

SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

X QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE  
SECURITIES EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED  
September 30, 1997 OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE  
SECURITIES EXCHANGE ACT OF 1934 FOR THE TRANSITION PERIOD FROM  
TO

Commission file No. 1-7259

SOUTHWEST AIRLINES CO.  
(Exact name of registrant as specified in its charter)

TEXAS 74-1563240  
(State or other jurisdiction of (I.R.S. Employer  
incorporation or organization) Identification No.)

P.O. Box 36611, Dallas, Texas 75235-1611  
(Address of principal executive offices) (Zip Code)

(214) 792-4000  
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all  
reports required to be filed by Section 13 or 15(d) of the  
Securities Exchange Act of 1934 during the preceding 12 months  
(or for such shorter period that the registrant was required to  
file such reports), and (2) has been subject to such filing  
requirements for the past 90 days. Yes X No .

Indicate the number of shares outstanding of each of the issuer's  
classes of common stock, as of the latest practicable date.

Number of shares of Common Stock outstanding as of the close  
of business on November 12, 1997 : 147,146,248

SOUTHWEST AIRLINES CO.  
FORM 10-Q  
Part I - FINANCIAL INFORMATION  
Item 1. Financial Statements

Southwest Airlines Co.  
CONDENSED CONSOLIDATED BALANCE SHEET  
(in thousands)  
(unaudited)

<TABLE>  
<CAPTION>

|                                                    | September 30,<br>1997 | December 31,<br>1996 |
|----------------------------------------------------|-----------------------|----------------------|
| <S>                                                |                       |                      |
| ASSETS                                             |                       |                      |
| Current assets:                                    | <C>                   | <C>                  |
| Cash and cash equivalents                          | \$554,118             | \$581,841            |
| Accounts receivable                                | 106,000               | 73,440               |
| Inventories of parts and supplies                  | 52,281                | 51,094               |
| Deferred income taxes                              | 12,303                | 11,560               |
| Prepaid expenses and other current<br>assets       | 32,276                | 33,055               |
| Total current assets                               | 756,978               | 750,990              |
| Property and equipment:                            |                       |                      |
| Flight equipment                                   | 3,894,762             | 3,435,304            |
| Ground property and equipment                      | 581,341               | 523,958              |
| Deposits on flight equipment<br>purchase contracts | 227,899               | 198,366              |
|                                                    | 4,704,002             | 4,157,628            |
| Less allowance for depreciation                    | 1,323,068             | 1,188,405            |
|                                                    | 3,380,934             | 2,969,223            |
| Other assets                                       | 4,122                 | 3,266                |
|                                                    | \$4,142,034           | \$3,723,479          |

## LIABILITIES AND STOCKHOLDERS' EQUITY

## Current liabilities:

|                                                    |             |             |
|----------------------------------------------------|-------------|-------------|
| Accounts payable                                   | \$164,510   | \$214,232   |
| Accrued liabilities                                | 394,707     | 368,625     |
| Air traffic liability                              | 205,292     | 158,098     |
| Income taxes payable                               | 6,526       | -           |
| Current maturities of long-term debt               | 119,635     | 12,327      |
| Other current liabilities                          | 7,960       | 12,122      |
| Total current liabilities                          | 898,630     | 765,404     |
| Long-term debt less current maturities             | 632,143     | 650,226     |
| Deferred income taxes                              | 414,606     | 349,987     |
| Deferred gains from sale and leaseback of aircraft | 260,716     | 274,891     |
| Other deferred liabilities                         | 28,489      | 34,659      |
| Stockholders' equity:                              |             |             |
| Common stock                                       | 146,785     | 145,112     |
| Capital in excess of par value                     | 206,867     | 181,650     |
| Retained earnings                                  | 1,553,798   | 1,321,550   |
| Total stockholders' equity                         | 1,907,450   | 1,648,312   |
|                                                    | \$4,142,034 | \$3,723,479 |

&lt;/TABLE&gt;

See accompanying notes.

