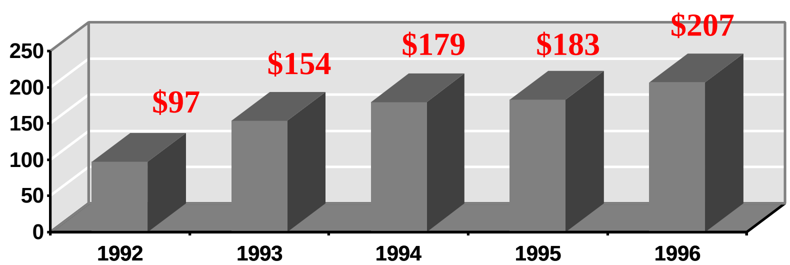
1996 Annual Report

CONSOLIDATED HIGHLIGHTS

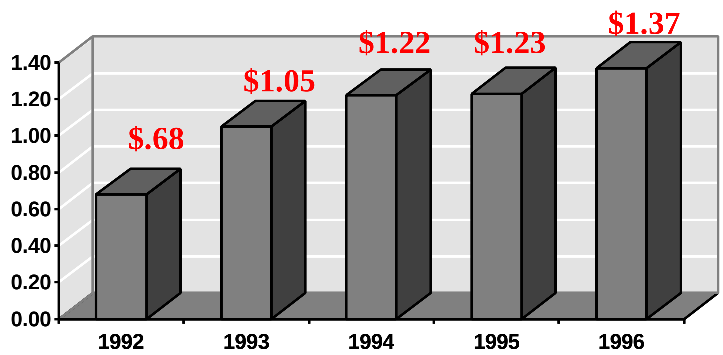
(DOLLARS IN THOUSANDS EXCEPT PER SHARE AMOUNTS)	1996	1995	PERCENT CHANGE
Operating revenues	$3,406,170	$2,872,751	18.6
Operating expenses	$3,055,335	$2,559,220	19.4
Operating income	$350,835	$313,531	11.9
Operating margin	10.3%	10.9%	(0.6)pts.
Net income	$207,337	$182,626	13.5
Net margin	6.1%	6.4%	(0.3)pts.
Net income per common and common equivalent share	$1.37	$1.23	11.4
Stockholders' equity	$1,648,312	$1,427,318	15.5
Return on average stockholders' equity	13.5%	13.7%	(0.2)pts.
Debt as a percentage of invested capital	28.3%	31.7%	(3.4)pts.
Stockholders' equity per common share outstanding	$11.36	$9.91	14.6
Revenue passengers carried	49,621,504	44,785,573	10.8
Revenue passenger miles (RPMs)(000s)	27,083,483	23,327,804	16.1
Available seat miles (ASMs)(000s)	40,727,495	36,180,001	12.6
Passenger load factor	66.5%	64.5%	2.0 pts.
Passenger revenue yield per RPM	12.07¢	11.83¢	2.0
Operating revenue yield per ASM	8.36¢	7.94¢	5.3
Operating expenses per ASM	7.50¢	7.07¢	6.1
Number of Employees at yearend	22,944	19,933	15.1

NET INCOME

(in millions)



NET INCOME PER SHARE



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 1996, Southwest operated 243 Boeing 737 aircraft and provided service to 50 airports in 49 cities throughout the United States. Southwest has one of the best overall Customer Service records and one of the lowest operating cost structures and consistently offers the lowest and simplest fares in the domestic airline industry. LUV is our stock exchange symbol, selected to represent our home at Dallas Love Field, as well as the theme of our Employee and Customer relationships.

Twenty-five years ago, Rollin W. King scribbled three lines on a cocktail napkin, leaned across the table, and muttered to his longtime friend: "Herb, let's start our own airline." Herbert D. Kelleher loosened his tie and knitted his brow before replying: "Rollin, you're crazy." Then he paused, grinned, and added, "Let's do it!"

Twenty-five years later, Southwest Airlines has literally written the book on low fares, which includes the recipe for business and personal success. This 1996 annual report is dedicated to the 36 Original Employees who have been with us from the very beginning. Cheers!

To Our Shareholders:

1996 was another excellent year for Southwest Airlines. Our earnings of $207.3 million ($1.37 per share) exceeded the $182.6 million ($1.23 per share) of 1995 by 13.5 percent.

Our net income for the first half of 1996 increased over our net income for the first half of 1995. Our net income for the second half of 1996 decreased from our net income for the second half of 1995. The single most significant factor in changing an upward quarterly earnings trend to a downward quarterly trend was an appreciable increase in jet fuel prices beginning in June 1996. At the time of composing this letter, jet fuel prices are still approximately 25 percent higher than in January 1996. It is predicted, and we are hopeful, that the level of those prices will soon begin to recede. We are also optimistic that our recent modest fare increases and intensive cost control efforts will be productive.

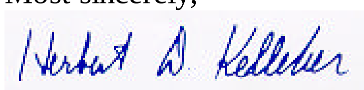
In 1996, we introduced service to four new cities: Tampa, Fort Lauderdale, and Orlando, Florida, and Providence, Rhode Island. We are very pleased with our results in all four cities; each has proven to be a valuable addition to our route system. We added Jacksonville, Florida, to our system on January 15, 1997 and will possibly begin service to another new city this year.

Much of our estimated nine percent increase in available seat mile capacity during 1997 will be deployed in cities presently served, either as incremental capacity over existing routings or as introductory capacity over new routings. As an example, today we announced seven new nonstop flights from Nashville beginning April 6, 1997 and two new nonstop flights beginning June 11, 1997. The introductory nonstop routings will be Nashville to Detroit, Los Angeles, Oakland, and Columbus, and current nonstop service will be enhanced from Nashville to Las Vegas and Tampa.

In October 1997, Southwest will receive delivery of the first new generation 737, the Boeing 737-700. This aircraft will be more fuel efficient, quiet, and emission free, as well as less maintenance intensive than any of its proud predecessors. All of Southwest's People salute and thank the People of Boeing and the General Electric engine division for producing a superb new "chariot" to carry Southwest and our Customers into the twenty-first century.

The People of Southwest Airlines are not only exceptional but unmatched in the understanding of their minds; the goodness of their hearts; and the joy of their spirits. Their vision, and their dedication to making that vision an ongoing reality, have engendered a magnificent family that has enjoyed bringing the freedom and pleasure of flight to most of America and now, by example, to much of the world. Southwest has enjoyed a great 25 years and, if our People always remember how they did it, they will always be able to do it. The best-selling business book *NUTS!*, by Kevin and Jackie Freiberg, is the story of the People of Southwest Airlines and how the low Southwest fares and high Southwest spirits which they created have made Southwest a true "Symbol of Freedom." Seldom, if ever, has a business book been written about the People of a Company and their unique culture, and never have the People of a Company deserved that tribute and that love more than ours. So here's to our People and another superb 25 years — for them — and for our Customers and Shareholders.

Most sincerely,



Herbert D. Kelleher
Chairman, President, and Chief Executive Officer
January 23, 1997

We are a company of People, not planes. That is what distinguishes us from other airlines and other companies.

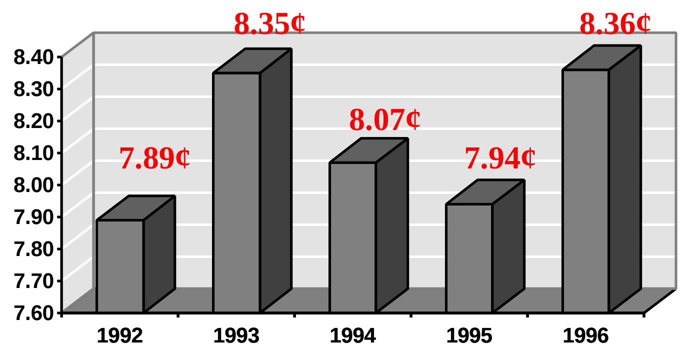
At Southwest Airlines, People are our most important asset. Our People know that because that's the way we treat them. Our People, in turn, provide the best Customer Service in the airline industry. And that's what we are in business for — to provide Legendary Customer Service. We start by hiring only the best People, and we know how to find them. People want to work for a "winner," and because of our success and the genuine concern and respect we have for each of our Employees, we have earned an excellent reputation as a great place to work. As a result, we attract and hire the very best applicants. Once hired, we train, develop, nurture, and, most important of all, support our People! In other words, we empower our Employees to effectively make decisions and to perform their jobs in this very challenging industry.
And what a terrific job they do:

- 25 years of safe, reliable operations;
- Five consecutive years of Triple Crown Customer Service;
- Five consecutive years of record profits and 24 consecutive years of profitability;
- Recognition as one of the top ten places to work in Robert Levering and Milton Moscowitz's book, *The Best Companies To Work For In America*;
- Top ranking in the Airline Quality Survey conducted by The National Institute for Aviation Research for two of the last three years;
- Launch customer for three different Boeing airplanes, providing thousands of jobs in the aerospace industry; and
- A route system that has grown to 50 cities in 24 states, carrying almost 50 million Customers in 1996 on 243 Boeing 737 aircraft.

It's not surprising authors Kevin and Jackie Freiberg paid tribute to the People of Southwest in 1996 with their best-selling business book, *NUTS!*, a story of the unique Culture and successes of the People of Southwest Airlines and their commitment to low fares. We ended 1996 in the strongest financial position ever, with $582 million in cash and a fully available bank line of credit of $460 million. Our balance sheet is strong enough to warrant an "A" credit rating from all three agencies that rate us (Standard & Poor's, Moody's, and Duff & Phelps). We have numerous expansion opportunities and are poised, financially, to take advantage of them. More importantly, we have 23,000 of the best People in aviation dedicated to the continued success of Southwest Airlines.

