsecured notes. See Note 5 to the Consolidated Financial Statements for further information. Interest income decreased $287,000 in 1992 due to lower interest rates offset by higher investment balances. Net nonoperating losses consisted primarily of payments related to deficiency guarantees as discussed in Note 7 to the Consolidated Financial Statements.

Income Taxes The provision for income taxes decreased in 1992, as a percentage of income before income taxes and cumulative effect of change in accounting principle, to 38.0 percent from 38.6 percent in 1991. The decrease was primarily the result of a reduction in state income taxes versus previous estimates. See Note 12 to the Consolidated Financial Statements for further information.

1991 COMPARED WITH 1990 The Company's consolidated net income for the year 1991 was $26.9 million, or $.31 per share, compared to $47.1 million, or $.55 per share, for 1990, a decrease of 42.8 percent. The decrease in earnings primarily was attributable to: 1) a decrease in operating income of 23.1 percent; 2) a $7.3 million increase in net interest expense; and 3) a $4.6 million decrease in nonoperating gains, before the effects of income taxes.

Operating Revenues Operating revenues increased by 10.7 percent in 1991 to $1,313.6 million. Passenger revenues, which accounted for 96.5 percent of total operating revenues, increased 10.8 percent to $1,267.9 million while freight revenues increased 19.1 percent to $26.4 million and other revenues declined by 4.3 percent to $19.3 million.

Passenger revenue growth was negatively impacted in 1991 by the war in the Persian Gulf and the domestic economic recession. As a result, operating revenue per ASM declined in 1991 to $.0710 from 1990's $.0723, or 1.8 percent. The 1991 passenger revenue increase was attributable to a 14.3 percent increase in revenue passengers carried, which resulted from aggressive discount and promotional programs to stimulate an otherwise weak domestic travel market. However, the promotional programs that were successful in stimulating traffic caused passenger revenue yield per RPM to decline to $.1122 from $.1149 in 1990, or 2.3 percent.

The increase in RPMs was 13.4 percent in 1991 as compared to 1990 versus a 12.7 percent increase in ASMs for the same period, resulting in an increase in the load factor from 60.7 percent to 61.1 percent. The 1991 ASM increase primarily resulted from the addition of 18 aircraft that were used primarily to initiate service in Sacramento, California to Ontario, Burbank, and San Diego, California; expand service in Oakland, Los Angeles, Phoenix, and Las Vegas; and initiate service between Kansas City/St. Louis and between Los Angeles/Las Vegas.

During the third quarter 1991, traffic demand began to improve as compared to the preceding months of 1991, considering seasonality. As a result, RPM yields began to improve as compared to earlier 1991 results and load factors were up as compared to the corresponding month of the prior year for the period September through December 1991. Revenues per ASM increased in fourth quarter 1991 versus fourth quarter 1990, the first such favorable quarterly comparison in 1991. The Company believes it benefited from slightly improved economic conditions in its markets; successful expansion into new California markets; and service reductions from competitors in its California, Phoenix, Las Vegas, and Chicago markets.

Freight revenues increased 19.1 percent in 1991 to $26.4 million from $22.2 million in 1990. Freight revenues grew 83.1 percent from 1989 to 1991, more than double the rate of ASM growth over the same period. This growth primarily resulted from expanded United States mail services and increased cargo marketing efforts. Other revenues decreased 4.3 percent primarily due to a 20.7 percent decrease in charter revenues resulting from a decline in military activities requiring domestic charters.

Operating Expenses Consolidated operating expenses increased 13.2 percent to $1,250.7 million from $1,104.9 million in 1990. The primary factors contributing to the increase were the 12.7 percent increase in ASMs resulting from the addition of eighteen 737 aircraft and increases in aircraft rentals, terminal rentals, and landing fees. These increases were offset by a large decrease in jet fuel costs. The net result was an increase in operating expenses per ASM of only .4 percent over 1990 levels.

Salaries, wages and benefits per ASM increased 2.4 percent in 1991 resulting from a 1.8 percent increase in salaries and wages per ASM and a 4.7 percent increase in employee benefits per ASM. Headcount increased 13.4 percent in 1991, slightly more than the 12.7 percent increase in ASMs. Despite this increase in headcount, employee productivity increased from 2,393 passengers handled per employee in 1990 to 2,451 in 1991. Average salary and benefit costs per employee increased 3.2 percent from 1990 to 1991.

Profit sharing and employee savings plan expenses on a per-ASM basis decreased 18.2 percent in 1991. The decrease was a result of decreased profitability offset by increased employee eligibility and resulting participation in the employee savings plan matching contributions program. For additional information, see Note 10 to the Consolidated Financial Statements.

Fuel and oil expenses per ASM decreased 17.0 percent in 1991 as the jet fuel average cost per gallon decreased 15.7 percent to 65.69¢ in 1991 from 77.89¢ in 1990. During 1990, crude oil prices and, therefore, jet fuel prices, were very volatile as a result of the invasion of Kuwait and resulting war in the Persian Gulf. Jet fuel prices declined to pre-invasion levels by second quarter 1991. In addition, fuel conservation measures implemented following the Iraqi invasion of Kuwait were continued throughout 1991 reducing fuel burn approximately 4.0 percent from 1990 pre-invasion levels. As a result of declining production rates in the former Soviet Union, coupled with overall supply concerns, jet fuel prices escalated in third and fourth quarters 1991. In late fourth quarter 1991, as a consequence of continued high OPEC production and a relatively mild winter, the supply concerns disappeared based on high inventories of crude oil and refined products, thus precipitating a rapid decline in jet fuel costs.

Maintenance materials and repairs per ASM increased 3.9 percent in 1991. This increase was primarily a result of the higher cost of engine overhauls for the more expensive 737-300 and -500 high-bypass engines.