Southwest Airlines Co.  
CONDENSED CONSOLIDATED STATEMENT OF INCOME  
(in thousands except per share amounts)  
(unaudited)

&lt;TABLE&gt;

&lt;CAPTION&gt;

|                                                                  | Three months ended<br>September 30, |           | Nine months ended<br>September 30, |             |
|------------------------------------------------------------------|-------------------------------------|-----------|------------------------------------|-------------|
|                                                                  | 1997                                | 1996      | 1997                               | 1996        |
| <S>                                                              |                                     |           |                                    |             |
| Operating revenues:                                              | <C>                                 | <C>       | <C>                                | <C>         |
| Passenger                                                        | \$949,540                           | \$855,719 | \$2,710,327                        | \$2,473,142 |
| Freight                                                          | 25,613                              | 19,677    | 69,350                             | 58,668      |
| Other                                                            | 22,088                              | 16,096    | 61,551                             | 42,519      |
| Total operating revenues                                         | 997,241                             | 891,492   | 2,841,228                          | 2,574,329   |
| Operating expenses:                                              |                                     |           |                                    |             |
| Salaries, wages, and benefits                                    | 293,032                             | 254,798   | 841,463                            | 750,241     |
| Fuel and oil                                                     | 119,062                             | 126,239   | 370,698                            | 345,757     |
| Maintenance materials and repairs                                | 72,430                              | 70,565    | 185,688                            | 199,598     |
| Agency commissions                                               | 39,902                              | 37,098    | 117,578                            | 106,500     |
| Aircraft rentals                                                 | 50,402                              | 47,960    | 151,250                            | 138,879     |
| Landing fees and other rentals                                   | 51,966                              | 49,158    | 152,454                            | 140,003     |
| Depreciation                                                     | 49,873                              | 46,171    | 145,768                            | 136,295     |
| Other operating expenses                                         | 168,804                             | 156,569   | 480,949                            | 454,522     |
| Total operating expenses                                         | 845,471                             | 788,558   | 2,445,848                          | 2,271,795   |
| Operating income                                                 | 151,770                             | 102,934   | 395,380                            | 302,534     |
| Other expenses (income):                                         |                                     |           |                                    |             |
| Interest expense                                                 | 16,428                              | 14,717    | 47,872                             | 44,642      |
| Capitalized interest                                             | (5,709)                             | (5,009)   | (14,448)                           | (17,731)    |
| Interest income                                                  | (9,478)                             | (7,480)   | (26,973)                           | (16,878)    |
| Nonoperating losses (gains), net                                 | 142                                 | 463       | 1,318                              | (2,504)     |
| Total other expenses                                             | 1,383                               | 2,691     | 7,769                              | 7,529       |
| Income before income taxes                                       | 150,387                             | 100,243   | 387,611                            | 295,005     |
| Provision for income taxes                                       | 57,876                              | 39,385    | 150,394                            | 115,828     |
| Net income                                                       | \$92,511                            | \$60,858  | \$237,217                          | \$179,177   |
| Weighted average common and common equivalent shares outstanding | 154,433                             | 150,808   | 152,407                            | 152,295     |
| Net income per common and common equivalent share                | \$ .60                              | \$ .40    | \$1.56                             | \$1.18      |

</TABLE>

See accompanying notes.

Southwest Airlines Co.  
CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS  
(in thousands)  
(unaudited)

<TABLE>  
<CAPTION>

|                                                         | Three Months Ended<br>September 30,<br>1997 |           | Nine Months Ended<br>September 30,<br>1997 |           |
|---------------------------------------------------------|---------------------------------------------|-----------|--------------------------------------------|-----------|
| <S>                                                     | <C>                                         | <C>       | <C>                                        | <C>       |
| Net cash provided by operating activities               | \$126,769                                   | \$82,033  | \$440,884                                  | \$445,924 |
| Investing activities:                                   |                                             |           |                                            |           |
| Net purchases of property and equipment                 | (165,040)                                   | (161,503) | (577,514)                                  | (495,250) |
| Financing activities:                                   |                                             |           |                                            |           |
| Issuance of long-term debt                              | -                                           | -         | 98,764                                     | -         |
| Payment of long-term debt and capital lease obligations | (3,610)                                     | (3,047)   | (10,182)                                   | (11,103)  |
| Payment of cash dividends                               | (1,688)                                     | (1,595)   | (6,565)                                    | (6,216)   |
| Proceeds from aircraft sale and leaseback transactions  | -                                           | 198,000   | -                                          | 330,000   |
| Proceeds from Employee stock plans                      | 19,903                                      | 1,857     | 26,890                                     | 13,312    |
| Net cash provided by financing activities               | 14,605                                      | 195,215   | 108,907                                    | 325,993   |
| Net increase (decrease) in cash and cash equivalents    | (23,666)                                    | 115,745   | (27,723)                                   | 276,667   |
| Cash and cash equivalents at beginning of period        | 577,784                                     | 478,285   | 581,841                                    | 317,363   |
| Cash and cash equivalents at end of period              | \$554,118                                   | \$594,030 | \$554,118                                  | \$594,030 |
| Cash payments for:                                      |                                             |           |                                            |           |
| Interest, net of amount capitalized                     | \$19,840                                    | \$17,276  | \$42,446                                   | \$35,220  |
| Income taxes                                            | \$59,860                                    | \$36,556  | \$72,984                                   | \$58,447  |

