

SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549  
FORM 10-K

(Mark One)

☒ ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE  
ACT OF 1934 [FEE REQUIRED]

For the Fiscal Year Ended December 31, 1994 or

☐ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES  
EXCHANGE ACT OF 1934 [NO FEE REQUIRED]

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 of other jurisdiction of  
incorporation or organization)

(I.R.S. employer  
identification no.)

P.O. BOX 36611

DALLAS, TEXAS

(Address of principal executive offices)

75235-1611

(Zip Code)

Registrant's telephone number, including area code: (214) 904-4000

SECURITIES REGISTERED PURSUANT TO SECTION 12(b) OF THE ACT:

TITLE OF EACH CLASS

NAME OF EACH EXCHANGE  
ON WHICH REGISTERED

-----

-----

Common Stock (\$1.00 par value)

New York Stock Exchange, Inc.

Common Share Purchase Rights

New York Stock Exchange, Inc.

SECURITIES REGISTERED PURSUANT TO SECTION 12(g) OF THE ACT:

None

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 ☒ No ☐

Indicate by check mark if disclosure of delinquent filers pursuant to Item  
405 of Regulation S-K is not contained herein, and will not be contained, to the  
best of registrant's knowledge, in definitive proxy or information statements  
incorporated by reference in Part III of this Form 10-K or any amendment to this  
Form 10-K. Yes ☒ No ☐

Aggregate market value of Common Stock held by nonaffiliates as of February  
28, 1995:

\$2,472,861,013

Number of shares of Common Stock outstanding as of the close of business on  
February 28, 1995:

143,360,669 shares

DOCUMENTS INCORPORATED BY REFERENCE

Proxy Statement for Annual Meeting of  
Shareholders, May 18, 1995:

PART III

PART I

ITEM 1. BUSINESS

DESCRIPTION OF BUSINESS

Southwest Airlines Co. (Southwest) is a major domestic airline that  
provides shorthaul, high frequency, point-to-point, low fare service. Southwest  
was incorporated in Texas and commenced Customer Service on June 18, 1971 with  
three Boeing 737 aircraft serving three Texas cities - Dallas, Houston, and San  
Antonio.

At yearend 1994, Southwest operated 199 Boeing 737 aircraft and provided  
service to 45 airports in 44 cities primarily in the midwestern, southwestern,  
and western regions of the United States.

On December 31, 1993, Southwest acquired Morris Air Corporation (Morris) in a stock-for-stock exchange, issuing approximately 3.6 million shares of Southwest Common Stock in exchange for all of the outstanding shares of Morris. During 1994, the operations of Morris were substantially integrated with those of Southwest. As a result of that process, Southwest commenced service to seven new cities in 1994: Tucson, Arizona; Santa Ana (Orange County), California; Boise, Idaho; Portland, Oregon; Salt Lake City, Utah; Seattle, and Spokane, Washington. Unless the context requires otherwise, references in this annual report to the "Company" include Southwest and Morris.

The business of the Company is somewhat seasonal. Quarterly operating income and, to a lesser extent, revenues tend to be somewhat lower in the first quarter (January 1 - March 31).

#### FUEL

The cost of fuel is an item having significant impact on the Company's operating results. The Company's average cost of jet fuel per gallon for scheduled carrier service over the past five years was as follows:

<TABLE>

| <S>  | <C>   |
|------|-------|
| 1990 | \$.78 |
| 1991 | \$.66 |
| 1992 | \$.61 |
| 1993 | \$.59 |
| 1994 | \$.54 |

</TABLE>

The Company is unable to predict the extent of future fuel cost changes. The Company has standard industry arrangements with major fuel suppliers. Standard industry fuel contracts do not provide material protection against price increases or for assured availability of supplies. The Company uses various price-risk management techniques, including derivative products such as fixed-price swaps, caps, and collars, to help protect against price increases. To date, not more than 11 percent of then-current usage was hedged in this manner. Although market conditions can significantly impact the price of jet fuel, at present, these conditions have not resulted in an inadequate supply of jet fuel. For more discussion of current jet fuel costs and the impact of these costs on the Company's operations, see Management's Discussion and Analysis of Financial Condition and Results of Operations.

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#### REGULATION

Economic. The Dallas Love Field section of the International Air Transportation Competition Act of 1979 (Competition Act), as it affects Southwest's scheduled service, provides that no common carrier may provide scheduled passenger air transportation for compensation between Love Field and one or more points outside Texas, except that an air carrier may transport individuals by air on a flight between Love Field and one or more points within the states of Arkansas, Louisiana, New Mexico, Oklahoma, and Texas if (a) "such air carrier does not offer or provide any through service or ticketing with another air carrier" and (b) "such air carrier does not offer for sale transportation to or from, and the flight or aircraft does not serve, any point which is outside any such states." Southwest does not interline or offer joint fares with any other air carrier. The Competition Act does not restrict Southwest's intrastate Texas flights or its air service from points other than Love Field to points beyond Texas and the four contiguous states.

The Department of Transportation (DOT) has significant regulatory jurisdiction over passenger airlines. Unless exempted, no air carrier may furnish air transportation over any route without a DOT certificate of authorization, which does not confer either exclusive or proprietary rights. The Company's certificates are unlimited in duration and permit the Company to operate among any points within the United States, its territories and possessions, except as limited by the Love Field section of the Competition Act, as do the certificates of all other U.S. carriers. DOT may revoke such certificates, in whole or in part, for intentional failure to comply with any provisions of subchapter IV of the Federal Aviation Act of 1958, or any order, rule or regulation issued thereunder or any term, condition or limitation of such certificate; provided that, with respect to revocation, the certificate holder has first been advised of the alleged violation and has been given a reasonable time to effect compliance.

DOT prescribes uniform disclosure standards regarding terms and conditions of carriage, and prescribes that terms incorporated into the Contract of Carriage by reference are not binding upon passengers unless notice is given in accordance with its regulations.

Safety. The Company is subject to the jurisdiction of the Federal Aviation Administration (FAA) with respect to its aircraft maintenance and operations, including equipment, ground facilities, dispatch, communications, flight

training personnel, and other matters affecting air safety. To ensure compliance with its regulations, the FAA requires airlines to obtain operating, airworthiness and other certificates which are subject to suspension or revocation for cause. The Company has obtained such certificates. The FAA, acting through its own powers or through the appropriate U. S. Attorney, also has the power to bring proceedings for the imposition and collection of fines for violation of the Federal Air Regulations.

Environmental. The Airport Noise and Capacity Act of 1990 (ANCA) requires the phase out of Stage 2 airplanes (which meet less stringent noise emission standards than later model Stage 3 airplanes) in the contiguous 48 states by December 31, 1999. FAA rules establish interim compliance dates for ANCA of December 31, 1994, December 31, 1996, and December 31, 1998. An operator may comply by either implementing a reduction of the operator's base level, as defined in ANCA, of Stage 2 aircraft by at least 25 percent increments by the end of the three interim compliance dates or by operating a fleet that is at least 55 percent Stage 3 by December 31, 1994, 65 percent by December 31, 1996, and 75 percent by December 31, 1998. Selection of one of the two alternative compliance techniques is not irrevocable and operators are free to opt for one method at one compliance date and another at the next. Operation of Stage 2 aircraft after December 31, 1999 is prohibited, subject, however, to an extension of the final compliance date to December 31, 2003, if at least 85 percent of the aircraft used by the operator in the contiguous United States will comply with Stage 3 noise levels by July 1, 1999 and the operator successfully obtains a waiver from the FAA of the December 31, 1999 final phaseout date. Statutory requirements to obtain a waiver include a determination by the FAA that the waiver is in the

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public interest or would enhance competition or benefit service to small communities. There is no assurance that such a waiver is obtainable.

The Company's fleet, as of December 31, 1994, consisted of 50 Stage 2 aircraft and 149 Stage 3 aircraft, yielding a Stage 3 percentage of 74.9 percent. Accordingly, the Company exceeds the Stage 3 fleet percentage requirement for the December 31, 1994 and December 31, 1996 interim compliance dates.

As of December 31, 1994, of the 50 Stage 2 aircraft operated by the Company, 30 are leased from third parties and 20 are owned by the Company. The Company can comply with the rules by acquiring additional Stage 3 aircraft, returning Stage 2 aircraft to the lessors as the leases terminate according to their terms, retiring owned Stage 2 aircraft, or hushkitting Stage 2 aircraft. Because the Company already complies with the December 31, 1998 interim compliance requirement of a 75 percent Stage 3 fleet, the Company could operate all 50 of its Stage 2 aircraft until December 31, 1999. Based upon the Company's current schedule for delivery of new Stage 3 aircraft, including options, the Company could achieve 85 percent compliance by July 1, 1999 through the retirement of only seven of the 50 Stage 2 aircraft, assuming no hushkitting. This would qualify the Company to apply for a waiver from the final compliance date, which, if obtained, could permit the Company to continue operation of the remaining 43 Stage 2 aircraft until, at the latest, December 31, 2003.

ANCA also requires the FAA to establish parameters within which any new Stage 2 and Stage 3 noise or access restrictions at individual airports must be developed. The published rules generally provide that local noise restrictions on Stage 3 aircraft first effective after October 1990 require FAA approval, and establish a regulatory notice and review process for local restrictions on Stage 2 aircraft first proposed after October 1990. Certain airports, including Dallas Love Field, Los Angeles, San Diego, San Francisco, and Orange County, have established airport restrictions to limit noise, including restrictions on aircraft types to be used and limits on the number of hourly or daily operations or the time of such operations. In some instances, these restrictions have caused curtailments in service or increases in operating costs and such restrictions could limit the ability of Southwest to expand its operations at the affected airports. Local authorities at other airports are considering adopting similar noise regulations.

Operations at John Wayne Airport, Orange County, California, are governed by the Airport's Phase 2 Commercial Airline Access Plan and Regulation (the "Plan"). Pursuant to the Plan, each airline is allocated total annual seat capacity to be operated at the airport, subject to renewal/reallocation on an annual basis. The airport's governing body completed the reallocation process on February 7, 1995. The Company was allocated seat capacity to operate only 14 daily flights, rather than the 21 flights being operated as of January 15, 1995, thereby necessitating a reduction of seven daily flights by the Company. To comply with the Plan, the Company will maintain seven daily flights to San Jose and Oakland, California, respectively, and will eliminate non-stop service to Salt Lake City, Utah (two daily flights) and Phoenix, Arizona (four daily flights) and one daily flight to San Jose, all effective April 1, 1995.

The Company is subject to various other federal, state, and local laws and regulations relating to the protection of the environment, including the

discharge of materials into the environment.

## MARKETING AND COMPETITION

Southwest focuses on point-to-point, rather than hub-and-spoke, service in shorthaul markets with frequent, conveniently timed flights, and low fares. For example, Southwest's average aircraft trip length in 1994 was 391 miles with an average duration of approximately one hour. At yearend, Southwest served 298 nonstop city pairs with an average weekday frequency of six roundtrips per city pair.

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Southwest's point-to-point route system, as compared to hub-and-spoke, provides for more direct nonstop routings for shorthaul customers and, therefore, minimizes connections, delays, and total trip time. Southwest focuses on local, not connecting, traffic. As a result, approximately 80 percent of the Company's customers fly nonstop. In addition, Southwest serves many conveniently-located satellite or downtown airports such as Dallas Love Field, Houston Hobby, Chicago Midway, Baltimore, Burbank, Oakland, and San Jose airports, which are typically less congested than other airlines' hub airports and enhance the Company's ability to sustain high employee productivity and reliable ontime performance. This operating strategy also permits the Company to achieve high asset utilization. Aircraft are scheduled to minimize the amount of time the aircraft is at the gate, approximately 20 minutes, thereby reducing the number of aircraft and gate facilities that would otherwise be required. Southwest does not interline with other jet airlines, nor have any commuter feeder relationships.

Southwest employs a very simple fare structure, maintaining low, unrestricted, unlimited everyday coach fares. The Company operates only one aircraft type, the Boeing 737, which simplifies scheduling, maintenance, flight operations, and training activities.

In May 1994, the computer reservations systems (CRSs) used by travel agencies owned by United Airlines (Apollo) and Continental Airlines (System One) disabled automated ticketing for Southwest travel. Rather than pay the fees associated with CRS participation in Apollo and System One, Southwest has taken the following actions: Southwest has provided direct access to its own reservation system and ticketing for the 50 largest travel agencies (SWAT); instituted overnight delivery of Southwest-produced tickets for approximately 300 large travel agencies; improved access to Ticket By Mail for direct Customers by reducing the time limit from seven days out from the date of travel to three days; and introduced a Ticketless travel option, eliminating the need to print a paper ticket altogether. Southwest has also entered into a new arrangement with SABRE, the CRS in which Southwest has historically participated to a limited extent, providing for ticketing and automated booking on Southwest in a very cost-effective manner.

The airline industry is highly competitive as to fares, frequent flyer benefits, routes, and service, and some carriers competing with the Company have greater financial resources, larger fleets, and wider name recognition. Several of the Company's larger competitors have initiated low-cost, shorthaul service in markets served by the Company, which represents a more direct threat in Southwest's market niche. Profit levels in the air transport industry are highly sensitive to changes in operating and capital costs and the extent to which competitors match an airline's fares and services. The profitability of a carrier in the airline industry is also impacted by general economic trends. For more discussion on the current competitive environment for Southwest, see Management's Discussion and Analysis of Financial Condition and Results of Operations.

The Company is also subject to varying degrees of competition from surface transportation in its shorthaul markets, particularly the private automobile. In shorthaul air services which compete with surface transportation, price is a competitive factor, but frequency and convenience of scheduling, facilities, transportation safety, and Customer Service may be of equal or greater importance to many passengers.

## INSURANCE

The Company carries insurance of types customary in the airline industry and in amounts deemed adequate to protect the Company and its property and to comply both with federal regulations and certain of the Company's credit and lease agreements. The policies principally provide coverage for public and passenger liability, property damage, cargo and baggage liability, loss or damage to aircraft, engines, and spare parts, and workers' compensation.

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## FREQUENT FLYER AWARDS

Southwest's frequent flyer program, The Company Club, is based on trips flown rather than mileage. The Company Club offers one free roundtrip travel award to any Southwest destination after flying eight roundtrips (or 16 one-way

trips) on Southwest within a consecutive twelve-month period.

The trips flown as credit towards a free travel award certificate are valid for twelve months only; the free travel award is automatically generated when earned by the Customer rather than allowing the Customer to bank the trip credits indefinitely; and the free travel award is valid for one year with an automatic expiration date. Based on the issuance of free travel awards to qualified members, coupled with the foregoing program characteristics and the use of "black out" dates for the free travel awards during peak holiday periods, the financial impact of free travel awards used on the Company's consolidated financial statements has not been material. Free travel awards redeemed were approximately 279,000, 256,000, and 209,000 during 1994, 1993, and 1992, respectively. The amount of free travel award usage as a percentage of total Southwest revenue passengers carried was 1.4 percent in 1994 and 1.5 percent in both 1993 and 1992.

The Company accounts for free travel awards using the incremental cost method, consistent with the other major airlines. This method recognizes an average incremental cost to provide roundtrip transportation to one additional passenger. The incremental cost to provide free transportation is accrued at the time an award is earned and revenue is subsequently recognized, at the amount accrued, when the free travel award is used. The estimated incremental costs include passenger costs such as beverage and snack supplies, baggage claims, baggage handling, and liability insurance; operations costs such as security services, airport rentals, fuel, oil, and into-plane charges; and reservations costs, such as communications and system operations fees. The liability for free travel awards earned but not used at December 31, 1994 and 1993 was not material.

The number of free travel awards for Southwest outstanding at December 31, 1994 and 1993 was approximately 248,000 and 178,000, respectively. These numbers do not include partially earned awards. The Company currently does not have a system to accurately estimate partially earned awards. However, these partially earned awards may equate to approximately 60-70 percent of the current outstanding awards. Since the inception of The Company Club in 1987, approximately 15 percent of all award certificates have expired without being used.

#### EMPLOYEES

At December 31, 1994, Southwest (including Morris) had 16,818 employees, consisting of 4,894 flight, 747 maintenance, 9,237 ground customer service and 1,940 management, accounting, marketing, and clerical personnel.

Southwest has nine collective bargaining agreements covering approximately 83 percent of its employees. Southwest's fleet service employees are subject to an agreement with the Ramp, Operations and Provisioning Association, which became amendable in December 1994 and is currently in negotiation. Customer service and reservation employees are subject to an agreement with the International Association of Machinists and Aerospace Workers, AFL-CIO (IAM), which becomes amendable in November 1997. Flight attendants are subject to an agreement with the Transportation Workers Union of America, AFL-CIO, which becomes amendable May 31, 1996. The pilots are subject to an agreement with the Southwest Airlines Pilots' Association (SWAPA), which becomes amendable in September 1999 (described below). Flight dispatchers are represented by the Southwest Airlines Employees Association, pursuant to an agreement which becomes amendable in November 1997. Mechanics, aircraft cleaners

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and stock clerks are subject to agreements with the International Brotherhood of Teamsters, with both agreements becoming amendable in August 1995. The flight simulator technicians are represented by the International Brotherhood of Teamsters pursuant to an agreement which becomes amendable in October 1995. The flight/ground school instructors are subject to an agreement with the Southwest Airlines Professional Instructors Association which becomes amendable in December 1995.

The Company recently entered into two labor contracts with large employee groups. In November 1994, Southwest entered into an agreement with the IAM covering Customer service and reservation employees. In January 1995, Southwest's pilots ratified a ten-year labor contract that calls for no wage increases in the first five years and three percent annual wage increases in three of the last five years of the contract. Initially, the pilots will receive options to purchase approximately 14.5 million shares of Southwest common stock at \$20 per share over the term of the contract; pilots hired subsequently will receive additional grants at a five percent premium over then current fair market value, up to a total of 18,000,000 shares that can be issued under the stock option plan. Pilots will be eligible for profitability bonuses of up to three percent of compensation in three of the first five years and profitability-based pay increases up to three percent in two of the second five years of the contract. The pilot group may choose to reopen the contract in five years, in which event all unexercised options will terminate.

#### ITEM 2. PROPERTIES

## AIRCRAFT

Southwest and Morris operated a total of 199 Boeing 737 aircraft as of December 31, 1994, of which 89 and 13 were under operating and capital leases, respectively. The remaining 97 aircraft are owned.

In January 1994, Southwest entered into an agreement with The Boeing Company, pursuant to which Southwest is the launch customer for the Boeing 737-700 aircraft, the newest generation of the Boeing 737 aircraft type. As the launch customer, Southwest has agreed to purchase sixty-three Boeing 737-700 aircraft from 1997 to 2001, with options for an additional 63 737-700 aircraft from 1998 to 2004. As a part of this transaction, 42 of the 53 options for 737-300 aircraft from 1997 to 1999 were canceled.

In total, including an agreement in principle to lease two used aircraft in second quarter 1995, at December 31, 1994, the Company had 118 firm orders and 74 options as follows:

<TABLE>  
<CAPTION>

| Type    | Seats | 1994 | 1995 | 1996 | 1997 | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 |
|---------|-------|------|------|------|------|------|------|------|------|------|------|------|
| ----    | ----- | ---- | ---- | ---- | ---- | ---- | ---- | ---- | ---- | ---- | ---- | ---- |
| <S>     | <C>   | <C>  | <C>  | <C>  | <C>  | <C>  | <C>  | <C>  | <C>  | <C>  | <C>  | <C>  |
| 737-200 | 122   | 50   | ---  | ---  | ---  | ---  | ---  | ---  | ---  | ---  | ---  | ---  |
| 737-300 | 137   | 124  | 27   | 18   | 21   | ---  | ---  | ---  | ---  | ---  | ---  | ---  |
| 737-500 | 122   | 25   | ---  | ---  | ---  | ---  | ---  | ---  | ---  | ---  | ---  | ---  |
| 737-700 | 137   | ---  | ---  | ---  | 4    | 21   | 21   | 21   | 18   | 18   | 18   | 5    |

</TABLE>

The average age of the Company's fleet at December 31, 1994 was 7.6 years.

For information regarding the Company's obligations under capital leases and noncancelable operating leases see Notes 6 and 7 to the Consolidated Financial Statements.

For information concerning Southwest's aircraft purchase commitments, see Note 4 to the Consolidated Financial Statements.

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The Company has an agreement with CFM International, Inc. (a joint company of SNECMA (France) and General Electric Company) dated May 28, 1981, as amended, for the supply of spare engines for its Boeing 737-300, -500, and -700 aircraft. CFM also supplies the engines to The Boeing Company for original installation on such aircraft. CFM is the sole manufacturer of engines for use on the Boeing 737-300, -400, -500, and -700 aircraft.

## GROUND FACILITIES AND SERVICES

Southwest leases terminal passenger service facilities at each of the airports it serves to which it has added various leasehold improvements. The Company leases land on a long-term basis for its maintenance centers located at Dallas Love Field, Houston Hobby, and Phoenix Sky Harbor, its training center near Love Field which houses three 737 simulators, and its corporate headquarters also located near Love Field. The maintenance, training center, and corporate headquarters buildings on these sites were built and are owned by Southwest. At December 31, 1994, the Company operated seven reservation centers. The reservation centers located in Chicago, Illinois; Albuquerque, New Mexico; and Salt Lake City, Utah occupy leased space. The Company owns its Dallas, Texas; Houston, Texas; Phoenix, Arizona; and San Antonio, Texas reservation centers. In January 1995, the Company opened its newest reservation center in Little Rock, Arkansas on leased land and has announced an intention to locate an additional reservation center on leased land in Oklahoma City, Oklahoma.

The Company performs substantially all line maintenance on its aircraft and provides ground support services at most of the airports it serves. However, the Company has arrangements with certain aircraft maintenance firms for major component overhauls and repairs for its airframes and engines, which comprise the majority of the annual maintenance cost.

In recent years, many airports have increased or sought to increase the rates charged to airlines. The extent to which such charges are limited by statute and the ability of airlines to contest such charges has been subject to litigation, including a case recently decided against certain carriers by the United States Supreme Court. To the extent the limitations on such charges are relaxed or the ability of airlines to challenge such charges is restricted, the rates charged by airports to airlines may increase substantially. Management cannot predict the magnitude of any such increase.

## ITEM 3. LEGAL PROCEEDINGS

In January 1994, Southwest received an examination report from the Internal Revenue Service proposing certain adjustments to Southwest's income tax returns for 1987 and 1988. 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 made with which it does not agree. The industry's differences with the IRS involve complex issues of law and fact which 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.

#### ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None to be reported.

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#### EXECUTIVE OFFICERS OF THE REGISTRANT

The executive officers of Southwest, their positions, and their respective ages (as of March 1, 1995) are as follows:

<TABLE>  
<CAPTION>

| NAME<br>----        | POSITION<br>-----                                                | AGE<br>--- | OFFICER<br>CONTINUOUSLY<br>SINCE<br>----- |
|---------------------|------------------------------------------------------------------|------------|-------------------------------------------|
| <S>                 | <C>                                                              | <C>        | <C>                                       |
| Herbert D. Kelleher | Chairman of the Board, President,<br>and Chief Executive Officer | 63         | 1967                                      |
| Colleen C. Barrett  | Executive Vice President-Customers<br>and Corporate Secretary    | 50         | 1978                                      |
| Gary A. Barron      | Executive Vice President,<br>Chief Operations Officer            | 50         | 1978                                      |
| John G. Denison     | Executive Vice President-<br>Corporate Services                  | 50         | 1986                                      |
| Gary C. Kelly       | Vice President-Finance,<br>Chief Financial Officer               | 39         | 1986                                      |
| James F. Parker     | Vice President-General Counsel                                   | 48         | 1986                                      |
| Ron Ricks           | Vice President-Governmental Affairs                              | 45         | 1986                                      |
| James C. Wimberly   | Vice President-Ground Operations                                 | 42         | 1985                                      |

</TABLE>

Executive officers are elected annually at the first meeting of Southwest's Board of Directors following the annual meeting of shareholders or appointed by the President pursuant to Board authorization. All of the executive officers have held their current positions with Southwest for more than five years except Ms. Barrett. On November 21, 1990, Ms. Barrett was appointed Executive Vice President - Customers. Ms. Barrett had served as Vice President - Administration since July 1985, and Corporate Secretary of Southwest since March 28, 1978.

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#### PART II

#### ITEM 5. MARKET FOR THE REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

Southwest's common stock is listed on the New York Stock Exchange and is traded under the symbol LUV. The high and low sales prices of the common stock on the Composite Tape and the quarterly dividends per share paid on the common stock, as adjusted for the July 1993 three-for-two stock split were:

<TABLE>  
<CAPTION>

| PERIOD<br>----- | DIVIDEND<br>----- | HIGH<br>---- | LOW<br>--- |
|-----------------|-------------------|--------------|------------|
| <S>             | <C>               | <C>          | <C>        |
| 1994            |                   |              |            |
| 1st Quarter     | \$.01000          | \$39.00      | \$31.25    |
| 2nd Quarter     | .01000            | 34.38        | 24.13      |
| 3rd Quarter     | .01000            | 29.63        | 21.63      |
| 4th Quarter     | .01000            | 23.63        | 15.50      |
| 1993            |                   |              |            |
| 1st Quarter     | \$.00933          | \$25.17      | \$18.17    |
| 2nd Quarter     | .00933            | 30.00        | 22.17      |

|             |        |       |       |
|-------------|--------|-------|-------|
| 3rd Quarter | .01000 | 37.63 | 28.00 |
| 4th Quarter | .01000 | 37.63 | 29.88 |

</TABLE>

As of February 28, 1995, there were 10,720 holders of record of the Company's common stock.

#### ITEM 6. SELECTED FINANCIAL DATA

The following financial information for the five years ended December 31, 1994 has been derived from the Company's consolidated financial statements. This information should be read in conjunction with the Consolidated Financial Statements and related notes thereto included elsewhere herein.