Aircraft rentals increased 62.5 percent in 1991 as a result of the 1991 sale/leaseback financing of three new aircraft with long-term operating leases and five older aircraft with short-term operating leases. In addition, in 1991 the Company leased three used 737-300 aircraft under long-term operating leases and three used 737-200 aircraft under short-term operating leases.

Landing fees and other rentals increased on a per-ASM basis by 18.9 percent in 1991 as a result of rate increases and expanded terminal facilities, principally Phoenix Sky Harbor Airport. Other operating expenses increased primarily due to increases in advertising and promotional expenses to stimulate traffic and increases in ad valorem tax rates.

Other "Other expenses (income)" included interest expense, interest income and nonoperating gains and losses. Interest expense, net of capitalized interest, increased 56.8 percent in 1991 due to issuances of $300 million in senior unsecured notes. See Note 5 to the Consolidated Financial Statements for further information. Interest income increased $3.0 million in 1991 due to higher investment balances, offset by lower interest rates. Net nonoperating gains declined $4.6 million in 1991, as more fully described in Note 11 to the Consolidated Financial Statements.

Income Taxes As a percentage of income before income taxes, the provision for income taxes increased in 1991 to 38.6 percent from 37.0 percent in 1990. The increase primarily resulted from increases in estimated state income tax rates. See Note 12 to the Consolidated Financial Statements for further information.

LIQUIDITY AND CAPITAL RESOURCES

Cash provided from operations was $264.5 million in 1992 as compared to $103.2 million in 1991. During 1992, additional funds of $98.5 million were generated from the September 1992 issuance of $100 million in senior unsecured 7⅞% notes due in 2007 (see Note 5 to the Consolidated Financial Statements for additional information). In addition, $120.0 million was generated from the sale and leaseback of four new 737-300 aircraft subject to long-term operating leases (increasing total commitments for operating leases by $245.0 million). The Company also received net proceeds of $86.9 million from the sale of 2,500,000 pre-split shares of its common stock in a public offering (see Note 8 to the Consolidated Financial Statements). These proceeds were primarily used to finance aircraft-related capital expenditures and provide working capital.

During 1992, capital expenditures of $409.2 million were primarily for the purchase of six new 737-300 aircraft and seven new 737-500 aircraft delivered during the year along with progress payments for future aircraft deliveries. At December 31, 1992, capital commitments for the Company consisted primarily of scheduled aircraft acquisitions. At yearend, Southwest had sixty 737s on firm order with options to purchase another fifty-three 737s. Aggregate funding required for these commitments approximated $1,497.1 million at December 31, 1992. See Note 3 to the Consolidated Financial Statements for further information.

As of December 31, 1992, the Company had 2,500,000 shares available from a 1990 authorization by its Board of Directors to purchase shares of its common stock from time to time on the open market. No shares have been purchased since 1990.

See Note 5 to the Consolidated Financial Statements regarding the 1992 conversion of the outstanding 6¾% convertible subordinated Debentures issued by Southwest Airlines Eurofinance N.V. into Southwest's common stock.

During 1992, the Company satisfied certain "deficiency guarantees." See Note 7 to the Consolidated Financial Statements for further information.

In January 1993, the Company's Board of Directors approved the early redemption, effective March 1, 1993, of $100 million 9% senior unsecured Notes due 1996. See Note 5 to the Consolidated Financial Statements for further discussion.

The Company will adopt Statement of Financial Accounting Standards No. 109, "Accounting for Income Taxes," and Statement of Financial Accounting Standards No. 106, "Accounting for Postretirement Benefits Other Than Pensions," in first quarter 1993. See Note 1 to the Consolidated Financial Statements for additional information.

The Clinton Administration has proposed certain deficit reduction measures. These measures, among other things, presently include an increase in the Federal corporate income tax rate and a broad-based energy tax. If put into law, these measures would increase the Company's costs and, potentially, reduce its net earnings to the extent that the increased taxes cannot be recovered through increased revenues. Management cannot predict the ultimate outcome of any changes in taxes.

The Company has various options available to meet its capital and operating commitments, including cash on hand at December 31, 1992 of $411.0 million, internally generated funds and a revolving credit line with a group of banks of up to $250 million (none of which had been drawn at December 31, 1992). In addition, the Company will also consider various borrowing or leasing options to maximize earnings and cash flows.

During 1991, cash generated from operations was $103.2 million. Additional funds of $296.4 million were generated from issuances of a total of $300 million in senior unsecured notes. In addition, $132.4 million was generated from the sale and leaseback of eight aircraft: three were new 737-500 aircraft subject to long-term operating leases and five were older 737-200 aircraft subject to short-term operating leases (increasing total commitments for operating leases by $218.8 million). These proceeds were primarily used to finance aircraft-related capital expenditures, provide working capital, and retire long-term debt.

During 1990, cash generated from operations was $111.9 million. Additional funds of $200.0 million were generated through the sale and leaseback of 10 aircraft: six were new 737-500 aircraft subject to long-term operating leases with four older 737-200 aircraft subject to short-term operating leases (increasing total commitments for operating leases by $381.1 million). These proceeds were primarily used to finance aircraft-related capital expenditures, provide working capital, retire long-term debt, and purchase treasury stock.