</TABLE>

See accompanying notes.

SOUTHWEST AIRLINES CO.  
Notes to Condensed Consolidated Financial Statements

1. Basis of presentation - The accompanying unaudited condensed consolidated financial statements of Southwest Airlines Co. (Company) have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. The condensed consolidated financial statements for the interim periods ended September 30, 1997 and 1996 include all adjustments (which include only normal recurring adjustments) which are, in the opinion of management, necessary for a fair presentation of the results for the interim periods. Operating results for the three and nine month periods ended September 30, 1997 are not necessarily indicative of the results that may be expected for the year ended December 31, 1997. For further information, refer to the consolidated financial statements and footnotes thereto included in the Southwest Airlines Co. Annual Report on Form 10-K for the year ended December 31, 1996.

2. Dividends - During the three month periods ended September 30, 1997, June 30, 1997, and March 31, 1997, dividends of \$.01155 per share were declared on the 146,109,112, 145,643,837, and 145,335,143 shares of common stock then outstanding, respectively. During the three month periods ended September 30, 1996, June 30, 1996, and March 31, 1996, dividends of \$.011 per share were declared on the 144,956,331, 144,715,343,

3. Long-term debt - During February 1997, the Company issued \$100 million of senior unsecured 7 3/8 percent Debentures due March 1, 2027. Interest on the Debentures is payable semi-annually on March 1 and September 1, commencing September 1, 1997. The Debentures may be redeemed, at the option of the Company, in whole at any time or in part from time to time, at a redemption price equal to the greater of the principal amount of the Debentures plus accrued interest at the date of redemption or the sum of the present values of the remaining scheduled payments of principal of the Debentures and interest thereon discounted to the date of redemption plus accrued interest at the date of redemption.

5. Recently issued accounting standard - In February 1997, the Financial Accounting Standards Board issued Statement No. 128, Earnings per Share, which is required to be adopted for interim and annual periods ending after December 15, 1997. At that time, the Company will be required to change the method currently used to compute earnings per share and to restate all prior periods. Under the new requirements for calculating basic earnings per share, the dilutive effect of stock options will be excluded. Basic earnings per share for the three and nine month periods ended September 30, 1997 would be \$.63 and \$1.63, respectively, and for the three and nine month periods ended September 30, 1996 would be \$.42 and \$1.24, respectively. Diluted earnings per share for the three and nine month periods ended September 30, 1997 would be \$.60 and \$1.56, respectively, and for the three and nine month periods ended September 30, 1996 would be \$.40 and \$1.18, respectively.

Item 2. Management's Discussion and Analysis of Results of Operations and Financial Condition

Relevant operating statistics for the three and nine month periods ended September 30, 1997 and 1996 are as follows:

Three months ended  
September 30,

|           |
|-----------|
| <TABLE>   |
| <CAPTION> |

| Nine months ended<br>September 30,       |            |            |       |      |
|------------------------------------------|------------|------------|-------|------|
| <S>                                      | <C>        | <C>        | <C>   |      |
| Revenue passengers carried               | 37,787,869 | 36,826,493 | 2.6   | %    |
| Revenue passenger miles<br>(RPMs) (000s) | 21,113,381 | 19,979,952 | 5.7   | %    |
| Available seat miles<br>(ASMs) (000s)    | 32,990,974 | 30,286,698 | 8.9   | %    |
| Load factor                              | 64.0%      | 66.0%      | (2.0) | pts. |
| Average length of<br>passenger haul      | 559        | 543        | 2.9   | %    |
| Trips flown                              | 587,153    | 558,788    | 5.1   | %    |
| Average passenger fare                   | \$71.72    | \$67.16    | 6.8   | %    |
| Passenger revenue yield<br>per RPM       | \$.1284    | \$.1238    | 3.7   | %    |
| Operating revenue yield<br>per ASM       | \$.0861    | \$.0850    | 1.3   | %    |
| Operating expenses per ASM               | \$.0741    | \$.0750    | (1.2) | %    |
| Average fuel cost per<br>gallon          | \$.6318    | \$.6279    | 0.6   | %    |
| Number of employees at<br>period-end     | 23,840     | 23,066     | 3.4   | %    |
| Size of fleet at period-<br>end          | 258        | 241        | 7.1   | %    |