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<TABLE>  
<CAPTION>

|                                            | YEARS ENDED DECEMBER 31, |                 |             |             |     |
|--------------------------------------------|--------------------------|-----------------|-------------|-------------|-----|
|                                            | 1994                     | 1993            | 1992        | 1991        |     |
| 1990                                       | ----                     | ----            | ----        | ----        |     |
| <S>                                        | <C>                      | <C>             | <C>         | <C>         | <C> |
| FINANCIAL DATA:                            |                          |                 |             |             |     |
| (in thousands except per share amounts)    |                          |                 |             |             |     |
| Operating revenues.....                    | \$2,591,933              | \$2,296,673     | \$1,802,979 | \$1,379,286 |     |
| \$1,237,276                                |                          |                 |             |             |     |
| Operating expenses.....                    | 2,275,224                | 2,004,700       | 1,609,175   | 1,306,675   |     |
| 1,150,015                                  | -----                    | -----           | -----       | -----       | --- |
| Operating income.....                      | 316,709                  | 291,973         | 193,804     | 72,611      |     |
| 87,261                                     |                          |                 |             |             |     |
| Other expenses, net.....                   | 17,186                   | 32,336          | 36,361      | 18,725      |     |
| 6,827/(4)/                                 | -----                    | -----           | -----       | -----       | --  |
| Income before income taxes and cumula-     |                          |                 |             |             |     |
| tive effect of accounting changes.....     | 299,523                  | 259,637         | 157,443     | 53,886      |     |
| 80,434                                     |                          |                 |             |             |     |
| Provision for income taxes /(1)/.....      | 120,192                  | 105,353         | 60,058      | 20,738      |     |
| 29,829                                     | -----                    | -----           | -----       | -----       | --  |
| Income before cumulative effect of         |                          |                 |             |             |     |
| accounting changes /(1)/.....              | 179,331                  | 154,284         | 97,385      | 33,148      |     |
| 50,605                                     |                          |                 |             |             |     |
| Cumulative effect of accounting changes... | -                        | 15,259/(2)/     | 12,538/(3)/ | --          |     |
| --                                         | -----                    | -----           | -----       | -----       | --- |
| Net income /(1)/.....                      | \$ 179,331               | \$ 169,543      | \$ 109,923  | \$ 33,148   | \$  |
| 50,605                                     | =====                    | =====           | =====       | =====       |     |
| Net income per common and common           |                          |                 |             |             |     |
| equivalent share before cumulative         |                          |                 |             |             |     |
| effect of accounting changes /(1)/.....    | \$1.22                   | \$1.05          | \$0.68      | \$0.25      |     |
| \$0.39                                     |                          |                 |             |             |     |
| Cash dividends per common share.....       | \$ .04000                | \$ .03867       | \$ .03533   | \$ .03333   |     |
| \$ .03223                                  |                          |                 |             |             |     |
| Total assets at period-end.....            | \$2,823,071              | \$2,576,037     | \$2,368,856 | \$1,854,331 |     |
| \$1,480,813                                |                          |                 |             |             |     |
| Long-term obligations at period-end.....   | \$583,071                | \$639,136       | \$735,754   | \$617,434   |     |
| \$327,553                                  |                          |                 |             |             |     |
| Stockholders' equity at period-end.....    | \$1,238,706              | \$1,054,019     | \$879,536   | \$635,793   |     |
| \$607,294                                  |                          |                 |             |             |     |
| OPERATING DATA:                            |                          |                 |             |             |     |
| Revenue passengers carried.....            | 42,742,602/(6)/          | 36,955,221/(6)/ | 27,839,284  | 22,669,942  |     |
| 19,830,941                                 |                          |                 |             |             |     |
| Revenue passenger miles (RPMs) (000s)..... | 21,611,266               | 18,827,288      | 13,787,005  | 11,296,183  |     |
| 9,958,940                                  |                          |                 |             |             |     |
| Available seat miles (ASMs) (000s).....    | 32,123,974               | 27,511,000      | 21,366,642  | 18,491,003  |     |
| 16,411,115                                 |                          |                 |             |             |     |
| Load factor.....                           | 67.3%                    | 68.4%           | 64.5%       | 61.1%       |     |

|                                            |         |            |         |         |
|--------------------------------------------|---------|------------|---------|---------|
| 60.7%                                      |         |            |         |         |
| Average length of passenger haul (miles).. | 506     | 509        | 495     | 498     |
| 502                                        |         |            |         |         |
| Trips flown.....                           | 624,476 | 546,297    | 438,184 | 382,752 |
| 338,108                                    |         |            |         |         |
| Average passenger fare.....                | \$58.44 | \$59.97    | \$58.33 | \$55.93 |
| \$57.71                                    |         |            |         |         |
| Passenger revenue yield per RPM.....       | 11.56c  | 11.77c     | 11.78c  | 11.22c  |
| 11.49c                                     |         |            |         |         |
| Operating revenue yield per ASM.....       | 8.07c   | 8.35c      | 7.89c   | 7.10c   |
| 7.23c                                      |         |            |         |         |
| Operating expenses per ASM.....            | 7.08c   | 7.25c/(7)/ | 7.03c   | 6.76c   |
| 6.73c                                      |         |            |         |         |
| Fuel cost per gallon (average).....        | 53.92c  | 59.15c     | 60.82c  | 65.69c  |
| 77.89c                                     |         |            |         |         |
| Number of employees at period-end.....     | 16,818  | 15,175     | 11,397  | 9,778   |
| 8,620                                      |         |            |         |         |
| Size of fleet at period-end /(5)/.....     | 199     | 178        | 141     | 124     |
| 106                                        |         |            |         |         |
| </TABLE>                                   |         |            |         |         |

/(1)/ Proforma prior to 1993, assuming Morris, an S-Corporation prior to 1993, was taxed at statutory rates.

/(2)/ Includes the net cumulative effect of adopting Statement of Financial Accounting Standards No. 109, "Accounting for Income Taxes" and Statement of Financial Accounting Standards No. 106, "Employers' Accounting for Postretirement Benefits Other than Pensions." For additional information, see the Consolidated Financial Statements of the Company and the accompanying notes thereto.

/(3)/ Includes one-time adjustment for the cumulative effect of a change in the method of accounting for scheduled airframe overhaul costs from the direct expense method to that of capitalizing and amortizing the costs over the periods benefited. For additional information, see the Consolidated Financial Statements of the Company and the accompanying notes thereto.

/(4)/ Includes \$2.6 million gains on sales of aircraft and \$3.1 million from the sale of certain financial assets. (Footnotes continued on next page)

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/(5)/ Includes leased aircraft.

/(6)/ Includes certain estimates for Morris.

/(7)/ Excludes merger expenses of \$10.8 million.

#### ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Management's Discussion and Analysis listed in the accompanying Index to Consolidated Financial Statements on Page F-1 is filed as part of this annual report.

#### ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

The Consolidated Financial Statements, Notes to Consolidated Financial Statements, and Report of Ernst & Young LLP, Independent Auditors, listed in the accompanying Index to Consolidated Financial Statements on page F-1 are filed as part of this annual report.

The amounts shown on the following table differ from those previously reported in Southwest's Form 10-Q's filed in respect of the 1993 periods shown below. These differences are solely due to Southwest's acquisition of Morris, which was accounted for as a pooling of interests. See Note 2 to the Consolidated Financial Statements.

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

<TABLE>  
<CAPTION>

| 1994                         | THREE MONTHS ENDED |           |           |           |
|------------------------------|--------------------|-----------|-----------|-----------|
|                              | MARCH 31           | JUNE 30   | SEPT. 30  | DEC. 31   |
| ----                         | -----              | -----     | -----     | -----     |
| <S>                          | <C>                | <C>       | <C>       | <C>       |
| Operating revenues.....      | \$619,412          | \$661,056 | \$685,289 | \$626,176 |
| Operating income.....        | 76,046             | 101,834   | 101,710   | 37,119    |
| Income before income taxes.. | 69,538             | 97,156    | 97,128    | 35,701    |
| Net income.....              | 41,847             | 58,522    | 58,619    | 20,343    |

Net income per common and  
common equivalent share.. \$ .28      \$ .40      \$ .40      \$ .14

| 1993                         | THREE MONTHS ENDED |           |           |           |
|------------------------------|--------------------|-----------|-----------|-----------|
|                              | MARCH 31           | JUNE 30   | SEPT. 30  | DEC. 31   |
| <S>                          | <C>                | <C>       | <C>       | <C>       |
| Operating revenues.....      | \$498,943          | \$568,251 | \$620,918 | \$608,561 |
| Operating income.....        | 48,784             | 75,812    | 95,820    | 71,557    |
| Income before income taxes.. | 40,393             | 68,241    | 86,214    | 64,789    |
| Net income.....              | 24,933/(1)/        | 42,149    | 48,833    | 38,369    |

Net income per common and  
common equivalent share.. \$ .17/(1)/      \$ .29      \$ .33      \$ .26  
</TABLE>

/(1)/ Excludes cumulative effect of accounting changes.

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#### ITEM 9. CHANGES AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None to be reported.

### PART III

#### ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

See "Election of Directors," incorporated herein by reference, from pages 1-4 of the definitive Proxy Statement for Southwest's Annual Meeting of Shareholders to be held May 18, 1995. See "Executive Officers of the Registrant" in Part I following Item 4 for information relating to executive officers.

#### ITEM 11. EXECUTIVE COMPENSATION

See "Compensation of Executive Officers," incorporated herein by reference, from pages 6-9 of the definitive Proxy Statement for Southwest's Annual Meeting of Shareholders to be held May 18, 1995.

#### ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

See "Voting Securities and Principal Shareholders," incorporated herein by reference, from pages 4-5 of the definitive Proxy Statement for Southwest's Annual Meeting of Shareholders to be held May 18, 1995.

#### ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

See "Election of Directors" incorporated herein by reference, from pages 1-4 of the definitive Proxy Statement for Southwest's Annual Meeting of Shareholders to be held May 18, 1995.

### PART IV

#### ITEM 14. EXHIBITS, FINANCIAL STATEMENT SCHEDULES, AND REPORTS ON FORM 8-K

- (a) 1. Financial Statements: The financial statements listed in the accompanying Index to Consolidated Financial Statements on page F-1 are filed as part of this annual report.
2. Financial Statement Schedules:  
  
There are no financial statement schedules filed as part of this annual report, since the required information is included in the consolidated financial statements, including the notes thereto, or the circumstances requiring inclusion of such schedules are not present.

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#### 3. Exhibits:

- 3.1 Restated Articles of Incorporation of Southwest (incorporated by reference to Exhibit 4.1 to Southwest's Registration

- 3.2 Bylaws of Southwest, as amended through February 1994 (incorporated by reference to Exhibit 3.2 to Southwest's Annual Report on Form 10-K for the year ended December 31, 1993 (File No. 1-7259)).
- 4.1 Credit Agreement dated December 15, 1990, between Southwest and Texas Commerce Bank - Dallas, N.A., as agent for itself and four other banks named therein, and such banks (incorporated by reference to Exhibit 4.1 on Southwest's Current Report on Form 8-K dated February 14, 1991 (File No. 1-7259)); First Amendment to Credit Agreement, dated April 4, 1991 and Second Amendment to Credit Agreement, dated December 14, 1991 (incorporated by reference to Exhibit 4.1 to Southwest's Annual Report on Form 10-K for the year ended December 31, 1991 (File No. 1-7259)); Third Amendment to Credit Agreement, dated December 14, 1992 (incorporated by reference in Exhibit 4.1 to Southwest's Annual Report on Form 10-K for the year ended December 31, 1992 (File No. 1-7259)); Fourth Amendment to Credit Agreement, dated December 14, 1993.
- 4.2 Specimen certificate representing Common Stock of Southwest.
- 4.3 Indenture dated as of December 1, 1985 between Southwest and MBank Dallas, N.A., Trustee, relating to an unlimited amount of Debt Securities (incorporated by reference to Exhibit 4.1 of Southwest's Current Report on Form 8-K dated February 26, 1986 (File No. 1-7259)) and First Supplemental Indenture dated as of January 21, 1988, substituting MTrust Corp, National Association, as Trustee, thereunder (incorporated by reference to Exhibit 4.3 on Southwest's Annual Report on Form 10-K for the year ended December 31, 1987 (File 1-7259)).
- 4.4 Rights Agreement dated July 14, 1986 between Southwest and MBank Dallas, N.A., as Rights Agent (incorporated by reference to Exhibit 1, Southwest's Registration Statement on Form 8-A dated July 15, 1986 (File No. 1-7259)) and Amendment No. 1 to Rights Agreement, dated as of December 1, 1990 between Southwest and Ameritrust Texas N.A. (incorporated by reference to Exhibit 4.2 on Southwest's Current Report on Form 8-K dated February 14, 1991 (File No. 1-7259)).
- 4.5 Indenture dated as of June 20, 1991 between Southwest Airlines Co. and NationsBank of Texas, N.A. (formerly NCNB Texas National Bank), Trustee (incorporated by reference to Exhibit 4.1 to Southwest's Current Report on Form 8-K dated June 24, 1991 (File No. 1-7259)).
- 4.6 Form of 9.4 percent Note due 2001 (incorporated by reference to Exhibit 4.2 to Southwest's Current Report on Form 8-K dated June 24, 1991 (File No. 1-7259)).
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- 4.7 Form of 8-3/4 percent Note due 2003 (incorporated by reference to Exhibit 4.2 to Southwest's Current Report on Form 8-K dated October 4, 1991 (File No. 1-7259)).
- 4.9 Form of 9-1/4 percent Note due 1998 (incorporated by reference to Exhibit 4.9 to Southwest's Annual Report on Form 10-K for the year ended December 31, 1991 (File No. 1-7259)).
- 4.10 Form of 7-7/8 percent Note due 2007 (incorporated by reference to Exhibit 4.10 to Southwest's Annual Report on Form 10-K for the year ended December 31, 1992 (File No. 1-7259)).
- 4.11 Form of Global Security representing all 8 percent Notes due 2005 (incorporated by reference to Exhibit 4 to Southwest's current Report on Form 8-K dated March 6, 1995 (File No. 1-7259)).
- 10.1 Purchase Agreement No. 1510, dated July 22, 1988 between The Boeing Company and Southwest (with all amendments through March 29, 1990) (incorporated by reference to Exhibit 10.1 on Southwest's Annual Report on Form 10-K for the year ended December 31, 1989 (File No. 1-7259)); Amendments from April 1, 1990 through March 29, 1993 (incorporated by reference to Exhibit 10.1 on Southwest's Annual Report on Form 10-K for the year ended December 31, 1992 (File No. 1-7259)).
- 10.2 General Terms Agreement between CFM International, Inc. and Southwest (with all amendments through March 29, 1990) dated May 28, 1981 (incorporated by reference to Exhibit 10.2 on Southwest's Annual Report on Form 10-K for the year ended

December 31, 1989 (File No. 1-7259)); Amendments from November 6, 1989 through March 29, 1993 (incorporated by reference to Exhibit 10.2 on Southwest's Annual Report on Form 10-K for the year ended December 31, 1992 (File No. 1-7259)); Amendments from March 29, 1993 through March 29, 1994 (incorporated by reference to Exhibit 10.2 to Southwest's Annual Report on Form 10-K for the year ended December 31, 1993 (File No. 1-7259)); Amendment No. 7 and Letter Agreement No. 11, each dated as of January 19, 1994.

- 10.3 Purchase Agreement No. 1405, dated July 23, 1987 between The Boeing Company and Southwest (with all amendments through March 29, 1990) (incorporated by reference to Exhibit 10.3 on Southwest's Annual Report on Form 10-K for the year ended December 31, 1989 (File No. 1-7259)); Amendments from April 1, 1990 through March 29, 1993 (incorporated by reference to Exhibit 10.3 on Southwest's Annual Report on Form 10-K for the year ended December 31, 1992 (File No. 1-7259)); Amendments from March 29, 1993 through March 29, 1994 (incorporated by reference to Exhibit 10.3 to Southwest's Annual Report on Form 10-K for the year ended December 31, 1993 (File No. 1-7259)); Amendments from March 30, 1994 through March 29, 1995.
- 10.4 Purchase Agreement No. 1810, dated January 19, 1994 between The Boeing Company and Southwest (incorporated by reference to Exhibit 10.4 to Southwest's Annual Report on Form 10-K for the year ended December 31, 1993 (File No. 1-7259)).

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The following exhibits filed under paragraph 10 of Item 601 are the Company's compensation plans and arrangements.

- 10.5 1985 stock option agreements between Southwest and Herbert D. Kelleher (incorporated by reference to Exhibit 10.1 to Southwest's Quarterly Report on Form 10-Q for the quarter ended September 30, 1985 (File No. 1-7259)).
- 10.6 Form of Executive Employment Agreement between Southwest and certain key employees pursuant to Executive Service Recognition Plan (incorporated by reference to Exhibit 28 to Southwest Quarterly Report on Form 10-Q for the quarter ended June 30, 1987 (File No. 1-7259)).
- 10.7 1992 employment contract between Southwest and Herbert D. Kelleher and related stock option agreements (incorporated by reference to Exhibit 10.8 to Southwest's Annual Report on Form 10-K for the year ended December 31, 1991 (File No. 1-7259)).
- 10.8 1987 stock option agreement between Southwest and Herbert D. Kelleher (incorporated by reference to Exhibit 10.11 to Southwest's Annual Report on Form 10-K for the year ended December 31, 1987 (File No. 1-7259)).
- 10.9 1991 Incentive Stock Option Plan (incorporated by reference to Exhibit 4.1 to Registration Statement on Form S-8 (File No. 33-40652)).
- 10.10 1991 Non-Qualified Stock Option Plan (incorporated by reference to Exhibit 4.2 to Registration Statement on Form S-8 (File No. 33-40652)).
- 10.11 1991 Employee Stock Purchase Plan as amended May 20, 1992 (incorporated by reference to Exhibit 10.13 to Southwest's Annual Report on Form 10-K for the year ended December 31, 1992 (File No. 1-7259)).
- 10.12 Southwest Airlines Co. Profit Sharing Plan (incorporated by reference to Exhibit 10.13 to Southwest's Annual Report on Form 10-K for the year ended December 31, 1991 (File No. 1-7259)).
- 10.13 Southwest Airlines Co. 401(k) Plan (incorporated by reference to Exhibit 10.14 to Southwest's Annual Report on Form 10-K for the year ended December 31, 1991 (File No. 1-7259)).
- 10.14 Southwest Airlines Co. 1995 SWAPA Non-Qualified Stock Option Plan.
- 11 Computation of earnings per share.
- 22 Subsidiaries of Southwest.
- 23 Consent of Ernst & Young LLP, Independent Auditors.
- 27 Financial Data Schedule.

Southwest will furnish to the Commission supplementally upon request a copy of each other instrument with respect to the long-term debt of the Company.

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A copy of each exhibit may be obtained at a price of 15 cents per page, \$10.00 minimum order, by writing to: Director of Investor Relations, Southwest Airlines Co., P.O. Box 36611, Dallas, Texas 75235-1611.

(b) There were no reports on Form 8-K filed during the fourth quarter of 1994.

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#### INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

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| Report of Independent Auditors       | F-17              |

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

##### INDUSTRY CONDITIONS

The 1990s have been devastating financially for the domestic passenger airline industry, with Southwest as the sole exception among larger carriers. Since 1990, the industry has been shrinking and we have been expanding. We are now carrying more than twice the number of passengers annually than in 1990, an annualized growth rate of 21 percent. In 1993, with the advent of Continental Lite and plans laid for the United Shuttle, the competitive trend away from Southwest began to reverse. In 1994, in the face of our own aggressive expansion, we experienced a massive increase of new competitive service from United, Continental, Reno, and TWA. We also were negatively impacted by the industry's use of persistent fare sales during the fourth quarter, which occurred at a time when we were aggressively converting Morris Air Corporation (Morris) to Southwest's operations and were experiencing operating difficulties of our own in reservations and revenue management. The result was a 47 percent decline in earnings in fourth quarter 1994 as compared to fourth quarter 1993. Many of the operational issues that surfaced during fourth quarter 1994 have been, or will soon be, addressed, most notably reservations capacity. However, some of their effects will carry over into the first two quarters of 1995, and, further, we cannot predict the actions of our competitors.

In response to these increasing competitive pressures, we implemented several measures. However, we face significantly more competition than we did a year ago, which may also continue to adversely affect comparisons to 1994 quarterly performances, particularly in first half 1995.

As compared to year ago levels, load factors and passenger revenue yields are currently down (the consolidated load factor for January 1995 was 57.8 percent, compared with 63.1 percent for the same month a year ago). Our expectation is that this trend will continue at least during first half 1995. As expected, the integration of Morris into Southwest during 1994, which included 21 aircraft and seven new cities, resulted in our immediate competitive presence in the northwestern region of the U.S. and Salt Lake City. However, these new markets, which are in the development stage and, therefore, understandably low-yielding, will need to improve for overall yields to compare favorably to year ago levels. While there is no way to predict precisely how fast these markets will develop, we are encouraged by the pace thus far. We have also been encouraged with Customer acceptance of recent price increases, which may improve yield comparisons.

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From an operating cost perspective, we have been pleased with recent favorable trends versus year ago levels, including fuel prices. Our goal is to continue this trend in 1995, despite our basic lack of control over fuel prices. Significant cost reduction opportunities lie in distribution costs. Ticketless travel, the new SABRE Basic Booking Request, our enhanced Ticket By Mail product, and expanded reservations operations should all combine to help reduce distribution costs. During 1995, we currently plan to add twenty-seven 737-300 aircraft to our fleet and one new city, Omaha, Nebraska, to our route system,

which will allow us to focus on strengthening our existing route system.

## RESULTS OF OPERATIONS

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

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

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

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

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Operating expenses per ASM for 1994 and 1993 (excluding 1993 merger expenses) were as follows:

<TABLE>  
<CAPTION>

| Operating expenses per ASM                  |       |       |                        |                   |
|---------------------------------------------|-------|-------|------------------------|-------------------|
|                                             | 1994  | 1993  | Increase<br>(decrease) | Percent<br>change |
| <S>                                         | <C>   | <C>   | <C>                    | <C>               |
| Salaries, wages,<br>and benefits            | 2.13c | 2.12c | .01c                   | 0.5%              |
| Profitsharing and Employee<br>savings plans | .22   | .21   | .01                    | 4.8               |
| Fuel and oil                                | 1.00  | 1.11  | (.11)                  | (9.9)             |
| Maintenance materials and<br>repairs        | .59   | .59   | -                      | -                 |
| Agency commissions                          | .47   | .53   | (.06)                  | (11.3)            |
| Aircraft rentals                            | .42   | .39   | .03                    | 7.7               |
| Landing fees and<br>other rentals           | .46   | .47   | (.01)                  | (2.1)             |
| Depreciation                                | .43   | .44   | (.01)                  | (2.3)             |
| Other                                       | 1.36  | 1.39  | (.03)                  | (2.2)             |
| TOTAL                                       | 7.08c | 7.25c | (.17)c                 | (2.3)%            |

</TABLE>

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

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

Fuel and oil expenses per ASM decreased 9.9 percent in 1994, primarily due to an 8.8 percent reduction in the average jet fuel cost per gallon from 1993. Jet

fuel prices remained relatively stable throughout 1994, with quarterly averages ranging from

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\$0.51 to \$0.56 per gallon. Since year-end, fuel prices have averaged approximately \$0.54 per gallon.

In August 1993, the Revenue Reconciliation Act of 1993 was enacted, which, among other things, included an increase of 4.3 cents per gallon in transportation fuel tax, which becomes effective September 30, 1995, for jet fuel used in commercial aviation. This additional fuel tax will increase fuel expenses approximately \$7.5 million in fourth quarter 1995.

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

Agency commissions per ASM decreased 11.3 percent due to a lower mix of travel agency sales and lower 1994 passenger revenue per ASM. The lower travel agency sales mix resulted from 1994 enhancements to Southwest's ticket delivery systems for direct Customers, as described below.

In response to actions taken by our competitor-owned reservations systems, 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 customers (Ticket By Mail); developed our own Ticketless system, which was rolled out system-wide on January 31, 1995; and subscribed to a new level of service with SABRE that will automate the booking process for SABRE travel agencies effective May 1, 1995. We also continue to actively pursue other cost-effective solutions for automating non-SABRE travel agency bookings.

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

Other operating expenses per ASM decreased 2.2 percent in 1994 compared to 1993. The overall decrease is primarily attributable to operating efficiencies resulting from the transition of Morris operational functions to Southwest, primarily contract services which decreased \$8.8 million (24.4 percent per ASM), offset by an increase in advertising costs of \$24.1 million (22.9 percent per ASM) primarily associated with the start-up of seven new cities and new competitive pressures in 1994.

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

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

**1993 COMPARED WITH 1992** Prior to 1993, Morris operated as a charter carrier. In 1993, Morris began operating as a FAR 121 Certificated Air Carrier, or scheduled service carrier, consistent with Southwest. For comparability from 1993 to 1992, the statistical and operating data for 1992 are based on scheduled passenger service only (i.e., Southwest). Accordingly, RPMs and ASMs for 1992 relate only to scheduled carrier operations.

The Company's consolidated income for the year 1993 was \$154.3 million (\$1.05 per share), before the cumulative effect of accounting changes, compared to pro forma consolidated income of \$97.4 million (\$.68 per share) for 1992, an increase of 58.4 percent. The increase in earnings was primarily attributable to an increase in operating income of 50.7 percent and was achieved despite an increase in the federal income tax rate, which increased the provision for income taxes \$6.5 million, or \$.04 per share.

**Operating Revenues** Consolidated operating revenues increased by 27.4 percent

in 1993 to \$2,296.7 million. Operating revenue per ASM for scheduled service carrier operations increased in 1993 to \$.0835 from \$.0789 in 1992. The increase in consolidated operating revenues was primarily related to a 36.5 percent increase in passenger revenues, which accounted for 96.5 percent of total operating revenues in 1993 versus 90.1 percent in 1992.

Consolidated RPMs increased 36.6 percent in 1993, which exceeded the 28.8 percent increase in ASMs, resulting in an increase in the load factor from 64.5 percent to 68.4 percent. The 1993 ASM

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increase resulted from the conversion of the Morris system from charter to scheduled service and the addition of 16 aircraft to the Southwest fleet. The additional 16 Southwest aircraft were primarily used to expand California, St. Louis, and Chicago markets and to initiate service from Louisville, Baltimore, and San Jose.

Freight revenues increased in 1993 to \$42.9 million from \$33.1 million in 1992. The 29.6 percent increase in freight revenues exceeded the 28.8 percent ASM increase primarily due to further expansion of United States mail services and increased freight marketing programs.

Charter and other revenues decreased in 1993 from 1992 on a consolidated basis as Morris converted its operations in 1993 to scheduled service from charter operations. In 1993, consistent with the beginning of scheduled carrier service, Morris revenues were primarily derived from scheduled operations and, accordingly, classified as "passenger" revenues. Morris charter revenues totaled \$117.8 million in 1992.

Operating Expenses Consolidated operating expenses increased 24.6 percent to \$2,004.7 million from \$1,609.2 million in 1992. The primary factors contributing to the increase were the 28.8 percent increase in ASMs; increased contributions to profitsharing and Employee savings plans; higher agency commissions; higher aircraft rentals; and increased maintenance costs.

On a consolidated basis, the Company incurred \$10.8 million of one-time merger expenses in connection with the December 1993 Morris acquisition. These expenses included \$1.9 million of various professional fees; \$4.7 million for disposal of duplicate or incompatible property and equipment; and \$4.2 million for Employee relocation and severance costs related to elimination of duplicate or incompatible operations. As required for financial reporting purposes, these expenses have been reported as operating expenses.

Salaries, wages, and benefits per ASM decreased 2.3 percent in 1993. Excluding the effects of Morris, Southwest's cost per ASM for salaries, wages, and benefits increased .9 percent from 1992 to 1993. This increase resulted from a 2.2 percent increase in salaries and wages, offset by a 5.0 percent decrease in health benefit and workers' compensation costs per ASM. Headcount for Southwest increased 17.0 percent in 1993, slightly more than the 15.9 percent increase in ASMs. However, Employee productivity improved to 2,633 passengers handled per Employee in 1993 from 2,597 in 1992.

Morris contracted out all ground handling services, which are included in "other operating expenses." Consequently, salaries, wages, and benefits on a per-ASM basis are considerably lower for

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Morris than for Southwest contributing to the decrease in consolidated salaries, wages, and benefits per ASM.