Consolidated Balance Sheet

(in thousands except share and per share amounts)

	December 31, 1992	December 31, 1991
Assets		
Current assets:		
Cash and cash equivalents	$ 411,036	$ 260,856
Accounts receivable	51,787	47,507
Inventories of parts and supplies, at cost	30,758	23,036
Prepaid expenses and other current assets	12,505	8,602
Total current assets	506,086	340,001
Property and equipment, at cost (Notes 3, 5 and 6):		
Flight equipment	1,842,517	1,551,519
Ground property and equipment	287,923	218,522
Deposits on flight equipment purchase contracts	212,904	182,932
	2,343,344	1,952,973
Less allowance for depreciation	559,052	458,779
	1,784,292	1,494,194
Other assets	2,599	3,096
	$2,292,977	$1,837,291
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	$ 78,358	$ 54,970
Accrued liabilities (Note 4)	216,648	150,870
Air traffic liability	55,850	42,069
Income taxes payable	6,744	377
Current maturities of long-term debt	10,760	6,583
Total current liabilities	368,360	254,869
Long-term debt less current maturities (Note 5)	699,123	617,016
Deferred income taxes	133,430	105,757
Deferred gains from sale and leaseback of aircraft	224,645	222,818
Other deferred liabilities	13,166	8,310
Commitments and contingencies (Notes 3, 6 and 7)		
Stockholders' equity (Notes 8 and 9):		
Common stock, $1.00 par value: 200,000,000 shares authorized; 92,472,755 shares issued in 1992 and 42,437,922 shares in 1991	92,473	42,438
Capital in excess of par value	155,938	81,987
Retained earnings	605,928	507,259
	854,339	631,684
Less treasury stock, at cost (2,904 shares in 1992; 217,732 shares in 1991)	86	3,163
Total stockholders' equity	854,253	628,521
	$2,292,977	$1,837,291

See accompanying notes.

Consolidated Statement of Income

(in thousands except per share amounts)

	Years ended December 31, 1992	1991	1990
Operating revenues:			
Passenger	$1,623,828	$1,267,897	$1,144,421
Freight	33,088	26,428	22,196
Other	28,262	19,280	20,142
Total operating revenues	1,685,178	1,313,605	1,186,759
Operating expenses:			
Salaries, wages and benefits (Note 10)	501,870	407,961	357,357
Fuel and oil	243,543	225,463	242,001
Maintenance materials and repairs	120,578	97,598	82,887
Agency commissions	106,372	81,245	72,084
Aircraft rentals	64,169	49,171	26,085
Landing fees and other rentals	102,717	83,177	61,167
Depreciation	101,188	86,202	79,429
Other operating expenses	262,105	219,852	183,870
Total operating expenses	1,502,542	1,250,669	1,104,880
Operating income	182,636	62,936	81,879
Other expenses (income):			
Interest expense	58,941	43,939	32,001
Capitalized interest	(15,350)	(15,301)	(13,738)
Interest income	(10,344)	(10,631)	(7,595)
Nonoperating losses (gains), net (Note 11)	2,552	1,089	(3,542)
Total other expenses	35,799	19,096	7,126
Income before income taxes and cumulative effect of change in accounting principle	146,837	43,840	74,753
Provision for income taxes (Note 12)	55,816	16,921	27,670
Income before cumulative effect of change in accounting principle	91,021	26,919	47,083
Cumulative effect of change in accounting principle (Note 2)	12,538	–	–
Net income	$ 103,559	$ 26,919	$ 47,083
Per share amounts (Notes 2, 8 and 13):			
Income before cumulative effect of change in accounting principle	$ .97	$ .31	$ .55
Cumulative effect of change in accounting principle	.13	–	–
Net income	$ 1.10	$ .31	$ .55
Pro forma amounts assuming the new method is applied retroactively:			
Net income	$ 91,021	$ 27,109	$ 47,538
Net income per share	$ .97	$ .32	$ .56

See accompanying notes.

Consolidated Statement of Stockholders' Equity

Three years ended December 31, 1992
(in thousands except per share amounts)

	Common stock	Capital in excess of par value	Retained earnings	Treasury stock	Total
Balance at December 31, 1989	$ 32,254	$175,170	$441,591	$(61,699)	$587,316
Three-for-two stock split (Note 8)	14,133	(14,135)	–	–	(2)
Purchase of treasury stock	–	–	–	(25,560)	(25,560)
Retirement of treasury stock (Note 8)	(3,996)	(79,785)	–	83,781	–
Issuance of common stock upon exercise of executive stock options (Note 9)	21	197	–	(89)	129
Cash dividends, $.04835 per share	–	–	(4,115)	–	(4,115)
Net income–1990	–	–	47,083	–	47,083
Balance at December 31, 1990	42,412	81,447	484,559	(3,567)	604,851
Issuance of common and treasury stock upon exercise of executive stock options and pursuant to employee stock option and purchase plans (Note 9)	26	540	–	404	970
Cash dividends, $.05 per share	–	–	(4,219)	–	(4,219)
Net income–1991	–	–	26,919	–	26,919
Balance at December 31, 1991	42,438	81,987	507,259	(3,163)	628,521
Public common stock offering (Note 8)	2,328	82,094	–	2,524	86,946
Conversion of debentures (Note 5)	1,371	34,678	–	–	36,049
Two-for-one stock split (Note 8)	46,180	(46,180)	–	–	–
Issuance of common and treasury stock upon exercise of executive stock options and pursuant to employee stock option and purchase plans (Note 9)	156	3,359	–	553	4,068
Cash dividends, $.053 per share			(4,890)		(4,890)
Net income–1992	–	–	103,559	–	103,559
Balance at December 31, 1992	$ 92,473	$155,938	$605,928	$ (86)	$854,253

See accompanying notes.