</TABLE>

#### Material Changes in Results of Operations

Consolidated net income for the three months ended September 30, 1997 was \$92.5 million (\$.60 per share) compared with \$60.9 million (\$.40 per share) earned in third quarter 1996. Consolidated net income for the nine months ended September 30, 1997 was \$237.2 million (\$1.56 per share) compared with \$179.2 million (\$1.18 per share) earned for the nine months ended September 30, 1996.

Consolidated operating revenues increased 11.9 percent for the third quarter of 1997 and 10.4 percent for the nine months ended September 30, 1997, as compared to the corresponding periods of the prior year, primarily as a result of an 11.0 percent and 9.6 percent increase, respectively, in consolidated passenger revenues. The increase in passenger revenues resulted from a 3.2 percent and 5.7 percent increase in revenue passenger miles (RPMs) for the three and nine month periods ended September 30, 1997, respectively, coupled with 7.5 percent and 3.7 percent increases in passenger revenue yield per RPM over these same periods.

While RPMs increased 3.2 percent in third quarter 1997 and 5.7 percent in the nine month period ended September 30, 1997, available seat miles (ASMs) increased 9.7 percent and 8.9 percent for these same periods. This resulted in load factors of 65.8 percent and 64.0 percent for the three and nine month periods ended September 30, 1997, respectively, compared with 70.0% and 66.0% for the corresponding periods of the prior year. Load factors were lower in 1997 generally as a result of higher fares and less promotional activity. The increase in ASMs resulted primarily from the net addition of 17 aircraft since third quarter 1996.

Due to last fall's heavy promotional activities, load factor for October 1997 of 63.1 percent fell below last year's October load factor of 72.2 percent but was in line with historical performances. Revenue yield per passenger mile in October 1997 was up sharply from October of last year. Thus far, November and December bookings are good which should result in more favorable year-over-year load factor comparisons. (The immediately preceding sentence is a forward-looking statement which involves uncertainties that could result in actual results differing materially from expected results. Some significant factors include, but may not be limited to, competitive pressure such as fare sales and capacity changes by other carriers, general economic conditions, and variations in advance booking trends.)

In August 1997, the Taxpayer Relief Act of 1997 was enacted, which included, among other things, a revision, phased in over five years, of the then current ten percent federal excise tax on domestic tickets to (ultimately) an excise tax of 7.5 percent and a fee of \$3.00 per passenger segment. Effective October 1, 1997 through September 30, 1998, the tax rate was reduced to nine percent of the ticket price for amounts paid for transportation beginning on or after October 1, 1997 and a new \$1.00 flight segment tax was imposed. From October 1, 1998 to September 30, 1999, the tax rate will decrease to eight percent and the segment tax will increase to \$2.00. Beginning October 1, 1999, the tax

rate will change to 7.5 percent of the ticket price. However, the segment tax will increase to \$2.25 from October 1, 1999 to December 31, 1999; \$2.50 during 2000; \$2.75 during 2001; and \$3.00 per segment during 2002. Thereafter, the \$3.00 segment tax will be indexed to changes in the Consumer Price Index (CPI). The legislation also includes a new tax on the sale of frequent flier miles, raises the international departure fee, and institutes a new international arrival fee. Management estimates these changes may increase Southwest's tax burden by \$25 to \$35 million in 1998. Effective October 1, 1997, the Company raised fares to attempt to offset the immediate impact of these changes. Management cannot predict how successful these fare increases will be or how successful the Company will be in offsetting future scheduled tax increases. (The immediately preceding three sentences are forward-looking statements which involve uncertainties that could result in actual results differing materially from expected results. Some significant factors include, but may not be limited to, regulations implementing the tax, competitors' response to the tax, and the ability to pass through the tax in the form of fare increases.)