Profitsharing and Employee savings plan expenses per ASM increased 16.7 percent in 1993. The increase was primarily the result of higher earnings in 1993. For additional information, see Note 10 to the Consolidated Financial Statements.

Fuel and oil expenses per ASM decreased 2.6 percent in 1993 due to a 2.7 percent reduction in the average cost per gallon of jet fuel from 1992. Jet fuel prices remained relatively stable throughout 1993, continuing the trend which began in 1992, with quarterly averages ranging from \$0.57 to \$0.63 per gallon.

Maintenance materials and repairs per ASM increased 5.4 percent in 1993. This increase was primarily the result of higher airframe component repairs and higher amortization of capitalized scheduled airframe overhauls.

Agency commissions per ASM increased 6.0 percent in 1993 primarily due to increased passenger revenues per ASM.

Aircraft rentals per ASM increased 30.0 percent in 1993. The increase was primarily attributable to the expansion of Morris scheduled operations, which leased 18 of its 21 aircraft, 11 of which were leased in 1993. Additionally, the increase partially resulted from the sale/leaseback financing by Southwest, since late 1992, of seven 737-300 aircraft with long-term operating leases. Also

in 1993, Southwest leased one used 737-300 aircraft under a long-term operating lease and one used 737-200 aircraft under a short-term operating lease.

Depreciation expense per ASM decreased 8.5 percent in 1993 due to the expansion of Morris, which, as stated above, consisted primarily of a leased aircraft fleet.

Other operating expenses per ASM increased 13.8 percent from 1992 to 1993. This increase is primarily the result of higher usage of contract services at Morris. As previously discussed, Morris contracted for all ground handling service, along with various other services that are handled internally at Southwest.

Other "Other expenses(income)" included interest expense, interest income, and nonoperating gains and losses. Interest expense, net of capitalized interest, decreased 7.0 percent in 1993 due to the March 1, 1993 early redemption of \$100 million in senior unsecured 9% Notes due 1996. See Note 6 to the Consolidated Financial Statements for further information. Net nonoperating losses in 1993 resulted from the write-down of certain internal system development costs and the settlement of certain employment-

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related litigation for \$1.7 million.

**Income Taxes** The provision for income taxes increased in 1993, as a percentage of income before income taxes and cumulative effect of accounting changes, to 40.6 percent from pro forma 38.1 percent in 1992. The increase was primarily the result of the increase in the federal income tax rate. See Note 11 to the Consolidated Financial Statements for further information.

#### LIQUIDITY AND CAPITAL RESOURCES

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

During 1994, capital expenditures of \$788.6 million were primarily for the purchase of 18 new 737-300 aircraft, one used 737-300 aircraft previously leased by Morris, and progress payments for future aircraft deliveries. At December 31, 1994, capital commitments of the Company consisted primarily of scheduled aircraft acquisitions.

As of January 1995, Southwest had one-hundred-sixteen 737s on firm order, including twenty-five to be delivered in 1995, with options to purchase another seventy-four. Aggregate funding required for firm commitments approximated \$3,042.7 million through the year 2001 of which \$602.6 million related to 1995. See Note 4 to the Consolidated Financial Statements for further information.

The Company recently completed the construction of a \$10.0 million reservation center in Little Rock, Arkansas, which began accepting calls on January 24, 1995, and announced that it will build an additional reservation center in Oklahoma City scheduled to open in second quarter 1995. Total estimated cost of the new Oklahoma City reservation center is approximately \$10.0 million.

As of December 31, 1994 and since 1990, the Company had authority from its Board of Directors to purchase 3,750,000 shares of its common stock from time-to-time on the open market. No shares have been purchased since 1990.

The Company has various options available to meet its capital and operating commitments, including cash on hand at December 31, 1994 of \$174.5 million, internally generated funds, and a revolving credit line with a group of banks of up to \$300 million (none of which had been drawn at December 31, 1994). In addition, the

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Company will also consider various borrowing or leasing options to maximize earnings and supplement cash requirements.

At yearend, the Company had outstanding shelf registrations for the issuance of \$100 million senior unsecured notes and \$98 million pass-through certificates relating to sale/leaseback transactions. The Company presently intends to utilize these sources of financing during 1995.

Cash provided from operations was \$392.7 million in 1993 as compared to \$282.1 million in 1992. During 1993, additional funds of \$90.0 million were generated from the sale and leaseback of three new 737-300 aircraft subject to long-term operating leases (increasing total commitments for operating leases by \$145.0 million). Morris also generated \$17.8 million from certain bank borrowings. These proceeds were primarily used to finance aircraft-related capital

expenditures and to provide working capital.

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SOUTHWEST AIRLINES CO.  
CONSOLIDATED BALANCE SHEET  
(IN THOUSANDS EXCEPT SHARE AND PER SHARE AMOUNTS)  
<TABLE>  
<CAPTION>

|                                                          | December 31, |              |
|----------------------------------------------------------|--------------|--------------|
|                                                          | 1994         | 1993         |
| <S>                                                      | <C>          | <C>          |
| ASSETS                                                   |              |              |
| Current assets:                                          |              |              |
| Cash and cash equivalents                                | \$ 174,538   | \$ 295,571   |
| Accounts receivable                                      | 75,692       | 70,484       |
| Inventories of parts and supplies,<br>at cost            | 37,565       | 31,707       |
| Deferred income taxes (Note 11)                          | 9,822        | 10,475       |
| Prepaid expenses and other current<br>assets             | 17,281       | 23,787       |
|                                                          | -----        | -----        |
| Total current assets                                     | 314,898      | 432,024      |
| Property and equipment, at cost<br>(Notes 3, 4, and 7):  |              |              |
| Flight equipment                                         | 2,564,551    | 2,257,809    |
| Ground property and equipment                            | 384,501      | 329,605      |
| Deposits on flight equipment<br>purchase contracts       | 393,749      | 242,230      |
|                                                          | -----        | -----        |
|                                                          | 3,342,801    | 2,829,644    |
| Less allowance for depreciation                          | 837,838      | 688,280      |
|                                                          | -----        | -----        |
|                                                          | 2,504,963    | 2,141,364    |
| Other assets                                             | 3,210        | 2,649        |
|                                                          | -----        | -----        |
|                                                          | \$ 2,823,071 | \$ 2,576,037 |
|                                                          | =====        | =====        |
| LIABILITIES AND STOCKHOLDERS' EQUITY                     |              |              |
| Current liabilities:                                     |              |              |
| Accounts payable                                         | \$ 117,599   | \$ 94,040    |
| Accrued liabilities (Note 5)                             | 288,979      | 265,333      |
| Air traffic liability                                    | 106,139      | 96,146       |
| Income taxes payable                                     | -            | 7,025        |
| Current maturities of long-term<br>debt                  | 9,553        | 16,068       |
|                                                          | -----        | -----        |
| Total current liabilities                                | 522,270      | 478,612      |
| Long-term debt less current<br>maturities (Note 6)       | 583,071      | 639,136      |
| Deferred income taxes (Note 11)                          | 232,850      | 183,616      |
| Deferred gains from sale and<br>leaseback of aircraft    | 217,677      | 199,362      |
| Other deferred liabilities                               | 28,497       | 21,292       |
| Commitments and contingencies<br>(Notes 4, 7, and 11)    |              |              |
| Stockholders' equity (Notes 8 and 9):                    |              |              |
| Common stock, \$1.00 par value:                          |              |              |
| 500,000,000 shares authorized;                           |              |              |
| 143,255,795 shares issued and<br>outstanding in 1994 and |              |              |
| 142,756,308 shares in 1993                               | 143,256      | 142,756      |
| Capital in excess of par value                           | 151,746      | 141,168      |
| Retained earnings                                        | 943,704      | 770,095      |
|                                                          | -----        | -----        |
| Total stockholders' equity                               | 1,238,706    | 1,054,019    |
|                                                          | -----        | -----        |
|                                                          | \$ 2,823,071 | \$ 2,576,037 |
|                                                          | =====        | =====        |

</TABLE>  
SEE ACCOMPANYING NOTES.

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SOUTHWEST AIRLINES CO.

CONSOLIDATED STATEMENT OF INCOME  
(IN THOUSANDS EXCEPT PER SHARE AMOUNTS)

<TABLE>  
<CAPTION>

|                                                                        | Years ended December 31, |             |             |
|------------------------------------------------------------------------|--------------------------|-------------|-------------|
|                                                                        | 1994                     | 1993        | 1992        |
| <S>                                                                    | <C>                      | <C>         | <C>         |
| OPERATING REVENUES:                                                    |                          |             |             |
| Passenger                                                              | \$2,497,765              | \$2,216,342 | \$1,623,828 |
| Freight                                                                | 54,419                   | 42,897      | 33,088      |
| Charter and other                                                      | 39,749                   | 37,434      | 146,063     |
| Total operating revenues                                               | 2,591,933                | 2,296,673   | 1,802,979   |
| OPERATING EXPENSES:                                                    |                          |             |             |
| Salaries, wages, and benefits (Note 10)                                | 756,023                  | 641,747     | 512,983     |
| Fuel and oil                                                           | 319,552                  | 304,424     | 257,481     |
| Maintenance materials and repairs                                      | 190,308                  | 163,395     | 122,561     |
| Agency commissions                                                     | 151,247                  | 144,941     | 113,504     |
| Aircraft rentals                                                       | 132,992                  | 107,885     | 77,472      |
| Landing fees and other rentals                                         | 148,107                  | 129,222     | 105,929     |
| Depreciation                                                           | 139,045                  | 119,338     | 101,976     |
| Other operating expenses                                               | 437,950                  | 382,945     | 317,269     |
| Merger expenses (Note 2)                                               | -                        | 10,803      | -           |
| Total operating expenses                                               | 2,275,224                | 2,004,700   | 1,609,175   |
| OPERATING INCOME                                                       | 316,709                  | 291,973     | 193,804     |
| OTHER EXPENSES (INCOME):                                               |                          |             |             |
| Interest expense                                                       | 53,368                   | 58,460      | 59,084      |
| Capitalized interest                                                   | (26,323)                 | (17,770)    | (15,350)    |
| Interest income                                                        | (9,166)                  | (11,093)    | (10,672)    |
| Nonoperating (gains) losses, net                                       | (693)                    | 2,739       | 3,299       |
| Total other expenses                                                   | 17,186                   | 32,336      | 36,361      |
| INCOME BEFORE INCOME TAXES AND CUMULATIVE EFFECT OF ACCOUNTING CHANGES | 299,523                  | 259,637     | 157,443     |
| PROVISION FOR INCOME TAXES (NOTE 11)                                   | 120,192                  | 105,353     | 55,816      |
| INCOME BEFORE CUMULATIVE EFFECT OF ACCOUNTING CHANGES                  | 179,331                  | 154,284     | 101,627     |
| CUMULATIVE EFFECT OF ACCOUNTING CHANGES (NOTE 3)                       | -                        | 15,259      | 12,538      |
| NET INCOME                                                             | \$ 179,331               | \$ 169,543  | \$ 114,165  |
| PER SHARE AMOUNTS (NOTES 3, 8, AND 12):                                |                          |             |             |
| Income before cumulative effect of accounting changes                  | \$ 1.22                  | \$ 1.05     | \$ .71      |
| Cumulative effect of accounting changes                                | -                        | .10         | .09         |
| Net income                                                             | \$ 1.22                  | \$ 1.15     | \$ .80      |

</TABLE>

SEE ACCOMPANYING NOTES.

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SOUTHWEST AIRLINES CO.  
CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY  
YEARS ENDED DECEMBER 31, 1994, 1993, AND 1992  
(IN THOUSANDS EXCEPT PER SHARE AMOUNTS)

<TABLE>  
<CAPTION>

|  | Common stock | Capital in excess of par value | Retained earnings | Treasury stock | Total |
|--|--------------|--------------------------------|-------------------|----------------|-------|
|--|--------------|--------------------------------|-------------------|----------------|-------|

| <S>                                                                                                                                                                                        | <C>      | <C>      | <C>       | <C>        | <C>       |
|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------|----------|-----------|------------|-----------|
| Balance at December 31, 1991                                                                                                                                                               | \$45,265 | \$79,240 | \$515,885 | \$ (4,597) | \$635,793 |
| Public common stock offering<br>(Note 8)                                                                                                                                                   | 2,328    | 82,094   | -         | 2,524      | 86,946    |
| Conversion of debentures<br>(Note 6)                                                                                                                                                       | 1,371    | 34,678   | -         | -          | 36,049    |
| Two-for-one stock split<br>(Note 8)                                                                                                                                                        | 46,180   | (46,180) | -         | -          | -         |
| Sale (retirement) of<br>treasury stock, pooled<br>company                                                                                                                                  | (307)    | 60       | -         | 1,434      | 1,187     |
| Issuance of common and treasury<br>stock upon exercise of<br>executive stock options and<br>pursuant to Employee stock<br>option and purchase plans and<br>related tax benefit<br>(Note 9) | 156      | 3,359    | -         | 553        | 4,068     |
| Sale of preferred stock, pooled<br>company                                                                                                                                                 | 1,054    | 13,584   | -         | -          | 14,638    |
| Cash dividends, \$.03533 per<br>share                                                                                                                                                      | -        | -        | (4,890)   | -          | (4,890)   |
| Cash distributions of pooled<br>company (Note 2)                                                                                                                                           | -        | -        | (5,388)   | -          | (5,388)   |
| Reclassification of retained<br>earnings, pooled company<br>(Note 2)                                                                                                                       | -        | 13,844   | (13,844)  | -          | -         |
| Reinstatement of deferred<br>taxes, pooled company<br>(Note 2)                                                                                                                             | -        | (3,032)  | -         | -          | (3,032)   |
| Net income - 1992                                                                                                                                                                          | -        | -        | 114,165   | -          | 114,165   |
| Balance at December 31, 1992                                                                                                                                                               | 96,047   | 177,647  | 605,928   | (86)       | 879,536   |
| Three-for-two stock split<br>(Note 8)                                                                                                                                                      | 46,325   | (46,325) | -         | -          | -         |
| Issuance of common and treasury<br>stock upon exercise of<br>executive stock options and<br>pursuant to Employee stock<br>option and purchase plans and<br>related tax benefit<br>(Note 9) | 384      | 9,846    | -         | 86         | 10,316    |
| Cash dividends, \$.03867 per<br>share                                                                                                                                                      | -        | -        | (5,376)   | -          | (5,376)   |
| Net income - 1993                                                                                                                                                                          | -        | -        | 169,543   | -          | 169,543   |
| Balance at December 31, 1993                                                                                                                                                               | 142,756  | 141,168  | 770,095   | -          | 1,054,019 |

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<TABLE>

| <S>                                                                                                                                                                        | <C>       | <C>       | <C>       | <C>  | <C>         |
|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------|-----------|-----------|------|-------------|
| Issuance of common stock upon<br>exercise of executive stock<br>options and pursuant to Employee<br>stock option and purchase plans<br>and related tax benefit<br>(Note 9) | 500       | 10,578    | -         | -    | 11,078      |
| Cash dividends, \$.04000 per<br>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 |

</TABLE>

SEE ACCOMPANYING NOTES.

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SOUTHWEST AIRLINES CO.  
CONSOLIDATED STATEMENT OF CASH FLOWS  
(IN THOUSANDS)

<TABLE>

<CAPTION>

|                                                                               | YEARS ENDED DECEMBER 31, |            |            |
|-------------------------------------------------------------------------------|--------------------------|------------|------------|
|                                                                               | 1994                     | 1993       | 1992       |
| -----                                                                         |                          |            |            |
| <S>                                                                           | <C>                      | <C>        | <C>        |
| CASH FLOWS FROM OPERATING ACTIVITIES:                                         |                          |            |            |
| Net income_____                                                               | \$ 179,331               | \$ 169,543 | \$ 114,165 |
| Cumulative effect of accounting changes (Note 3)_____                         | -                        | (15,259)   | (12,538)   |
|                                                                               | -----                    | -----      | -----      |
| Income before cumulative effect of accounting changes_____                    | 179,331                  | 154,284    | 101,627    |
| Adjustments to reconcile net income to cash provided by operating activities: |                          |            |            |
| Depreciation_____                                                             | 139,045                  | 119,338    | 101,976    |
| Deferred income taxes_____                                                    | 49,887                   | 53,200     | 21,260     |
| Amortization of deferred gains on sale and leaseback of aircraft_____         | (30,341)                 | (32,509)   | (32,719)   |
| Amortization of scheduled airframe overhauls_____                             | 14,216                   | 11,630     | 6,930      |
| Changes in certain assets and liabilities:                                    |                          |            |            |
| Increase in accounts receivable_____                                          | (5,208)                  | (14,253)   | (7,440)    |
| Decrease (increase) in other current assets_____                              | 648                      | (9,641)    | (12,000)   |
| Increase in accounts payable and accrued liabilities_____                     | 52,679                   | 67,585     | 65,706     |
| Increase in air traffic liability_____                                        | 9,993                    | 30,212     | 18,602     |
| Increase (decrease) in other current liabilities_____                         | (4,690)                  | 2,393      | 12,179     |
| Other_____                                                                    | 7,106                    | 10,440     | 5,978      |
|                                                                               | -----                    | -----      | -----      |
| Net cash provided by operating activities_____                                | 412,666                  | 392,679    | 282,099    |
| CASH FLOWS FROM INVESTING ACTIVITIES:                                         |                          |            |            |
| Purchases of property and equipment_____                                      | (788,649)                | (524,169)  | (432,528)  |
|                                                                               | -----                    | -----      | -----      |
| Net cash used in investing activities_____                                    | (788,649)                | (524,169)  | (432,528)  |
| CASH FLOWS FROM FINANCING ACTIVITIES:                                         |                          |            |            |
| Issuance of long-term debt_____                                               | -                        | 17,810     | 113,827    |
| Proceeds from public common stock offering (Note 8)_____                      | -                        | -          | 86,946     |
| Proceeds from aircraft sale and leaseback transactions_____                   | 315,000                  | 90,000     | 120,000    |
| Proceeds from sale of preferred stock, pooled company_____                    | -                        | -          | 14,638     |
| Payment of long-term debt and capital lease obligations_____                  | (63,071)                 | (120,098)  | (10,358)   |
| Payment of cash dividends_____                                                | (5,722)                  | (5,376)    | (4,890)    |
| Cash distributions of pooled company (Note 2)_____                            | -                        | -          | (5,389)    |
| Proceeds from Employee stock plans_____                                       | 8,743                    | 6,743      | 3,517      |
| Other_____                                                                    | -                        | (7)        | 803        |
|                                                                               | -----                    | -----      | -----      |
| Net cash provided by (used in) financing activities_____                      | 254,950                  | (10,928)   | 319,094    |

</TABLE>

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<TABLE>

|                                                           |            |            |            |
|-----------------------------------------------------------|------------|------------|------------|
| <S>                                                       | <C>        | <C>        | <C>        |
| NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS_____ | (121,033)  | (142,418)  | 168,665    |
| CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD_____     | 295,571    | 437,989    | 269,324    |
|                                                           | -----      | -----      | -----      |
| CASH AND CASH EQUIVALENTS AT END OF PERIOD-_____          | \$ 174,538 | \$ 295,571 | \$ 437,989 |
|                                                           | -----      | -----      | -----      |
| CASH PAYMENTS FOR:                                        |            |            |            |
| Interest, net of amount capitalized_____                  | \$ 26,598  | \$ 43,161  | \$ 39,936  |
| Income taxes_____                                         | 80,461     | 45,292     | 27,728     |

</TABLE>

SEE ACCOMPANYING NOTES.

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SOUTHWEST AIRLINES CO.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
December 31, 1994

# 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of presentation The consolidated financial statements include the accounts of Southwest Airlines Co. (Southwest) and its wholly owned subsidiaries (the Company). All significant intercompany balances and transactions have been eliminated. Certain prior year amounts have been reclassified for comparison purposes.

Cash and cash equivalents Cash equivalents consist of investment grade

commercial paper issued by major financial institutions that are highly liquid and have original maturity dates of three months or less. Cash and cash equivalents are carried at cost, which approximates market value.

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

**Property and equipment** Depreciation is provided by the straight-line method to residual values over periods ranging from 15 to 20 years for flight equipment (see Note 3) 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 lessee's incremental borrowing rate or, when known, the interest rate implicit in the lease. Amortization of property under capital leases is on a straight-line basis over the lease term and is included in depreciation expense.

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

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

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

**Advertising** The Company expenses the production costs of advertising as incurred. Advertising expense for the years ended December 31, 1994, 1993, and 1992 was \$79,475,000, \$55,344,000, and \$42,068,000, respectively.

## 2. ACQUISITION

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

Prior to 1993, Morris was treated as an S-Corporation for federal and state income tax purposes under applicable provisions of the Internal Revenue Code and various state tax laws. Therefore, no provision for income taxes was made prior to 1993. Morris made regular cash distributions to its shareholders sufficient to meet their tax liabilities. Upon termination of S-Corporation status on December 31, 1992, the undistributed S-Corporation retained earnings were reclassified to capital in excess of par value. Additionally, Morris established \$3,032,000 of deferred income taxes for the cumulative differences in the timing of reporting certain items for financial statement and income tax purposes. These deferred taxes related primarily to depreciation. The establishment of deferred taxes was offset by a reduction of capital in excess of par value.

Merger expenses of \$10,803,000 relating to the merger of Southwest and Morris have been included in 1993 operating expenses as required for financial reporting purposes; however, these expenses have been separately reported as "merger expenses" to reflect the impact of the nonrecurring expenses on operating results. Included in these one-time costs resulting from the merger were \$1,900,000 of various professional fees; \$4,703,000 for disposal of duplicate or incompatible property and equipment; and \$4,200,000 for Employee relocation and severance costs related to elimination of duplicate or incompatible operations. During 1994, the integration of Morris into Southwest was substantially completed, including the disposal of incompatible property and equipment and settlement of Employee relocation and severance costs.

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## 3. ACCOUNTING CHANGES

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

\$16,025,000 (\$.11 per share) for the cumulative effect of the accounting change.

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

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

Given the significant growth of the Company's fleet and the Company's 1991 modification of its airframe overhaul maintenance program with the Federal Aviation Administration (FAA), Southwest changed its method of accounting for scheduled airframe overhauls costs from the direct expense method to that of capitalizing and amortizing the costs over the periods benefited. The Company believes this method is preferable because it results in charges to expense that are consistent with the growth in the fleet; improves financial reporting; and better matches revenues and expenses.

For the year ended December 31, 1992, the Company recognized approximately \$6,900,000 in amortization of airframe overhaul expense. Had the direct expense method been used to provide for scheduled airframe overhaul costs during the year ended December 31, 1992, income before cumulative effect of accounting change would have been reduced by approximately \$9,800,000 (net of provision for income taxes and profitsharing of approximately \$8,800,000), or approximately \$.07 per share.

This change in accounting principle had the effect of a one-time adjustment increasing net income for the year ended December 31, 1992 by approximately \$12,538,000 (net of provision for income taxes and profitsharing of approximately \$11,500,000).

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**Change in Accounting Estimate** Effective January 1, 1992, the Company revised the estimated useful lives of its 737-200 aircraft from 15 years to 15-19 years. This change was the result of the Company's assessment of the remaining useful lives of its 737-200 aircraft following the recent promulgation of rules by the FAA for the phase out of Stage 2 aircraft by December 31, 1999. The effect of this change was to reduce depreciation expense approximately \$3,680,000, or \$.03 per share, for the year ended December 31, 1992.

#### 4. COMMITMENTS

The Company's contractual purchase commitments consist primarily of scheduled aircraft acquisitions. Twenty-five 737-300 aircraft are scheduled for delivery in 1995, 18 in 1996, and ten in 1997. Four 737-700s are scheduled for delivery in 1997, 16 in 1998, 16 in 1999, 15 in 2000, and 12 in 2001. In addition, the Company has options to purchase up to eleven 737-300s in 1997 and up to sixty-three 737-700s during 1998-2004. The Company has the option, which must be exercised two years prior to the contractual delivery date, to substitute 737-400s or 737-500s for the 737-300s to be delivered during 1997 and 737-600s or 737-800s for the 737-700s delivered subsequent to 1999. Aggregate funding needed for these commitments was approximately \$3,042.7 million, subject to adjustments for inflation, due as follows: \$602.6 million in 1995, \$489.5 million in 1996, \$447.8 million in 1997, \$445.4 million in 1998, \$452.9 million in 1999, \$366.0 million in 2000, and \$238.5 million in 2001. In addition, the Company has an agreement in principle to lease two used 737-300 aircraft in 1995.

The Company uses jet fuel fixed price swap arrangements to hedge its exposure to price fluctuations on approximately 5 percent of its annual fuel requirements. As of December 31, 1994, the Company had jet fuel swap agreements with broker-dealers to exchange monthly payments on notional quantities amounting to 2,100,000 gallons per month, over the ensuing three months. Under the swap agreements, the Company pays or receives the difference between the daily average jet fuel price and a fixed price of approximately \$.518 per gallon. Gains and losses on such transactions are recorded as adjustments to fuel expense and have been insignificant. Although the 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.

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<TABLE>

<CAPTION>

#### 5. ACCRUED LIABILITIES

(in thousands)

|                                                   | 1994      | 1993      |
|---------------------------------------------------|-----------|-----------|
| <S>                                               | <C>       | <C>       |
| Aircraft rentals_____                             | \$ 67,407 | \$ 55,459 |
| Profitsharing and savings plans<br>(Note 10)_____ | 53,512    | 45,691    |
| Aircraft maintenance costs____                    | 37,330    | 37,853    |
| Vacation pay_____                                 | 31,801    | 26,781    |
| Taxes, other than income_____                     | 25,001    | 19,183    |
| Interest_____                                     | 20,270    | 21,311    |
| Merger expenses_____                              | -         | 8,527     |
| Other_____                                        | 53,658    | 50,528    |
|                                                   | \$288,979 | \$265,333 |

6. LONG-TERM DEBT  
(in thousands)

|                                                                       | 1994       | 1993       |
|-----------------------------------------------------------------------|------------|------------|
| 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    |
| Capital leases (Note 7)_____                                          | 195,756    | 204,904    |
| Secured notes payable to<br>financial institutions, repaid in<br>1994 | -          | 53,950     |
| Industrial Revenue Bonds,<br>repaid in 1994                           | -          | 375        |
| Other_____                                                            | 435        | 13         |
|                                                                       | 596,191    | 659,242    |
| Less current maturities_____                                          | 9,553      | 16,068     |
| Less debt discount_____                                               | 3,567      | 4,038      |
|                                                                       | \$ 583,071 | \$ 639,136 |

</TABLE>

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On March 1, 1993, the Company redeemed the \$100 million in senior unsecured 9% Notes due March 1, 1996 issued in March 1986. The Notes were redeemed at par plus accrued interest.

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

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

The fair values, based on quoted market prices, of these Notes at December 31, 1994, were as follows (in thousands):

|                            |           |
|----------------------------|-----------|
| <TABLE>                    |           |
| <S>                        | <C>       |
| 9 1/4% Notes due 1998_____ | \$102,000 |
| 9.4% Notes due 2001_____   | 103,820   |
| 8 3/4% Notes due 2003_____ | 100,670   |

In 1992, certain Convertible Subordinated Debentures issued by Southwest Airlines Eurofinance N.V. were redeemed. The principal amount of \$35,000,000 was converted into 1,370,902 shares (unadjusted for the 1993 and 1992 stock splits) of Southwest's common stock at the conversion price of \$25.53 per share. The conversion was primarily a noncash transaction and, therefore, was excluded from the Statement of Cash Flows.