Consolidated Statement of Cash Flows

(in thousands)

	Years ended December 31, 1992	1991	1990
Cash flows from operating activities:			
Net income	$ 103,559	$ 26,919	$ 47,083
Cumulative effect of change in accounting principle (Note 2)	(12,538)	–	–
Income before cumulative effect of change in accounting principle	91,021	26,919	47,083
Adjustments to reconcile net income to cash provided by operating activities:			
Depreciation	101,188	86,202	79,429
Deferred income taxes	21,260	(3,516)	(9,123)
Amortization of deferred gains on sale and leaseback of aircraft	(32,719)	(31,484)	(21,626)
Amortization of scheduled airframe overhauls (Note 2)	6,930	–	–
Gains from sale and leaseback of aircraft (Note 11)	–	(454)	(2,645)
Changes in certain assets and liabilities:			
Increase in accounts receivable	(4,280)	(3,620)	(5,936)
Increase in other current assets	(11,325)	(5,205)	(6,870)
Increase in accounts payable and accrued liabilities	65,706	38,972	20,666
Increase in air traffic liability	13,781	3,507	5,624
Increase (decrease) in other current liabilities	6,881	(9,339)	5,726
Other	6,092	1,240	(393)
Net cash provided by operating activities	264,535	103,222	111,935
Cash flows from investing activities:			
Purchases of property and equipment	(409,154)	(341,127)	(317,730)
Proceeds from sales of other property and equipment	251	97	2,464
Net cash used in investing activities	(408,903)	(341,030)	(315,266)
Cash flows from financing activities:			
Issuance of long-term debt	98,510	296,378	–
Proceeds from public common stock offering (Note 8)	86,946	–	–
Proceeds from aircraft sale and leaseback transactions	120,000	132,350	200,000
Proceeds from note receivable	–	–	4,200
Purchase of treasury stock	(86)	–	(25,560)
Payment of long-term debt and capital lease obligations	(9,449)	(13,634)	(29,832)
Payment of cash dividends	(4,890)	(4,219)	(4,115)
Proceeds from employee stock plans	3,517	970	–
Other	–	(688)	(219)
Net cash provided by financing activities	294,548	411,157	144,474
Net increase (decrease) in cash and cash equivalents	150,180	173,349	(58,857)
Cash and cash equivalents at beginning of period	260,856	87,507	146,364
Cash and cash equivalents at end of period	$ 411,036	$ 260,856	$ 87,507
Cash payments for:			
Interest, net of amount capitalized	$ 39,395	$ 16,963	$ 19,342
Income taxes	27,728	29,799	31,134

See accompanying notes.

Notes To Consolidated Financial Statements

December 31, 1992

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, see Note 7), Southwest Jet Fuel Co., Southwest ABQ Res Center, Inc., and Southwest Airlines Eurofinance N.V. (collectively referred to as the Company). All significant intercompany balances and transactions have been eliminated. Certain prior year amounts have been reclassified for comparison purposes.

Cash and cash equivalents Cash equivalents are primarily investment grade commercial paper issued by major 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 fair value.

Inventories Inventories of flight equipment expendable parts, materials and supplies are carried at 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 (see Note 2) and three 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 lessee'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 and amortized over the estimated periods benefited (see Note 2). 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 transportation is provided. Tickets sold but not yet used are included in "Air traffic liability."

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

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

Income taxes In February 1992, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 109, "Accounting for Income Taxes" (SFAS 109), which requires the establishment of a deferred tax asset or liability for the recognition of future deductions or taxable amounts, and operating loss and tax credit carryforwards. Deferred tax expense or benefit is recognized as a result of the change in the asset or liability during the year. SFAS 109 requires adoption for fiscal years beginning after December 15, 1992. The initial effect of applying SFAS 109 may be either reported as the cumulative effect of an accounting change or through retroactive restatement of the financial statements of prior years.

The Company is currently accumulating the necessary data and will apply SFAS 109 beginning in first quarter 1993. The Company is currently planning to make a one-time adjustment reflecting the cumulative effect of this accounting change. Based on preliminary estimates, the cumulative effect of the accounting change at January 1, 1993 is expected to reduce reported deferred tax liabilities by approximately $15 to $20 million.

Postretirement benefits In December 1990, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions" (SFAS 106), which requires the projected future cost of providing postretirement benefits, such as health care and life insurance, be recognized as an expense as employees render service rather than when the benefits are paid. Companies can elect to record the cumulative effect of the accounting change as a charge against income in the year the Standard is adopted or, alternatively, on a prospective basis as a part of the future annual benefit cost.

The Company is currently accumulating the necessary data and will apply SFAS 106 beginning in the first quarter of 1993. The Company is currently planning to utilize the cumulative effect method. Because the Company currently offers only limited postretirement benefits, the effect on the Company's future earnings from applying SFAS 106 is not expected to be material. Based on preliminary estimates, the cumulative effect of the accounting change at January 1, 1993 is expected to approximate $1 to $2 million. The application of SFAS 106 is anticipated to increase 1993 postretirement benefit expense approximately $500,000.

2. ACCOUNTING CHANGES

Change in Accounting Principle Prior to January 1, 1992, the Company expensed scheduled airframe overhaul costs as incurred. This practice was adopted at a time when costs were relatively constant from year to year and consistent with the growth of the fleet.

Given the significant growth of the Company's fleet over the past 10 years and the Company's recent modification of its airframe overhaul maintenance program with the Federal Aviation Administration (FAA), Southwest changed its method of accounting for scheduled airframe overhaul costs from the direct expense method to that of capitalizing and amortizing the costs over the periods benefited, currently estimated to be 10 years. At December 31, 1992, amounts capitalized, including the net book value of the aircraft, were below the fair market value of the related aircraft. The Company believes this method is preferable because it results in charges to expense that are consistent with the growth in the fleet; improves finanical reporting; and better matches revenues and expenses.