On October 27, 1997, the International Air Transportation Competition Act of 1979 was amended to allow scheduled service from Dallas Love Field to Alabama, Mississippi, and Kansas. By mid-November, the Company's reservations system will offer service from Dallas Love Field to Jackson via connecting flights through Houston and service from Dallas Love Field to Birmingham via connecting flights through New Orleans or Houston. No additional flights have been added, thus far, from Dallas Love Field to Alabama, Mississippi, or Kansas.

Consolidated freight revenues increased 30.2 percent in the third quarter of 1997 and 18.2 percent for the nine months ended September 30, 1997 as compared to the same periods of the prior year, due to increased capacity and increased service resulting, in part, from the United Parcel Service labor strike. Other revenues increased 37.2 percent in the third quarter 1997 and 44.8 percent for the nine months ended September 30, 1997, primarily due to increased revenues from the sale of frequent flyer credits to participating partners in the Rapid Rewards program.

Operating expenses per ASM decreased 2.1 percent and 1.2 percent for the three months and nine months ended September 30, 1997, respectively, primarily due to lower jet fuel prices; lower aircraft engine repair costs; lower advertising spending; and favorable results from numerous Companywide cost reduction efforts.

Southwest Airlines Co.  
Consolidated Operating Expenses per ASM  
(in cents except percent change)

<TABLE>  
<CAPTION>

|                                             | Three months ended<br>September 30, |             |                               | Percent       |
|---------------------------------------------|-------------------------------------|-------------|-------------------------------|---------------|
| <S>                                         | 1997<br><C>                         | 1996<br><C> | Increase<br>(decrease)<br><C> | change<br><C> |
| Salaries, wages, and benefits               | 2.23                                | 2.17        | .06                           | 2.8           |
| Profitsharing and Employee<br>savings plans | .32                                 | .26         | .06                           | 23.1          |
| Fuel and oil                                | 1.04                                | 1.20        | (.16)                         | (13.3)        |
| Maintenance materials<br>and repairs        | .63                                 | .68         | (.05)                         | (7.4)         |
| Agency commissions                          | .35                                 | .35         | -                             | -             |
| Aircraft rentals                            | .44                                 | .46         | (.02)                         | (4.3)         |
| Landing fees and other rentals              | .45                                 | .47         | (.02)                         | (4.3)         |
| Depreciation                                | .43                                 | .44         | (.01)                         | (2.3)         |
| Other operating expenses                    | 1.47                                | 1.49        | (.02)                         | (1.3)         |
| Total                                       | 7.36                                | 7.52        | (.16)                         | (2.1)         |

</TABLE>

<TABLE>  
<CAPTION>

|     | Nine months ended<br>September 30, |             |                               | Percent       |
|-----|------------------------------------|-------------|-------------------------------|---------------|
| <S> | 1997<br><C>                        | 1996<br><C> | Increase<br>(decrease)<br><C> | change<br><C> |

|                                          |      |      |       |        |
|------------------------------------------|------|------|-------|--------|
| Salaries, wages, and benefits            | 2.25 | 2.22 | .03   | 1.4    |
| Profitsharing and Employee savings plans | .30  | .26  | .04   | 15.4   |
| Fuel and oil                             | 1.12 | 1.14 | (.02) | (1.8)  |
| Maintenance materials and repairs        | .56  | .66  | (.10) | (15.2) |
| Agency commissions                       | .36  | .35  | .01   | 2.9    |
| Aircraft rentals                         | .46  | .46  | -     | -      |
| Landing fees and other rentals           | .46  | .46  | -     | -      |
| Depreciation                             | .44  | .45  | (.01) | (2.2)  |
| Other operating expenses                 | 1.46 | 1.50 | (.04) | (2.7)  |
| Total                                    | 7.41 | 7.50 | (.09) | (1.2)  |

</TABLE>

Salaries, wages, and benefits per ASM increased 2.8 percent and 1.4 percent for the three and nine month periods ended September 30, 1997, respectively, as compared to the same periods of the prior year, primarily due to increased health care costs.

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.

Profitsharing and Employee savings plans expense per ASM increased 23.1 percent and 15.4 percent for the three and nine months ended September 30, 1997 as compared to the same periods of the prior year due to higher earnings available for profitsharing in 1997.