In addition to the credit facilities described above, Southwest has an unsecured Bank Credit Agreement with a group of domestic banks that permits Southwest to borrow through December 14, 1996 on a revolving credit basis up to \$300 million. Interest rates on borrowings under the Credit Agreement can be, at the option of Southwest, the agent bank's prime rate, .30% over LIBOR, or .50% over domestic certificate of deposit rates. The commitment fee is 0.1875% per annum. There were no outstanding borrowings under this agreement at December 31, 1994 or 1993.

#### 7. LEASES

Total rental expense for operating leases charged to operations in 1994, 1993, and 1992 was \$198,987,000, \$167,303,000, and \$125,835,000, respectively. The majority of the Company's terminal

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operations space, as well as 89 aircraft, were under operating leases. The amounts applicable to capital leases included in property and equipment were (in thousands):

<TABLE>  
<CAPTION>

|                                    | 1994      | 1993      |
|------------------------------------|-----------|-----------|
| <S>                                | <C>       | <C>       |
| Flight equipment_____              | \$233,324 | \$232,853 |
| Less accumulated amortization_____ | 88,656    | 74,234    |
|                                    | \$144,668 | \$158,619 |

</TABLE>

Future minimum lease payments under capital leases and noncancelable operating leases, with initial or remaining terms in excess of one year, at December 31, 1994, were (in thousands):

<TABLE>  
<CAPTION>

|                                                 | Capital<br>leases | Operating<br>leases |
|-------------------------------------------------|-------------------|---------------------|
| <S>                                             | <C>               | <C>                 |
| 1995_____                                       | \$ 26,282         | \$ 176,439          |
| 1996_____                                       | 28,897            | 178,253             |
| 1997_____                                       | 26,843            | 168,132             |
| 1998_____                                       | 32,903            | 148,017             |
| 1999_____                                       | 20,999            | 137,845             |
| After 1999_____                                 | 191,096           | 1,559,478           |
| Total minimum lease payments                    | 327,020           | \$ 2,368,164        |
| Less amount representing<br>interest_____       | 131,264           |                     |
| Present value of minimum<br>lease payments_____ | 195,756           |                     |
| Less current portion_____                       | 9,542             |                     |
| Long-term portion_____                          | \$ 186,214        |                     |

</TABLE>

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.

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#### 8. COMMON STOCK

At December 31, 1994, the Company had common stock reserved for issuance pursuant to Employee stock benefit plans (12,009,293 shares) and upon exercise of rights pursuant to the Common Stock Rights Agreement (Agreement), as amended (155,265,088 shares).

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

On May 19, 1993, the Company's Board of Directors declared a three-for-two stock split, distributing 46,325,147 shares on July 15, 1993. On May 20, 1992, the Company's Board of Directors declared a two-for-one stock split, distributing 46,180,531 shares on July 15, 1992.

In February 1992, the Company sold 2,500,000 shares (unadjusted for the subsequent 1993 and 1992 stock splits) of its common stock (2,327,892 new shares and 172,108 shares from treasury) in a public offering. Net proceeds from the sale of approximately \$86,946,000 were added to the working capital of the Company for general corporate purposes, including the acquisition of aircraft and related equipment.

#### 9. STOCK PLANS

In May 1991, the Company's stockholders approved the Incentive Stock Option Plan and the Non-Qualified Stock Option Plan. Under the Incentive Stock Option Plan, options to purchase a maximum of 9,000,000 shares of Southwest common stock may be granted to key Employees. Under the Non-Qualified Stock Option Plan, options to purchase up to 750,000 shares of Southwest common stock may be granted to key Employees and non-employee directors. Under each plan, the option price per share may not be less than the fair market value of a share on the date the option is granted and the maximum term of an option may not exceed 10 years.

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Information regarding the stock option plans is summarized below:

<TABLE>

<CAPTION>

|                                   | Incentive<br>Plan | Non-Qualified<br>Plan |
|-----------------------------------|-------------------|-----------------------|
| <S>                               | <C>               | <C>                   |
| Outstanding December 31, 1991____ | 3,948,957         | 282,825               |
| Granted_____                      | 430,974           | 97,950                |
| Exercised_____                    | (251,817)         | (4,350)               |
| Surrendered_____                  | (111,210)         | (1,800)               |
|                                   | -----             | -----                 |
| Outstanding December 31, 1992____ | 4,016,904         | 374,625               |
| Granted_____                      | 724,646           | 22,512                |
| Exercised_____                    | *(198,285)        | ** (94,810)           |
| Surrendered_____                  | (230,978)         | (1,050)               |
|                                   | -----             | -----                 |
| Outstanding December 31, 1993____ | 4,312,287         | 301,277               |
| Granted_____                      | 794,714           | 63,918                |
| Exercised_____                    | (190,159)         | (9,940)               |
| Surrendered_____                  | (104,880)         | -                     |
|                                   | -----             | -----                 |
| Outstanding December 31, 1994____ | 4,811,962         | 355,255               |

| Exercisable _____                            | -----     | -----   |
|----------------------------------------------|-----------|---------|
| 1994 _____                                   | 572,244   | 163,936 |
| 1993 _____                                   | 314,322   | 108,509 |
| 1992 _____                                   | 198,474   | 142,575 |
| Available for granting in<br>future periods: |           |         |
| 1994 _____                                   | 3,447,694 | 279,165 |
| 1993 _____                                   | 4,137,528 | 343,083 |
| 1992 _____                                   | 4,631,196 | 364,545 |
| Average price of exercised<br>options:       |           |         |
| 1994 _____                                   | \$8.23    | \$7.85  |

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| <S>        | <C>    | <C>     |
|------------|--------|---------|
| 1993 _____ | \$7.14 | \$7.37  |
| 1992 _____ | \$6.10 | \$11.36 |

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

\*\*Includes 12,740 pre-split shares and 75,700 post-split shares.

The exercise price of outstanding options ranged from \$6.02 to \$37.44 in 1994, \$6.02 to \$19.71 in 1993, and \$6.02 to \$12.06 in 1992.

In 1991, the Company's stockholders also approved the Employee Stock Purchase Plan that provides for the sale of common stock to Employees of the Company at a price equal to 90% of the market value at the end of each purchase period. Common stock purchases are paid for through periodic payroll deductions. Participants under the plan received 290,054 shares in 1994, 182,459 shares (59,442 pre-split shares and 93,296 post-split shares) in 1993 and 166,436 shares in 1992 at average prices of \$24.98, \$25.25, and \$12.89, respectively.

At December 31, 1994, 1993, and 1992, 1,489,753, 1,504,752, and 1,512,252 options to purchase the Company's common stock were also outstanding related to employment contracts with the Company's president and chief executive officer. Exercise prices range from \$1.00 to \$11.33 per share. Options for 15,000 shares, 7,500 shares (5,000 pre-split shares, of which 968 shares were issued from treasury), and 22,500 shares were exercised in 1994, 1993, and 1992, respectively.

Effective January 12, 1995, the Company adopted, pursuant to a collective bargaining agreement between the Company and the Southwest Airlines Pilots' Association (SWAPA), the 1995 SWAPA Non-Qualified Stock Option Plan (SWAPA Plan). Under the terms of the SWAPA Plan, 18,000,000 common shares have been reserved for issuance. An initial grant of approximately 14.5 million shares was made on the effective date at an option price of \$20.00 per share. On September 1 of each year of the agreement, commencing September 1, 1996, additional options will be granted to Pilots that became eligible during that year at an option price equal to the fair market value of the common stock of the Company on the date of grant plus 5 percent. Options vest in ten annual increments of 10 percent and must be exercised prior to January 31, 2007, or within a specified time upon retirement or termination. In the event that SWAPA exercises its option to make the collective

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bargaining agreement amendable on or before September 1, 1999, any unexercised options will be canceled on December 1, 1999.

#### 10. EMPLOYEE PROFITSHARING AND SAVINGS PLANS

Substantially all of Southwest's Employees are members of the Southwest Airlines Co. Profitsharing Plan (the Plan). Total profitsharing expense charged to operations in 1994, 1993, and 1992 was \$52,782,000, \$44,959,000, and \$26,363,000, respectively. The Company also elected to contribute \$3,605,000 in 1992 as a result of an accounting change (see Note 3).

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 1994, 1993, and 1992 were \$19,817,000, \$13,986,000, and \$11,611,000, respectively.

# 11. INCOME TAXES

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

Under SFAS 109, deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. The components of deferred tax assets and liabilities at December 31, 1994 and 1993 are as follows (in thousands):

|                                                         | 1994      | 1993      |
|---------------------------------------------------------|-----------|-----------|
|                                                         | -----     | -----     |
| Deferred tax liabilities:                               |           |           |
| <S>                                                     | <C>       | <C>       |
| Accelerated depreciation_____                           | \$343,585 | \$299,195 |
| Scheduled airframe overhauls_____                       | 23,966    | 21,512    |
| Other_____                                              | 55,953    | 45,734    |
|                                                         | -----     | -----     |
| Total deferred tax liabilities____                      | 423,504   | 366,441   |
| Deferred tax assets:                                    |           |           |
| Deferred gains from sale and leaseback of aircraft_____ | 95,602    | 87,358    |
| Capital and operating leases_____                       | 38,240    | 33,637    |
| Alternative minimum tax credit carry forward_____       | 22,778    | 32,122    |
| Other_____                                              | 43,856    | 40,183    |
|                                                         | -----     | -----     |
| Total deferred tax assets_____                          | 200,476   | 193,300   |
|                                                         | -----     | -----     |
| Net deferred tax liability_____                         | \$223,028 | \$173,141 |
|                                                         | =====     | =====     |

</TABLE>

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

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

|                     | Liability Method |           | Deferred Method |
|---------------------|------------------|-----------|-----------------|
|                     | -----            | -----     | -----           |
|                     | 1994             | 1993      | 1992            |
|                     | =====            | =====     | =====           |
| <S>                 | <C>              | <C>       | <C>             |
| Current:            |                  |           |                 |
| Federal_____        | \$ 59,603        | \$ 46,744 | \$30,586        |
| State_____          | 10,702           | 5,409     | 3,970           |
|                     | -----            | -----     | -----           |
| Total current_____  | 70,305           | 52,153    | 34,556          |
| Deferred:           |                  |           |                 |
| Federal_____        | 46,470           | 48,524    | 18,144          |
|                     | 3,417            | 4,676     | 3,116           |
|                     | -----            | -----     | -----           |
| State_____          | 49,887           | 53,200    | 21,260          |
|                     | -----            | -----     | -----           |
| Total deferred_____ | \$120,192        | \$105,353 | \$55,816        |
|                     | =====            | =====     | =====           |

</TABLE>

The components of the provision for deferred income taxes as reported under the

previous method of accounting for the year ended December 31, 1992 are as follows (in thousands):

<TABLE>  
<CAPTION>

|                                           | 1992     |
|-------------------------------------------|----------|
| =====                                     |          |
| <S>                                       | <C>      |
| Depreciation_____                         | \$27,947 |
| Deferred gains on<br>sale\leasebacks_____ | (4,275)  |
| Scheduled airframe<br>overhauls_____      | 6,336    |
| Vacation pay_____                         | (1,220)  |
| Alternative minimum<br>tax_____           | (10,645) |
| Other, net_____                           | 3,117    |
|                                           | -----    |
|                                           | \$21,260 |
|                                           | =====    |

</TABLE>

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In January 1994, Southwest received an examination report from the Internal Revenue Service proposing certain adjustments to Southwest's income tax returns for 1987 and 1988. The adjustments relate to certain types of aircraft financings consummated by Southwest, as well as other members of the aviation industry during that time period. Southwest intends to vigorously protest the adjustments proposed with which it does not agree. The industry's difference with the IRS involves complex issues of law and fact that are likely to take a substantial period of time to resolve. Management believes that final resolution of such protest will not have a materially adverse effect upon the results of operations of Southwest.

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

<TABLE>  
<CAPTION>

|                                                                                     | Liability<br>Method | Deferred<br>Method |
|-------------------------------------------------------------------------------------|---------------------|--------------------|
|                                                                                     | -----               | -----              |
|                                                                                     | 1994                | 1993               |
|                                                                                     | -----               | -----              |
| <S>                                                                                 | <C>                 | <C>                |
| Tax at statutory<br>U.S. tax rates_____                                             | \$104,833           | \$ 90,873          |
| Less amount associated<br>with S-Corporation<br>earnings of Morris<br>(Note 2)_____ | -                   | -                  |
|                                                                                     | -----               | -----              |
|                                                                                     | 104,833             | 90,873             |
|                                                                                     | -----               | -----              |
|                                                                                     | 49,924              |                    |
| Nondeductible items____                                                             | 3,689               | 1,361              |
| State income taxes,<br>net of federal<br>benefit_____                               | 9,177               | 6,632              |
| Effect of increase<br>in U.S. statutory<br>rates_____                               | -                   | 3,957              |
| Other, net_____                                                                     | 2,493               | 2,530              |
|                                                                                     | -----               | -----              |
| Total income tax<br>provision_____                                                  | \$120,192           | \$105,353          |
|                                                                                     | =====               | =====              |

</TABLE>

## 12. NET INCOME PER COMMON AND COMMON EQUIVALENT SHARE

Net income per common and common equivalent share is computed based on the weighted average number of common and common equivalent shares outstanding (147,305,374 in 1994, 147,144,568 in 1993, and 142,945,890 in 1992). 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 or conversion of Convertible Subordinated Debentures is anti-dilutive or is not material.

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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, 1994 and 1993, and the related consolidated statements of income, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 1994. 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, 1994 and 1993, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 1994, in conformity with generally accepted accounting principles.

As discussed in Note 3, during 1993, the Company changed its method of accounting for income taxes and postretirement benefits. Also as discussed in Note 3, during 1992, the Company changed its method of accounting for scheduled airframe overhauls.

ERNST & YOUNG LLP

Dallas, Texas  
January 26, 1995

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities and 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.

March 20, 1995

By /s/ GARY C. KELLY

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

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on March 20, 1995 on behalf of the registrant and in the capacities indicated.

<TABLE>

<CAPTION>

| Signature<br>-----                                               | Capacity<br>-----                                                                       |
|------------------------------------------------------------------|-----------------------------------------------------------------------------------------|
| <S><br>/s/ HERBERT D. KELLEHER<br>-----<br>Herbert D. Kelleher   | <C><br>Chairman of the Board of Directors,<br><br>President and Chief Executive Officer |
| /s/ GARY C. KELLY<br>-----<br>President-Finance<br>Gary C. Kelly | Vice President-Finance<br>(Chief Financial and Accounting Officer)                      |
| /s/ Samuel E. Barshop<br>-----<br>Samuel E. Barshop              | Director                                                                                |
| /s/ Gene H. Bishop<br>-----<br>Gene H. Bishop                    | Director                                                                                |
| /s/ Webb Crockett<br>-----<br>C. Webb Crockett                   | Director                                                                                |
| /s/ William P. Hobby                                             | Director                                                                                |



- 4.10 Form of 7-7/8 percent Note due 2007 (incorporated by reference to Exhibit 4.10 to Southwest's Annual Report on Form 10-K for the year ended December 31, 1992 (File No. 1-7259)).
- 4.11 Form of Global Security representing all 8 percent Notes due 2005 (incorporated by reference to Exhibit 4 to Southwest's current Report on Form 8-K dated March 6, 1995 (File No. 1-7259)).
- 10.1 Purchase Agreement No. 1510, dated July 22, 1988 between The Boeing Company and Southwest (with all amendments through March 29, 1990) (incorporated by reference to Exhibit 10.1 on Southwest's Annual Report on Form 10-K for the year ended December 31, 1989 (File No. 1-7259)); Amendments from April 1, 1990 through March 29, 1993 (incorporated by reference to Exhibit 10.1 on Southwest's Annual Report on Form 10-K for the year ended December 31, 1992 (File No. 1-7259)).
- 10.2 General Terms Agreement between CFM International, Inc. and Southwest (with all amendments through March 29, 1990) dated May 28, 1981 (incorporated by reference to Exhibit 10.2 on Southwest's Annual Report on Form 10-K for the year ended December 31, 1989 (File No. 1-7259)); Amendments from November 6, 1989 through March 29, 1993 (incorporated by reference to Exhibit 10.2 on Southwest's Annual Report on Form 10-K for the year ended December 31, 1992 (File No. 1-7259)); Amendments from March 29, 1993 through March 29, 1994 (incorporated by reference to Exhibit 10.2 to Southwest's Annual Report on Form 10-K for the year ended December 31, 1993 (File No. 1-7259)); Amendment No. 7 and Letter Agreement No. 11, each dated as of January 19, 1994.
- 10.3 Purchase Agreement No. 1405, dated July 23, 1987 between The Boeing Company and Southwest (with all amendments through March 29, 1990) (incorporated by reference to Exhibit 10.3 on Southwest's Annual Report on Form 10-K for the year ended December 31, 1989 (File No. 1-7259)); Amendments from April 1, 1990 through March 29, 1993 (incorporated by reference to Exhibit 10.3 on Southwest's Annual Report on Form 10-K for the year ended December 31, 1992 (File No. 1-7259)); Amendments from March 29, 1993 through March 29, 1994 (incorporated by reference to Exhibit 10.3 to Southwest's Annual Report on Form 10-K for the year ended December 31, 1993 (File No. 1-7259)); Amendments from March 30, 1994 through March 29, 1995.
- 10.4 Purchase Agreement No. 1810, dated January 19, 1994 between The Boeing Company and Southwest (incorporated by reference to Exhibit 10.4 to Southwest's Annual Report on Form 10-K for the year ended December 31, 1993 (File No. 1-7259)).

The following exhibits filed under paragraph 10 of Item 601 are the Company's compensation plans and arrangements.

- 10.5 1985 stock option agreements between Southwest and Herbert D. Kelleher (incorporated by reference to Exhibit 10.1 to Southwest's Quarterly Report on Form 10-Q for the quarter ended September 30, 1985 (File No. 1-7259)).
- 10.6 Form of Executive Employment Agreement between Southwest and certain key employees pursuant to Executive Service Recognition Plan (incorporated by reference to Exhibit 28 to Southwest Quarterly Report on Form 10-Q for the quarter ended June 30, 1987 (File No. 1-7259)).

- 10.7 1992 employment contract between Southwest and Herbert D. Kelleher and related stock option agreements (incorporated by reference to Exhibit 10.8 to Southwest's Annual Report on Form 10-K for the year ended December 31, 1991 (File No. 1-7259)).
- 10.8 1987 stock option agreement between Southwest and Herbert D. Kelleher (incorporated by reference to Exhibit 10.11 to Southwest's Annual Report on Form 10-K for the year ended December 31, 1987 (File No. 1-7259)).
- 10.9 1991 Incentive Stock Option Plan (incorporated by reference to Exhibit 4.1 to Registration Statement on Form S-8 (File No. 33-40652)).
- 10.10 1991 Non-Qualified Stock Option Plan (incorporated by reference

to Exhibit 4.2 to Registration Statement on Form S-8 (File No. 33-40652)).

- 10.11 1991 Employee Stock Purchase Plan as amended May 20, 1992 (incorporated by reference to Exhibit 10.13 to Southwest's Annual Report on Form 10-K for the year ended December 31, 1992 (File No. 1-7259)).
- 10.12 Southwest Airlines Co. Profit Sharing Plan (incorporated by reference to Exhibit 10.13 to Southwest's Annual Report on Form 10-K for the year ended December 31, 1991 (File No. 1-7259)).
- 10.13 Southwest Airlines Co. 401(k) Plan (incorporated by reference to Exhibit 10.14 to Southwest's Annual Report on Form 10-K for the year ended December 31, 1991 (File No. 1-7259)).
- 10.14 Southwest Airlines Co. 1995 SWAPA Non-Qualified Stock Option Plan.
- 11 Computation of earnings per share.
- 22 Subsidiaries of Southwest.
- 23 Consent of Ernst & Young LLP, Independent Auditors.
- 27 Financial Data Schedule.

FOURTH AMENDMENT TO COMPETITIVE ADVANCE AND  
-----  
REVOLVING CREDIT FACILITY AGREEMENT  
-----

THIS AMENDMENT is entered into as of December 14, 1993, among SOUTHWEST AIRLINES CO., a Texas corporation (the "COMPANY"), the banks listed on the signature pages hereof ("BANKS"), TEXAS COMMERCE BANK NATIONAL ASSOCIATION (formerly TEXAS COMMERCE BANK, NATIONAL ASSOCIATION), a national banking association, as agent for the Banks (in such capacity, "AGENT"), TEXAS COMMERCE BANK NATIONAL ASSOCIATION, a national banking association, as Funds Administrator (in such capacity, "FUNDS ADMINISTRATOR"), and CHEMICAL BANK, a New York banking corporation, as auction administration agent (in such capacity, "AUCTION ADMINISTRATION AGENT").

The Company, Banks, Agent, Funds Administrator and Auction Administration Agent have entered into the Competitive Advance and Revolving Credit Facility Agreement dated as of December 14, 1990 (as amended as of April 4, 1991, December 14, 1991, and December 14, 1992, and as further renewed, extended, amended, or supplemented, the "CREDIT AGREEMENT"). Pursuant to SECTION 2.20 of the Credit Agreement, the Company has provided Agent with Notice of Extension requesting an extension of the Termination Date, and Agent has notified the Banks of the contents thereof. The Company also has requested certain amendments to the Credit Agreement in order add The Boatmen's National Bank of St. Louis and First Security Bank of Utah, N.A. as Banks, each with a Commitment of \$25,000,000.

NOW, THEREFORE, in consideration of the premises and other valuable consideration, the receipt and adequacy of which are hereby acknowledged, the Company, Banks, Agent, Funds Administrator and Auction Administration Agent agree as follows:

1. Unless otherwise specified herein, terms defined in the Credit Agreement have the same meaning when used herein and all references to "Sections" and "Schedules" are references to sections and schedules of or to the Credit Agreement.

2. The Boatmen's National Bank of St. Louis and First Security Bank of Utah, N.A. are hereby added as Banks, effective April 12, 1994, and the Commitment of each of them as of that date is \$25,000,000.

3. Effective April 12, 1994, wherever in the Agreement and Exhibits thereto "\$250,000,000" appears, it is hereby amended to be "\$300,000,000," and wherever "Two Hundred Fifty Million" appears, it is hereby amended to be "Three Hundred Million."

4. The definition of Original Termination Date in SECTION 1.101 of the Credit Agreement is amended to read "December 14, 1996," instead of "December 14, 1995."

5. SCHEDULE I is amended, effective April 12, 1994, to add the following information with respect to The Boatmen's National Bank of St. Louis and First Security Bank of Utah, N.A.:

<TABLE>

<CAPTION>

| NAME<br>----                                | LENDING OFFICE<br>-----                                                                   | NOTICE<br>-----                                                                                                                                                                 |
|---------------------------------------------|-------------------------------------------------------------------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
|                                             |                                                                                           | INFORMATION<br>-----                                                                                                                                                            |
| <S>                                         | <C>                                                                                       | <C>                                                                                                                                                                             |
| THE BOATMEN'S NATIONAL<br>BANK OF ST. LOUIS | The Boatmen's National Bank<br>800 Market Street<br>St. Louis, MO 63166-0236              | The Boatmen's National Bank<br>800 Market Street<br>St. Louis, MO 63166-0236<br>Attn: Dwight D. Erdbruegger,<br>Vice President<br>(314) 466-7053<br>(314) 466-6499 FAX          |
| FIRST SECURITY BANK OF<br>UTAH, N.A.        | First Security Bank of Utah<br>15 East 100 South<br>2nd Floor<br>Salt Lake City, UT 84111 | First Security Bank of Utah<br>15 East 100 South<br>2nd Floor<br>Salt Lake City, UT 84111<br>Attn: Jeffrey J. Jensen,<br>Vice President<br>(801) 246-5019<br>(801) 246-5532 FAX |

</TABLE>

6. Effective December 14, 1993, the definition of Facility Fee Percentage in SECTION 1.01 of the Agreement is hereby amended to read as follows:

"Facility Fee Percentage" means the following percentages in the

following contexts:

Company's senior unsecured long-term debt  
as rated by Standard & Poors Corporation  
("S&P") or Moody's Investor Service, Inc.,  
("MOODY'S"), whichever is higher

<TABLE>  
<CAPTION>

|                 | Percentage |
|-----------------|------------|
| <S>             | <C>        |
| A or above      | .1625      |
| A- or BBB+/1/   | .1875      |
| BBB/2/ or below | .2875      |

</TABLE>

7. Effective December 14, 1993, SECTION 2.09(A)(II) is amended in its entirety as follows:

/1/BBB+ is the S&P rating designation. The rating from Moody's which corresponds to BBB+ is Baa1.

/2/BBB is the S&P rating. The rating from Moody's which corresponds to BBB is Baa2.

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(ii) the LIBO Rate for the Interest Period in effect for such Loan (A) plus or minus, as the case may be, in the case of each Competitive Loan, the Margin specified by a Bank with respect to such Loan in its Competitive Bid submitted pursuant to SECTION 2.02(B) or (B) plus, in the case of each Committed Loan, 0.30% per annum (or 0.425% per annum if the Company's senior unsecured long-term debt is rated BBB or lower by Standard & Poor's Corporation and Baa2 or lower by Moody's Investor Service, Inc.).

8. Effective December 14, 1993, SECTION 2.09(B)(II) is amended in its entirety as follows:

(ii) the CD Rate for the Interest Period in effect for such Loan, plus 0.50% per annum (or 0.625% per annum if the Company's senior unsecured long-term debt is rated BBB or lower by Standard & Poor's Corporation and Baa2 or lower by Moody's Investor Services, Inc.).

9. Effective December 14, 1993, the "90" on the first line of SECTION 5.10(A) is amended to be "120".

10. CONDITIONS PRECEDENT. The foregoing shall not become effective until all of the following conditions have been satisfied:

(a) Each of The Boatmen's National Bank of St. Louis and First Security Bank of Utah, N.A. shall have received a Committed Note, and each Bank shall have received a Competitive Note, properly dated and executed by the Company payable to the order of such Banks, in the amount of its Commitment, in the case of the Committed Notes to The Boatmen's National Bank of St. Louis and First Security Bank of Utah, N.A., and in the amount of the Total Commitment in the case of the Competitive Notes to all Banks.

(b) (i) Agent shall have received, in sufficient copies for each Bank, a copy of this amendment executed by the Company together with Officers' Certificates dated the date hereof certifying inter alia, (A) true and correct copies of resolutions adopted by the Board of Directors or Executive Committee, as appropriate, of the Company authorizing the Company to borrow and effect other transactions pursuant to the Credit Agreement as amended hereby, (B) the incumbency and specimen signatures of the Persons executing any documents on behalf of the Company, (C) the truth as of the date first written above of the representations and warranties made by the Company in the Credit Agreement, as amended hereby, and (D) the absence of the occurrence and continuance of any Default or Event of Default; (ii) Existence and Good Standing Certificates of the Company, from the Secretary of State and the Comptroller of Public Accounts of Texas; (iii) completed Administrative Questionnaires from The Boatmen's National Bank of St. Louis and First Security Bank of Utah, N.A.; (iv) the written opinion of counsel to the Company substantially in the form set out as EXHIBIT E-1 to the Credit Agreement, modified to include the transactions contemplated hereby; and (v) the written opinion

of counsel for Agent and Banks substantially in the form set out as EXHIBIT E-2 to the Credit Agreement, modified to include the transactions contemplated hereby.