For the years ended December 31, 1991 and 1990, the Company incurred and expensed approximately \$3.7 million and \$4.2 million, respectively, in scheduled airframe overhaul costs using the direct expense method. Had the Company capitalized and amortized airframe overhaul costs over the periods benefited, the expense recognized would have been approximately \$3.4 million in each of years 1991 and 1990. The Company recognized approximately \$6.9 million during the year ended December 31, 1992 in amortization of airframe overhaul expense. Had the direct expense method been used to provide for scheduled airframe overhaul costs during the year ended December 31, 1992, income before cumulative effect of accounting change would have been reduced by approximately \$9.8 million (net of provision for income taxes and profit sharing of approximately \$8.8 million), or approximately \$.10 per share.

This change in accounting principle had the effect of a one-time adjustment increasing net income for the year ended December 31, 1992 by approximately \$12.5 million (net of provision for income taxes and profit sharing of approximately \$11.5 million).

Change in Accounting Estimate Effective January 1, 1992, the Company revised the estimated useful lives of its 737-200 aircraft from 15 years to 15-19 years. This change was the result of the Company's assessment of the remaining useful lives of its 737-200 aircraft following the recent promulgations of rules by the FAA for the phase out of stage 2 aircraft by December 31, 1999. The effect of this change was to reduce depreciation expense approximately \$3,680,000, or \$.02 per share, for the year ended December 31, 1992.

3. COMMITMENTS

At December 31, 1992, the Company's contractual commitments consisted primarily of scheduled aircraft acquisitions. Thirteen 737-300s are scheduled for delivery in 1993, 13 in 1994, 12 in 1995, 12 in 1996, and 10 in 1997. In addition, the Company has options to purchase up to fifty-three 737-300s during 1997-1999. The Company has the option to substitute 737-400s or 737-500s for the 737-300s to be delivered during 1995-1999. Aggregate funding needed for these commitments was approximately \$1,497.1 million at December 31, 1992 due as follows: \$330.3 million in 1993, \$339.9 million in 1994, \$338.5 million in 1995, \$288.7 million in 1996, and \$199.7 million in 1997.

4. ACCRUED LIABILITIES

(in thousands)	1992	1991
Aircraft maintenance costs	\$ 48,522	\$ 21,203
Aircraft rentals	41,712	40,403
Profitsharing and savings plans (Note 10)	30,470	8,337
Interest	24,947	23,110
Vacation pay	22,781	18,530
Taxes, other than income	14,907	12,854
Other	33,309	26,433
	\$216,648	\$150,870

5. LONG-TERM DEBT

(in thousands)	1992	1991
9% Notes due 1996	\$100,000	\$100,000
9¼% Notes due 1998	100,000	100,000
9.4% Notes due 2001	100,000	100,000
8¾% Notes due 2003	100,000	100,000
7⅞% Notes Due 2007	100,000	–
6¾% Convertible Subordinated Debentures due 1998	–	35,000
French Export Credit Agreement	2,525	5,051
Capital leases (Note 6)	211,049	185,374
Industrial Revenue Bonds	1,075	1,725
Other	11	223
	714,660	627,373
Less current maturities	10,760	6,583
Less debt discount	4,777	3,774
	\$699,123	\$617,016

In March 1986, Southwest issued \$100 million of senior unsecured 9% Notes due March 1, 1996, with interest due semi-annually. In January 1993, the Company's Board of Directors approved the early redemption, effective March 1, 1993, of the Notes at par plus accrued interest. For financial presentation purposes, these Notes are classified as long-term based on their stated maturity dates.

During 1991, the Company issued \$100 million of senior unsecured 9¼% Notes, \$100 million of senior unsecured 9.4% Notes and \$100 million of senior unsecured 8¾% 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.

On September 9, 1992, Southwest issued \$100 million in senior unsecured 7⅞% Notes due September 1, 2007. Interest is payable semi-annually on March 1 and September 1. The Notes are not redeemable prior to maturity.

The fair values, based on quoted market prices, of these Notes at December 31, 1992 were as follows (in thousands):

9% Notes due 1996	\$100,463
9¼% Notes due 1998	107,337
9.4% Notes due 2001	108,575
8¾% Notes due 2003	105,414
7⅞% Notes due 2007	98,597

The 6¾% Convertible Subordinated Debentures issued by Southwest Airlines Eurofinance N.V. were redeemed during first quarter 1992. The principal amount of \$35,000,000 was converted into 1,370,902 pre-split shares of Southwest's common stock at the pre-split conversion price of \$25.53 per share. The conversion was primarily a noncash transaction and therefore was excluded from the Statement of Cash Flows.

The French Export Credit Agreement requires semi-annual installments of principal and interest through December 20, 1993. The debt is secured by one 737-300 and one 737-200 aircraft and bears interest at 10.5% per annum. Since the debt is due in 1993, the carrying value of the French Export Credit Agreement approximates its fair value.

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 carrying value of the Bonds approximates its fair value due to its variable rate.

In addition to the credit facilities described above, Southwest has a Bank Credit Agreement with a group of domestic banks that permits Southwest to borrow through December 14, 1995 on a revolving credit basis up to $250 million. Interest rates on borrowings under the Credit Agreement can be, at the option of Southwest, the agent bank's prime rate, ¼% over LIBOR or 5/16% over domestic certificate of deposit rates. The commitment fee is 0.15% per annum. There were no outstanding borrowings under this agreement at December 31, 1992 or 1991.