Fuel and oil expense per ASM decreased 13.3 percent and 1.8 percent in third quarter 1997 and the nine month period then ended due to lower jet fuel prices. The average price paid for jet fuel in the three and nine month periods ended September 30, 1997 was \$.5841 and \$.6318 per gallon, respectively, compared to \$.6615 and \$.6279 for the corresponding periods in 1996. Since the end of third quarter 1997, fuel prices have averaged approximately \$.61 per gallon.

Maintenance materials and repairs per ASM decreased 7.4 percent and 15.2 percent for the three and nine month periods ended September 30, 1997, respectively, as compared to the corresponding periods of 1996, primarily as a result of lower engine overhaul costs.

On August 1, 1997, the Company signed a ten year engine maintenance contract with General Electric Engine Services, Inc. (General Electric). Under the terms of the contract, Southwest will pay General Electric a rate per flight hour in exchange for General Electric performing substantially all engine maintenance for the CFM56-3 engines on the 737-300 and 737-500 aircraft.

Agency commissions per ASM remained unchanged for the third quarter 1997 and increased 2.9 percent for the nine months ended September 30, 1997. The increase in the nine months ended September 30, 1997 is primarily due to an increase in operating revenue yield per ASM.

Aircraft rentals per ASM decreased 4.3 percent for the third quarter 1997 and remained unchanged for the nine months ended September 30, 1997, compared to the corresponding periods of 1996. The decrease in third quarter 1997 is primarily due to a lower percentage of the aircraft fleet being leased.

Landing fees and other rentals per ASM decreased 4.3 percent for the three month period ended September 30, 1997, and remained unchanged for the nine month period ended September 30, 1997 compared to the corresponding periods of 1996. The third quarter 1997 decrease is primarily due to a 4.4 percent increase in the average aircraft trip distance compared to third quarter 1996.

Depreciation expense per ASM decreased 2.3 percent for third quarter 1997 and 2.2 percent for the nine months ended September 30, 1997 as compared to the same periods of 1996 due to a higher mix of longer-lived depreciable assets.

Other operating expenses per ASM decreased 1.3 percent and 2.7 percent for the three and nine month periods ended September 30, 1997, respectively. These decreases were primarily due to lower advertising spending, lower insurance rates, lower passenger costs, and favorable results from numerous Companywide cost reduction efforts.

The Company is in the process of converting its computer systems to be Year 2000 compliant. The conversion is expected to be completed by the end of 1998 at a total cost of approximately \$10 to \$15 million (\$3.5 million in 1997). The Company is expensing costs attributable to Year 2000 compliance. The Company is in the process of assessing Year 2000 compliance by significant vendors. This assessment is incomplete, but management is not aware of any Year 2000 issues that would materially adversely affect operations or results thereof.

Other expenses (income) for the three months and nine months ended September 30, 1997 included interest expense, capitalized interest, interest income, and nonoperating gains and losses. Interest expense increased for the three and nine months ended September 30, 1997 as compared to same periods in 1996 due to the February 1997 issuance of \$100 million of senior unsecured 7 3/8 percent Debentures due March 1, 2027. Capitalized interest increased in third quarter 1997 and decreased for the nine month period ended September 30, 1997 as a result of the timing of payments related to aircraft purchase contracts. Interest income increased for the three and nine months ended September 30, 1997 due to higher invested cash balances.

#### Material Changes in Financial Condition

Net cash provided by operating activities was \$126.8 million for the three months ended September 30, 1997. During the twelve months ended September 30, 1997, cash of \$610.2 million was provided from operations. This cash was primarily used to finance aircraft-related expenditures and provide working capital.

For the twelve months ended September 30, 1997, net capital expenditures were \$759.7 million, which were primarily for the purchase of 20 new 737-300 aircraft and progress payments for future aircraft deliveries.

As of September 30, 1997, the Company had authority from its Board of Directors to purchase up to 2,500,000 shares of its Common Stock from time to time on the open market. No shares have been purchased since 1990.