11. RATIFICATIONS. Except as herein specifically amended and modified,  
-----

(a) the Credit Agreement is unchanged and continues in full force and effect, and (b) the Company hereby confirms and ratifies the Credit Agreement's existence and each and every term, condition, and covenant therein contained, to the same extent and as though the same were set out herein in full.

12. REPRESENTATIONS AND WARRANTIES. The Company hereby represents and  
-----

warrants to Banks, Agent, Funds Administrator, and Auction Administration Agent that (a) this amendment and the Loan Papers to be delivered hereunder have been duly executed and delivered by the Company, (b) no action of, or filing with, any Tribunal is required to authorize, or is otherwise required in connection with, the execution, delivery, and performance by the Company of this amendment and the Loan Papers to be delivered hereunder, (c) this amendment and the Loan Papers to be delivered hereunder are valid and binding upon the Company and are enforceable against the Company in accordance with their respective terms, except as limited by the Bankruptcy Code of the United States of America and all other similar Laws affecting the rights of creditors generally, (d) the execution, delivery and performance by the Company of this amendment and the Loan Papers to be delivered hereunder do not require the consent of any other Person and do not and will not constitute a violation of any laws, agreement, or understanding to which the Company is a party or by which the Company is bound, (e) the representations and warranties contained in the Credit Agreement, as amended hereby, and any other Loan Paper are true and correct in all material respects on and as of the date of execution hereof as though made as of the date of execution hereof, and (f) as of the date of this amendment, no default or Event of Default has occurred and is continuing.

13. REFERENCES. All references in the Loan Papers to the Credit  
-----

Agreement shall refer to the Credit Agreement as amended by this amendment, and, because this amendment is a "LOAN PAPER" referred to in the Credit Agreement, then the provisions relating to Loan Papers set forth in the Credit Agreement are incorporated herein by reference, the same as if set forth herein verbatim.

14. COUNTERPARTS. This amendment may be executed in a number of  
-----

identical counterparts, each of which shall be deemed an original. In making proof of this instrument, it shall not be necessary for any party to account for all counterparts, and it shall be sufficient for any party to produce but one such counterpart.

15. PARTIES BOUND. This amendment shall be binding upon and shall inure  
-----

to the benefit of the Company, Agent, and each Bank, and, subject to SECTION 8.11, their respective successors and assigns.

16. ENTIRETY. THIS AMENDMENT, THE CREDIT AGREEMENT AS AMENDED HEREBY,  
-----

AND THE OTHER LOAN PAPERS REPRESENT THE FINAL

4

CREDIT AGREEMENT BETWEEN THE PARTIES FOR THE TRANSACTIONS THEREIN, AND MAY NOT BE CONTRADICTED BY EVIDENCE OF PRIOR, CONTEMPORANEOUS, OR SUBSEQUENT ORAL AGREEMENTS BY THE PARTIES. THERE ARE NO UNWRITTEN ORAL AGREEMENTS BETWEEN THE PARTIES.

[REMAINDER OF PAGE LEFT INTENTIONALLY BLANK. SIGNATURE PAGES FOLLOW.]

5

EXECUTED as of the date and year first stated above.

SOUTHWEST AIRLINES CO.

By /s/ John D. Owen  
-----

John D. Owen  
Treasurer

\$70,000,000

TEXAS COMMERCE BANK NATIONAL  
ASSOCIATION, individually, as  
Agent and as Funds Administrator

By /s/ Mark J. Denton

-----  
Mark J. Denton, Senior Vice  
President

CHEMICAL BANK, as Auction  
Administration Agent

By /s/ Janet Beldin  
-----  
Janet Beldin, Vice President

\$45,000,000 NATIONSBANK OF TEXAS, N.A.

By /s/ Donald L. Harrison Jr.  
-----  
Donald L. Harrison Jr., Senior Vice  
President

6

\$40,000,000 BANK OF AMERICA NATIONAL TRUST  
AND SAVINGS ASSOCIATION

By /s/ Patrick P. Horan  
-----  
Patrick P. Horan, Senior Vice President

\$40,000,000 BANK ONE, TEXAS, N.A.

By /s/ Michael R. Silverman  
-----  
Michael R. Silverman, Vice President

\$30,000,000 FIRST INTERSTATE BANK OF  
TEXAS, N.A.

By /s/ Connor J. Duffey  
-----  
Connor J. Duffey, Vice President

\$25,000,000 THE FIRST NATIONAL BANK OF CHICAGO

By /s/ David Dixon  
-----  
David Dixon, Vice President

\$25,000,000 THE BOATMEN'S NATIONAL BANK OF  
ST. LOUIS

By /s/ Dwight D. Erdbruegger  
-----  
Dwight D. Erdbruegger, Vice President

7

\$25,000,000 FIRST SECURITY BANK OF UTAH, N.A.

By /s/ Jeffrey J. Jensen  
-----  
Jeffrey J. Jensen, Vice President

8

INCORPORATED UNDER THE LAWS  
OF THE STATE OF TEXAS

THIS CERTIFICATE IS TRANSFERABLE IN  
DALLAS, TEXAS AND NEW YORK, NEW YORK

COMMON STOCK

CUSIP 844741 10 8

PAR VALUE \$1.00 EACH

SEE REVERSE FOR CERTAIN DEFINITIONS

SOUTHWEST AIRLINES CO.

THIS CERTIFIES THAT

SPECIMEN

IS THE OWNER OF

FULLY PAID AND NON-ASSESSABLE SHARES OF THE COMMON STOCK OF

Southwest Airlines Co. transferable on the books of the Corporation by the holder hereof in person or by duly authorized attorney upon surrender of this Certificate properly endorsed. This Certificate and the shares represented hereby are issued and shall be subject to all the provisions of the Articles of Incorporation of the Corporation, as now or hereafter amended, to all of which the holder hereof by acceptance hereof assents. This Certificate is not valid unless countersigned and registered by the Transfer Agent and Registrar.

Witness the facsimile seal  
facsimile signatures of its

of the Corporation and the  
duly authorized officers.

[SEAL APPEARS HERE]

DATED:

/s/ Herbert D. Kelleher  
CHAIRMAN OF THE BOARD  
AND PRESIDENT

COUNTERSIGNED AND REGISTERED:  
Continental Stock Transfer  
and Trust Co.

TRANSFER AGENT  
AND REGISTRAR

/s/ Colleen C. Barrett  
SECRETARY

AUTHORIZED SIGNATURE

SOUTHWEST AIRLINES CO.

Reference is made to Article Four of the Articles of Incorporation of the corporation, and all amendments thereto, now or hereafter on file with the Secretary of State of the State of Texas, for a statement of the designations, preferences, limitations, and relative rights of the shares of each class of stock authorized to be issued by the Corporation and the denial of pre-emptive rights of shareholders.

Copies of such Articles of Incorporation, as amended, are also on file with each Transfer Agent, and copies thereof may be obtained by any shareholder, without charge, from the Corporation or from any such Transfer Agent.

The following abbreviations, when used in the inscription on the face of this certificate, shall be construed as though they were written out in full according to applicable laws or regulations;

|         |                               |                     |                    |
|---------|-------------------------------|---------------------|--------------------|
| TEN COM | -as tenants in common         | UNIF GIFT MIN ACT-- | .....Custodian.... |
| TEN ENT | -as tenants by the entireties |                     | (Cust) (Minor)     |
| JT TEN  | -as joint tenants with right  |                     | under Uniform      |
|         | of survivorship and not as    |                     | Gifts to Minors    |
|         | tenants in common             |                     | Act.....           |
|         |                               |                     | (State)            |

Additional abbreviations may also be used though not in the above list.

For Value Received, \_\_\_\_\_ hereby sell,  
assign and transfer unto

[ \_\_\_\_\_ ]  
(PLEASE PRINT OR TYPEWRITE NAME AND ADDRESSEE,  
INCLUDING ZIP CODE, OF ASSIGNEE)

to transfer the said stock on the books of the within named Corporation with  
full power of substitution in the premises.

Dated \_\_\_\_\_

NOTICE: THE SIGNATURE TO THIS ASSIGNMENT MUST CORRESPOND WITH THE NAME AS WRITTEN UP ON THE FACE OF THE CERTIFICATE IN EVERY PARTICULAR, WITHOUT ALTERATION OR ENLARGEMENT OR ANY CHANGE WHATSOEVER

## AMENDMENT NO. 7

-----

Whereas, CFM International, Inc., (hereinafter referred to as "CFM") and Southwest Airlines Co. (hereinafter referred to as "Airline") have entered into (a) General Terms Agreement 6-3418 dated May 19, 1981, as previously amended, (the "GTA") heretofore consisting of terms and conditions with respect to (i) CFM's support (including warranty) of CFM56 equipment purchased by The Boeing Company (hereinafter referred to as "Boeing") and sold to Airline as installed equipment on Boeing model 737-300, 737-400, and/or 737-500 aircraft and (ii) the sale and support by CFM and the purchase by Airline from CFM of spare turbofan engines, engine modules, spare parts, and other specified equipment, all in support of the above referenced aircraft powered by CFM56-3-B1, CFM56-3B-2, and/or CFM56-3C-1 engines and (b) ten (10) Letter Agreements which accompany the GTA (the GTA and Letter Agreements being collectively referred to as the "Agreement"); and

Whereas, the Agreement has heretofore included a cumulative total of one-hundred-forty-four (144) Firm and fifty-three (53) Option 737-300, 737-400, and/or 737-500 aircraft for delivery through 1999; and

Whereas, (a) only eleven (11) of such 53 Option aircraft (3 in April 1997, 2 in August 1997, 2 in September 1997 and 4 in October 1997) continue to be scheduled for delivery to Airline (the "Eleven aircraft") and (b) the remainder of such 53 Option aircraft are replaced by a purchase agreement with Boeing (the "Aircraft Purchase Agreement") for CFM56-7 (22,000 lbs. SLS thrust to 86 degreesF) powered 737-700 aircraft as set forth in Attachment I to this Amendment No. 7 (the aircraft set forth in Attachment I being collectively referred to as the "Aircraft"); and

Whereas, sixty-three (63) of the Aircraft (as defined in such Attachment I hereto) are Firm Aircraft (the "Firm Aircraft").

Now, in consideration of Airline (a) entering into the Aircraft Purchase Agreement and (b) actually purchasing and taking delivery of all of the Firm Aircraft as set forth in such Attachment I hereto, the parties agree that (i) the applicable terms heretofore set forth in the GTA shall continue to apply to the Eleven aircraft, (ii) the applicable terms hereinafter set forth shall apply to the Aircraft, and (iii) the GTA is further amended by this Amendment No. 7 as follows:

First: The following paragraph D is added to Article I (Equipment):

- D. Except for (a) the prices heretofore set forth in Article II, as amended, of the GTA, (b) the payment terms as set forth in Article V of the GTA, (c) the special guarantees set forth in Section XIII, as amended, of Exhibit B of the GTA, (d) Letter Agreements Nos. 1 through 10 to the GTA, or (e) unless otherwise agreed to the contrary in writing by the parties, (i) applicable terms and conditions of the GTA shall hereafter likewise apply to CFM56-7 installed engines purchased from Boeing, spare engines, engine modules, spare parts, and other specified equipment purchased from CFM in support of Airline's 737-700 aircraft fleet and (ii) such equipment shall be included under the term Products as used in the GTA and applicable letter Agreements subsequent to letter Agreement No. 10.

Second: Article II (Prices) is further amended to include the following part K:

- K. Base prices for new CFM56-7 spare engines, engine modules, and optional equipment rated at SLS thrusts to 86 degreesF of 20,000 lbs. and 22,000 lbs. ordered within lead time for delivery to Airline by CFM prior to December 31, 2003 in support of the Aircraft are shown in Attachment II to this Amendment No. 7.

Third: In support of the above CFM56-7 pricing, the escalation provisions set forth in Exhibit D of the Aircraft Purchase Agreement are hereby incorporated by reference into the GTA and such CFM56-7 pricing shall be escalated to the time of Product delivery in the same manner as the aircraft price is escalated to the time of aircraft delivery. However, such escalation provisions shall not be applicable to CFM56-3 pricing set forth in the Agreement.

Fourth: Payment terms for CFM56-7 spare engines, engine modules and optional equipment are shown in Attachment III to this Amendment No. 7.

Fifth: The Special Guarantees set forth in Attachment IV to this Amendment No. 7 are added as a separate section (SECTION XIV) of Exhibit B

Total Option Aircraft 63

</TABLE>

3. Delivery Positions -- Rollover Option Aircraft

<TABLE>

<CAPTION>

| Year | Quantity |
|------|----------|
| ---- | -----    |
| <S>  | <C>      |
| 2004 | 13       |
| 2005 | 18       |
| 2006 | 18       |
| --   | --       |

Total Rollover Option Aircraft 49

</TABLE>

ATTACHMENT II

-----

BASE PRICES FOR CFM56-7

-----

SPARE ENGINES, OPTIONAL EQUIPMENT AND MODULES

-----

<TABLE>

<CAPTION>

| Item  |                                      | Base Price             |
|-------|--------------------------------------|------------------------|
| ----- |                                      | July 1993 U.S. Dollars |
| <S>   | <C>                                  | <C>                    |
| 1.    | Basic CFM56-7 Engine (20,000 lb.)    | \$3,540,000            |
|       | -----                                |                        |
|       | Associated Equipment                 | 150,000                |
|       | Max Climb Thrust Increase            | 115,000                |
| 2.    | Basic CFM56-7 Engine (22,000 lb.)    | \$3,894,000            |
|       | -----                                |                        |
|       | Associated Equipment                 | 150,000                |
|       | Max Climb Thrust Increase            | 57,500                 |
| 3.    | Optional Equipment                   |                        |
|       | -----                                |                        |
|       | Engine Condition Monitoring Hardware | 78,527                 |
| 4.    | Modules                              |                        |
|       | -----                                |                        |
|       | Core Engine                          | 3,133,577              |
|       | LPT                                  | 1,406,987              |
|       | Accessory Gearbox                    | 369,797                |

</TABLE>

- A. The above base prices are effective for Firm orders received by CFM within quoted lead time for basic spare engines (including associated equipment and max. climb thrust increase), optional equipment and engine modules for delivery to Airline by CFM on or before December 31, 2003 in support of the Aircraft defined in Amendment No. 7 to the GTA. The base prices are FOB Evendale, Ohio or point of manufacture and are subject to adjustment for escalation as further defined in Amendment No. 7 to the GTA.
- B. For the above base prices, the base ECI is 123.7 and the base ICI is 118.3 (ECI and ICI being as defined in Exhibit D of the Aircraft Purchase Agreement for July 1993 deliveries).
- C. The selling price of CFM56-7 basic spare engines, optional equipment and modules ordered for delivery after the period set forth in Paragraph A above shall be the base price then in effect and as set forth in each purchase order as accepted by CFM, which base price shall be subject to adjustment for escalation in accordance with CFM's then-current escalation provisions.

ATTACHMENT III

-----

PAYMENT

-----

Airline shall pay CFM with respect to each purchase order hereunder, in United States Dollars as follows:

1. For Engines, Engine Modules, and Associated/Optional Equipment therefor:
  - a. Ten percent (10%) of the total purchase order base price,

escalated to the month payment is due, shall be paid eighteen (18) months prior to scheduled delivery date thereof;

- b. Ten percent (10%) of the base price of each item, escalated to the month payment is due, shall be paid twelve (12) months prior to scheduled delivery date thereof; and
- c. Ten percent (10%) of the base price of each item, escalated to the month payment is due, shall be paid six (6) months prior to scheduled delivery date thereof; and
- d. Payment of the balance, including amount for price escalation to the month of scheduled delivery, shall be paid within thirty (30) days after delivery of each item.

Any payment following the first payment in a. above which becomes due prior to or at the time of purchase order placement, shall be paid concurrently therewith.

2. For Spare Parts, payment of the selling price shall be made thirty (30) days after delivery thereof.

3. For Special Tools and Test Equipment, payment of the selling price shall be made thirty (30) days after delivery thereof.

B. All invoicing and payments (including payment details) hereunder shall be transmitted electronically.

C. If delivery hereunder is delayed by Airline, payment shall be made based on the delivery schedule set forth in the purchase order as accepted by CFM.

D. In the event of delay in the payments to be made by Airline hereunder, CFM shall be entitled, without prejudice to any other rights to CFM, to claim interest on the amounts due, computed at the current rates of the monetary market in New York (The New York Prime Rate) or the then-prevailing equivalent in force on the day last payment is due, plus two

percent. Interest will cover the whole period of delayed payment.

E. In the event of a material adverse change in the financial condition of Airline, CFMI may require payment of an amount due under A.d above at the time of Product delivery.

#### ATTACHMENT IV

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#### SECTION XIV - SPECIAL GUARANTEES FOR CFM56-7 ENGINES

-----

The following Special Guarantees have been tailored to Airline's 737-700 fleet average flight conditions. The delivery schedule upon which such Special Guarantees are conditioned is set forth in Attachment I to Amendment No. 7 to the GTA (the "Aircraft"), and the basis for such guarantees is described in Attachment V to this Amendment No. 7 to the GTA.

##### A. Material Cost Guarantee

-----

CFM guarantees that the ten-year cumulative net material cost, including Life Limited parts material, for all engine Parts supported through CFM56 Engine Spare parts Catalog sales for Airline's fleet of CFM56-7 engines will not exceed the following values per engine flight hour:

\$51.10, based on an average Aircraft utilization of  
3600 hours per year; or

\$48.90, based on an average Aircraft utilization of  
3200 hours per year.

The appropriate guaranteed rate will be adjusted for escalation annually in the month of July in accordance with the provisions set forth in Exhibit D of the Aircraft Purchase Agreement using a base ECI of 123.7 and a base ICI of 118.3 (July 1993).

Such guaranteed rates are based on a stub life of 4,000 flight cycles for each module at the same guaranteed rate of \$51.10 or \$48.90 per engine flight hour, as appropriate. To the extent the fleetwide average exceeds 4,000 flight cycles, costs attributable to such excess shall not be included in Airline's cumulative net material cost for purposes of calculating the material cost guarantee. Excess costs due to stub lives greater than 4,000 cycles shall be calculated component by component and excluded on a prorated cycle basis for those cycles greater than 4,000 cycles. This reconciliation shall be completed on a yearly basis.

The cumulative net material cost is based on the actual price of

replacements for Parts scrapped during the guarantee period, less any material credits issued under warranty, other guarantee, or other program considerations. All other costs, including material handling fees, are excluded.

Parts scrapped due to service bulletin compliance will be included in the guarantee at 100% less any credits, provided the service bulletins are agreed to by Airline and CFM.

In cases where a Parts repair procedure is required and is not available within six (6) months from receipt of Airline's request for such repair procedure, the Part may be scrapped unless CFM and Airline agree otherwise.

Settlement of the ten (10) year net cumulative Material Cost Guarantee will be on a yearly basis. If at the time of any yearly settlement, Airline's cumulative net material cost under this guarantee exceeds the guarantee level, CFM will provide airline a credit against purchases from CFM in the amount of 65 percent (65%) of the actual cost overrun incurred by Airline since the last settlement. In the event that (a) at the time of any yearly settlement the guarantee level is not met, (b) CFM provides Airline a credit, and (c) subsequently the guarantee overrun is reduced such that the cumulative guarantee level is met, then Airline shall return to CFM all credits previously issued under the guarantee, without interest.

#### B. Performance Retention Guarantee

CFM guarantees that the cumulative fleet average cruise fuel consumption deterioration of new CFM56-7 engines will not exceed an average of two percent (2%) during the first five (5) years of Airline's 737-700 revenue service. This includes installed and spare engines to support all Aircraft delivered during the period of this guarantee. Attachment VI to Amendment No. 7 to the GTA describes the method of measurement to be used.

If at the end of the five-year guarantee period the guarantee level is exceeded, CFM will provide Airline with:

- 1) Reimbursement for the excess fuel consumed for that portion of the guarantee period during which the guarantee is exceeded, computed at Airline's average monthly cost of fuel; and
- 2) An extension of the guarantee to ten (10) years at a cumulative fuel consumption level of two and one half percent (2.5%), with reimbursement for the excess fuel consumed for the portion of years 6 through 10 inclusive during which the guarantee is exceeded.

This reimbursement will be in the form of a credit against purchases from CFM.

#### C. New Engine EGT Deterioration Guarantee

CFM guarantees that each new CFM56-7 engine delivered to Airline either as an installed or spare engine will operate the first 7,000 engine flight hours without removal due to exceeding the certified maximum takeoff EGT limit. Available on-wing performance restoration techniques to

regain EGT margin will be employed prior to engine removal. If an engine is removed from an Aircraft during the guarantee period solely for exceeding the takeoff EGT limit, CFM will provide Airline a credit against purchases from CFM equivalent to Airline's cost of restoration, less fees, to restore adequate EGT margin to meet the guarantee. As with the "Restored Engine EGT Deterioration Guarantee", a mutually agreed to workscope shall apply. Any material credit issued under this guarantee will be applied as credit under the Material Cost Guarantee.

#### D. Restored Engine EGT Deterioration Guarantee

CFM guarantees that for five (5) years beginning with delivery of Airline's first 737-700 Aircraft, each CFM56-7 engine operated by Airline since original delivery thereof and restored to a mutually agreed to workscope will operate for 5,000 engine flight hours following installation without removal due to exceeding the certified maximum takeoff EGT limit. If an engine is removed from an Aircraft during the guarantee period solely for exceeding the takeoff EGT limit, CFM will provide Airline a credit against purchases from CFM equivalent to Airline's cost of restoration, less fees, to restore adequate EGT margin to meet the guarantees. Any material credit issued under this guarantee will be applied as credit under the Material Cost Guarantee.

ATTACHMENT V

-----

The special guarantees set forth in Attachment IV to Amendment No. 7 to the GTA (the "Special Guarantees") have been developed specifically for Airline's new installed and spare CFM56-7 (22,000 lbs.) engines (the "Engines"). Such 737-700 fleet based guarantees are contingent upon Airline accepting delivery of sixty-three (63) firm, sixty-three (63) option, and forty-nine (49) rollover option CFM456-7 powered 737-700 aircraft (the "Aircraft") in the time period described in Attachment I to Amendment No. 7 to the GTA, and upon Airline procuring a mutually agreed upon number of spare CFM56-7 engines and engine modules. Such Special Guarantees are also contingent upon Airline's Engines being identified and maintained separately from other operators' engines at the repair agency, and upon agreement between Airline and CFM regarding administration of the Special Guarantees.

The Special Guarantees are based on an average flight leg of 0.95 hours or greater, an average takeoff thrust derate of 10 percent or greater, and an average Aircraft utilization of 3600 or 3200, as appropriate, hours per year maximum. Operation under different conditions including delivery of a lesser number of aircraft, changes in delivery schedule from that described in Attachment I to Amendment No. 7 to the GTA, and/or introduction of 737-700 aircraft with greater than 22,000 lb. thrust may require adjustment of the guaranteed values.

The Special Guarantees require that Airline and CFM agree upon the workscope necessary during each shop visit, that available on-wing maintenance and performance restoration procedures are used to avoid unnecessary shop visits, and that service bulletins agreed to between Airline and CFM are incorporated in a timely manner.

The Material Cost Guarantee includes Foreign Object Damage (FOD) caused by birds or hail.

Unless stated otherwise in the specific Special Guarantee, such Special Guarantees commence with delivery of Airline's first Aircraft.

CFM will, with Airline's assistance, conduct an accounting at least annually to determine the status of each of such Special Guarantees.

Special Guarantees shall not be the subject of claims and/or administration directly between Airline and CFM under the GTA in the event (i) Airline accepts a 737-700 aircraft maintenance cost guarantee from Boeing or any other third party and (ii) such guarantee includes an integration of such Special Guarantees as assigned by Airline to such third party and consented to by CFM.

Also, in the event Airline accepts a proposal independent of Amendment No. 7 (including from GE or SOCHATA) for any type of power-by-the-hour service contract for the Engines, Airline hereby agrees to assign all of the Special Guarantees (except the Performance Retention Guarantee which would remain between CFM and Airline even though such guarantee would be assignable by Airline subject to administration in the case of an aircraft maintenance cost guarantee) to the successful contractor for integration into said power-by-the-hour service contract.

The General Conditions of the CFM Product Support Plan included in the GTA apply to the Special Guarantees unless stated otherwise herein.

ATTACHMENT VI  
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CFM56-7 CUMULATIVE FLEET AVERAGE  
-----  
PERFORMANCE RETENTION GUARANTEE  
-----  
METHOD OF MEASUREMENT  
-----

1. Base point for the cumulative fleet average fuel flow guarantee is the average of the first twenty (20) revenue flight cruise points of each CFM56-7 engine covered by the GTA.
2. Performance Retention (fuel consumption deterioration) is determined quarterly by comparing the cumulative fleet average of the quarterly data points with the base point.
3. The period covered by this guarantee starts from the first revenue flight of the first Aircraft.
4. CFM also requests Airline to submit to CFM on a monthly basis copies of performance trending printed out from the ADEPT (Aircraft Data Engine Performance Trending) or GEM's (Ground-base Engine Monitoring) fleet average program.
5. Cruise data reported quarterly must include the following:

A/C Number; Engine Serial Number (ESN); Date; Flight Number; Engine Position; Altitude; Mach Number; Total Air Temperature (TAT); and at Cruise Point; N1, Exhaust Gas Temperature (EGT), N2, Fuel Flow, and Bleed Configuration.

6. If the deterioration of the cumulative fleet average fuel flow at N1 exceeds the guarantee or if the deterioration trend suggests that the guarantee might be exceeded, then, the following actions may be initiated:
  - a) CFM Flight Audits.
  - b) Test Cell confirmation runs on specific engines, adjusted to account for sea level to altitude effects plus installation loss. If the test cell run on a sample of engines shows more than this amount from new, this would support that the inflight guarantee has been exceeded.
7. If, as a result of incorporation of service bulletins (other than mandatory campaign change) or other modifications, the initially established relationship of Engine fuel flow, thrust and fan speed (N1) is altered, the measured, calibrated fuel consumption shall be suitably corrected as mutually agreed to account for the effect of such change.

CFM INTERNATIONAL

LETTER AGREEMENT NO. 11

Southwest Airlines Co.  
P.O.Box 37611  
Love Field  
Dallas, Texas 75235

Gentlemen:

WHEREAS, CFM International, Inc. ("CFM") and Southwest Airlines Co. ("Southwest") have entered into General Terms Agreement No. 6-3418 dated May 29, 1981, as amended ("GTA"). The GTA contains applicable terms and conditions governing the sale by CFM and the purchase by Southwest from CFM of spare CFM56 engines and associated equipment in support of its Boeing 737 series aircraft powered by CFM engines; and

WHEREAS, CFM and Southwest have, concurrent herewith, entered into Amendment No. 7 to the GTRA and therein defined sixty-three (63) Firm CFM56-7 powered 737-700 aircraft (the "Firm Aircraft") plus a complement of Option and Rollover Option aircraft which are collectively set forth in Attachment I thereto (all of the aircraft set forth in such Attachment I being collectively referred to as the "Aircraft").