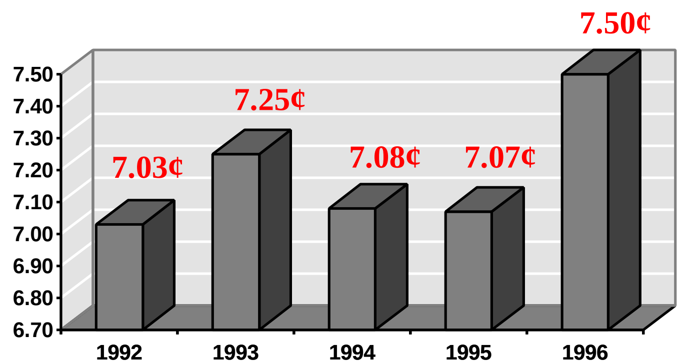
OPERATING REVENUE

PER AVAILABLE SEAT MILE



OPERATING EXPENSE

PER AVAILABLE SEAT MILE

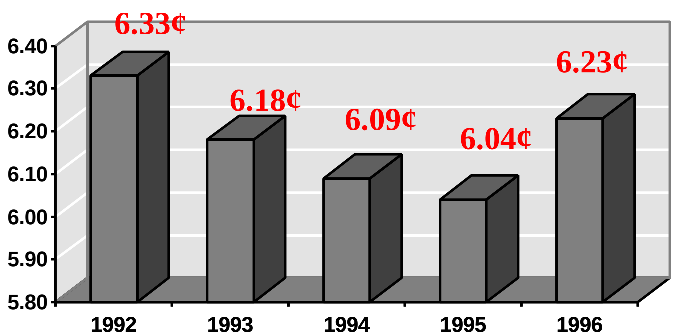


There's a certain Southwest Spirit. If you listen, you can hear it. And it's guaranteed to brighten up your day.

Southwest's accomplishments haven't come easy. We have had to overcome adversity many times in our history. It's part of our Culture and it's ingrained in each and every Employee. The airline industry is brutally competitive and subject to the volatility of energy prices and the economy. Why is Southwest different from the rest of the industry and able to consistently prosper despite this volatility? Because our People are different—they have Southwest Spirit. Inherent in every Southwest Employee we hire is an outrageously positive, altruistic, fun-loving attitude. There is a desire to be the best at everything, to work the hardest, and to overcome all adversity. Our People faced many challenges in 1996. We successfully managed an aggressive 12.6 percent capacity increase, expanding our route system into Florida and southern New England. New Customers embraced Southwest in droves, with our revenue Customers up 10.8 percent, to 49,621,504. All that was accomplished with high marks in Customer Service, safe and reliable operations, and record profits. Our People faced increasing cost challenges this year. After two consecutive years with declining unit costs, our costs rose in 1996. These increases were led by an 18.6 percent increase in jet fuel prices and $25.9 million in new federal jet fuel taxes. Although our unit costs are up, our low cost leadership within the industry remains comfortably intact, despite competitors' efforts to lower costs. We remain the low cost producer in the industry, which is particularly gratifying given the shorthaul nature of our operations, our very young modern fleet, and our generous compensation packages for our People. In the face of dramatically higher jet fuel prices and other cost pressures, including the possibility of enhanced security measures, we have intensified our never-ending crusade to lower costs further. We currently have major cost reduction initiatives underway, which are proving successful. One significant initiative that will impact costs favorably in 1998 and future years is the introduction of the new Boeing 737-700 aircraft, which will lower maintenance and fuel costs and require lower capital outlays. Another significant accomplishment relates to our continuing efforts to reduce distribution costs, where 50 percent of our Customers are now enjoying the convenience of Ticketless Travel. A growing number of our Customers are booking Southwest Ticketless Travel directly using our Home Page on the Internet (http://www.iflyswa.com). These efforts have resulted in a substantial cost savings, and we are optimistic we can reduce our ongoing distribution costs further through increased Customer acceptance and a new Southwest reservation system which will be implemented later in 1997.

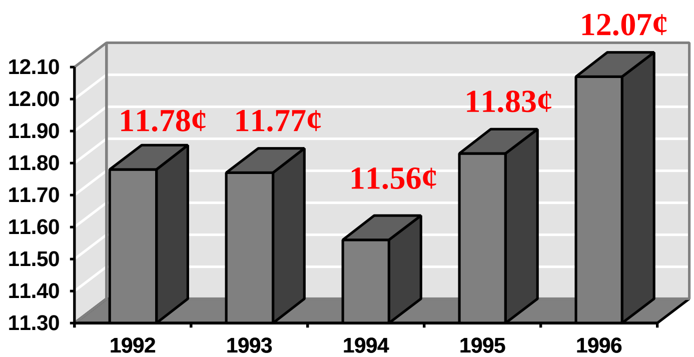
OPERATING EXPENSES

PER AVAILABLE SEAT MILE EXCLUDING FUEL AND RELATED TAXES



PASSENGER

REVENUE PER PASSENGER MILE



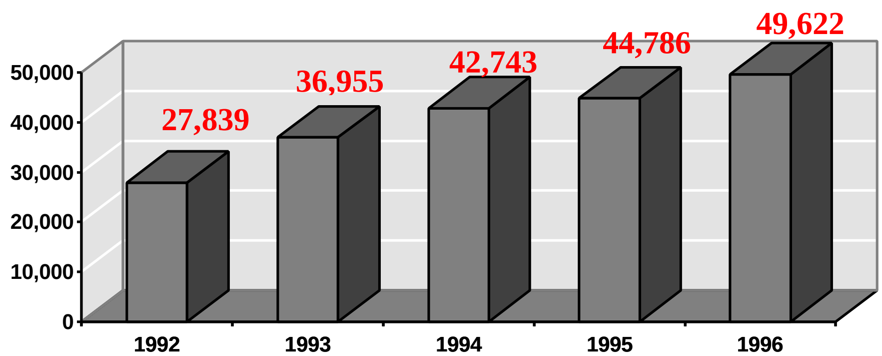
We're not <u>a</u> low fare airline, we're <u>THE</u> Low Fare Airline. The difference isn't just in our prices; it's in our philosophy.

Southwest's unique operating philosophy is to provide safe, reliable, friendly air service at the lowest fare. That's a Customer commitment and critically important in our market niche. We're a shorthaul carrier. Our average aircraft trip is roughly 400 miles, or a little over an hour in duration. Ground transportation is our most significant competitor and it always has been. We <u>have</u> to have low fares to compete with ground transportation regardless of what our airline competitors charge. As a result, we've become famous for low everyday, every seat fares. Our fare structure is also simple, which makes it easy for Customers to understand and, as a result, lowers our distribution costs. And our Customers respond enthusiastically. In new markets, we typically charge fares that are two-thirds lower than fares prevailing prior to our entry. The result? Traffic increases three- and four-fold compared to levels prior to Southwest service. Of course, lower fares mean more Customers and, in our market niche, more revenues. Our sophisticated and fully automated Revenue Management System enables us to maximize revenues while still keeping fares low and profits high. We also offer a frequent number of flights in the shorthaul markets we serve, again, to meet the needs of our shorthaul business Customers so they can travel when <u>they</u> want instead of when the airline wants. As a result of the combination of low fares, high frequencies, and our Triple Crown service, we dominate the majority of the markets we serve. We consistently rank first in market share in approximately 80 to 90 percent of our top 100 city-pair markets and, in the aggregate, hold 60 to 65 percent of the total market share. The U.S. Department of Transportation studied our unique operating strategy of low fare/high frequency service and the resultant surge in Customer traffic and termed it "the Southwest Effect." We call it giving our Customers the freedom to fly.

THE BATTLE BEGAN WHEN WE WERE JUST A YEAR OLD. THE BIG AIRLINES TRIED TO RUN US OUT OF TOWN BY ACTUALLY UNDERCUTTING OUR LOW FARES. IT WAS AN UNPRECEDENTED ATTACK, AND WE RESPONDED WITH AN UNPRECEDENTED OFFER. CUSTOMERS COULD PURCHASE OUR HALF-PRICE TICKET, OR BUY OUR FULL-FARE TICKET AND RECEIVE A BOTTLE OF PREMIUM WHISKEY. THE RESPONSE WAS HISTORIC. OUR PLANES WERE FULL, AND, FOR A SHORT TIME, WE WERE ONE OF THE TOP LIQUOR DISTRIBUTORS IN THE STATE OF TEXAS. THE PROMOTION KEPT US IN THE AIR AND LOW FARES ALIVE. TODAY, THE OFFER STILL HOLDS. FOR THE LOW FARES, THAT IS, NOT THE FREE BOTTLE OF LIQUOR.

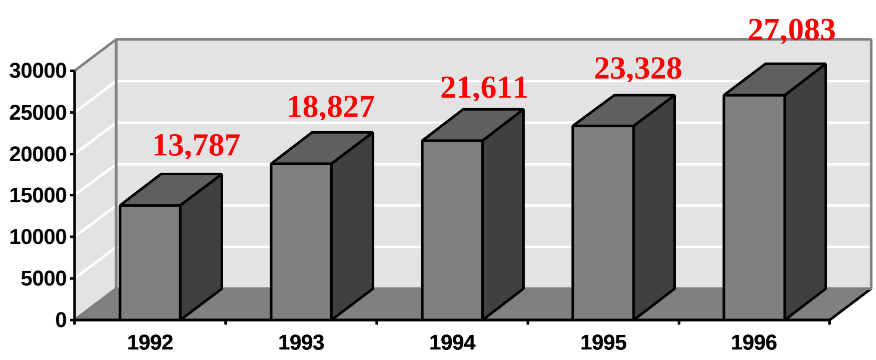
REVENUE PASSENGERS CARRIED

(in thousands)



REVENUE PASSENGER MILES

(in millions)



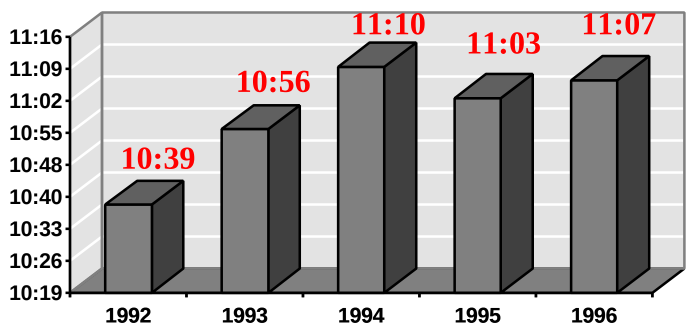
We didn't invent productivity, we just perfected it. If there's a faster, better way to do something, we'll find it.