Long-term debt principal payments, excluding capital leases, but adjusted for the $100 million of senior unsecured 9% Notes that will be redeemed effective March 1, 1993, are due in the next five years as follows (in thousands):

1993	$103,238
1994	375
1995	–
1996	–
1997	–

6. LEASES

Total rental expense for operating leases charged to operations in 1992, 1991 and 1990 was $115,335,000, $92,546,000, and $55,726,000, respectively. The majority of the Company's terminal operations space, as well as 54 aircraft, were under operating leases. The amounts applicable to capital leases included in property and equipment were (in thousands):

	1992	1991
Flight equipment	$230,140	$197,607
Less accumulated amortization	59,569	46,599
	$170,571	$151,008

Future minimum lease payments under capital leases and noncancelable operating leases with initial or remaining terms in excess of one year at December 31, 1992 were (in thousands):

	Capital leases	Operating leases
1993	$ 25,813	$ 113,661
1994	25,808	113,766
1995	25,802	104,525
1996	28,855	95,741
1997	26,843	88,614
After 1997	244,870	983,343
Total minimum lease payments	377,991	$1,499,650
Less amount representing interest	166,942	
Present value of minimum lease payments	211,049	
Less current portion	7,522	
Long-term portion	$203,527	

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 defined lessor's cost of the aircraft.

7. CONTINGENT LIABILITIES

In 1987, Transtar ceased operations and was liquidated. Prior to its liquidation, TranStar assigned its rights and obligations pursuant to safe harbor tax benefit transfer agreements for four aircraft and as lessee with respect to 10 aircraft to a subsidiary of a major U.S. airline. TranStar remained primary obligor on the assigned agreements in the event of a default by the assignee.

One of these assigned leases, a lease covering one MD-83 aircraft, includes a "deficiency guarantee" by Southwest respecting debt secured by the leased aircraft. The guarantee provides that, if the lessee defaults and the lender forecloses on the lessor and sells the aircraft, then, to the extent that the sales proceeds are not sufficient to cover a defined portion of the debt, Southwest is liable for such deficiency. At December 31, 1992, the debt in the MD-83 lease amounted to $14.4 million. Southwest's deficiency guarantee related to the debt in the MD-83 lease amounted to approximately $3.1 million. Based on current published market values for MD-83 aircraft, Southwest does not believe its exposure on this guarantee is material.

Southwest had a similar guarantee at the end of 1991 for a lease covering five DC9-51 aircraft. To satisfy its guarantee and mitigate any potential losses, Southwest acquired title to the five DC9-51 aircraft free and clear of any liability through a nonmonetary exchange transaction. Southwest conveyed three 737-200 aircraft to the previous owner of the five DC9-51 aircraft and simultaneously leased back the 737-200 aircraft pursuant to a seven-year capital lease. A gain of approximately $18.2 million was realized on this exchange, which has been deferred and will be amortized into depreciation expense over the seven-year lease term. For purposes of the Statement of Cash Flows, the capital lease obligation of approximately $31,691,000 was considered a noncash transaction. The guarantee related to this lease was terminated upon completion of this transaction.

In April 1992, the Company closed a transaction with Northwest Airlines to acquire its lease covering 18 gates and ticket counter space at Chicago Midway Airport. Southwest also received a 10-year sublease from Northwest for two gates at Detroit Metropolitan Airport. As consideration, the Company transferred ownership of the five DC9-51 aircraft to Northwest and assumed liabilities of $3.8 million. No material gain or loss resulted from this exchange.

8. COMMON STOCK
At December 31, 1992, based upon currently available authorized shares, the Company had common stock reserved for issuance pursuant to employee stock benefit plans (7,527,245 shares) and upon exercise of rights pursuant to the Common Stock Rights Agreement (Agreement), as amended (100,000,000 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 $25 and is exercisable only in the event of a proposed takeover, as defined by the Agreement. The Company may redeem the Rights at $.01665 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 $25 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 20, 1992, the Company's Board of Directors declared a two-for-one stock split, distributing 46,180,531 shares on July 15, 1992. Unless otherwise stated, all per share data included in the accompanying consolidated financial statements have been restated to give effect to the stock split.

In February 1992, the Company sold 2,500,000 pre-split shares of its common stock (2,327,892 new shares and 172,108 shares from treasury) in a public offering. Net proceeds from the sale of approximately $86,946,000 were added to the working capital of the Company for general corporate purposes, including the acquisition of aircraft and related equipment.

On July 18, 1990, the Company's Board of Directors declared a three-for-two stock split effected in the form of a stock dividend. The distribution of 14,132,218 shares was made on August 29, 1990 to shareholders of record on August 13, 1990. Also, on July 18, 1990, the Company's Board of Directors voted to cancel 3,995,800 pre-split shares of treasury stock.

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 6,000,000 shares of Southwest common stock may be granted to key employees. Under the Non-Qualified Stock Option Plan, options to purchase up to 500,000 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 10 years.

Information regarding the stock option plans, as adjusted for the two-for-one stock split, is summarized below:

	Incentive Plan	Non-Qualified Plan
Granted	2,730,360	192,870
Exercised	(66,722)	(4,320)
Surrendered	(31,000)	–
Outstanding, December 31, 1991	2,632,638	188,550
Granted	287,316	65,300
Exercised	(167,878)*	(2,900)
Surrendered	(74,140)**	(1,200)
Outstanding, December 31, 1992	2,677,936	249,750
Exercisable:		
1992	132,316	95,050
1991	171,358	68,550
Available for granting in future periods:		
1992	3,087,464	243,030
1991	3,300,640	307,130
Average price of exercised options:		
1992	$9.15	$17.04
1991	$9.03	$9.03

*Includes 59,873 pre-split shares and 48,132 post-split shares, of which 37,305 pre-split shares and 5,896 post-split shares were issued from treasury.
**Includes 11,870 pre-split shares and 50,400 post-split shares.