The Company's contractual commitments at September 30, 1997 consist primarily of scheduled aircraft acquisitions. Four 737-700s are scheduled for delivery in 1997, 21 in 1998, 18 in 1999, 15 in 2000, and 12 in 2001. In addition, the Company has options to purchase up to sixty-seven 737-700s during 1998-2004. The Company has the option, which must be exercised two years prior to the contractual delivery date, to substitute 737-600s or 737-800s for the 737-700s delivered subsequent to 1999. Aggregate funding needed for these commitments is approximately \$1,675.6 million at September 30, 1997 due as follows: \$73.1 million in 1997; \$532.7 million in 1998; \$547.4 million in 1999; \$318.1 million in 2000; and \$204.3 million in 2001.

Boeing Commercial Airplane Group has announced that there will be delayed deliveries of some commercial aircraft in the near term. These delays are expected to cause the Company's current aircraft delivery schedule for the next twelve months to slip by approximately one month. Management does not expect a significant impact on operation results as a result of these delays.

The Company has various options available to meet its capital and operating commitments, including cash on hand at September 30, 1997 of \$554.1 million, internally generated funds, and a revolving credit line with a group of banks of up to \$475 million (none of which had been drawn at September 30, 1997). 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 \$414.4 million public debt securities which it currently intends to substantially utilize for aircraft financings during the remainder of 1997, 1998, and 1999.

#### PART II. OTHER INFORMATION

##### Item 1. Legal Proceedings

The Company received a statutory notice of deficiency from the Internal Revenue Service (the



"IRS") in which the IRS proposed to disallow deductions claimed by the Company on its federal income tax returns for the taxable years 1989 through 1991 for the costs of certain aircraft inspection and maintenance procedures. The IRS has proposed similar adjustments to the tax returns of numerous other members of the airline industry. In response to the statutory notice of deficiency, the Company filed a petition in the United States Tax Court on October 30, 1997, seeking a determination that the IRS erred in disallowing the deductions claimed by the Company and that there is no deficiency in the Company's tax liability for the taxable years in issue. It is expected that the Tax Court's decision will not be entered for several years. Management believes that the final resolution of this controversy will not have a materially adverse effect upon the results of operations of the Company. This forward-looking statement is based on management's current understanding of the relevant law and facts; it is subject to various contingencies including the views of legal counsel, changes in the IRS' position, the potential cost and risk associated with litigation and the actions of the IRS, judges and juries.

Item 2. Changes in Securities and Use of Proceeds

None

Item 3. Defaults upon Senior Securities

None

Item 4. Submission of Matters to a Vote of Security Holders

None

Item 5. Other Information

None

Item 6. Exhibits and Reports on Form 8-K

a) Exhibits

(11.1) Computation of Earnings Per Share  
(27) Financial Data Schedule

b) Reports on Form 8-K

None

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

SOUTHWEST AIRLINES CO.

<TABLE>

<S>

November 13, 1997

Date

<C>

/s/ Gary C. Kelly

Gary C. Kelly

Vice President - Finance and

Chief Financial Officer

(Principal Financial and

Accounting Officer)

</TABLE>

INDEX TO EXHIBITS

Exhibit

Number

Exhibit

(11.1) Computation of Earnings Per Share

(27) Financial Data Schedule



<TABLE> <S> <C>

<ARTICLE> 5  
<CIK> 0000092380  
<NAME> SOUTHWEST AIRLINES  
<MULTIPLIER> 1,000

| <S>                          | <C>         |
|------------------------------|-------------|
| <PERIOD-TYPE>                | 9-MOS       |
| <FISCAL-YEAR-END>            | DEC-31-1997 |
| <PERIOD-START>               | JAN-01-1997 |
| <PERIOD-END>                 | SEP-30-1997 |
| <CASH>                       | 554,118     |
| <SECURITIES>                 | 0           |
| <RECEIVABLES>                | 106,000     |
| <ALLOWANCES>                 | 0           |
| <INVENTORY>                  | 52,281      |
| <CURRENT-ASSETS>             | 756,978     |
| <PP&E>                       | 4,704,002   |
| <DEPRECIATION>               | 1,323,068   |
| <TOTAL-ASSETS>               | 4,142,034   |
| <CURRENT-LIABILITIES>        | 898,630     |
| <BONDS>                      | 0           |
| <PREFERRED-MANDATORY>        | 0           |
| <PREFERRED>                  | 0           |
| <COMMON>                     | 146,785     |
| <OTHER-SE>                   | 1,760,665   |
| <TOTAL-LIABILITY-AND-EQUITY> | 4,142,034   |
| <SALES>                      | 0           |
| <TOTAL-REVENUES>             | 2,841,228   |
| <CGS>                        | 0           |
| <TOTAL-COSTS>                | 2,445,848   |
| <OTHER-EXPENSES>             | 0           |
| <LOSS-PROVISION>             | 0           |
| <INTEREST-EXPENSE>           | 47,872      |
| <INCOME-PRETAX>              | 387,611     |
| <INCOME-TAX>                 | 150,394     |
| <INCOME-CONTINUING>          | 237,217     |
| <DISCONTINUED>               | 0           |
| <EXTRAORDINARY>              | 0           |
| <CHANGES>                    | 0           |
| <NET-INCOME>                 | 237,217     |
| <EPS-PRIMARY>                | 1.56        |
| <EPS-DILUTED>                | 1.52        |