Productivity and the Spirit of our People have always been our secrets to low costs. Southwest has been able to continually achieve the highest productivity and, therefore, the lowest costs of any U.S. airline. One of the primary reasons for our productivity advantage is our dedication to the low-fare, point-to-point market niche. This market focus allows us to operate a single aircraft type, the Boeing 737, which significantly simplifies scheduling, operations, and maintenance and, thus, minimizes costs. We schedule our 737s on a point-to-point basis, as opposed to hub-and-spoke, and concentrate on nonstop, not connecting traffic. Inflight services are also designed and streamlined to meet the needs of primarily shorthaul passengers. As a result of this strategy, our People have the ability to turn aircraft much quicker than our competition allowing us to minimize ground time. In 1996, we kept our planes in the air eleven hours and seven minutes on average per day, which is significantly more than our competition. This statistic is even more remarkable when you consider that our average flight lasts just over an hour. We also understand that delays are very costly in terms of Customer satisfaction, aircraft utilization, and, ultimately, the bottom line. Our young, well-maintained fleet results in an excellent reliability record. In 1996, less than one percent of our flights were canceled due to mechanical incidents, which improves our productivity and contributes to lower operating costs. Our operating approach also allowed us to handle approximately 2,300 Customers per Employee in 1996, making our People by far the most productive workforce in the industry. Even though our Employees' compensation is above industry averages, we achieve competitive unit labor costs because of our People's dedication, extra effort, and remarkable productivity.

OH, THE STORIES WE COULD TELL. BACK WHEN WE BEGAN, A QUARTER OF A CENTURY AGO, WE HAD LESS THAN NOTHING. NO COMPUTERS. NO TICKETING MACHINES. NO FANCY OFFICES. JUST THREE PLANES, A HANDFUL OF DEDICATED EMPLOYEES, AND THE CONVICTION THAT ABSOLUTELY NOTHING COULD STOP US. AND NOTHING HAS. TODAY WE'RE INNOVATORS IN TICKETLESS TRAVEL, PIONEERS ON THE WORLD WIDE WEB, AND EVERYONE ELSE IS TRYING TO COPY OUR LOW FARE APPROACH. NOT BAD FOR AN AIRLINE THAT HAD TO COUNT CUSTOMERS BY HAND AND TAKE RESERVATIONS FROM A SINGLE ROTARY PHONE.

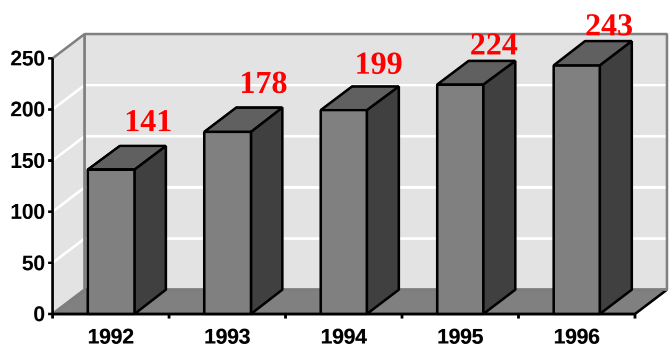
AIRCRAFT UTILIZATION

HOURS AND MINUTES PER DAY



FLEET SIZE

AT YEAREND



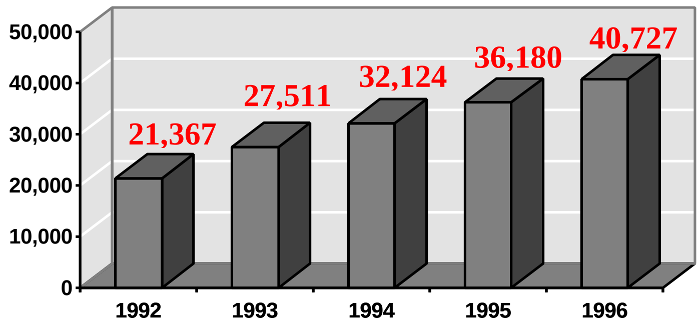
We not only save you money, we save you time. In today's fast-paced environment, time may be the ultimate currency.

Southwest understands how extremely valuable time is to our Customers in today's fast-paced world. That is why we are particularly proud of our Employees' outstanding ontime performance record. For the fifth straight year, Southwest had the very best ontime performance of all major airlines. When it comes to saving our Customers both time and money, we clearly offer the best value in the airline industry. Airlines face many obstacles in their quest to depart and arrive on time. Poor scheduling, weather, air traffic congestion, mechanical problems, and attitude all can contribute to flight delays. At Southwest, we work hard to minimize these issues. First, we design an operating schedule that is practical, realistic, and efficient. Second, we avoid congested hub airports, where possible. Instead, we like convenient, efficient airports like Dallas Love Field, Houston Hobby, Chicago Midway, Oakland, Burbank, Ft. Lauderdale, Providence, and Baltimore. Selection of convenient airports also minimizes our Customers' travel time to and from the airport. Third, we utilize a highly sophisticated, state-of-the-art flight dispatch system, which allows us to safely minimize weather and operational delays, whenever possible. Fourth, having the youngest fleet and a highly regarded, highly respected maintenance team and program minimizes both delays and cancellations due to mechanical problems. Southwest leads the industry in mechanical reliability, meaning fewer canceled flights for our Customers. Finally, our People, from dispatch to flight crews to ground operations, simply have the desire to get you there safely and on time and will put forth the extra effort to get it done. They are the best, and that's why our ontime performance is best. Period.

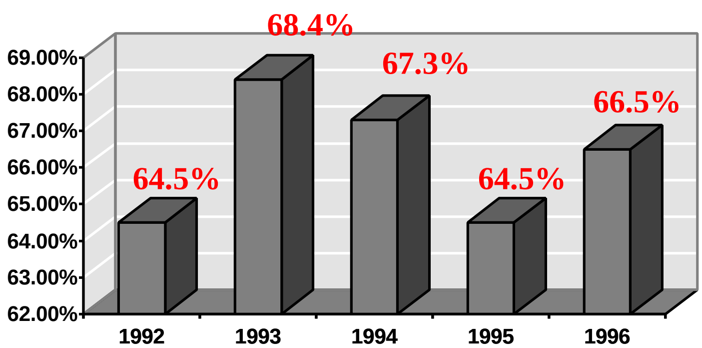
JUNE 27, 1977 WAS JUST ANOTHER DAY FOR WALL STREET. BUT NOT FOR SOUTHWEST AIRLINES. THAT MORNING OUR STOCK PREMIERED ON THE NYSE WITH THE SYMBOL-"LUV." WHILE THE SYMBOL WAS A LITTLE UNCONVENTIONAL FOR WALL STREET, IT WAS A NATURAL FOR US. BORN AT LOVE FIELD IN DALLAS, OUR TICKETS WERE ISSUED ON "LUV MACHINES," AND OUR BEVERAGES WERE CALLED "LUV POTIONS." BUT MOST IMPORTANTLY WE HAD AN INNATE, HEARTFELT LOVE FOR OUR CUSTOMERS. SO, IT WAS NO SURPRISE WE WERE THE COMPANY THAT PUT "LUV" ON THE MARKET. WHICH, AS WE KNOW, CAUSED MORE THAN ONE STOCKBROKER TO LOOK UP AT THE TICKER AND THINK, "YEAH, I COULD USE SOME OF THAT."

AVAILABLE SEAT MILES

(in millions)



PASSENGER LOAD FACTOR



That's Customer with a capital C. We never forget that we're in the service business — Triple Crown Service.

In 1996, the magnificent Employees of Southwest captured the annual Triple Crown for their fifth straight year, something no other airline has been able to do even for a month. In the airline industry, the Triple Crown is the combination of Best Ontime Performance record, Best Baggage Handling record, and Highest Customer Satisfaction record of all major airlines, based on statistics published in Department of Transportation consumer reports. Because of the caring, warm, and enthusiastic attitudes of our 23,000 Employees, the People of Southwest Airlines consistently rank on top of all three categories. Put quite simply, we deliver exactly what our Customers want in the shorthaul markets we serve. Our consistent and remarkable ontime performance record results from a combination of efficient aircraft scheduling, careful selection of airports served, quick and efficient ticketing and boarding procedures, and our highly productive and dedicated Employees. Our superb baggage handling is achieved despite our quick aircraft turns at the gate. As a result, our aircraft utilization is not impaired. In addition, this record has been compiled at a time when Southwest is carrying growing amounts of cargo and U.S. mail. In 1996 alone, total freight revenue grew faster than capacity, or 21.5 percent. Our streamlined approach and the caring and dedicated attitudes of our Ground Operations Employees enable us to efficiently control and handle our Customers' baggage. Our Employees never forget that we are in the business to serve the needs of our Customers and, as a result, we consistently deliver high-quality Customer Service in a friendly, caring, and enthusiastic manner. Our unique marketing and operating strategy, designed with our Customers' needs in mind, facilitates this exceptional service. Since our inception 25 years ago, we have basically adhered to our point-to-point service in shorthaul markets delivering the lowest fares, frequent flights, and Triple Crown Customer Service. We also offer our generous Rapid Rewards program, which does exactly what its name implies—allows our frequent flyers to earn free trips rapidly. With our frequent flyer plan, our Customers earn a trip after flying only eight roundtrips within a consecutive 12-month period, which is significantly below most other airlines' requirements. The awards are valid for travel anywhere Southwest flies, transferable, and expire one year after they have been earned. Thanks to the proud Employees of Southwest Airlines, we not only offer our Customers the lowest possible fares, we offer them the very best Customer Service in the industry. And that adds up to the best value in air transportation.

CUSTOMER SATISFACTION

Department of Transportation Rankings for 1996

Southwest	**1**
Alaska	2
Continental	3
USAir	4
Delta	5
United	6
Northwest	7
American	8
America West	9
TWA	10

ONTIME PERFORMANCE

Department of Transportation Rankings for 1996

Southwest	**1**
Continental	2
Northwest	3
USAir	4
United	5
American	6
Delta	7
America West	8
Alaska	9
TWA	10

BAGGAGE HANDLING

Department of Transportation Rankings for 1996

Southwest	**1**
Continental	2
America West	3
USAir	4
Delta	5
Northwest	6
American	7
TWA	8
United	9
Alaska	10

Our "continuous maintenance" is the safest in the sky.

After all, our families and friends fly Southwest, too.