NOW, THEREFORE, in consideration of Airline (i) actually purchasing and taking delivery of all of the Firm Aircraft as set forth in such Attachment I and (ii) agreeing that, in the event Southwest exercises any of its Option and Rollover Option aircraft set forth in such Attachment I, all such aircraft shall be powered by CFM56-7 engines, the parties agree as follows:

A. Spare Engine Allowance

Southwest agrees to order from CFM CFM56-7 spare engines, in a quantity as mutually agreed to by CFM and Southwest, to support the Firm Aircraft. CFM agrees to sell to Southwest up to twenty (20) such spare engines with a rating of 22,000 lbs. at the 20,000 lb. price level as set forth in Attachment II to Amendment No. 7 to the GTA, escalated, as defined in Amendment No. 7 to the GTA, to the delivery date of each respective spare engine, such delivery to occur no later than December 31, 2003.

=====

CFM INTERNATIONAL INCORPORATED a joint company of SNECMA (FRANCE) and GENERAL ELECTRIC Company (U.S.A.)  
CINCINNATI, OHIO 45215-0514 \* p.o.b. 15514 \* Tel: (513)563-4180 \* Tlx: 212078 GE AEG

LETTER AGREEMENT NO. 11  
Southwest Airlines Co.  
Page 2

B. Maximum Climb Thrust Increase Allowance

CFM will provide Southwest a per-engine allowance equal to the net invoice price of the appropriate Max Climb Thrust Increase identified in Attachment II to Amendment No. 7 to the GTA for each spare engine purchased from CFM by Southwest in support of the Aircraft.

C. Compensation for Additional Thrust  
-----

The engine model designation specified for all of the 737-700 aircraft and spare engines in support thereof reflects intended use and application by Southwest of the thrust ratings authorized for such engine model by the certification nameplate affixed to it. Additional compensation to CFM shall be made by Southwest for use or application of the engine at a higher thrust level model designation. For example, except as set forth in paragraph A above, additional compensation for engines purchased at the 20,000 lb. thrust level under the pricing set forth in Attachment II to Amendment No. 7 to the GTA but used by Southwest for up to 20,000 lb. thrust shall be the price difference between the 20,000 lb. engine model specified in such Attachment II and the 22,000 lb. engine model specified therein, escalated to the time the 20,000 lb. thrust level is exceeded. Any hardware modification required to effect the higher thrust model designation is not included in this compensation and shall be quoted separately. The price of additional thrust usage beyond 22,000 lbs. shall be as quoted by CFM.

The terms of this Letter Agreement No. 11 are subject to the conditions set forth in Attachment I hereto.

The obligations set forth in this Letter Agreement No. 11 are in addition to the obligations set forth in the GTA.

Please indicate your agreement with the foregoing by signing the original and one (1) copy in the space provided below.

Very truly yours,

SOUTHWEST AIRLINES CO.

CFM INTERNATIONAL, INC.

By: /s/ Gary A. Barron  
-----

By: /s/ Gilbert R. Eckler  
-----

Typed Name: Gary A. Barron  
-----

Typed Name: Gilbert R. Eckler  
-----

Title: Executive V.P. - COO  
-----

Title: Director Airline Sales  
-----

Date: January 19, 1994  
-----

Date: January 19, 1994  
-----

ATTACHMENT I  
-----

CONDITIONS FOR DELAY/CANCELLATION OF SPARE ENGINES  
-----

1. Cancellation of Spare Engines  
-----

In the event Southwest cancels any purchase order for, or otherwise fails to take delivery of, spare CFM engine(s), the parties agree that harm or damage will be sustained by CFM as a result. The parties agree that if written notice of cancellation is not received at least 12 months prior to the scheduled delivery date of a spare engine to Southwest, any cancellation or failure to accept delivery thereafter will subject Southwest to a cancellation charge of 10% of the spare engine price (determined as of the date of scheduled engine delivery) which the parties acknowledge to be a reasonable estimate of the harm or damage to CFM.

CFM shall retain any engine progress payments or other deposits (not to exceed 10% as noted above) made to CFM for such cancelled engine, and such progress payments will be applied to the above-described liquidated damages.

2. Delay Charge for Spare Engines.  
-----

In the event Southwest delays the scheduled delivery date of a spare engine for which CRFM has received a purchase order from Southwest, for a period, or cumulative period, of more than 24 months, such delay shall be considered a cancellation, and the applicable provisions hereof regarding the effect of cancellation shall apply.

Supplemental Agreement No. 17

to

Purchase Agreement No. 1405

between

The Boeing Company

and

SOUTHWEST AIRLINES CO.

Relating to Boeing Model 737 Aircraft

THIS SUPPLEMENTAL AGREEMENT, entered into as of the 8th day of June, 1994, by and between THE BOEING COMPANY, a Delaware corporation (hereinafter called Boeing), and SOUTHWEST AIRLINES CO., a Texas corporation with its principal office in the City of Dallas, State of Texas, (hereinafter called Buyer);

W I T N E S S E T H:

- - - - -

WHEREAS, the parties hereto entered into that certain Purchase Agreement No. 1405, dated July 23, 1987, relating to the purchase and sale of certain Boeing Model 737 aircraft (the "Aircraft"), which agreement, as amended, together with all exhibits and specifications attached thereto and made a part thereof, is hereinafter called the "Purchase Agreement;" and

WHEREAS, Buyer has agreed to purchase twelve (12) additional aircraft delivering in 1995 and 1996;

NOW THEREFORE, in consideration of the mutual covenants herein contained, the parties hereto agree as follows:

S17-1

1. Article 1, entitled "Subject Matter of Sale" is deleted in its entirety and replaced by the following new Article 1:

ARTICLE 1. Subject Matter of Sale.  
-----

ARTICLE 1. Subject Matter of Sale.  
-----

Subject to the provisions of this Agreement, Boeing shall sell and deliver to Buyer, and Buyer shall purchase from Boeing eighteen (18) Boeing Model 737-5H4 aircraft (hereinafter sometimes referred to as the "Block A and Block B" Aircraft) to be manufactured by Boeing in accordance with Boeing Detail Specification D6-38500-3 (which includes CFM International, Inc. CFM56-3-B1 engines), dated July 23, 1987 (as described in Exhibit A attached to the Purchase Agreement), twenty-three (23) Boeing Model 737-3H4 Aircraft (hereinafter sometimes referred to as the Block C-1 and Block D-1 Substitute Aircraft) to be manufactured by Boeing in accordance with Boeing Detail Specification D6-76300-2 Rev. T (which includes CFM International, Inc. CFM56-3-B1 engines), dated September 19, 1989 (as described in Exhibit A-1 attached to the Purchase Agreement), seven (7) Boeing Model 737-5H4 aircraft (hereinafter sometimes referred to as the "Block C Aircraft") to be manufactured by Boeing in accordance with Boeing Detail Specification D6-38500-3 (which includes CFM International, Inc. CFM56-3-B1 engines), dated June 7, 1989, thirty-four (34) Model 737-3H4 aircraft (hereinafter referred to as the "Block E Aircraft" to be manufactured by Boeing in accordance with Boeing Detail Specification D6-76300-2 Rev. W (which includes CFM International, Inc. CFM56-3-B1 engines) dated May 22, 1992, (as described in Exhibit A-2 attached to the Purchase Agreement), three (3) Model 737-3H4 aircraft (hereinafter referred to as the "Block F Aircraft") to be manufactured by Boeing in accordance with Boeing Detail Specification D6-76300-2 Rev. X (which includes CFM International, Inc. CFM56-3-B1 engines) dated February 26, 1993, (as described in Exhibit A-3 attached to the Purchase Agreement) and twelve (12) Model 737-3H4 aircraft (hereinafter referred to as the "Block G Aircraft") to be manufactured by Boeing in accordance with Boeing Detail Specification D6-76300-2 Rev. Z (which includes CFM International, Inc.

CFM56-3-B1 engines) dated February 15, 1994 (as further described in Exhibit A-4 attached to the Purchase Agreement) as such Detail Specifications may be modified from time to time in accordance with the terms and conditions of Article 7 herein. Such Detail Specifications as so modified are by this reference incorporated in this Agreement and are hereinafter referred to as the "Detail Specification." In connection with the sale and purchase of the Aircraft, Boeing shall also deliver to Buyer such other things as may be required by this Agreement including data, documents,

S17-2

training and services. All Block A, Block B, Block C, Block C-1 Substitute, Block D-1 Substitute, Block E, Block F and Block G Aircraft are referred to individually and collectively as the "Aircraft" or "AIRCRAFT."

2. Article 2.1, entitled "Time of Delivery" is deleted in its entirety  
-----  
and replaced by the following new article 2.1 which adds the Block G Aircraft:

2.1 Time of Delivery. Each Aircraft shall be delivered to Buyer  
-----  
assembled and ready for flight, and Buyer shall accept delivery of such Aircraft, during the months set forth in the following schedule or such earlier months as mutually agreed between Boeing and Buyer:

<TABLE>  
<CAPTION>

| Month and Year<br>of Delivery<br>----- |                                           | Quantity of Aircraft<br>----- |
|----------------------------------------|-------------------------------------------|-------------------------------|
|                                        | Block A<br>-----                          | <C>                           |
| <S>                                    |                                           |                               |
| February 1990                          |                                           | One (1)                       |
| March 1990                             |                                           | Two (2)                       |
| April 1990                             |                                           | Two (2)                       |
| May 1990                               |                                           | One (1)                       |
| August 1990                            |                                           | Two (2)                       |
| September 1990                         |                                           | Two (2)                       |
| May 1991                               |                                           | Two (2)                       |
| September 1991                         |                                           | One (1)                       |
|                                        | Block B<br>-----                          |                               |
| February 1991                          |                                           | One (1)                       |
| May 1991                               |                                           | Two (2)                       |
| September 1991                         |                                           | Two (2)                       |
|                                        | Block C<br>-----                          |                               |
| February 1992                          |                                           | Three (3)                     |
| May 1992                               |                                           | Four (4)                      |
|                                        | Block C-1<br>Substitute Aircraft<br>----- |                               |
| June 1992                              |                                           | Two (2)                       |
| July 1992                              |                                           | One (1)                       |
| February 1993                          |                                           | Three (3)                     |
| May 1993                               |                                           | Four (4)                      |
| August 1993                            |                                           | Two (2)                       |
| September 1993                         |                                           | One (1)                       |

</TABLE>

S17-3

<TABLE>  
<CAPTION>

|                |                                           |           |
|----------------|-------------------------------------------|-----------|
|                | Block D-1<br>Substitute Aircraft<br>----- |           |
| <S>            |                                           | <C>       |
| February 1994  |                                           | Three (3) |
| May 1994       |                                           | Four (4)  |
| September 1994 |                                           | Three (3) |
|                | Block F Aircraft<br>-----                 |           |
| July 1994      |                                           | Two (2)   |
| September 1994 |                                           | One (1)   |

Block E Aircraft

|                |           |
|----------------|-----------|
| January 1995   | Two (2)   |
| April 1995     | Three (3) |
| May 1995       | Two (2)   |
| September 1995 | Two (2)   |
| October 1995   | Three (3) |
| March 1996     | Two (2)   |
| April 1996     | Three (3) |
| May 1996       | Two (2)   |
| July 1996      | Two (2)   |
| August 1996    | One (1)   |
| September 1996 | Two (2)   |
| January 1997   | Four (4)  |
| June 1997      | Four (4)  |
| August 1997    | Two (2)   |

Block G Aircraft

|                |           |
|----------------|-----------|
| July 1995      | Two (2)   |
| August 1995    | Two (2)   |
| September 1995 | Two (2)   |
| January 1996   | Three (3) |
| March 1996     | One (1)   |
| June 1996      | Two (2)   |

</TABLE>

3. Article 3.1, entitled "Basic Price" is deleted in its entirety and  
-----  
replaced by the following new article 3.1 which adds the Basic Price for the  
Block G Aircraft:

3.1 Basic Price. The basic price of each Aircraft shall be equal to  
-----

the sum of (i) Twenty Million Five Hundred Seventy-Three Thousand One Hundred  
Twenty-Six Dollars (\$20,573,126) for the Block A and Block B Aircraft, Twenty  
Million, Six Hundred Three Thousand, Seven Hundred Twenty-Six Dollars  
(\$20,603,726) for the Block C Aircraft, Twenty-Three Million Seven Hundred  
Forty-One Thousand Eight Hundred Seventy-Six Dollars (\$23,741,876) for the Block  
C-1 Substitute Aircraft, Twenty-Three Million, Eight Hundred Eighty Thousand One  
Hundred Seventy-Six Dollars (\$23,880,176) for the Block D-1 Substitute Aircraft,

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Twenty-Nine Million Five Hundred Seventy-Three Thousand One Hundred Seventy-  
Eight Dollars (\$29,573,178) for the Block E Aircraft, Thirty Million Three  
Hundred Three Thousand Six Hundred Seventy-Eight Dollars (\$30,303,678) for the  
Block F Aircraft and Thirty-One Million Six Hundred Twenty-Eight Thousand Eight  
Hundred Sixty-Six Dollars (\$31,628,866) for the Block G Aircraft, and (ii) such  
price adjustments applicable to such Aircraft as may be made pursuant to the  
provisions of this Agreement, including Article 7 (changes to Detail  
Specification) and Article 8 (FAA Requirements) or other written agreements  
executed by Buyer and Boeing.

4. Article 5.1, entitled "Advance Payment Base Price" is revised by  
inserting after the Block F Aircraft the following:

<TABLE>  
<CAPTION>

Block G Aircraft

| Month and Year of<br>Scheduled Delivery<br>----- | Advance Payment Base<br>Price per Aircraft<br>----- |
|--------------------------------------------------|-----------------------------------------------------|
| <S>                                              | <C>                                                 |
| July 1995                                        | \$33,455,000                                        |
| August 1995                                      | \$33,550,000                                        |
| September 1995                                   | \$33,639,000                                        |
| January 1996                                     | \$34,026,000                                        |
| March 1996                                       | \$34,349,000                                        |
| June 1996                                        | \$34,914,000                                        |

</TABLE>

5. Article 5.2, entitled "Advance Payment Schedule" is revised by  
inserting after the Block F Aircraft the following schedules for the Block G  
Aircraft:

<TABLE>  
<CAPTION>

Amount Due per Aircraft

| Due Date of Payment<br>-----                                                           | Block G 1995 Aircraft<br>----- |
|----------------------------------------------------------------------------------------|--------------------------------|
| <S><br>Upon execution of Supplemental<br>Agreement No. 17                              | <C><br>15%                     |
| 12 months prior to the first<br>day of the scheduled delivery<br>month of the Aircraft | 5%                             |
| 9 months prior to the first<br>day of the scheduled delivery<br>month of the Aircraft  | 5%                             |
| 6 months prior to the first<br>day of the scheduled delivery<br>month of the Aircraft  | 5%<br>---                      |
| Total                                                                                  | 30%                            |

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<TABLE>  
<CAPTION>

| Due Date of Payment<br>-----                                                           | Amount Due per Aircraft<br>Block G January and March 1996 Aircraft<br>----- |
|----------------------------------------------------------------------------------------|-----------------------------------------------------------------------------|
| <S><br>Upon execution of Supplemental<br>Agreement No. 17                              | <C><br>10%                                                                  |
| 18 months prior to the first<br>day of the scheduled delivery<br>month of the Aircraft | 5%                                                                          |
| 12 months prior to the first<br>day of the scheduled delivery<br>month of the Aircraft | 5%                                                                          |
| 9 months prior to the first<br>day of the scheduled delivery<br>month of the Aircraft  | 5%                                                                          |
| 6 months prior to the first<br>day of the scheduled delivery<br>month of the Aircraft  | 5%<br>---                                                                   |
| Total                                                                                  | 30%                                                                         |

<CAPTION>

| Due Date of Payment<br>-----                                                           | Block G June 1996 Aircraft<br>----- |
|----------------------------------------------------------------------------------------|-------------------------------------|
| <S><br>Upon execution of Supplemental<br>Agreement No. 17                              | <C><br>5%                           |
| 21 months prior to the first<br>day of the scheduled delivery<br>month of the Aircraft | 5%                                  |
| 18 months prior to the first<br>day of the scheduled delivery<br>month of the Aircraft | 5%                                  |
| 12 months prior to the first<br>day of the scheduled delivery<br>month of the Aircraft | 5%                                  |
| 9 months prior to the first<br>day of the scheduled delivery<br>month of the Aircraft  | 5%                                  |
| 6 months prior to the first<br>day of the scheduled delivery<br>month of the Aircraft  | 5%<br>---                           |

Total 30%

</TABLE>

S17-6

6. The first sentence in Article 7.3.2 is revised to be written as "The Block E, F and G Aircraft."

7. A new Exhibit A-4, entitled "Aircraft Configuration - the Block G Aircraft," attached hereto, is incorporated into the Purchase Agreement by this reference.

8. A new Exhibit D-3, entitled "Airframe and Engine Price Adjustment - the Block G Aircraft" attached hereto, is incorporated into the Purchase Agreement by this reference.

9. Letter Agreement No. 6-1162-STE-1364 entitled "Additional Contractual Matters" is revised by inserting a new article 2.5 as follows:

"2.4 Block G Aircraft

At time of delivery of each of the Block G Aircraft, Boeing will provide a credit memorandum in the amount of \$7,500,000."

10. Boeing and Buyer agree that the provisions of Letter Agreement No. 6-1162-STE-1363, dated July 23, 1987, shall apply to paragraph 9 of this Supplemental Agreement.

The Purchase Agreement shall be deemed to be supplemented to the extent herein provided and as so supplemented shall continue in full force and effect.

EXECUTED IN DUPLICATE as of the day and year first above written.

THE BOEING COMPANY

SOUTHWEST AIRLINES CO.

By: /s/ R. Leo Lyons

By: /s/ Gary A. Barron

Its: Attorney-In-Fact

Its: Executive V.P. & COO

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EXHIBIT A-4

to

PURCHASE AGREEMENT NO. 1405

Dated \_\_\_\_\_

between

THE BOEING COMPANY

and

SOUTHWEST AIRLINES CO.

AIRCRAFT CONFIGURATION

BLOCK G AIRCRAFT

MODEL 737-3H4

The Detail Specification, referred to in Article 1 of the Purchase Agreement, is Boeing Detail Specification D6-76300-2 Revision Z dated February 15, 1994, as amended to incorporate the applicable specification language to reflect the effect of the changes set forth in the Master Changes listed below,

including the effects of such changes on Manufacturer's Empty Weight (MEW) and Operating Empty Weight (OEW). As soon as practicable, Boeing will furnish to Buyer copies of the Detail Specification, which copies will reflect the effect of such changes. The Aircraft Basic Price reflects and includes all effects of such changes of price.

A-4-8

Exhibit A-4 to  
Purchase Agreement No. 1405  
Page 2

<TABLE>  
<CAPTION>

| CHANGE REQUEST<br>NO./TITLE<br>-----              | PRICE PER<br>AIRCRAFT<br>(1993 STE \$)<br>----- |
|---------------------------------------------------|-------------------------------------------------|
| <S>                                               | <C>                                             |
| 2320MP3016<br>ATSCAL Installation                 | \$7,100                                         |
| 2523MP3102<br>Bilingual Placard Installation      | N/C                                             |
| 3040MP3033<br>Window Heat Control Unit P/N 1231-1 | N/C                                             |

</TABLE>

A-4-2

AIRFRAME AND ENGINE PRICE ADJUSTMENT

between

THE BOEING COMPANY

and

Southwest Airlines Co.

Exhibit D-3 to Purchase Agreement Number 1405

D-3

Exhibit D-3  
Page 1

PRICE ADJUSTMENT DUE TO  
-----  
ECONOMIC FLUCTUATIONS  
-----  
AIRFRAME PRICE ADJUSTMENT  
-----  
(July 1993 Base Price)  
-----  
  
The Block G Aircraft  
-----

1. Formula.

The Airframe Price Adjustment will be determined at the time of Aircraft delivery in accordance with the following formula:

$$Pa = (P) (L + M - 1)$$

Where:

Pa = Airframe Price Adjustment.

$$L = .65 \times \frac{ECI}{123.7}$$

$$M = .35 \times \frac{ICI}{118.3}$$

P = Aircraft Basic Price (as set forth in Article 3.2 of this Agreement) less the base price of Engines (as defined in this Exhibit D-3) in the amount of \$6,154,566.

ECI = A value using the "Employment Cost Index for workers in aerospace manufacturing" (aircraft manufacturing, standard industrial classification code 3721, compensation, base month and year June 1989 = 100), as released by the Bureau of Labor Statistics, U.S. Department of Labor on a quarterly basis for the months of March, June, September and December, calculated as follows: A three-month arithmetic average value (expressed as a decimal and rounded to the nearest tenth) will be determined using the months set forth in the table below for the applicable Aircraft, with the released Employment Cost Index value described above for the month of March also being used for the months of January and February; the value for June also used for April and May; the value for September also used for July and August; and the value for December also used for October and November.

Exhibit D-3  
Page 2

ICI = The three-month arithmetic average of the released monthly values for the Industrial Commodities Index as set forth in the "Producer Prices and Price Index" (Base Year 1982 = 100) as released by the Bureau of Labor Statistics, U.S. Department of Labor values (expressed as a decimal and rounded to the nearest tenth) for the months set forth in the table below for the applicable Aircraft.

In determining the value of L, the ratio of ECI divided by 123.7 will be expressed as a decimal rounded to the nearest ten-thousandth and then multiplied by .65 with the resulting value also expressed as a decimal and rounded to the nearest ten-thousandth.

In determining the value of M, the ratio of ICI divided by 118.3 will be expressed as a decimal rounded to the nearest ten-thousandth and then multiplied by .35 with the resulting value also expressed as a decimal and rounded to the nearest ten-thousandth.

<TABLE>  
<CAPTION>

| Month of Scheduled Aircraft Delivery | Months to be Utilized in Determining the Value of ECI and ICI |
|--------------------------------------|---------------------------------------------------------------|
| <S>                                  | <C>                                                           |
| January                              | June B, July B, Aug. B                                        |
| February                             | July B, Aug. B, Sept. B                                       |
| March                                | Aug. B, Sept. B, Oct. B                                       |
| April                                | Sept. B, Oct. B, Nov. B                                       |
| May                                  | Oct. B, Nov. B, Dec. B                                        |
| June                                 | Nov. B, Dec. B, Jan. D                                        |
| July                                 | Dec. B, Jan. D, Feb. D                                        |
| August                               | Jan. D, Feb. D, Mar. D                                        |
| September                            | Feb. D, Mar. D, Apr. D                                        |
| October                              | Mar. D, Apr. D, May D                                         |
| November                             | Apr. D, May D, June D                                         |
| December                             | May D, June D, July D                                         |

The following definitions of B and D will apply:

B = The calendar year before the year in which the scheduled month of delivery as set forth in Article 2.1 occurs.

D = The calendar year during which the scheduled month of delivery as set forth in Article 2.1 occurs.

Exhibit D  
Page 3

2. If at the time of delivery of an Aircraft Boeing is unable to determine the Airframe Price Adjustment because the applicable values to be used to determine the ECI and ICI have not been released by the Bureau of Labor Statistics, then:

2.1 The Airframe Price Adjustment, to be used at the time of delivery of each of the Aircraft, will be determined by utilizing the escalation provisions set forth above. The values released by the Bureau of Labor Statistics and available to Boeing 30 days prior to scheduled Aircraft delivery will be used to determine the ECI and ICI values for the applicable months (including those noted as preliminary by the Bureau of Labor Statistics) to calculate the Airframe Price Adjustment. If no values have been released for an applicable month, the provisions set forth in Paragraph 2.2 below will apply. If prior to delivery of an Aircraft the U.S. Department of Labor changes the base year for determination of the ECI or ICI values as defined above, such rebased values will be incorporated in the Airframe Price Adjustment calculation. The payment by Buyer to Boeing of the amount of the Purchase Price for such Aircraft, as determined at the time of Aircraft delivery, will be deemed to be the payment for such Aircraft required at the delivery thereof.

2.2 If prior to delivery of an Aircraft the U.S. Department of Labor substantially revises the methodology used for the determination of the values to be used to determine the ECI and ICI values (in contrast to benchmark adjustments or other corrections of previously released values), or for any reason has not released values needed to determine the applicable Aircraft Airframe Price Adjustment, the parties will, prior to delivery of any such Aircraft, select a substitute for such values from data published by the Bureau of Labor Statistics or other similar data reported by non-governmental United States organizations, such substitute to lead in application to the same adjustment result, insofar as possible, as would have been achieved by continuing the use of the original values as they may have fluctuated during the applicable time period. Appropriate revision of the formula will be made as required to reflect any substitute values. However, if within 24 months from delivery of the Aircraft the Bureau of Labor Statistics should resume releasing values for the months needed to determine the Airframe Price Adjustment, such values will be used to determine any increase or decrease in the Airframe Price Adjustment for the Aircraft from that determined at the time of delivery of such Aircraft.

Exhibit D-3

Page 4

2.3 In the event escalation provisions are made non-enforceable or otherwise rendered null and void by any agency of the United States Government, the parties agree, to the extent they may lawfully do so, to equitably adjust the Purchase Price of any affected Aircraft to reflect an allowance for increases or decreases in labor compensation and material costs occurring since February, 1993, which is consistent with the applicable provisions of paragraph 1 of this Exhibit D-3.

3. For the calculations herein, the values released by the Bureau of Labor Statistics and available to Boeing 30 days prior to scheduled Aircraft delivery will be used to determine the ECI and ICI values for the applicable months (including those noted as preliminary by the Bureau of Labor Statistics) to calculate the Airframe Price Adjustment.

Note: Any rounding of a number, as required under this Exhibit D-3 with respect to escalation of the airframe price, will be accomplished as follows: if the first digit of the portion to be dropped from the number to be rounded is five or greater, the preceding digit will be raised to the next higher number.

ENGINE PRICE ADJUSTMENT - CFM INTERNATIONAL, INC.

-----  
(1993 BASE PRICE)  
-----

(a) The Aircraft Basic Price of each Aircraft set forth in Article 3.1 of this Agreement includes an aggregate price for CFM56-3-B1 engines and all accessories, equipment and parts therefor provided by the engine manufacturer (collectively in this Exhibit D-3 called "Engines") of Six Million One Hundred Fifty-Four Thousand Five Hundred Sixty-Six Dollars (\$6,154,566). The adjustment in Engine price applicable to each Aircraft ("Engine Price Adjustment" herein) will be determined at the time of Aircraft delivery in accordance with the following formula:

$$D1 = (Pb \times \frac{CPI}{130.51}) - Pb$$

(b) The following definitions will apply herein:

D1 = Engine Price Adjustment

Pb = Aggregate Engine Base Price as set forth in Paragraph (a) above.