</TABLE>

<TABLE>  
<CAPTION>

Southwest Airlines Co.  
Computation of Earnings Per Share  
For the Three Months Ended September 30, 1997

| <S>                                                                                      | Primary<br><C> | Fully<br>Diluted<br><C> |
|------------------------------------------------------------------------------------------|----------------|-------------------------|
| Weighted average shares outstanding                                                      | 146,107,201    | 146,107,201             |
| Shares issuable upon exercise of<br>outstanding stock options<br>(treasury stock method) | 8,325,526      | 9,889,530               |
| Weighted average common and common<br>equivalent shares                                  | 154,432,727    | 155,996,731             |
| Earnings for per share computations                                                      | \$92,511,000   | \$92,511,000            |
| Earnings per common and common<br>equivalent share                                       | \$0.60         | \$0.59                  |

&lt;/TABLE&gt;

<TABLE>  
<CAPTION>

Southwest Airlines Co.  
Computation of Earnings Per Share  
For the Three Months Ended September 30, 1996

| <S>                                                                                      | Primary<br><C> | Fully<br>Diluted<br><C> |
|------------------------------------------------------------------------------------------|----------------|-------------------------|
| Weighted average shares outstanding                                                      | 144,928,794    | 144,928,794             |
| Shares issuable upon exercise of<br>outstanding stock options<br>(treasury stock method) | 5,879,425      | 5,878,891               |
| Weighted average common and common<br>equivalent shares                                  | 150,808,219    | 150,807,685             |
| Earnings for per share computations                                                      | \$60,858,000   | \$60,858,000            |
| Earnings per common and common<br>equivalent share                                       | \$0.40         | \$0.40                  |

&lt;/TABLE&gt;

<TABLE>  
<CAPTION>

Southwest Airlines Co.  
Computation of Earnings Per Share  
For the Nine Months Ended September 30, 1997

| <S>                                                                                      | Primary<br><C> | Fully<br>Diluted<br><C> |
|------------------------------------------------------------------------------------------|----------------|-------------------------|
| Weighted average shares outstanding                                                      | 145,674,106    | 145,674,106             |
| Shares issuable upon exercise of<br>outstanding stock options<br>(treasury stock method) | 6,732,990      | 10,034,325              |
| Weighted average common and common<br>equivalent shares                                  | 152,407,096    | 155,708,431             |
| Earnings for per share computations                                                      | \$237,217,000  | \$237,217,000           |

|                                                    |        |        |
|----------------------------------------------------|--------|--------|
| Earnings per common and common<br>equivalent share | \$1.56 | \$1.52 |
|----------------------------------------------------|--------|--------|

</TABLE>

EXHIBIT (11.1)  
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<TABLE>  
<CAPTION>

Southwest Airlines Co.  
Computation of Earnings Per Share  
For the Nine Months Ended September 30, 1996

|                                                                                          | Primary       | Fully<br>Diluted |
|------------------------------------------------------------------------------------------|---------------|------------------|
| <S>                                                                                      | <C>           | <C>              |
| Weighted average shares outstanding                                                      | 144,650,014   | 144,650,014      |
| Shares issuable upon exercise of<br>outstanding stock options<br>(treasury stock method) | 7,645,456     | 7,994,033        |
| Weighted average common and common<br>equivalent shares                                  | 152,295,470   | 152,644,047      |
| Earnings for per share computations                                                      | \$179,177,000 | \$179,177,000    |
| Earnings per common and common<br>equivalent share                                       | \$1.18        | \$1.17           |

</TABLE>