Since safety is the single most important priority at Southwest, we have rigid standards for aircraft maintenance and flight operations. Our aircraft are inspected on a weekly basis and undergo frequent, rigorous routine maintenance checks. In addition, airframes and engines are inspected and repaired when specified by the manufacturers. Our top-notch, highly skilled maintenance team and proven maintenance philosophy greatly contribute to our outstanding 25-year safety record. We also believe our highly skilled and trained pilots are the best in the industry. We are the only airline in the U.S. that requires first officers to be FAA captain-rated for Boeing 737 aircraft. Our new first officers are also required to have 1,000 hours minimum as pilot in command of jet/turbine-powered aircraft. It's like having two experienced captains in the cockpit. Our commitment to one aircraft also contributes to our superb safety record and our low cost structure. At December 31, 1996, we had 243 Boeing 737 aircraft in our fleet, the largest Boeing 737 fleet in the world, consisting of 171 -300s, 25 -500s, and 47 -200s. We owned 124 of the 243 aircraft in our fleet. Of the remaining 119 aircraft, 93 were operated pursuant to long-term leases with various renewal and purchase options at the end of the lease periods and 26 of the -200s were under short-term leases expiring over the next several years. Our philosophy is to operate a modern, young fleet of aircraft. The average age of our fleet at the end of 1996, 7.9 years, was and is consistently among the youngest in the U.S. airline industry. At yearend 1996, 81 percent of our fleet had the quieter, more fuel efficient Stage 3 engines. We recently announced our order for 20 hushkits (and 14 options) to upgrade some of our newer -200 aircraft to comply with the more stringent Stage 3 noise standards. All -200s not equipped with hushkits before the end of 1999 will be retired. Flying only 737s greatly simplifies our scheduling, maintenance, flight operations, and training requirements. As a consequence, flight crews, airport employees, dispatchers, and mechanics can devote their time and energy completely to mastering just one aircraft type. Not only is it easier for Southwest to substitute aircraft, reschedule flight crews, and transfer mechanics quickly and efficiently, we believe it contributes to the overall safety of each flight. In fourth quarter 1997, we will be the first airline to receive the new -700 model, which is a superb extension of the 737 family. As the launch customer, our agreement with Boeing allows for comparatively lower capital costs, and the -700 is expected to be quieter, more fuel-efficient, and more easily maintainable than its -300 counterpart. The new aircraft model will have the capability to fly faster, farther, and higher, and should carry the same type rating as the rest of the 737 family.

JET FLEET

December 31, 1996

737 Type	Seats	Avg. Age (in years)	# of Aircraft
-200	122	16.1	47
-300	137	6.0	171
-500	122	5.7	25
TOTAL	133	7.9	243

JET FLEET EXPANSION

	Firm		Options	
	-300	-700	-700	
1997	15	4	-	19
1998	-	16	5	21
1999	-	16	9	25
2000	-	15	6	21
2001	-	12	6	18
2002	-	-	18	18
2003	-	-	18	18
2004	-	-	5	5
TOTAL	15	63	67	145

What's next? So many U.S. cities have contacted us about bringing low fares to their markets, our analysts are logjammed.

At yearend 1996, Southwest provided service to only 49 cities in 24 states; therefore, it is abundantly clear we have enormous expansion opportunities. The problem our Employees have is deciding where to go next. Over 100 U.S. cities have requested our service because they understand the significant positive impact we have on their communities. The introduction of our low fares in a market opens the skies and gives Americans the freedom and pleasure to fly. When we enter a market, traffic typically increases three- and four-fold compared to levels prior to our entry. In 1996, Southwest entered four new markets: Tampa, Ft. Lauderdale, and Orlando, Florida, and Providence, Rhode Island. Thus far, our service has been tremendously received by each of these communities. With the addition of these cities, we were able to further diversify our growing route system. At yearend 1996, 22 percent of our ASMs were deployed on the west coast; 33 percent in the remaining part of the western region (west of Texas); 19 percent in the heartland region (Texas, Oklahoma, Arkansas, and Louisiana); 16 percent in the midwest region; and ten percent on the east coast (Providence, Baltimore, and Florida). While the rest of the industry is planning modest capacity increases in 1997, we will continue our growth and expect to place 17 aircraft in service, or an available seat mile increase of eight to ten percent. Two -300s were delivered in December 1996, and delivery of three -300s is scheduled for first quarter 1997; six -300s for second quarter; six -300s for third quarter; and four of the new -700s for fourth quarter. We plan to retire four -200 aircraft in fourth quarter. At this point, we plan to deploy the majority of our 1997 capacity increase to cities we currently serve. We have announced seven new nonstop flights from Nashville International Airport beginning April 6, 1997 and two additional departures effective June 11, 1997. The new nonstop routings will be Nashville to Detroit, Los Angeles, Oakland, and Columbus and current nonstop service will be enhanced from Nashville to Las Vegas and Tampa. We commenced service to Jacksonville, Florida, on January 15, 1997, and probably will begin service to at least one more new city during the year. Beyond 1997, we currently have 59 firm orders and 67 options for Boeing 737 aircraft through the year 2004. This baseline growth demonstrates our commitment to bring safe, affordable, Triple Crown service to even more Americans in order to allow them to go, see, and do things never before dreamed possible.

DESTINATIONS

Albuquerque (ABQ)
Amarillo (AMA)
Austin (AUS)
Baltimore (BWI)
Birmingham (BHM)
Boise (BOI)
Burbank (BUR)
Chicago Midway (MDW)
Cleveland (CLE)
Columbus (CMH)
Corpus Christi (CRP)
Dallas Love Field (DAL)
Detroit Metro (DTW)
El Paso (ELP)
Ft. Lauderdale (FLL)
Harlingen (HRL)
Houston Hobby (HOU)
Houston Intercontinental (IAH)
Indianapolis (IND)
Jacksonville (JAX)*
Kansas City (MCI)
Las Vegas (LAS)
Little Rock (LIT)
Los Angeles (LAX)
Louisville (SDF)
Lubbock (LBB)

Midland/Odessa (MAF)
Nashville (BNA)
New Orleans (MSY)
Oakland (OAK)
Oklahoma City (OKC)
Omaha (OMA)
Ontario (ONT)
Orange County (SNA)
Orlando (MCO)
Phoenix (PHX)
Portland (PDX)
Providence (PVD)
Reno/Tahoe (RNO)
Sacramento (SMF)
St. Louis (STL)
Salt Lake City (SLC)
San Antonio (SAT)
San Diego (SAN)
San Francisco (SFO)
San Jose (SJC)
Seattle (SEA)
Spokane (GEG)
Tampa (TPA)
Tucson (TUS)
Tulsa (TUL)

**Effective January 15, 1997*
New 1996-1997 destinations

SOUTHWEST AIRLINES CO. 1996 ANNUAL REPORT MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

YEAR IN REVIEW

Southwest and the airline industry continued to post record profits in 1996. Southwest's net income for the first half of 1996 benefited from the lapse in the ten percent federal ticket tax on December 31, 1995. Net income for the second half of 1996 fell below year ago levels primarily due to significant increases in jet fuel prices.

Southwest continued to maintain our advantage as the low cost leader in the industry. Despite this advantage, we continue pursuing numerous cost reduction efforts, which have proven to be beneficial.

We added 22 new Boeing 737-300 aircraft to our fleet in 1996 and retired three -200s. Our fleet remains one of the youngest in the industry with an average age of 7.9 years. In October 1997, we will be the launch customer for the new Boeing 737-700 aircraft. In total for 1997, we will accept delivery of 15 -300s and four -700s. We currently plan to retire four -200s in fourth quarter 1997.

Our expansion into Florida in 1996 has been successful with strong load factors. We added Jacksonville, Florida, service beginning January 15, 1997. Service to Providence, Rhode Island, which began October 27, 1996, also looks promising. Our current plan for capacity growth in 1997 will be primarily directed to cities we presently serve, either with increased frequencies or new routings. We may begin service to one more new city later in 1997.

Proposed FAA "funding reform" continues to present uncertainty as to how or if any changes would impact Southwest. While Congress reinstated the ten percent ticket tax in August 1996, the tax lapsed again as of December 31, 1996. At the current time, Southwest is unable to predict how this FAA funding issue will be resolved and what impact, if any, resolution of this uncertainty will have on future operating results.

RESULTS OF OPERATIONS

1996 COMPARED WITH 1995

The Company's consolidated net income for 1996 was $207.3 million ($1.37 per share), as compared to the corresponding 1995 amount of $182.6 million ($1.23 per share), an increase of 13.5 percent.

OPERATING REVENUES

Consolidated operating revenues increased by 18.6 percent in 1996 to $3,406.2 million, compared to $2,872.8 million for 1995. This increase in 1996 operating revenues was derived primarily from an 18.4 percent increase in passenger revenues. Revenue passenger miles (RPMs) increased 16.1 percent in 1996, compared to a 12.6 percent increase in available seat miles (ASMs), resulting in an increase in load factor from 64.5 percent in 1995 to 66.5 percent in 1996. The 1996 ASM growth resulted from the net addition of 19 aircraft during the year: 22 additions and three retirements.

In December 1995, because of the impasse in the federal budget, Congress allowed the ten percent federal ticket tax to lapse. This benefited Southwest's revenues until late August when Congress reimposed the tax through December 31, 1996. The reimposition of the ticket tax negatively impacted revenues in third and fourth quarters 1996 as compared to revenue trends in the first half of 1996.

In celebration of the Company's 25th Anniversary, Southwest launched a fare sale in July for travel between August 19 and October 31, 1996. The sale was extremely popular and resulted in record advance bookings, with more than four and a half million seats sold. Although July and early August load factors and revenues were negatively impacted by the telephone line congestion experienced during the sale, revenues for September and October 1996 were positively impacted with very heavy passenger volumes.

Freight revenues in 1996 were $80.0 million, compared to $65.8 million in 1995. The 21.5 percent increase in freight revenues exceeded the 12.6 percent increase in ASMs for the same period primarily due to increased air freight volumes and United States mail services, primarily resulting from the development of new markets added in 1995 and early 1996.

Other revenues increased by 23.3 percent in 1996 to $56.9 million, compared to $46.2 million in 1995. This increase is primarily due to increased charter revenue.

OPERATING EXPENSES

Consolidated operating expenses for 1996 were $3,055.3 million, compared to $2,559.2 million in 1995, an increase of 19.4 percent, compared to the 12.6 percent increase in capacity. Operating expenses per ASM increased 6.1 percent in 1996 compared to 1995, primarily due to significantly higher jet fuel prices along with the 4.3 cent per gallon federal jet fuel tax implemented October 1, 1995. Excluding jet fuel costs and related taxes, operating expenses per ASM were up 3.1 percent in 1996 compared to 1995.