CPI = The Composite Price Index as determined in accordance with the formula set forth below. The Index values referred to below, to be used in determining the CPI, will be for the ninth month prior to the month of scheduled Aircraft delivery. Such Index values will be those prepared by the Bureau of Labor Statistics, U.S. Department of Labor.

$$CPI = L + M1 + M2 + M3$$

L = The Labor Index for such month will be the quotient, expressed as a decimal and rounded to the nearest thousandth, of the "Hourly Earnings of Aircraft Engines and Engine Parts Production Workers" SIC 3724, for such month divided by Eleven Dollars and Sixteen Cents (\$11.16). Such quotient will be multiplied by 100 and then by fifty-five percent (55%) with the value resulting from the latter multiplication expressed as a decimal and rounded to the nearest hundredth.

M1 = The Industrial Commodities Index for such month will be equal to ten percent (10%) of the Producer Price Index for "all commodities other than Farm and Foods," Code 3-15, (Base Year 1982 = 100) for such month, expressed as a decimal and rounded to the nearest hundredth.

M2 = The Metals and Metal Products Index for such month will be equal to twenty-five percent (25%) of the Producer Price Index for "Metals and Metal Products," Code 10, (Base Year 1982 = 100) for such month expressed as a decimal and rounded to the nearest hundredth.

M3 = The Fuel Index for such month will be equal to ten percent (10%) of the Producer Price Index for "Fuel and Related Products and Power," Code 5, (Base Year 1982 = 100) for such month expressed as a decimal and rounded to the nearest hundredth.

130.51 = Composite Price Index for October, 1992.

The factor (CPI divided by 130.51) by which the Aggregate Engine Base Price is to be multiplied will be expressed as a decimal and rounded to the nearest thousandth.

The Engine Price Adjustment will not be made if it would result in a decrease in the aggregate Engine base price.

(c) The values of the Average Hourly Earnings and Producer Price Indices used in determining the Engine Price Adjustment will be those published by the Bureau of Labor Statistics, U.S. Department of Labor as of a date 30 days prior to the scheduled Aircraft delivery to Buyer. Such values will be considered final and no Engine Price Adjustment will be made after Aircraft delivery for any subsequent changes in published Index values.

(d) If the U.S. Department of Labor, Bureau of Labor Statistics (i) substantially revises the methodology (in contrast to benchmark adjustments or other corrections of previously published data) or (ii) discontinues publication of any of the data referred to above, CFMI agrees to meet jointly with Boeing and Buyer to jointly select a substitute for the revised or discontinued data; such substitute data to lead in application to the same adjustment result,

insofar as possible, as would have been achieved by continuing the use of the original data as it may have fluctuated had it not been revised or discontinued.

Appropriate revision of the Engine Price Adjustment provisions set forth above will be made to accomplish this result for the affected Engines.

In the event the Engine price escalation provisions are made non-enforceable or otherwise rendered null and void by any agency of the United States Government, CFMI agrees to meet with Boeing and Buyer to jointly agree, to the extent such parties may lawfully do so, to adjust equitably the purchase price of any affected Engine(s) to reflect an allowance for increases in labor, material and fuel costs that have occurred from the period represented by the CPI to the ninth month preceding the month of scheduled delivery of the applicable aircraft.

NOTE: Any rounding of a number, as required under this Exhibit D-3 with respect  
---- to escalation of the Engine price, will be accomplished as follows: if the first digit of the portion to be dropped from the number to be rounded is five or greater, the preceding digit will be raised to the next higher number.

CHANGE ORDER NO. 14

DATED

JUNE 6, 1994

TO

PURCHASE AGREEMENT NO. 1405

BETWEEN

THE BOEING COMPANY

AND

SOUTHWEST AIRLINES

[This paragraph to be filled in by contracts:]  
Purchase Agreement No. 1405, dated September 17, 1987, between The Boeing Company and Southwest Airlines, is hereby amended/ in accordance with Article 7.1 as follows:

I. Changes To Detail Specification D6-76300-2.

The effects of the changes listed below are hereby incorporated into Detail Specification D6-76300 under Revision "AA" dated May 11, 1994 and described in Exhibit A of the Purchase Agreement.

CHANGE NO./TITLE/AFFECTED AIRCRAFT:  
-----

<TABLE>  
<CAPTION>  
MASTER CHANGES  
-----

|            |                                                          |                                   |
|------------|----------------------------------------------------------|-----------------------------------|
| <S>        | <C>                                                      | <C>                               |
| 2320MP3016 | ATSCAL Installation                                      | 32 Block E Aircraft               |
| 2523MP3102 | Installation of Bilingual Placards - Courtesy Signs Only | PS779-PS780 & 32 Block E Aircraft |
| 3040MP3033 | PED Window Heat Control Unit P/N 1231-1                  | 22 Block E Aircraft               |

</TABLE>

<TABLE>  
<CAPTION>

|                           | Affected Aircraft | MEW lbs. | OEW lbs. |
|---------------------------|-------------------|----------|----------|
| Cumulative Weight Effect: | -----             | ----     | ----     |

|                                                                                                                                                                                                 |                                    |          |          |
|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|------------------------------------|----------|----------|
| <S>                                                                                                                                                                                             | <C>                                | <C>      | <C>      |
| The cumulative effect of the foregoing changes, except Rapid Revisions, on the weight of the affected Model 737-3H4 Aircraft, as reflected in Paragraph 3-60-00 of the Detail Specification is: | PS779-PS780<br>32 Block E Aircraft | +4<br>+4 | +4<br>+4 |

</TABLE>

II. Effect of Changes on Purchase Agreement No. 1510.

-----  
The effects of the foregoing changes, except Rapid Revisions, on the scheduled month of delivery, Aircraft Basic Price and Advance Payment Base Price of each affected Aircraft, as described in Articles 2 and 3. respectively, of the Purchase Agreement, are set forth below:

<TABLE>  
<CAPTION>

| Affected Aircraft | Effect On Delivery Month (Art.2)\$ | Effect On Basic Price Per Aircraft \$Aircraft(Art.3) |
|-------------------|------------------------------------|------------------------------------------------------|
| -----             | -----                              | -----                                                |
| <S>               | <C>                                | <C>                                                  |
| PS779-780         | None                               | \$ 6,500 increase                                    |

32 Block E                      None                      \$13,100 increase  
</TABLE>

SIGNED as of the day and year first above written.

THE BOEING COMPANY                      SOUTHWEST AIRLINES

By /s/ R. Leo Lyons                      By /s/ Gary A. Barron  
-----

Title Attorney - In - Fact                      Title Executive V.P. & CO  
-----

WEIGHT AND PRICE TABULATION

CHANGE ORDER NO. 14

TO

PURCHASE AGREEMENT NO. 1405

SOUTHWEST AIRLINES

MODEL 737-3H4 AIRCRAFT

<TABLE>  
<CAPTION>

|     | Change<br>Number<br>----- | Affected<br>Aircraft<br>----- | MEW<br>lbs<br>--- | OEW<br>lbs<br>--- | Basic Price<br>per Aircraft<br>1991 ECI \$<br>----- |
|-----|---------------------------|-------------------------------|-------------------|-------------------|-----------------------------------------------------|
| <S> |                           | <C>                           | <C>               | <C>               | <C>                                                 |

A. Master Changes  
-----

|    |            |                           |    |    |         |
|----|------------|---------------------------|----|----|---------|
| 1. | 2320MP3016 | 32 Block E                | +4 | +4 | \$6,600 |
| 2. | 2523MP3102 | PS779-PS780<br>32 Block E | 0  | 0  | N/C     |
| 3. | 3040MP3033 | 22 Block E                | 0  | 0  | N/C     |

Price Effect only:

|     |            |                         |  |  |       |
|-----|------------|-------------------------|--|--|-------|
| 1.  | 2350MP3021 | PS779-PS880, 32 Block E |  |  | 1,400 |
| 2.  | 2520MP3196 | PS779-PS880, 32 Block E |  |  | 1,900 |
| 3.  | 2525MP3008 | PS779-PS880, 32 Block E |  |  | N/C   |
| 4.  | 2530MP3212 | PS779-PS880, 32 Block E |  |  | 1,400 |
| 5.  | 3131MP3368 | PS779-PS880, 32 Block E |  |  | N/C   |
| 6.  | 3131MP3445 | PS779-PS880, 32 Block E |  |  | IB    |
| 7.  | 3131MP3471 | PS779-PS880, 32 Block E |  |  | N/C   |
| 8.  | 3443MP3070 | PS779-PS880, 32 Block E |  |  | 1,800 |
| 9.  | 3445MP3002 | PS779-PS880, 32 Block E |  |  | IB    |
| 10. | 3445MP3036 | PS779-PS880, 32 Block E |  |  | IB    |

|  | Affected<br>Aircraft<br>----- | MEW<br>lbs.<br>---- | OEW<br>lbs.<br>---- | Basic price<br>per Aircraft<br>1991 ECI \$<br>----- |
|--|-------------------------------|---------------------|---------------------|-----------------------------------------------------|
|--|-------------------------------|---------------------|---------------------|-----------------------------------------------------|

|               |    |  |       |        |
|---------------|----|--|-------|--------|
| Totals:       |    |  |       |        |
| PS779-PS780 0 | 0  |  | 6,500 |        |
| 32 Block E    | +4 |  | +4    | 13,100 |

</TABLE>

CHANGE SUMMARY

DEVELOPMENT CHANGE NO.25

DETAIL SPECIFICATION D6-76300-2

SOUTHWEST AIRLINES

MODEL 737-3H4 AIRCRAFT

1. Coffee Makers

Appendix II, Galley 1 and Galley 4, is revised to reflect the correct part number and effectivity in accordance with Boeing Telex number R-7200-9401507,

dated April 1, 1994, for Aircraft PS766 and on.

2. Miscellaneous Revisions

- Paragraph 1-60 is updated to reflect current airplanes and identification.
- Figure 1-4 is revised to reflect the accurate armrest orientation.
- Appendix I, Chapter 21, the effectivity of the Nord Micro part numbers is revised to reflect the accurate incorporation.
- The entire Detail Specification has been revised to our standard format.

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Supplemental Agreement No. 18

to

Purchase Agreement No. 1405

between

The Boeing Company

and

SOUTHWEST AIRLINES CO.

Relating to Boeing Model 737 Aircraft

THIS SUPPLEMENTAL AGREEMENT, entered into as of the 13th day of July, 1994, by and between THE BOEING COMPANY, a Delaware corporation (hereinafter called Boeing), and SOUTHWEST AIRLINES CO., a Texas corporation with its principal office in the City of Dallas, State of Texas, (hereinafter called Buyer);

W I T N E S S E T H:

- - - - -

WHEREAS, the parties hereto entered into that certain Purchase Agreement No. 1405, dated July 23, 1987, relating to the purchase and sale of certain Boeing Model 737 aircraft (the "Aircraft"), which agreement, as amended, together with all exhibits and specifications attached thereto and made a part thereof, is hereinafter called the "Purchase Agreement;" and

WHEREAS, Buyer has agreed to purchase four (4) additional aircraft delivering in February 1995 and to revise the delivery month of two (2) aircraft from January 1995 to November 1994;

NOW THEREFORE, in consideration of the mutual covenants herein contained, the parties hereto agree as follows:

S18-7

1. Article 1, entitled "Subject Matter of Sale" is deleted in its entirety

-----

and replaced by the following new Article 1:

ARTICLE 1. Subject Matter of Sale.

-----

ARTICLE 1. Subject Matter of Sale.

-----

Subject to the provisions of this Agreement, Boeing shall sell and deliver to Buyer, and Buyer shall purchase from Boeing eighteen (18) Boeing Model 737-5H4 aircraft (hereinafter sometimes referred to as the "Block A and Block B" Aircraft) to be manufactured by Boeing in accordance with Boeing Detail Specification D6-38500-3 (which includes CFM International, Inc. CFM56-3-B1 engines), dated July 23, 1987 (as described in Exhibit A attached to the Purchase Agreement), twenty-three (23) Boeing Model 737-3H4 Aircraft (hereinafter sometimes referred to as the Block C-1 and Block D-1 Substitute Aircraft) to be manufactured by Boeing in accordance with Boeing Detail Specification D6-76300-2 Rev. T (which includes CFM International, Inc. CFM56-3-B1 engines), dated September 19, 1989 (as described in Exhibit A-1 attached to the Purchase Agreement), seven (7) Boeing Model 737-5H4 aircraft (hereinafter sometimes referred to as the "Block C Aircraft) to be manufactured by Boeing in accordance with Boeing Detail Specification D6-38500-3 (which includes CFM International, Inc. CFM56-3-B1 engines), dated June 7, 1989, thirty-four (34) Model 737-3H4 aircraft (hereinafter referred to as the "Block E Aircraft" to be

manufactured by Boeing in accordance with Boeing Detail Specification D6-76300-2 Rev. W (which includes CFM International, Inc. CFM56-3-B1 engines) dated May 22, 1992, (as described in Exhibit A-2 attached to the Purchase Agreement), three (3) Model 737-3H4 aircraft (hereinafter referred to as the "Block F Aircraft") to be manufactured by Boeing in accordance with Boeing Detail Specification D6-76300-2 Rev. X (which includes CFM International, Inc. CFM56-3-B1 engines) dated February 26, 1993, (as described in Exhibit A-3 attached to the Purchase Agreement), twelve (12) Model 737-3H4 aircraft (hereinafter referred to as the "Block G Aircraft") to be manufactured by Boeing in accordance with Boeing Detail Specification D6-76300-2 Rev. Z (which includes CFM International, Inc. CFM56-3-B1 engines) dated February 15, 1994 (as further described in Exhibit A-4 attached to the Purchase Agreement) and four (4) Model 737-3H4 aircraft (hereinafter referred to as the "Block H Aircraft") to be manufactured by Boeing in accordance with Boeing Detail Specification D6-76300-2 Rev. Z (which includes CFM International, Inc. CFM56-3-B1 engines) dated February 15, 1994 (as further described in Exhibit A-5 attached to the Purchase Agreement) and as such Detail Specifications may be modified from time to time in accordance with the terms and conditions of Article 7

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herein. Such Detail Specifications as so modified are by this reference incorporated in this Agreement and are hereinafter referred to as the "Detail Specification." In connection with the sale and purchase of the Aircraft, Boeing shall also deliver to Buyer such other things as may be required by this Agreement including data, documents, training and services. All Block A, Block B, Block C, Block C-1 Substitute, Block D-1 Substitute, Block E, Block F, Block G and Block H Aircraft are referred to individually and collectively as the "Aircraft" or "AIRCRAFT."

2. Article 2.1, entitled "Time of Delivery" is deleted in its entirety and replaced by the following new article 2.1 which revises the contract delivery month of the January 1995 aircraft to November 1994 and adds the Block H Aircraft:

2.1 Time of Delivery. Each Aircraft shall be delivered to Buyer assembled and ready for flight, and Buyer shall accept delivery of such Aircraft, during the months set forth in the following schedule or such earlier months as mutually agreed between Boeing and Buyer:

<TABLE>  
<CAPTION>

| Month and Year<br>of Delivery<br>----- | Quantity of Aircraft<br>----- |
|----------------------------------------|-------------------------------|
| Block A<br>-----                       |                               |
| <S>                                    | <C>                           |
| February 1990                          | One (1)                       |
| March 1990                             | Two (2)                       |
| April 1990                             | Two (2)                       |
| May 1990                               | One (1)                       |
| August 1990                            | Two (2)                       |
| September 1990                         | Two (2)                       |
| May 1991                               | Two (2)                       |
| September 1991                         | One (1)                       |
| Block B<br>-----                       |                               |
| February 1991                          | One (1)                       |
| May 1991                               | Two (2)                       |
| September 1991                         | Two (2)                       |
| Block C<br>-----                       |                               |
| February 1992                          | Three (3)                     |
| May 1992                               | Four (4)                      |

</TABLE>

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<TABLE>  
<CAPTION>

Block C-1  
Substitute Aircraft  
-----

|                |           |
|----------------|-----------|
| <S>            | <C>       |
| June 1992      | Two (2)   |
| July 1992      | One (1)   |
| February 1993  | Three (3) |
| May 1993       | Four (4)  |
| August 1993    | Two (2)   |
| September 1993 | One (1)   |

Block D-1  
Substitute Aircraft

|                |           |
|----------------|-----------|
| February 1994  | Three (3) |
| May 1994       | Four (4)  |
| September 1994 | Three (3) |

Block F Aircraft

|                |         |
|----------------|---------|
| July 1994      | Two (2) |
| September 1994 | One (1) |

Block E Aircraft

|                |           |
|----------------|-----------|
| November 1994  | Two (2)   |
| April 1995     | Three (3) |
| May 1995       | Two (2)   |
| September 1995 | Two (2)   |
| October 1995   | Three (3) |
| March 1996     | Two (2)   |
| April 1996     | Three (3) |
| May 1996       | Two (2)   |
| July 1996      | Two (2)   |
| August 1996    | One (1)   |
| September 1996 | Two (2)   |
| January 1997   | Four (4)  |
| June 1997      | Four (4)  |
| August 1997    | Two (2)   |

Block G Aircraft

|                |           |
|----------------|-----------|
| July 1995      | Two (2)   |
| August 1995    | Two (2)   |
| September 1995 | Two (2)   |
| January 1996   | Three (3) |
| March 1996     | One (1)   |
| June 1996      | Two (2)   |

Block H Aircraft

|               |          |
|---------------|----------|
| February 1995 | Four (4) |
|---------------|----------|

</TABLE>

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3. Article 3.1, entitled "Basic Price" is deleted in its entirety and replaced by the following new article 3.1 which adds the Basic Price for the Block H Aircraft:

3.1 Basic Price. The basic price of each Aircraft shall be equal to

the sum of (i) Twenty Million Five Hundred Seventy-Three Thousand One Hundred Twenty-Six Dollars (\$20,573,126) for the Block A and Block B Aircraft, Twenty Million, Six Hundred Three Thousand, Seven Hundred Twenty-Six Dollars (\$20,603,726) for the Block C Aircraft, Twenty-Three Million Seven Hundred Forty-One Thousand Eight Hundred Seventy-Six Dollars (\$23,741,876) for the Block C-1 Substitute Aircraft, Twenty-Three Million, Eight Hundred Eighty Thousand One Hundred Seventy-Six Dollars (\$23,880,176) for the Block D-1 Substitute Aircraft, Twenty-Nine Million Five Hundred Seventy-Three Thousand One Hundred Seventy-Eight Dollars (\$29,573,178) for the Block E Aircraft, Thirty Million Three Hundred Three Thousand Six Hundred Seventy-Eight Dollars (\$30,303,678) for the Block F Aircraft, Thirty-One Million Six Hundred Twenty-Eight Thousand Eight Hundred Sixty-Six Dollars (\$31,628,866) for the Block G Aircraft and Thirty-One Million Six Hundred Twenty One Thousand Seven Hundred Sixty Six Dollars (\$31,621,766) for the Block H Aircraft, and (ii) such price adjustments applicable to such Aircraft as may be made pursuant to the provisions of this Agreement, including Article 7 (changes to Detail Specification) and Article 8 (FAA Requirements) or other written agreements executed by Buyer and Boeing.

4. Article 5.1, entitled "Advance Payment Base Price", for the Block E aircraft is revised by deleting the January 1995 aircraft and the associated advance payment base price and inserting the following:

November 1994

\$33,509,000

5. Article 5.1, entitled "Advance Payment Base Price" is revised by

-----  
inserting after the Block G Aircraft the following:

<TABLE>

<CAPTION>

Block H Aircraft

| Month and Year of<br>Scheduled Delivery | Advance Payment Base<br>Price per Aircraft |
|-----------------------------------------|--------------------------------------------|
| -----                                   | -----                                      |

|                      |                     |
|----------------------|---------------------|
| <S><br>February 1995 | <C><br>\$32,692,000 |
|----------------------|---------------------|

</TABLE>

S18-7

6. Article 5.2, entitled "Advance Payment Schedule" is revised by

-----  
inserting after the Block G Aircraft the following schedule for the Block H Aircraft:

<TABLE>

<CAPTION>

| Due Date of Payment | Amount Due per Aircraft<br>Block H Aircraft |
|---------------------|---------------------------------------------|
| -----               | -----                                       |

|                                                           |            |
|-----------------------------------------------------------|------------|
| <S><br>Upon execution of Supplemental<br>Agreement No. 18 | <C><br>25% |
|-----------------------------------------------------------|------------|

|                                                                                       |           |
|---------------------------------------------------------------------------------------|-----------|
| 6 months prior to the first<br>day of the scheduled delivery<br>month of the Aircraft | 5%<br>--- |
|---------------------------------------------------------------------------------------|-----------|

|       |     |
|-------|-----|
| Total | 30% |
|-------|-----|

</TABLE>

7. The title and the first sentence in Article 7.3.2 is revised to be written as "The Block E, F, G and H Aircraft."

8. A new Exhibit A-5, entitled "Aircraft Configuration - the Block H Aircraft," attached hereto, is incorporated into the Purchase Agreement by this reference.

9. Exhibit D-3, entitled "Airframe and Engine Price Adjustment - the Block G Aircraft" is revised by adding "and Block H" after the letter G and before Aircraft in the title on page 1.

10. Letter Agreement No. 6-1162-STE-1364 entitled "Additional Contractual Matters" is revised by adding "and Block H" after the letter G and before Aircraft in the title of Article 2.5 and in the text of Article 2.5.

11. Boeing and Buyer agree that the provisions of Letter Agreement No. 6-1162-STE-1363, dated July 23, 1987, shall apply to paragraph 10 of this Supplemental Agreement.

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The Purchase Agreement shall be deemed to be supplemented to the extent herein provided and as so supplemented shall continue in full force and effect.

EXECUTED IN DUPLICATE as of the day and year first above written.

THE BOEING COMPANY

SOUTHWEST AIRLINES CO.

By: /s/ R. Leo Lyons

By: /s/ Gary A. Barron

S18-7

EXHIBIT A-5

to

PURCHASE AGREEMENT NO. 1405

Dated July 13, 1994

between

THE BOEING COMPANY

and

SOUTHWEST AIRLINES CO.

AIRCRAFT CONFIGURATION

BLOCK H AIRCRAFT

MODEL 737-3H4

The Detail Specification, referred to in Article 1 of the Purchase Agreement, is Boeing Detail Specification D6-76300-2 Revision Z dated February 15, 1994, as amended to incorporate the applicable specification language to reflect the effect of the changes set forth in the Master Changes listed below, including the effects of such changes on Manufacturer's Empty Weight (MEW) and Operating Empty Weight (OEW). As soon as practicable, Boeing will furnish to Buyer copies of the Detail Specification, which copies will reflect the effect of such changes. The Aircraft Basic Price reflects and includes all effects of such changes of price.

A-5-1

Exhibit A-5 to  
Purchase Agreement No. 1405  
Page 2

2523MP3102  
BILINGUAL PLACARD INSTALLATION

N/C

S19-6

Supplemental Agreement No. 19

to

Purchase Agreement No. 1405

between

The Boeing Company

and

SOUTHWEST AIRLINES CO.

Relating to Boeing Model 737 Aircraft

THIS SUPPLEMENTAL AGREEMENT, entered into as of the 21st day of November, 1994, by and between THE BOEING COMPANY, a Delaware corporation (hereinafter called Boeing), and SOUTHWEST AIRLINES CO., a Texas corporation with its principal office in the City of Dallas, State of Texas, (hereinafter called Buyer);

W I T N E S S E T H:  
- - - - -

WHEREAS, the parties hereto entered into that certain Purchase Agreement No. 1405, dated July 23, 1987, relating to the purchase and sale of certain Boeing Model 737 aircraft (the "Aircraft"), which agreement, as amended, together with all exhibits and specifications attached thereto and made a part thereof, is hereinafter called the "Purchase Agreement;" and

WHEREAS, Buyer has agreed to purchase five (5) additional aircraft delivering in July 1995 (1), October 1995 (2) and November 1995 (2) and to revise the delivery month of one (1) aircraft from April 1995 to March 1995;

NOW THEREFORE, in consideration of the mutual covenants herein contained, the parties hereto agree as follows:

1. Article 1, entitled "Subject Matter of Sale" is deleted in its entirety  
-----  
and replaced by the following new Article 1:

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ARTICLE 1. Subject Matter of Sale.  
-----

ARTICLE 1. Subject Matter of Sale.  
-----

Subject to the provisions of this Agreement, Boeing shall sell and deliver to Buyer, and Buyer shall purchase from Boeing eighteen (18) Boeing Model 737-5H4 aircraft (hereinafter sometimes referred to as the "Block A and Block B" Aircraft) to be manufactured by Boeing in accordance with Boeing Detail Specification D6-38500-3 (which includes CFM International, Inc. CFM56-3-B1 engines), dated July 23, 1987 (as described in Exhibit A attached to the Purchase Agreement), twenty-three (23) Boeing Model 737-3H4 Aircraft (hereinafter sometimes referred to as the Block C-1 and Block D-1 Substitute Aircraft) to be manufactured by Boeing in accordance with Boeing Detail Specification D6-76300-2 Rev. T (which includes CFM International, Inc. CFM56-3-B1 engines), dated September 19, 1989 (as described in Exhibit A-1 attached to the Purchase Agreement), seven (7) Boeing Model 737-5H4 aircraft (hereinafter sometimes referred to as the "Block C Aircraft") to be manufactured by Boeing in accordance with Boeing Detail Specification D6-38500-3 (which includes CFM International, Inc. CFM56-3-B1 engines), dated June 7, 1989, thirty-four (34) Model 737-3H4 aircraft (hereinafter referred to as the "Block E Aircraft" to be manufactured by Boeing in accordance with Boeing Detail Specification D6-76300-2 Rev. W (which includes CFM International, Inc. CFM56-3-B1 engines) dated May 22, 1992, (as described in Exhibit A-2 attached to the Purchase Agreement), three (3) Model 737-3H4 aircraft (hereinafter referred to as the "Block F Aircraft") to be manufactured by Boeing in accordance with Boeing Detail Specification D6-76300-2 Rev. X (which includes CFM International, Inc. CFM56-3-B1 engines) dated February 26, 1993, (as described in Exhibit A-3 attached to the Purchase Agreement), twelve (12) Model 737-3H4 aircraft (hereinafter referred to as the "Block G Aircraft") to be manufactured by Boeing in accordance with Boeing Detail Specification D6-76300-2 Rev. Z (which includes CFM International, Inc. CFM56-3-B1 engines) dated February 15, 1994 (as further described in Exhibit A-4 attached to the Purchase Agreement), four (4) Model 737-3H4 aircraft (hereinafter referred to as the "Block H Aircraft") to be manufactured by Boeing in accordance with Boeing Detail Specification D6-76300-2 Rev. Z (which includes CFM International, Inc. CFM56-3-B1 engines) dated February 15, 1994 (as further described in Exhibit A-5 attached to the Purchase Agreement) and five (5) Model 737-3H4 aircraft (hereinafter referred to as the "Block I Aircraft") to be manufactured by Boeing in accordance with Boeing Detail Specification D6-76300-2 Rev. AA (which includes CFM International, Inc. CFM56-3-B1 engines) dated May 11, 1994 as further described in Exhibit A-6 attached to the Purchase Agreement and as such Detail

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Specifications may be modified from time to time in accordance with the terms and conditions of Article 7 herein. Such Detail Specifications as so modified are by this reference incorporated in this Agreement and are hereinafter referred to as the "Detail Specification." In connection with the sale and purchase of the Aircraft, Boeing shall also deliver to Buyer such other things as may be required by this Agreement including data, documents, training and services. All Block A, Block B, Block C, Block C-1 Substitute, Block D-1 Substitute, Block E, Block F, Block G, Block H and Block I Aircraft are referred to individually and collectively as the "Aircraft" or "AIRCRAFT."