The exercise price of outstanding options ranged from $9.03 to $18.09 in 1992 and was $9.03 in 1991.

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 110,957 shares (29,700 pre-split shares and 51,557 post-split shares, of which 8,453 pre-split shares were issued from treasury) in 1992 and 26,392 post-split shares in 1991 at average purchase prices of $19.33 and $12.16, respectively.

At December 31, 1992 and 1991, 1,008,168 and 742,500 options to purchase the Company's common stock were outstanding related to employment contracts with the Company's president and chief executive officer. Exercise prices range from $1.00 to $17.00 per share. Options for 15,000 shares and 52,500 shares were exercised in 1992 and 1991, respectively. In 1991, 22,792 shares of treasury stock were received as full consideration of the exercise price. The share amounts relating to these employment contracts have been adjusted for the two-for-one stock split.

10. EMPLOYEE PROFIT SHARING AND SAVINGS PLANS

Substantially all of the Company's employees are members of the Southwest Airlines Co. Profit Sharing Plan (the Plan). Total profit sharing expense charged to operations in 1992, 1991 and 1990 was $26,363,000, $7,929,000 and $12,595,000, respectively. The Company also elected to contribute $3,605,000 in 1992 as a result of an accounting change (see Note 2). In 1990, the Company amended the Plan to increase the profit sharing contribution by removing an "earnings threshold" from the calculation of income subject to profit sharing (as defined by the Plan).

The Company also sponsors employee savings plans under Section 401(k) of the Internal Revenue Code. The plans cover substantially all full-time employees. Effective January 1, 1990, the Company began matching employee contributions for certain employees covered by a collective bargaining agreement. Matching contributions for additional employee groups were effective January 1, 1991, with an additional group effective January 1, 1992. 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 1992, 1991 and 1990 were $11,611,000, $8,433,000, and $4,800,000, respectively.

11. NONOPERATING GAINS

In 1990, a gain of $2,645,000 was recognized on the sale and subsequent short-term leaseback of four 737-200 aircraft. The Company realized a gain of $3,134,000 in 1990 from the sale of certain financial assets.

12. INCOME TAXES

The provision for income taxes differed from the amount that resulted from applying the statutory federal income tax rate (34%) to income before income taxes as follows (in thousands):

	1992	1991	1990
Federal income tax provision at statutory rate	$49,924	$14,906	$25,416
Nondeductible expenses	1,131	834	613
State income tax provision, net of federal benefit	5,124	1,472	1,967
Other	(363)	(291)	(326)
	$55,816	$16,921	$27,670

The provision for income taxes included deferred taxes 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):

	1992	1991	1990
Current	$ 34,556	$ 20,437	$ 36,793
Deferred:			
Depreciation	27,947	20,222	11,020
Deferred gains on sale/leaseback	(4,275)	(8,979)	(18,073)
Scheduled airframe overhauls	6,336	–	–
Investment tax credits	–	–	2,722
Vacation pay	(1,220)	(1,306)	(1,226)
Alternative minimum tax	(10,645)	(14,229)	(3,242)
Other, net	3,117	776	(324)
Total deferred provision (benefit)	21,260	(3,516)	(9,123)
Total	$ 55,816	$ 16,921	$ 27,670

13. 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 (93,870,128 in 1992, 85,656,492 in 1991, and 85,435,077 in 1990). The weighted average share amounts have been restated for the 1992 two-for-one stock split. Fully diluted earnings per share have not been presented as the effect of shares issuable upon the exercise of options under the Company's Stock Option Plans or conversion of Convertible Subordinated Debentures is anti-dilutive or is not material.

Report of Ernst & Young Independent Auditors

The Board of Directors and Shareholders
Southwest Airlines Co.

We have audited the accompanying consolidated balance sheet of Southwest Airlines Co. as of December 31, 1992 and 1991, and the related consolidated statements of income, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 1992. 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, 1992 and 1991, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 1992, in conformity with generally accepted accounting principles.

As discussed in Note 2 to the financial statements, in 1992 the Company changed its method of accounting for scheduled airframe overhauls.

Ernst + Young

Dallas, Texas
January 25, 1993

Quarterly Financial Data (Unaudited)

(in thousands except per share amounts)

1992	Three months ended March 31	June 30	Sept. 30	Dec. 31
Operating revenues	$373,878	$416,828	$447,291	$447,181
Operating income	31,150	45,424	53,879	52,183
Income before income taxes	21,944	38,237	43,912	42,744
Net income	13,484*	23,479	26,888	27,170
Net income per common and common equivalent share	0.15*	0.25	0.28	0.29

*Excludes cumulative effect of change in accounting principle of $12.5 million ($.13 per share)

1991	Three months ended March 31	June 30	Sept. 30	Dec. 31
Operating revenues	$282,809	$324,656	$355,256	$350,884
Operating income (loss)	(10,492)	20,449	31,132	21,847
Income (loss) before income taxes	(13,057)	16,877	25,790	14,230
Net income (loss)	(8,215)	10,568	15,724	8,842
Net income (loss) per common and common equivalent share	(0.10)	0.12	0.18	0.10

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 paid on the common stock, as adjusted for the July 1992 two-for-one stock split, were:

Period	Dividend	High	Low
1992			
1st Quarter	$0.0125	$20.75	$16.19
2nd Quarter	0.0125	23.56	17.50
3rd Quarter	0.0140	22.19	20.00
4th Quarter	0.0140	29.88	22.13
1991			
1st Quarter	$0.0125	$14.19	$ 8.19
2nd Quarter	0.0125	14.82	10.94
3rd Quarter	0.0125	13.63	11.07
4th Quarter	0.0125	17.50	12.19

As of February 26, 1993, there were 6,462 holders of record of the Company's common stock.