Unit costs are expected to increase in first quarter 1997 versus first quarter 1996 due to higher jet fuel prices. (The immediately preceding sentence is a forward-looking statement which involves uncertainties that could result in actual results differing materially from expected results. Such uncertainties include, but may not be limited to, the largely unpredictable levels of fuel prices.)

Operating expenses per ASM for 1996 and 1995 were as follows:

OPERATING EXPENSES PER ASM

	1996	1995	INCREASE (DECREASE)	PERCENT CHANGE
Salaries, wages, and benefits....................	2.22¢	2.17¢	.05¢	2.3%
Employee profitsharing and savings plans	.23	.23	-	-
Fuel and oil...	1.19	1.01	.18	17.8
Maintenance materials and repairs...........	.62	.60	.02	3.3
Agency commissions...............................	.35	.34	.01	2.9
Aircraft rentals	.47	.47	-	-
Landing fees and other rentals	.46	.44	.02	4.5
Depreciation	.45	.43	.02	4.7
Other	1.51	1.38	.13	9.4
Total...	7.50¢	7.07¢	.43¢	6.1%

Salaries, wages, and benefits per ASM increased 2.3 percent in 1996. This increase resulted primarily from a 16.2 percent increase in 1996 average headcount, which outpaced the 1996 capacity (ASM) increase of 12.6 percent, and offset a 0.8 percent decrease in average salary and benefits cost per Employee. The 16.2 percent increase in average headcount was primarily the result of a 24.3 percent increase in Reservations Sales Agents in 1996. Excluding Reservations Sales Agents, total average headcount increased 13.1 percent, in line with capacity.

Southwest's mechanics are subject to an agreement with the International Brotherhood of Teamsters, Chauffeurs, Warehousemen and Helpers of America (the Teamsters), which became amendable August 16, 1995. The Company reached an agreement with the Teamsters which was ratified by its membership in March 1996. The Company's flight attendants are subject to an agreement with the Transport Workers Union of America, AFL-CIO (TWU), which became amendable May 31, 1996. Southwest is currently in negotiations with TWU to amend the contract.

Fuel and oil expenses per ASM increased 17.8 percent in 1996, primarily due to an 18.6 percent increase in the average jet fuel cost per gallon from 1995. The average price paid for jet fuel in 1996 was $.6547 compared to $.5522 in 1995. During fourth quarter 1996, the average cost per gallon increased 25.0 percent to $.7323 compared to $.5859 in fourth quarter 1995. In January 1997, fuel prices have averaged approximately $.76 per gallon.

Maintenance materials and repairs per ASM increased 3.3 percent in 1996 compared to 1995 primarily as a result of increased scheduled airframe inspections during 1996.

Agency commissions per ASM increased 2.9 percent in 1996 compared to 1995, which was slightly slower than the 5.2 percent increase in passenger revenues per ASM.

Landing fees and other rentals per ASM increased 4.5 percent in 1996 compared to 1995, which included an airport credit of $4.9 million.

Depreciation expense per ASM increased 4.7 percent in 1996 compared to 1995 due to an increase in the percentage of owned aircraft.

Other operating expenses per ASM increased 9.4 percent in 1996 compared to 1995. This increase was primarily due to increased advertising costs resulting from the expansion into Florida and Providence, Rhode Island, as well as a new advertising campaign; the 4.3 cents per gallon tax on commercial aviation jet fuel purchased for use in domestic operations, which became effective October 1, 1995; and increased airport security costs. The additional fuel tax increased 1996 and 1995 "other operating expenses" by $32.7 million and $7.4 million, respectively.

OTHER

"Other expenses (income)" included interest expense, capitalized interest, interest income, and nonoperating gains and losses. Capitalized interest decreased $9.1 million in 1996 as a result of certain amendments to aircraft purchase contracts during third quarter 1995 that affected the timing of payments. Interest income for 1996 increased $5.7 million primarily due to higher invested cash balances.

INCOME TAXES

The provision for income taxes as a percentage of income before taxes decreased in 1996 to 39.3 percent from 40.2 percent in 1995. The decrease was primarily the result of lower effective state tax rates.

1995 COMPARED WITH 1994

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

OPERATING REVENUES

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

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

OPERATING EXPENSES

Consolidated operating expenses for 1995 were $2,559.2 million, compared to $2,275.2 million in 1994, an increase of 12.5 percent, compared to the 12.6 percent increase in ASMs. For the second consecutive year, operating expenses on a per-ASM basis decreased year-over-year, down 0.1 percent in 1995.

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

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

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

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

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

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

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

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

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

OTHER

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

INCOME TAXES

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

LIQUIDITY AND CAPITAL RESOURCES

Cash provided from operations was $615.2 million in 1996, compared to $456.4 million in 1995. During 1996, additional funds of $330.0 million were generated from the sale and leaseback of ten new 737-300 aircraft subject to long-term operating leases (increasing total commitments for operating leases by $588.8 million).

During 1996, capital expenditures of $677.4 million primarily were for the purchase of 22 new 737-300 aircraft, one used 737-200 aircraft previously leased by the Company, and progress payments for future aircraft deliveries. At December 31, 1996, capital commitments of the Company consisted primarily of scheduled aircraft acquisitions.

The Company recently announced its intention to order 20 hushkits for some of our 737-200 aircraft, with options for 14 more, for delivery in 1997-1999. These hushkits, with an approximate cost of $1.0 million per aircraft, will make the Stage 2 -200 aircraft compliant with Stage 3 noise requirements.

As of January 1997, Southwest had 78 new 737s on firm order, including 19 to be delivered in 1997, with options to purchase another 67. Aggregate funding required for firm commitments approximated $1,960.1 million through the year 2001, of which $515.1 million related to 1997. See Note 2 to the Consolidated Financial Statements for further information.

In September 1996, the Company's Board of Directors reaffirmed a 1990 authorization for the Company to purchase shares of its common stock from time to time on the open market. The authorization reaffirmed the purchase of up to 2,500,000 shares. As of February 21, 1997, no shares have been purchased pursuant to this authority since 1990.

The Company has various options available to meet its capital and operating commitments, including cash on hand at December 31, 1996 of $581.8 million, internally generated funds, and a revolving credit line with a group of banks of up to $460 million (none of which had been drawn at December 31, 1996). In addition, the Company will also consider various borrowing or leasing options to maximize earnings and supplement cash requirements.

The Company currently has outstanding shelf registrations for the issuance of $114.4 million of public debt securities which it currently intends to utilize for aircraft financings in 1997.

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

CONSOLIDATED BALANCE SHEET
(in thousands except share and per share amounts)

	December 31, 1996	1995
ASSETS		
Current assets:		
Cash and cash equivalents	$581,841	$317,363
Accounts receivable	73,440	79,781
Inventories of parts and supplies, at cost	51,094	41,032
Deferred income taxes (Note 9)	11,560	10,476
Prepaid expenses and other current assets	33,055	24,484
Total current assets	750,990	473,136
Property and equipment, at cost (Notes 2 and 5):		
Flight equipment	3,435,304	3,024,702
Ground property and equipment	523,958	435,822
Deposits on flight equipment purchase contracts	198,366	323,864
	4,157,628	3,784,388
Less allowance for depreciation	1,188,405	1,005,081
	2,969,223	2,779,307
Other assets	3,266	3,679
	$3,723,479	$3,256,122
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$214,232	$116,530
Accrued liabilities (Note 3)	380,747	349,419
Air traffic liability	158,098	131,156
Current maturities of long-term debt	12,327	13,516
Total current liabilities	765,404	610,621
Long-term debt less current maturities (Note 4)	650,226	661,010
Deferred income taxes (Note 9)	349,987	281,650
Deferred gains from sale and leaseback of aircraft	274,891	245,154
Other deferred liabilities	34,659	30,369
Commitments and contingencies (Notes 2, 5, and 9)		
Stockholders' equity (Notes 6 and 7):		
Common stock, $1.00 par value: 680,000,000 shares authorized; 145,112,090 and 144,033,273 shares issued and outstanding in 1996 and 1995, respectively	145,112	144,033
Capital in excess of par value	181,650	162,704
Retained earnings	1,321,550	1,120,581
Total stockholders' equity	1,648,312	1,427,318
	$3,723,479	$3,256,122

See accompanying notes.

CONSOLIDATED STATEMENT OF INCOME
(in thousands except per share amounts)

	Years ended December 31, 1996	1995	1994
Operating revenues:			
Passenger	$3,269,238	$2,760,756	$2,497,765
Freight	80,005	65,825	54,419
Other	56,927	46,170	39,749
Total operating revenues	3,406,170	2,872,751	2,591,933
Operating expenses:			
Salaries, wages, and benefits (Note 8)	999,719	867,984	756,023
Fuel and oil	484,673	365,670	319,552
Maintenance materials and repairs	253,521	217,259	190,308
Agency commissions	140,940	123,380	133,081
Aircraft rentals	190,663	169,461	132,992
Landing fees and other rentals	187,600	160,322	148,107
Depreciation	183,470	156,771	139,045
Other operating expenses	614,749	498,373	456,116
Total operating expenses	3,055,335	2,559,220	2,275,224
Operating income	350,835	313,531	316,709
Other expenses (income):			
Interest expense	59,269	58,810	53,368
Capitalized interest	(22,267)	(31,371)	(26,323)
Interest income	(25,797)	(20,095)	(9,166)
Nonoperating (gains) losses, net	(1,732)	1,047	(693)
Total other expenses	9,473	8,391	17,186
Income before income taxes	341,362	305,140	299,523
Provision for income taxes (Note 9)	134,025	122,514	120,192
Net income	$207,337	$182,626	$179,331
Net income per share (Notes 6, 7, and 10)	$1.37	$1.23	$1.22

See accompanying notes.

CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY
(in thousands except per share amounts)

	Years ended December 31, 1996, 1995, and 1994			
	Common stock	**Capital in excess of par value**	**Retained earnings**	**Total**
Balance at December 31, 1993..........................	$142,756	$141,168	$770,095	$1,054,019
Issuance of common stock upon exercise of executive stock ..... options and pursuant to Employee stock option and purchase plans (Note 7)..	500	8,243	-	8,743
Tax benefit of options exercised.................	-	2,335	-	2,335
Cash dividends, $.04 per share	-	-	(5,722)	(5,722)
Net income - 1994	-	-	179,331	179,331
Balance at December 31, 1994..........................	143,256	151,746	943,704	1,238,706
Issuance of common stock upon exercise of executive stock ..... options and pursuant to Employee stock option and purchase plans (Note 7)..	777	9,907	-	10,684
Tax benefit of options exercised.................	-	1,051	-	1,051
Cash dividends, $.04 per share	-	-	(5,749)	(5,749)
Net income - 1995	-	-	182,626	182,626
Balance at December 31, 1995..........................	$144,033	$162,704	$1,120,581	$1,427,318
Issuance of common stock upon exercise of executive stock ..... options and pursuant to Employee stock option and purchase plans (Note 7)..	1,079	14,513	-	15,592
Tax benefit of options exercised.................	-	4,433	-	4,433
Cash dividends, $.044 per share.................	-	-	(6,368)	(6,368)
Net income - 1996	-	-	207,337	207,337
Balance at December 31, 1996..........................	$145,112	$181,650	$1,321,550	$1,648,312

See accompanying notes.

CONSOLIDATED STATEMENT OF CASH FLOWS
(in thousands)

	Years ended December 31,		
	1996	**1995**	**1994**
Cash flows from operating activities:			
Net income	$207,337	$182,626	$179,331
Adjustments to reconcile net income to cash provided by operating activities:			
Depreciation	183,470	156,771	139,045
Deferred income taxes	67,253	48,147	49,887
Amortization of deferred gains on sale and leaseback of aircraft	(18,263)	(24,286)	(30,341)
Amortization of scheduled airframe overhauls	20,539	17,337	14,216
Changes in certain assets and liabilities:			
Accounts receivable	6,341	(4,089)	(5,208)
Other current assets	(19,534)	(11,857)	648
Accounts payable and accrued liabilities	132,096	61,937	52,679
Air traffic liability	26,942	25,017	9,993
Other current liabilities	5,334	1,050	(4,690)
Other	3,713	3,789	7,106
Net cash provided by operating activities	615,228	456,442	412,666
Cash flows from investing activities:			
Purchases of property and equipment	(677,431)	(728,643)	(788,649)
Net cash used in investing activities	(677,431)	(728,643)	(788,649)
Cash flows from financing activities:			
Issuance of long-term debt		98,811	
Proceeds from aircraft sale and leaseback transactions	330,000	321,650	315,000
Payment of long-term debt and capital lease obligations	(12,695)	(10,379)	(63,071)
Payment of cash dividends	(6,216)	(5,749)	(5,722)
Proceeds from Employee stock plans	15,592	10,693	8,743
Net cash provided by financing activities	326,681	415,026	254,950
Net increase (decrease) in cash and cash equivalents	264,478	142,825	(121,033)
Cash and cash equivalents at beginning of period	317,363	174,538	295,571
Cash and cash equivalents at end of period	$581,841	$317,363	$174,538
Cash payments for:			
Interest, net of amount capitalized	$36,640	$25,277	$26,598
Income taxes	66,447	73,928	80,461

See accompanying notes.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 1996

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

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

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

PROPERTY AND EQUIPMENT Depreciation is provided by the straight-line method to residual values over periods ranging from 12 to 20 years for flight equipment and 3 to 30 years for ground property and equipment. Property under capital leases and related obligations are recorded at an amount equal to the present value of future minimum lease payments computed on the basis of the Company's incremental borrowing rate or, when known, the interest rate implicit in the lease. Amortization of property under capital leases is on a straight-line basis over the lease term and is included in depreciation expense. In accordance with Statement of Financial Accounting Standards No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of," the Company records impairment losses on long-lived assets used in operations when events and circumstances indicate that the assets might be impaired and the undiscounted cash flows to be generated by those assets are less than the carrying amounts of those assets.

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 period benefited, presently eight years. Modifications that significantly enhance the operating performance or extend the useful lives of aircraft or engines are capitalized and amortized over the remaining life of the asset.

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

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

ADVERTISING The Company expenses the production costs of advertising as incurred. Advertising expense for the years ended December 31, 1996, 1995, and 1994 was $109,136,000, $92,087,000, and $79,475,000, respectively.

STOCK-BASED EMPLOYEE COMPENSATION Pursuant to Statement of Financial Accounting Standards No. 123 (SFAS 123), "Accounting for Stock-Based Compensation," the Company accounts for stock-based compensation plans utilizing the provisions of Accounting Principles Board Opinion No. 25 (APB 25), "Accounting for Stock Issued to Employees" and related Interpretations because, as discussed in Note 7, the alternative fair value accounting provided for under SFAS 123 requires use of option valuation models that were not developed for use in valuing employee stock options.

2. COMMITMENTS

The Company's contractual purchase commitments consist primarily of scheduled aircraft acquisitions. Timing of payments pursuant to contractual commitments was favorably affected by third quarter 1995 amendments to certain aircraft purchase contracts, which modified future progress payment schedules. Fifteen 737-300 and four 737-700 aircraft are scheduled for delivery in 1997. Sixteen -700s are scheduled for delivery in 1998, 16 in 1999, 15 in 2000, and 12 in 2001. In addition, the Company has options to purchase up to 67 -700s during 1998-2004. The Company has the option, which must be exercised two years prior to the contractual delivery date, to substitute 737-600s or 737-800s for the -700s delivered subsequent to 1999. Aggregate funding needed for these commitments is approximately $1,960.1 million, subject to adjustments for inflation, due as follows: $515.1 million in 1997, $420.0 million in 1998, $502.2 million in 1999, $318.3 million in 2000, and $204.5 million in 2001.

The Company has historically used jet fuel and heating oil fixed price swap arrangements to hedge its exposure to price fluctuations on an insignificant percentage of its annual fuel requirements. As of December 31, 1996, the Company had no open swap agreements, although the hedging program has not been discontinued. As of December 31, 1995, the Company had a heating oil swap agreement with a broker-dealer to exchange monthly payments on a notional quantity of 1,050,000 gallons during May 1996. Under the swap agreement, the Company paid or received the difference between the daily average heating oil price and a fixed price of $.46 per gallon.

The Company's principal hedging program utilizes the purchase of crude oil call options at a nominal premium and at volumes of up to 30 percent of its annual fuel requirements.

Gains and losses on hedging transactions are recorded as adjustments to fuel expense and have been insignificant. Any such future agreements expose the Company to credit loss in the event of nonperformance by the other parties to the agreements. The Company does not anticipate such nonperformance.

3. ACCRUED LIABILITIES

(in thousands)

	1996	1995
Aircraft rentals	$ 121,384	$ 105,534
Employee profitsharing and savings plans (Note 8)	61,286	55,253
Vacation pay	44,763	38,777
Aircraft maintenance costs	25,942	31,463
Taxes, other than income	25,574	22,478
Interest	21,853	22,326
Other	79,945	73,588
	$ 380,747	$ 349,419

4. LONG-TERM DEBT

(in thousands)

	1996	1995
9 1/4% Notes due 1998	$ 100,000	$ 100,000
9.4% Notes due 2001	100,000	100,000
8 3/4% Notes due 2003	100,000	100,000
7 7/8% Notes due 2007	100,000	100,000
8% Notes due 2005	100,000	100,000
Capital leases (Note 5)	165,610	177,696
Other	10	430
	665,620	678,126
Less current maturities	12,327	13,516
Less debt discount	3,067	3,600
	$ 650,226	$661,010

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

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

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

The fair values, based on quoted market prices, of these Notes at December 31, 1996, were as follows (in thousands):

9 1/4% Notes due 1998	$ 103,520
9.4% Notes due 2001	110,670
8 3/4% Notes due 2003	109,820
7 7/8% Notes due 2007	104,800
8% Notes due 2005	106,190

In addition to the credit facilities described above, Southwest has an unsecured Bank Credit Agreement with a group of banks that permits Southwest to borrow through December 14, 1999 on a revolving credit basis up to $460 million. Interest rates on borrowings under the Credit Agreement can be, at the option of Southwest, the agent bank's prime rate, 0.275% over LIBOR, or 0.50% over domestic certificate of deposit rates. The commitment fee is 0.125% per annum. There were no outstanding borrowings under this agreement at December 31, 1996 or 1995.

5. LEASES

Total rental expense for operating leases charged to operations in 1996, 1995, and 1994 was $280,389,000, $247,033,000, and $198,987,000, respectively. The majority of the Company's terminal operations space, as well as 106 aircraft, were under operating leases at December 31, 1996. The amounts applicable to capital leases included in property and equipment were (in thousands):

	1996	1995
Flight equipment	$226,677	$223,844
Less accumulated amortization	111,815	101,641
	$114,862	$122,203

Future minimum lease payments under capital leases and noncancelable operating leases, with initial or remaining terms in excess of one year, at December 31, 1996 were (in thousands):

	CAPITAL LEASES	OPERATING LEASES
1997	$25,858	$243,253
1998	32,026	223,479
1999	20,245	215,553
2000	16,871	213,798
2001	17,391	208,460
After 2001	155,360	2,342,794
Total minimum lease payments	267,751	$3,447,337
Less amount representing interest	102,141	
Present value of minimum lease payments	165,610	
Less current portion	12,317	
Long-term portion	$153,293	

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

6. COMMON STOCK

At December 31, 1996, the Company had common stock reserved for issuance pursuant to Employee stock benefit plans (35,257,962 shares) and upon exercise of rights (180,370,052 shares) pursuant to the Common Stock Rights Agreement, as amended (Agreement).

Effective July 18, 1996, the Company amended and restated the Agreement. The principal purpose of the amendment and restatement was to extend the Agreement by ten years. Pursuant to the Agreement, each outstanding share of the Company's common stock is accompanied by one common share purchase right (Right). Each Right entitles its holder to purchase one share of common stock at an exercise price of $16.67 and is exercisable only in the event of a proposed takeover, as defined by the Agreement. The Company may redeem the

Rights at $.0111 per Right prior to the time that 15 percent of the common stock has been acquired by a person or group. If the Company is acquired, as defined in the Agreement, each Right will entitle its holder to purchase for $16.67 that number of the acquiring company's or the Company's common shares, as provided in the Agreement, having a market value of two times the exercise price of the Right. The Rights will expire no later than July 30, 2006.

7. STOCK PLANS

At December 31, 1996, the Company had six stock-based compensation plans and other stock options outstanding, which are described below. The Company applies APB 25 and related Interpretations in accounting for its stock-based compensation. Accordingly, no compensation cost is recognized for its fixed option plans because the exercise prices of the Company's Employee stock options equal the market prices of the underlying stock on the date of the grants. Compensation cost charged against income for other options outstanding was $649,778, $564,251, and $451,400 for 1996, 1995, and 1994, respectively.

The Company has five fixed option plans. Under the 1991 Incentive Stock Option Plan, the Company may grant options to key Employees for up to 9,000,000 shares of common stock. Under the 1991 Non-Qualified Stock Option Plan, the Company may grant options to key Employees and non-employee directors for up to 750,000 shares of common stock. All options granted under these plans have ten-year maximum terms and vest and become fully exercisable at the end of three, five, or ten years of continued employment, depending upon the grant type.

Under the 1995 Southwest Airlines Pilots' Association Non-Qualified Stock Option Plan (SWAPA Plan), the Company may grant options to Pilots for up to 18,000,000 shares of common stock. An initial grant of approximately 14,500,000 shares was made on January 12, 1995 at an option price of $20.00 per share, which exceeded the market price of the Company's stock on that date. Options granted under the initial grant vest in ten annual increments of ten percent. On September 1 of each year of the agreement, beginning September 1, 1996, additional options will be granted to Pilots that become eligible during that year. Additional options granted on September 1, 1996 vest in eight annual increments of 12.5 percent. Options under both grants must be exercised prior to January 31, 2007, or within a specified time upon retirement or termination. In the event that the Southwest Airlines Pilots' Association exercises its option to make the collective bargaining agreement amendable on September 1, 1999, any unexercised options will be canceled on December 1, 1999.

Under the 1996 Incentive Stock Option Plan, the Company may grant options to key Employees for up to 6,000,000 shares of common stock. Under the 1996 Non-Qualified Stock Option Plan, the Company may grant options to key Employees and non-employee directors for up to 575,000 shares of common stock. All options granted under these plans have ten-year terms and vest and become fully exercisable at the end of three, five, or ten years of continued employment, depending upon the grant type.

Under all fixed option plans, except the SWAPA Plan, the exercise price of each option equals the market price of the Company's stock on the date of grant. Under the SWAPA Plan, for additional options granted each September 1, eligible Pilots will be required to pay a purchase price equal to 105 percent of the fair value of such stock on the date of the grant.

A summary of the status of the Company's five fixed option plans as of December 31, 1996, 1995, and 1994, and changes during the years ending on those dates is presented below:

	INCENTIVE PLAN*		NON-QUALIFIED PLANS**	
	OPTIONS	AVERAGE EXERCISE PRICE	OPTIONS	AVERAGE EXERCISE PRICE
Outstanding				
December 31, 1993	4,312,287	$8.83	301,277	$8.92
Granted - Incentive Plan	794,714	29.02	-	-
Granted - Other Non-Qualified Plans	-	-	63,918	34.85
Exercised	(190,159)	8.23	(9,940)	7.85
Surrendered	(104,880)	14.22	-	-
Outstanding				
December 31, 1994	4,811,962	12.07	355,255	13.61
Granted - Incentive Plan	983,214	18.80	-	-
Granted - SWAPA Plan	-	-	14,527,050	20.00
Granted - Other Non-Qualified Plans	-	-	93,315	18.77
Exercised	(275,058)	8.50	(60,510)	15.12
Surrendered	(308,239)	12.71	(61,041)	19.61
Outstanding				
December 31, 1995	5,211,879	13.47	14,854,069	19.86
Granted - Incentive Plan	1,670,344	25.18	-	-
Granted - SWAPA Plan	-	-	466,200	23.82
Granted - Other Non-Qualified Plans	-	-	69,122	25.17
Exercised	(395,848)	10.27	(290,385)	17.89
Surrendered	(250,446)	20.16	(94,985)	20.00
Outstanding				
December 31, 1996	6,235,929	$16.54	15,004,021	$20.04
Exercisable				
December 31, 1996	1,237,517		4,250,643	
Available for granting in future periods	7,352,821		3,854,504	

*Includes 1991 Incentive Stock Option Plan. No options have been granted under the 1996 Incentive Stock Option Plan.

**Includes 1991 Non-Qualified Stock Option Plan and SWAPA Plan. No options have been granted under the 1996 Non-Qualified Stock Option Plan.

The following table summarizes information about fixed stock options outstanding under the fixed option plans at December 31, 1996:

	OPTIONS OUTSTANDING		
RANGE OF EXERCISE PRICES	NUMBER OUTSTANDING AT 12/31/96	WEIGHTED-AVERAGE REMAINING CONTRACTUAL LIFE	WEIGHTED-AVERAGE EXERCISE PRICE
$6.02 to $7.81	2,487,991	4.05 yrs.	$6.12
$11.33 to $16.87	326,591	5.09	12.02
$18.81 to $27.19	18,248,078	8.09	20.71
$35.69 to $37.44	177,290	7.02	37.29
$6.02 to $37.44	21,239,950	7.56 yrs.	$19.01

	OPTIONS EXERCISABLE	
RANGE OF EXERCISE PRICES	NUMBER EXERCISABLE AT 12/31/96	WEIGHTED-AVERAGE EXERCISE PRICE
$6.02 to $7.81	682,231	$6.39
$11.33 to $16.87	71,291	12.07
$18.81 to $27.19	4,572,348	20.33
$35.69 to $37.44	162,290	37.40
$6.02 to $37.44	5,488,160	$18.99

The Company has granted options to purchase the Company's common stock related to employment contracts with the Company's president and chief executive officer. These options have terms of ten years from the date of grant or ten years from the date exercisable, depending upon the grant. The options vest and become fully exercisable over three or four years. In 1996, the Company granted 144,395 options with an exercise price of $1.00 per share and 500,000 options with an exercise price of $23.50 per share related to the 1996 employment agreement. None of the 1996 options granted were exercised in 1996; however, 128,879 options were exercisable at December 31, 1996. At December 31, 1996, 1995, and 1994, 1,897,898, 1,422,253, and 1,489,753 total options were outstanding, respectively. Exercise prices range from $1.00 to $23.50 per share. Options for 168,750, 67,500, and 15,000 shares were exercised in 1996, 1995, and 1994, respectively.

Under the 1991 Employee Stock Purchase Plan (ESPP), at December 31, 1996, the Company is authorized to issue up to a balance of 1,183,236 shares of common stock to Employees of the Company at a price equal to 90 percent 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 309,446 shares in 1996, 388,339 shares in 1995, and 290,054 shares in 1994 at average prices of $23.05, $19.18, and $24.98, respectively.

Pro forma information regarding net income and net income per share is required by SFAS 123, and has been determined as if the Company had accounted for its employee stock-based compensation plans and other stock options under the fair value method of that SFAS. The fair value of each option grant is estimated on the date of grant using the Black-Scholes option pricing model with the following weighted-average assumptions used for grants under the fixed option plans in 1996 and 1995, respectively: dividend yield of .16% and .21%; expected volatility of 35.4% and 36.9%; risk-free interest rate of 5.9% and 7.8%; and expected lives of 5.0 years for both periods. Assumptions for the stock options granted in 1996 to the Company's president and chief executive officer were the same as for the fixed option plans except for the weighted average expected lives of 8.0 years.

The Black-Scholes option valuation model was developed for use in estimating the fair value of traded options which have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions including the expected stock price volatility. Because the Company's Employee stock options have characteristics significantly different from those of traded options, and because changes in the subjective input assumptions can materially affect the fair value estimate, in management's opinion, the existing models do not necessarily provide a reliable single measure of the fair value of its Employee stock options.

For purposes of pro forma disclosures the estimated fair value of stock-based compensation plans and other options is amortized to expense primarily over the vesting period. The Company's pro forma net income and net income per share is as follows (in thousands except per share amounts):

	1996	1995
Net income:		
As reported	$ 207,337	$ 182,626
Pro forma	$ 196,478	$ 167,907
Net income per share:		
As reported	$ 1.37	$ 1.23
Pro forma	$ 1.33	$ 1.14

The effects of applying SFAS 123 for providing pro forma disclosures during the initial phase-in period may not be representative of the effects on reported net income for future years.

The weighted-average fair value of options granted under the five fixed option plans during 1996 and 1995 was $10.17 and $8.42, respectively, for the incentive plans, $9.24 and $7.97, respectively, for the SWAPA Plan, and $10.17 and $8.42, respectively, for other non-qualified plans. The weighted-average fair value of options granted in 1996 to the Company’s president and chief executive officer (no options were granted in 1995) was $13.98. The weighted-average fair value of each purchase right under the ESPP granted in 1996 and 1995, which is equal to the ten percent discount from the market value of the common stock at the end of each purchase period, was $2.56 and $2.15, respectively.

8. EMPLOYEE PROFITSHARING AND SAVINGS PLANS

Substantially all of Southwest’s Employees are members of the Southwest Airlines Co. Profitsharing Plan. Total profitsharing expense charged to operations in 1996, 1995, and 1994 was $59,927,000, $54,033,000, and $52,782,000, respectively.

The Company sponsors Employee savings plans under Section 401(k) of the Internal Revenue Code. The plans cover substantially all full-time Employees. The amount of matching contributions varies by Employee group. Company contributions generally vest over five years with credit for prior years’ service granted. Company matching contributions expensed in 1996, 1995, and 1994 were $35,125,000, $28,954,000, and $19,817,000, respectively.