Ten Year Summary

SELECTED CONSOLIDATED FINANCIAL DATA (in thousands except per share amounts)	1992	1991	1990	1989
Operating revenues:				
Passenger	$ 1,623,828	$ 1,267,897	$ 1,144,421	$ 973,568
Freight	33,088	26,428	22,196	18,771
Other	28,262	19,280	20,142	22,713
Total operating revenues	1,685,178	1,313,605	1,186,759	1,015,052
Operating expenses	1,502,542	1,250,669	1,104,880	917,426
Operating income	182,636	62,936	81,879	97,626
Other expense (income), net	35,799	19,096	7,126 (2)	(13,356) (3)
Income before income taxes	146,837	43,840	74,753	110,982
Provision for income taxes	55,816	16,921	27,670	39,424
Net income	$ 91,021 (1)	$ 26,919	$ 47,083	$ 71,558
Net income per common and common equivalent share	$.97 (1)	$.31	$.55	$.79
Cash dividends per common share	$.05300	$.05000	$.04835	$.04665
Total assets	$ 2,292,977	$ 1,837,291	$ 1,471,138	$ 1,415,096
Long-term debt	$ 699,123	$ 617,061	$ 326,956	$ 354,147
Stockholders' equity	$ 854,253	$ 628,521	$ 604,851	$ 587,316
CONSOLIDATED FINANCIAL RATIOS				
Return on average total assets	4.4% (1)	1.6%	3.3%	5.2%
Return on average stockholders' equity	11.7% (1)	4.4%	7.9%	12.4%
Debt as a percentage of invested capital	45.0%	49.5%	35.1%	37.6%
CONSOLIDATED OPERATING STATISTICS				
Revenue passengers carried	27,839,284	22,669,942	19,830,941	17,958,263
RPMs (000s)	13,787,005	11,296,183	9,958,940	9,281,992
ASMs (000s)	21,366,642	18,491,003	16,411,115	14,796,732
Load factor	64.5%	61.1%	60.7%	62.7%
Average length of passenger haul	495	498	502	517
Trips flown	438,184	382,752	338,108	304,673
Average passenger fare	$58.33	$55.93	$57.71	$54.21
Passenger revenue yield per RPM	11.78¢	11.22¢	11.49¢	10.49¢
Operating revenue yield per ASM	7.89¢	7.10¢	7.23¢	6.86¢
Operating expenses per ASM	7.03¢	6.76¢	6.73¢	6.20¢
Fuel cost per gallon (average)	60.82¢	65.69¢	77.89¢	59.46¢
Number of employees at yearend	11,397	9,778	8,620	7,760
Size of fleet at yearend (9)	141	124	106	94

(1) Excludes cumulative effect of change in accounting principle of $12.5 million ($.13 per share)

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

(3) 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

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

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

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

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

(8) Includes the accounts of TranStar since June 30, 1985

(9) Includes leased aircraft

	1988	1987	1986	1985[8]	1984	1983
	$ 828,343	$ 751,649	$ 742,287	$ 656,689	$ 519,106	$ 433,388
	14,433	13,428	13,621	13,643	12,115	10,357
	17,658	13,251	12,882	9,340	4,727	4,491
	860,434	778,328	768,790	679,672	535,948	448,236
	774,454	747,881	679,827	601,148	467,451	379,738
	85,980	30,447[5]	88,963	78,524	68,497	68,498
	620[4]	1,374[6]	23,517[7]	17,740	649	4,927
	85,360	29,073	65,446	60,784	67,848	63,571
	27,408	8,918	15,411	13,506	18,124	22,704
	$ 57,952	$ 20,155	$ 50,035	$ 47,278	$ 49,724	$ 40,867
	$.61	$.21	$.51	$.51	$.56	$.46
	$.04415	$.04335	$.04335	$.04335	$.04335	$.04335
	$ 1,308,389	$ 1,042,640	$ 1,061,419	$ 1,002,403	$ 646,244	$ 587,258
	$ 369,541	$ 251,130	$ 339,069	$ 381,308	$ 153,314	$ 158,701
	$ 567,375	$ 514,278	$ 511,850	$ 466,004	$ 361,768	$ 314,556
	5.1%	1.9%	4.8%	5.6%	8.1%	8.1%
	10.8%	4.0%	10.3%	11.4%	14.7%	14.2%
	39.4%	32.8%	39.8%	45.0%	29.8%	33.5%
	14,876,582	13,503,242	13,637,515	12,651,239	10,697,544	9,511,000
	7,676,257	7,789,376	7,388,401	5,971,400	4,669,435	3,893,821
	13,309,044	13,331,055	12,574,484	9,884,526	7,983,093	6,324,224
	57.7%	58.4%	58.8%	60.4%	58.5%	61.6%
	516	577	542	472	436	409
	274,859	270,559	262,082	230,227	200,124	175,421
	$55.68	$55.66	$54.43	$51.91	$48.53	$45.57
	10.79¢	9.65¢	10.05¢	11.00¢	11.12¢	11.13¢
	6.47¢	5.84¢	6.11¢	6.88¢	6.71¢	7.09¢
	5.82¢	5.61¢	5.41¢	6.08¢	5.86¢	6.00¢
	51.37¢	54.31¢	51.42¢	78.17¢	82.44¢	85.92¢
	6,467	5,765	5,819	5,271	3,934	3,462
	85	75	79	70	54	46

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
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 19, 1993 at the Southwest Airlines Corporate Headquarters, 2702 Love Field Drive, Dallas, Texas.

SEC FORM 10-K
Shareholders 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 36611, Dallas, Texas 75235-1611.


Number 1 Customer Satisfaction
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Southwest Airlines Co.

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