9. INCOME TAXES

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. The components of deferred tax assets and liabilities at December 31, 1996 and 1995 are as follows (in thousands):

	1996	1995
Deferred tax liabilities:		
Accelerated depreciation	$467,372	$400,321
Scheduled airframe overhauls	30,984	27,129
Other	78,195	68,458
Total deferred tax liabilities	576,551	495,908
Deferred tax assets:		
Deferred gains from sale and leaseback of aircraft	114,514	106,119
Capital and operating leases	58,252	54,472
Alternative minimum tax credit carryforward	6,019	11,333
Other	59,339	52,810
Total deferred tax assets	238,124	224,734
Net deferred tax liability	$338,427	$271,174

The provision for income taxes is composed of the following (in thousands):

	1996	1995	1994
Current:			
Federal	$ 59,101	$ 64,420	$ 59,603
State	7,671	9,947	10,702
Total current	66,772	74,367	70,305
Deferred:			
Federal	60,967	44,580	46,470
State	6,286	3,567	3,417
Total deferred	67,253	48,147	49,887
	$134,025	$122,514	$120,192

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

The effective tax rate on income before income taxes differed from the federal income tax statutory rate for the following reasons (in thousands):

	1996	1995	1994
Tax at statutory U.S. tax rates	$119,477	$106,799	$104,833
Nondeductible items	5,168	4,488	3,689
State income taxes, net of federal benefit	9,072	8,784	9,177
Other, net	308	2,443	2,493
Total income tax provision	$134,025	$122,514	$120,192

10. 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 (151,793,477 in 1996, 148,850,512 in 1995, and 147,305,374 in 1994). Fully diluted earnings per share have not been presented as the fully dilutive effect of shares issuable upon the exercise of options under the Company's Stock Option Plans is not material.

REPORT OF ERNST & YOUNG LLP INDEPENDENT AUDITORS

THE BOARD OF DIRECTORS AND SHAREHOLDERS
SOUTHWEST AIRLINES CO.

We have audited the accompanying consolidated balance sheets of Southwest Airlines Co. as of December 31, 1996 and 1995, and the related consolidated statements of income, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 1996. 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, 1996 and 1995, and the consolidated results of its operations and its cash flows for each of the three years in the period ending December 31, 1996, in conformity with generally accepted accounting principles.

Dallas, Texas
January 23, 1997

QUARTERLY FINANCIAL DATA (UNAUDITED)
(IN THOUSANDS EXCEPT PER SHARE AMOUNTS)

	THREE MONTHS ENDED			
	MARCH 31	JUNE 30	SEPT. 30	DEC. 31
1996				
Operating revenues	$772,529	$910,308	$891,492	$831,841
Operating income	57,393	142,206	102,934	48,302
Income before income taxes	54,771	139,989	100,243	46,359
Net income	33,000	85,316	60,858	28,163
Net income per common and common equivalent share	.22	.56	.40	.19
1995				
Operating revenues	$620,999	$738,205	$764,975	$748,572
Operating income	23,409	103,425	114,098	72,599
Income before income taxes	20,034	100,801	114,215	70,090
Net income	11,826	59,724	67,717	43,359
Net income per common and common equivalent share	.08	.41	.45	.29

COMMON STOCK PRICE RANGES AND DIVIDENDS

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

PERIOD	DIVIDENDS	HIGH	LOW
1996			
1st quarter	$ .011	$33.00	$22.13
2nd quarter	.011	33.25	25.75
3rd quarter	.011	29.00	21.38
4th quarter	.011	26.00	20.63

PERIOD	DIVIDENDS	HIGH	LOW
1995			
1st quarter	$ .01	$20.00	$16.38
2nd quarter	.01	25.75	17.63
3rd quarter	.01	29.88	23.63
4th quarter	.01	26.13	19.75

CORPORATE DATA

TRANSFER AGENT AND REGISTRAR

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

STOCK EXCHANGE LISTING

New York Stock Exchange
Ticker Symbol: LUV

AUDITORS

Ernst & Young LLP
Dallas, Texas

GENERAL OFFICES

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

ANNUAL MEETING

The Annual Meeting of Shareholders of Southwest Airlines Co. will be held at 10:00 a.m. on May 15, 1997, at the Southwest Airlines Corporate Headquarters, 2702 Love Field Drive, Dallas, Texas.

FINANCIAL INFORMATION

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

Investor Relations
Southwest Airlines Co.
P. O. Box 36611
Dallas, Texas 75235-1611
Telephone (214) 792-4908

DEDICATION

This 25th Anniversary Annual Report is dedicated to the thirty-six Original Employees who have been with us since 1971. Your loyalty, your service, and your spirit are the stuff legends are made of. Southwest Airlines is truly <u>your</u> airline.

DIRECTORS

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

GENE H. BISHOP
Retired, Dallas, Texas;
Audit, Compensation, and Executive Committees

C. WEBB CROCKETT
Shareholder and Director, Fennemore Craig,
Attorneys at Law, Phoenix, Arizona;
Audit Committee

WILLIAM P. HOBBY, JR.
Chancellor, University of Houston System;
Former Lieutenant Governor of Texas;
Houston, Texas;
Audit and Compensation Committees

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

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

ROLLIN W. KING
Retired, Dallas, Texas;
Audit and Executive Committees

WALTER M. MISCHER, SR.
Chairman of the Board and Chief Executive Officer, Hallmark Residential Group, Inc., Houston, Texas (Real Estate Development); Audit and Compensation Committees

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

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

CAROLYN R. BATES
Vice President–Reservations

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

LUKE J. GILL
Vice President–Maintenance and Engineering

MICHAEL P. GOLDEN
Vice President–Purchasing

GINGER C. HARDAGE
Vice President–Public Relations and Corporate Communications

CAMILLE T. KEITH
Vice President–Special Marketing

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

WILLIAM D. LYONS
Controller

PETE McGLADE
Vice President–Schedule Planning

WILLIAM Q. MILLER
Vice President–Inflight Service

JOHN D. OWEN
Treasurer

JAMES F. PARKER*
Vice President–General Counsel

ROBERT W. RAPP, JR.
Vice President–Systems

RON RICKS*
Vice President–Governmental Affairs

DAVE RIDLEY
Vice President–Marketing and Sales

JOYCE C. ROGGE*
Vice President–Advertising and Promotions

ROGER W. SAARI
Vice President–Fuel Management

ELIZABETH P. SARTAIN
Vice President–People

PAUL E. STERBENZ
Vice President–Flight Operations

KEITH L. TAYLOR
Vice President–Revenue Management

JAMES C. WIMBERLY*
Vice President–Ground Operations

*Member of Executive Planning Committee

Southwest Airlines Co.
P.O. Box 36611
Dallas, Texas 75235-1611
214/792-4000
1-800-I-FLY-SWA
www.iflyswa.com

SOUTHWEST AIRLINES CO.
TEN YEAR SUMMARY

SELECTED CONSOLIDATED FINANCIAL DATA(1) (IN THOUSANDS EXCEPT PER SHARE AMOUNTS)	1996	1995	1994	1993	1992	1991	1990
Operating revenues:							
Passenger	$3,269,238	$2,760,756	$2,497,765	$2,216,342	$1,623,828	$1,267,897	$1,144,421
Freight	80,005	65,825	54,419	42,897	33,088	26,428	22,196
Other	56,927	46,170	39,749	37,434	146,063	84,961	70,659
Total operating revenues	3,406,170	2,872,751	2,591,933	2,296,673	1,802,979	1,379,286	1,237,276
Operating expenses	3,055,335	2,559,220	2,275,224	2,004,700	1,609,175	1,306,675	1,150,015
Operating income	350,835	313,531	316,709	291,973	193,804	72,611	87,261
Other expenses (income), net	9,473	8,391	17,186	32,336	36,361	18,725	6,827(6)
Income before income taxes	341,362	305,140	299,523	259,637	157,443	53,886	80,434
Provision for income taxes(3)	134,025	122,514	120,192	105,353	60,058	20,738	29,829
Net income(3)	$207,337	$182,626	$179,331	$154,284(4)	$97,385(5)	$33,148	$50,605
Net income per common and common equivalent share(3)	$1.37	$1.23	$1.22	$1.05(4)	$.68(5)	$.25	$.39
Cash dividends per common share	$.04284	$.04000	$.04000	$.03867	$.03533	$.03333	$.03223
Total assets	$3,723,479	$3,256,122	$2,823,071	$2,576,037	$ 2,368,856	$ 1,854,331	$ 1,480,813
Long-term debt	$650,226	$661,010	$583,071	$639,136	$735,754	$617,434	$327,553
Stockholders' equity	$1,648,312	$1,427,318	$1,238,706	$1,054,019	$879,536	$635,793	$607,294
CONSOLIDATED FINANCIAL RATIOS(1)							
Return on average total assets	5.9%	6.0%	6.6%	6.2%(4)	4.6%(5)	2.0%	3.5%
Return on average stockholders' equity	13.5%	13.7%	15.6%	16.0%(4)	12.9%(5)	5.3%	8.4%
Debt as a percentage of invested capital	28.3%	31.7%	32.0%	37.7%	45.5%	49.3%	35.0%
CONSOLIDATED OPERATING STATISTICS(2)							
Revenue passengers carried	49,621,504	44,785,573	42,742,602(11)	36,955,221(11)	27,839,284	22,669,942	19,830,941
RPMs (000s)	27,083,483	23,327,804	21,611,266	18,827,288	13,787,005	11,296,183	9,958,940
ASMs (000s)	40,727,495	36,180,001	32,123,974	27,511,000	21,366,642	18,491,003	16,411,115
Load factor	66.5%	64.5%	67.3%	68.4%	64.5%	61.1%	60.7%
Average length of passenger haul	546	521	506	509	495	498	502
Trips flown	748,634	685,524	624,476	546,297	438,184	382,752	338,108
Average passenger fare	$65.88	$61.64	$58.44	$59.97	$58.33	$55.93	$57.71
Passenger revenue yield per RPM	12.07¢	11.83¢	11.56¢	11.77¢	11.78¢	11.22¢	11.49¢
Operating revenue yield per ASM	8.36¢	7.94¢	8.07¢	8.35¢	7.89¢	7.10¢	7.23¢
Operating expenses per ASM	7.50¢	7.07¢	7.08¢	7.25¢(12)	7.03¢	6.76¢	6.73¢
Fuel cost per gallon (average)	65.47¢	55.22¢	53.92¢	59.15¢	60.82¢	65.69¢	77.89¢
Number of Employees at yearend	22,944	19,933	16,818	15,175	11,397	9,778	8,620
Size of fleet at yearend(13)	243	224	199	178	141	124	106

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

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

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

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

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

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

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

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

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

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

(11) Includes certain estimates for Morris

(12) Excludes merger expenses of $10.8 million

(13) Includes leased aircraft