2. Article 2.1, entitled "Time of Delivery" is deleted in its entirety and

replaced by the following new article 2.1 which revises the contract delivery month of one (1) of the April 1995 aircraft to March 1995 and adds the Block I Aircraft:

2.1 Time of Delivery. Each Aircraft shall be delivered to Buyer assembled and ready for flight, and Buyer shall accept delivery of such Aircraft, during the months set forth in the following schedule or such earlier months as mutually agreed between Boeing and Buyer:

| <TABLE><br><CAPTION>                   |                               |
|----------------------------------------|-------------------------------|
| Month and Year<br>of Delivery<br>----- | Quantity of Aircraft<br>----- |
| Block A<br>-----                       |                               |
| <S>                                    | <C>                           |
| February 1990                          | One (1)                       |
| March 1990                             | Two (2)                       |
| April 1990                             | Two (2)                       |
| May 1990                               | One (1)                       |
| August 1990                            | Two (2)                       |
| September 1990                         | Two (2)                       |
| May 1991                               | Two (2)                       |
| September 1991                         | One (1)                       |
| Block B<br>-----                       |                               |
| February 1991                          | One (1)                       |
| May 1991                               | Two (2)                       |
| September 1991                         | Two (2)                       |
| Block C<br>-----                       |                               |
| February 1992                          | Three (3)                     |
| May 1992                               | Four (4)                      |
| </TABLE>                               |                               |

S19-7

| <TABLE><br><CAPTION>                      |           |
|-------------------------------------------|-----------|
| Block C-1<br>Substitute Aircraft<br>----- |           |
| <S>                                       | <C>       |
| June 1992                                 | Two (2)   |
| July 1992                                 | One (1)   |
| February 1993                             | Three (3) |
| May 1993                                  | Four (4)  |
| August 1993                               | Two (2)   |
| September 1993                            | One (1)   |
| Block D-1<br>Substitute Aircraft<br>----- |           |
| February 1994                             | Three (3) |
| May 1994                                  | Four (4)  |
| September 1994                            | Three (3) |
| Block F Aircraft<br>-----                 |           |
| July 1994                                 | Two (2)   |
| September 1994                            | One (1)   |
| Block E Aircraft<br>-----                 |           |
| November 1994                             | Two (2)   |
| March 1995                                | One (1)   |
| April 1995                                | Two (2)   |
| May 1995                                  | Two (2)   |
| September 1995                            | Two (2)   |
| October 1995                              | Three (3) |
| March 1996                                | Two (2)   |
| April 1996                                | Three (3) |
| May 1996                                  | Two (2)   |
| July 1996                                 | Two (2)   |
| August 1996                               | One (1)   |
| September 1996                            | Two (2)   |

|              |          |
|--------------|----------|
| January 1997 | Four (4) |
| June 1997    | Four (4) |
| August 1997  | Two (2)  |

Block G Aircraft  
-----

|                |           |
|----------------|-----------|
| July 1995      | Two (2)   |
| August 1995    | Two (2)   |
| September 1995 | Two (2)   |
| January 1996   | Three (3) |
| March 1996     | One (1)   |
| June 1996      | Two (2)   |

Block H Aircraft  
-----

|               |          |
|---------------|----------|
| February 1995 | Four (4) |
|---------------|----------|

</TABLE>

S19-6

<TABLE>  
<CAPTION>

Block I Aircraft  
-----

|               |         |
|---------------|---------|
| <S>           | <C>     |
| July 1995     | One (1) |
| October 1995  | Two (2) |
| November 1995 | Two (2) |

</TABLE>

3. Article 3.1, entitled "Basic Price" is deleted in its entirety and  
-----  
replaced by the following new article 3.1 which adds the Basic Price for the Block I Aircraft:

3.1 Basic Price. The basic price of each Aircraft shall be equal to  
-----  
the sum of (i) Twenty Million Five Hundred Seventy-Three Thousand One Hundred Twenty-Six Dollars (\$20,573,126) for the Block A and Block B Aircraft, Twenty Million, Six Hundred Three Thousand, Seven Hundred Twenty-Six Dollars (\$20,603,726) for the Block C Aircraft, Twenty-Three Million Seven Hundred Forty-One Thousand Eight Hundred Seventy-Six Dollars (\$23,741,876) for the Block C-1 Substitute Aircraft, Twenty-Three Million, Eight Hundred Eighty Thousand One Hundred Seventy-Six Dollars (\$23,880,176) for the Block D-1 Substitute Aircraft, Twenty-Nine Million Five Hundred Seventy-Three Thousand One Hundred Seventy-Eight Dollars (\$29,573,178) for the Block E Aircraft, Thirty Million Three Hundred Three Thousand Six Hundred Seventy-Eight Dollars (\$30,303,678) for the Block F Aircraft, Thirty-One Million Six Hundred Twenty-Eight Thousand Eight Hundred Sixty-Six Dollars (\$31,628,866) for the Block G Aircraft, Thirty-One Million Six Hundred Twenty One Thousand Seven Hundred Sixty Six Dollars (\$31,621,766) for the Block H Aircraft, Thirty-Two Million Sixty-Five Thousand Four Hundred Fifty Eight Dollars (\$32,065,458) for the Block I Aircraft and (ii) such price adjustments applicable to such Aircraft as may be made pursuant to the provisions of this Agreement, including Article 7 (changes to Detail Specification) and Article 8 (FAA Requirements) or other written agreements executed by Buyer and Boeing.

4. Article 5.1, entitled "Advance Payment Base Price", for the Block E  
-----  
aircraft is revised by inserting the March 1995 aircraft and the associated advance payment base price:

|            |              |
|------------|--------------|
| March 1995 | \$32,879,000 |
|------------|--------------|

5. Article 5.1, entitled "Advance Payment Base Price" is revised by  
-----  
inserting after the Block H Aircraft the following:

S19-7

<TABLE>  
<CAPTION>

Block I Aircraft  
-----

|                                                  |                                                     |
|--------------------------------------------------|-----------------------------------------------------|
| Month and Year of<br>Scheduled Delivery<br>----- | Advance Payment Base<br>Price per Aircraft<br>----- |
| <S>                                              | <C>                                                 |
| July 1995                                        | \$33,376,000                                        |

October 1995  
November 1995  
</TABLE>

\$33,637,000  
\$33,726,000

6. Article 5.2, entitled "Advance Payment Schedule" is revised by inserting  
-----  
after the Block H Aircraft the following schedule for the Block I Aircraft:

<TABLE>  
<CAPTION>

| Due Date of Payment<br>-----                                                              | Amount Due per Aircraft<br>Block I Aircraft<br>----- |            |            |
|-------------------------------------------------------------------------------------------|------------------------------------------------------|------------|------------|
|                                                                                           | Jul 1995                                             | Oct 1995   | Nov 1995   |
| <S><br>Upon execution of<br>Supplemental<br>Agreement No. 19                              | <C><br>25%                                           | <C><br>20% | <C><br>20% |
| 12 months prior to the<br>first day of the scheduled<br>delivery month of the<br>Aircraft | ---                                                  | ---        | ---        |
| 9 months prior to the first<br>day of the scheduled delivery<br>month of the Aircraft     | ---                                                  | 5%         | 5%         |
| 6 months prior to the first<br>day of the scheduled delivery<br>month of the Aircraft     | 5%                                                   | 5%         | 5%         |
| Total                                                                                     | 30%                                                  | 30%        | 30%        |

</TABLE>

7. The title and the first sentence in Article 7.3.2 is revised to be  
written as "The Block E, F, G H and I Aircraft."

8. A new Exhibit A-6, entitled "Aircraft Configuration - the Block I  
-----  
Aircraft," attached hereto, is incorporated into the Purchase Agreement by this  
-----  
reference.

9. Exhibit D-4, entitled "Airframe and Engine Price Adjustment - the Block  
-----  
I Aircraft" attached hereto, is incorporated into the Purchase Agreement by this  
-----  
reference.

10. Letter Agreement No. 1405-6R3 entitled "Option Aircraft" is revised in  
Article 5, paragraph 5.1 by deleting the phrase "thirty (30) months" and  
inserting the phrase "twenty (20) months."

S19-6

11. Letter Agreement No. 6-1162-STE-1364 entitled "Additional Contractual  
-----  
Matters" is revised in the title of Article 2.5 and in the text of Article 2.5  
-----  
by deleting the word "and" and inserting a comma after the letter G and adding  
"and Block I" after the letter H and before Aircraft

12. A new paragraph 12 is incorporated into Letter Agreement No. 6-1162-  
STE-1364, dated July 23, 1987, by this reference. "Boeing will issue to Buyer  
at the time of delivery of the July 1995 Block I Aircraft a credit memorandum in  
the amount of \$153,000. Such credit memorandum will be applied to the final  
delivery price of the July 1995 Block I Aircraft. The credit memorandum is for  
Buyer's 737-300 simulator data for the Heads Up Display System."

13. Boeing and Buyer agree that the provisions of Letter Agreement No. 6-  
1162-STE-1363, dated July 23, 1987, shall apply to paragraph 11 and 12 of this  
Supplemental Agreement.

The Purchase Agreement shall be deemed to be supplemented to the extent herein  
provided and as so supplemented shall continue in full force and effect.

EXECUTED IN DUPLICATE as of the day and year first above written.

By: /s/ R. L, Lyons  
-----  
By: /s/ Gary J. Barron  
-----  
Its: Attorney-In-Fact  
-----  
Its: Executive V.P. & COO  
-----

S19-3  
EXHIBIT A-6  
to  
PURCHASE AGREEMENT NO. 1405  
Dated \_\_\_\_\_  
between  
THE BOEING COMPANY  
and  
SOUTHWEST AIRLINES CO.  
AIRCRAFT CONFIGURATION  
BLOCK I AIRCRAFT  
MODEL 737-3H4

The Detail Specification, referred to in Article 1 of the Purchase Agreement, is Boeing Detail Specification D6-76300-2 Revision AA dated May 11, 1994 as amended to incorporate the applicable specification language to reflect the effect of the changes set forth in the Master Changes listed below, including the effects of such changes on Manufacturer's Empty Weight (MEW) and Operating Empty Weight (OEW). As soon as practicable, Boeing will furnish to Buyer copies of the Detail Specification, which copies will reflect the effect of such changes. The Aircraft Basic Price reflects and includes all effects of such changes of price.

A-6-1

Exhibit A-6 to  
Purchase Agreement No. 1405  
Page 2

<TABLE>  
<CAPTION>

CHANGE REQUEST  
NO./TITLE  
-----

PRICE PER  
AIRCRAFT  
(1994 STE \$)  
-----

<S>  
3342MP3018  
Illuminated Sidewall  
Mounted overwing  
Exit Sign - Reposition  
</TABLE>

<C>  
N/C

A-6-2  
AIRFRAME AND ENGINE PRICE ADJUSTMENT  
between  
THE BOEING COMPANY  
and  
SOUTHWEST AIRLINES CO.

PRICE ADJUSTMENT DUE TO  
-----  
ECONOMIC FLUCTUATIONS  
-----  
AIRFRAME PRICE ADJUSTMENT  
-----  
(July 1994 Base Price)  
-----

The Block I Aircraft  
-----

1. Formula.  
-----

The Airframe Price Adjustment will be determined at the time of Aircraft delivery in accordance with the following formula:

$$Pa = (P) (L + M - 1)$$

Where:

Pa = Airframe Price Adjustment.

$$L = .65 \times \frac{ECI}{125.9}$$

$$M = .35 \times \frac{ICI}{118.5}$$

P = Aircraft Basic Price (as set forth in Article 3.2 of this Agreement) less the base price of Engines (as defined in this Exhibit D) in the amount of \$6,277,658.

ECI = A value using the "Employment Cost Index for workers in aerospace manufacturing" (aircraft manufacturing, standard industrial classification code 3721, compensation, base month and year June 1989 = 100), as released by the Bureau of Labor Statistics, U.S. Department of Labor on a quarterly basis for the months of March, June, September and December, calculated as follows: A three-month arithmetic average value (expressed as a decimal and rounded to the nearest tenth) will be determined using the months set forth in the table below for the applicable Aircraft, with the released Employment Cost Index value described above for the month of March also being used for the months of January and February; the value for June also used for April and May; the value for September also used for July and August; and the value for December also used for October and November.

D-4-1

ICI = The three-month arithmetic average of the released monthly values for the Industrial Commodities Index as set forth in the "Producer Prices and Price Index" (Base Year 1982 = 100) as released by the Bureau of Labor Statistics, U.S. Department of Labor values (expressed as a decimal and rounded to the nearest tenth) for the months set forth in the table below for the applicable Aircraft.

In determining the value of L, the ratio of ECI divided by 125.9 will be expressed as a decimal rounded to the nearest ten-thousandth and then multiplied by .65 with the resulting value also expressed as a decimal and rounded to the nearest ten-thousandth.

In determining the value of M, the ratio of ICI divided by 118.5 will be expressed as a decimal rounded to the nearest ten-thousandth and then multiplied by .35 with the resulting value also expressed as a decimal and rounded to the nearest ten-thousandth.

<TABLE>  
<CAPTION>

Month of Scheduled  
Aircraft Delivery  
-----

Months to be Utilized  
in Determining the  
Value of ECI and ICI  
-----

|           |                         |
|-----------|-------------------------|
| <S>       | <C>                     |
| January   | June B, July B, Aug. B  |
| February  | July B, Aug. B, Sept. B |
| March     | Aug. B, Sept. B, Oct. B |
| April     | Sept. B, Oct. B, Nov. B |
| May       | Oct. B, Nov. B, Dec. B  |
| June      | Nov. B, Dec. B, Jan. D  |
| July      | Dec. B, Jan. D, Feb. D  |
| August    | Jan. D, Feb. D, Mar. D  |
| September | Feb. D, Mar. D, Apr. D  |
| October   | Mar. D, Apr. D, May D   |
| November  | Apr. D, May D, June D   |
| December  | May D, June D, July D   |
| </TABLE>  |                         |

The following definitions of B and D will apply:

B = The calendar year before the year in which the scheduled month of  
-----  
delivery as set forth in Article 2.1 occurs.

D = The calendar year during which the scheduled month of delivery as  
-----  
set forth in Article 2.1 occurs.

D-4-2

Exhibit D-4

Page 3

2. If at the time of delivery of an Aircraft Boeing is unable to determine the Airframe Price Adjustment because the applicable values to be used to determine the ECI and ICI have not been released by the Bureau of Labor Statistics, then:

2.1 The Airframe Price Adjustment, to be used at the time of delivery of each of the Aircraft, will be determined by utilizing the escalation provisions set forth above. The values released by the Bureau of Labor Statistics and available to Boeing 30 days prior to scheduled Aircraft delivery will be used to determine the ECI and ICI values for the applicable months (including those noted as preliminary by the Bureau of Labor Statistics) to calculate the Airframe Price Adjustment. If no values have been released for an applicable month, the provisions set forth in Paragraph 2.2 below will apply. If prior to delivery of an Aircraft the U.S. Department of Labor changes the base year for determination of the ECI or ICI values as defined above, such rebased values will be incorporated in the Airframe Price Adjustment calculation. The payment by Buyer to Boeing of the amount of the Purchase Price for such Aircraft, as determined at the time of Aircraft delivery, will be deemed to be the payment for such Aircraft required at the delivery thereof.

2.2 If prior to delivery of an Aircraft the U.S. Department of Labor substantially revises the methodology used for the determination of the values to be used to determine the ECI and ICI values (in contrast to benchmark adjustments or other corrections of previously released values), or for any reason has not released values needed to determine the applicable Aircraft Airframe Price Adjustment, the parties will, prior to delivery of any such Aircraft, select a substitute for such values from data published by the Bureau of Labor Statistics or other similar data reported by non-governmental United States organizations, such substitute to lead in application to the same adjustment result, insofar as possible, as would have been achieved by continuing the use of the original values as they may have fluctuated during the applicable time period. Appropriate revision of the formula will be made as required to reflect any substitute values. However, if within 24 months from delivery of the Aircraft the Bureau of Labor Statistics should resume releasing values for the months needed to determine the Airframe Price Adjustment, such values will be used to determine any increase or decrease in the Airframe Price Adjustment for the Aircraft from that determined at the time of delivery of such Aircraft.

D-4-3

Exhibit D

Page 4

2.3 In the event escalation provisions are made non-enforceable or otherwise rendered null and void by any agency of the United States Government, the parties agree, to the extent they may lawfully do so, to equitably adjust the Purchase Price of any affected Aircraft to reflect an allowance for increases or decreases in labor compensation and material costs occurring since February, 1994, which is consistent with the applicable provisions of paragraph 1 of this Exhibit D.

3. For the calculations herein, the values released by the Bureau of Labor Statistics and available to Boeing 30 days prior to scheduled Aircraft delivery will be used to determine the ECI and ICI values for the applicable months (including those noted as preliminary by the Bureau of Labor Statistics) to calculate the Airframe Price Adjustment.

Note: Any rounding of a number, as required under this Exhibit D-4 with respect  
---- to escalation of the airframe price, will be accomplished as follows: if the first digit of the portion to be dropped from the number to be rounded is five or greater, the preceding digit will be raised to the next higher number.

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Exhibit D  
Page 7

ENGINE PRICE ADJUSTMENT - CFM INTERNATIONAL, INC.

-----  
(1994 BASE PRICE)  
-----

(a) The Aircraft Basic Price of each Aircraft set forth in Article 3.1 of this Agreement includes an aggregate price for CFM56-3-B1 engines and all accessories, equipment and parts therefor provided by the engine manufacturer (collectively in this Exhibit D called "Engines") of Six Million Two Hundred Seventy-Seven Thousand Six Hundred Fifty Eight Dollars (\$6,277,658). The adjustment in Engine price applicable to each Aircraft ("Engine Price Adjustment" herein) will be determined at the time of Aircraft delivery in accordance with the following formula:

$$D1 = (Pb \times \frac{CPI}{133.18}) - Pb$$

(b) The following definitions will apply herein:

D1 = Engine Price Adjustment

Pb = Aggregate Engine Base Price as set forth in Paragraph (a) above.

CPI = The Composite Price Index as determined in accordance with the formula set forth below. The Index values referred to below, to be used in determining the CPI, will be for the ninth month prior to the month of scheduled Aircraft delivery. Such Index values will be those prepared by the Bureau of Labor Statistics, U.S. Department of Labor.

$$CPI = L + M1 + M2 + M3$$

L = The Labor Index for such month will be the quotient, expressed as a decimal and rounded to the nearest thousandth, of the "Hourly Earnings of Aircraft Engines and Engine Parts Production Workers" SIC 3724, for such month divided by Eleven Dollars and Sixteen Cents (\$11.16). Such quotient will be multiplied by 100 and then by fifty-five percent (55%) with the value resulting from the latter multiplication expressed as a decimal and rounded to the nearest hundredth.

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Exhibit D  
Page 6

M1 = The Industrial Commodities Index for such month will be equal to ten percent (10%) of the Producer Price Index for "all commodities other than Farm and Foods," Code 3-15, (Base Year 1982 = 100) for such month, expressed as a

decimal and rounded to the nearest hundredth.

M2 = The Metals and Metal Products Index for such month will be equal to twenty-five percent (25%) of the Producer Price Index for "Metals and Metal Products," Code 10, (Base Year 1982 = 100) for such month expressed as a decimal and rounded to the nearest hundredth.

M3 = The Fuel Index for such month will be equal to ten percent (10%) of the Producer Price Index for "Fuel and Related Products and Power," Code 5, (Base Year 1982 = 100) for such month expressed as a decimal and rounded to the nearest hundredth.

133.18 = Composite Price Index for October, 1993.

The factor (CPI divided by 133.18) by which the Aggregate Engine Base Price is to be multiplied will be expressed as a decimal and rounded to the nearest thousandth.

The Engine Price Adjustment will not be made if it would result in a decrease in the aggregate Engine base price.

(c) The values of the Average Hourly Earnings and Producer Price Indices used in determining the Engine Price Adjustment will be those published by the Bureau of Labor Statistics, U.S. Department of Labor as of a date 30 days prior to the scheduled Aircraft delivery to Buyer. Such values will be considered final and no Engine Price Adjustment will be made after Aircraft delivery for any subsequent changes in published Index values.

(d) If the U.S. Department of Labor, Bureau of Labor Statistics (i) substantially revises the methodology (in contrast to benchmark adjustments or other corrections of previously published data) or (ii) discontinues publication of any of the data referred to above, CFMI agrees to meet

D-6

Exhibit D  
Page 7

jointly with Boeing and Buyer to jointly select a substitute for the revised or discontinued data; such substitute data to lead in application to the same adjustment result, insofar as possible, as would have been achieved by continuing the use of the original data as it may have fluctuated had it not been revised or discontinued.

Appropriate revision of the Engine Price Adjustment provisions set forth above will be made to accomplish this result for the affected Engines.

In the event the Engine price escalation provisions are made non-enforceable or otherwise rendered null and void by any agency of the United States Government, CFMI agrees to meet with Boeing and Buyer to jointly agree, to the extent such parties may lawfully do so, to adjust equitably the purchase price of any affected Engine(s) to reflect an allowance for increases in labor, material and fuel costs that have occurred from the period represented by the CPI to the ninth month preceding the month of scheduled delivery of the applicable aircraft.

NOTE: Any rounding of a number, as required under this Exhibit D-4 with respect  
---- to escalation of the Engine price, will be accomplished as follows: if the first digit of the portion to be dropped from the number to be rounded is five or greater, the preceding digit will be raised to the next higher number.

D-7

## SOUTHWEST AIRLINES CO.

## 1995 SWAPA NON-QUALIFIED

## STOCK OPTION PLAN

SOUTHWEST AIRLINES CO., a Texas corporation (the "Company"), hereby formulates and adopts the following 1995 SWAPA Non-Qualified Stock Option Plan.

1. **PURPOSE.** This Plan is adopted pursuant to the Collective Bargaining Agreement (the "Agreement") between the Company and the Southwest Airlines Pilots Association ("SWAPA") ratified on January 12, 1995.

2. **ADMINISTRATION.** This Plan shall be administered by an Administrative Committee (the "Committee") consisting of not more than five (5) persons designated from time to time by the Chief Executive Officer of the Company, including as one of its members the President of SWAPA or his or her designee. Members of the Committee may be removed or replaced at any time by the Chief Executive Officer of the Company. The Administrative Committee shall select one of its members as Chairman and shall adopt such rules and regulations as it shall deem appropriate concerning the holding of its meetings, the transaction of its business and the administration of this Plan. A majority of the whole Committee shall constitute a quorum, and the act of a majority of the members of the Committee present at a meeting at which a quorum is present shall be the act of the Committee; any decision or determination reduced to writing and signed by a majority of the members of the Administrative Committee shall be fully as effective as if made by a majority vote at a meeting duly called and held.

3. **GRANT OF OPTIONS; PERSONS ELIGIBLE.** The Stock Option Committee of the Board of Directors of the Company, or such other committee as may be appointed by the Board, shall have the authority and responsibility, within the limitations of this Plan, to grant options from time to time to persons employed as pilots (including pilots in management positions retaining seniority numbers) by the Company or Morris Air Corporation pursuant to the Agreement and as set forth in the schedule attached as Exhibit A and made a part hereof. Initial Grants (as defined in Exhibit A) shall be granted at an exercise price of \$20 per share; thereafter, Options shall be granted at an exercise price equal to the fair market value of the Common Stock of the Company on the date of the grant of the option plus five percent (5%). Only persons who are employed as pilots of SWA or Morris Air Corporation on the date of the grant may be granted options under this Plan; under no circumstances shall executive officers of the Company be eligible to receive options hereunder.

4. **DEFINITIONS.** An employee receiving any option under this Plan is hereinafter referred to as an "Optionee." Any reference herein to the employment of an Optionee with the Company shall include only employment with the Company or Morris Air Corporation. The fair market value of the Common Stock on any day shall be the mean between the highest and lowest quoted selling prices of the Common Stock on such day as reported by the primary national stock exchange on which such stock is listed. If no sale shall have been made on that day, or if the Common Stock is not listed on a national exchange at that time, fair market value will be determined by the Committee.

5. **STOCK SUBJECT TO OPTIONS.** Subject to the provisions of paragraph 12, the number of shares of the Company's Common Stock subject at any one time to options, plus the number of such shares then outstanding pursuant to exercises of options, granted under this Plan, shall not exceed 18,000,000 shares. If, and to the extent the options granted under this Plan terminate or expire without having been exercised, new options may be granted with respect to the shares covered by such terminated or expired options; provided that the granting and terms of such new options shall in all respects comply with the provisions of this Plan.

Shares sold or distributed upon the exercise of any option granted under this Plan may be shares of the Company's authorized and unissued Common Stock, shares of the Company's issued Common Stock held in the Company's treasury, or both.

There shall be reserved at all times for sale or distribution under this Plan a number of shares of Common Stock (either authorized and unissued shares or shares held in the Company's treasury, or both) equal to the maximum number of shares which may be purchased or distributed upon the exercise of options granted under this Plan.

Exercise of an Option in any manner shall result in a decrease in the number of shares of Common Stock which may thereafter be available, both for purposes of this Plan and for sale to any one individual, by the number of shares as to which the Option is exercised.

6. EXPIRATION AND TERMINATION OF THE PLAN. This Plan will expire on  
-----  
January 31, 2007.

No modification, extension, renewal or other change in any option granted under this Plan shall be made after the grant of such option unless the same is consistent with the provisions of this Plan.

=====

1995 SWAPA NON-QUALIFIED STOCK OPTION PLAN

Page 2

7. EXERCISABILITY AND DURATION OF OPTIONS.  
-----

(a) Exercisability. Options granted under this Plan shall become  
-----  
exercisable pursuant to the vesting schedule and requirements set forth in Exhibit A attached hereto.

(b) Duration. The unexercised portion of any option granted under this  
-----  
Plan shall automatically and without notice terminate and become null and void at the time of the earliest to occur of the following:

(1) January 31, 2007;

(2) The expiration of three months from the date of termination of the Optionee's employment with the Company (unless such termination was as a result of the circumstances set forth in subparagraphs (3) or (4) below); provided that if the Optionee shall die during such 3-month period the provisions of subparagraph (3) below shall apply;

(3) The expiration of 12 months following the issuance of letters testamentary or letters of administration to the executor or administrator of a deceased Optionee, if the Optionee's death occurs either during his employment with the Company, during the three-month period following the date of termination of such employment, or during the 24-month period following retirement as a result of FAA-imposed mandatory retirement age;

(4) The expiration of 24 months following the retirement of the Optionee as a result of FAA-imposed mandatory retirement age; provided that if the Optionee shall die during such 24-month period, the provisions of subparagraph (3) above shall apply; or

(5) December 1, 1999 in the event the Agreement is made amendable by SWAPA on or before September 1, 1999.

In the case of subparagraphs (2), (3) and (4) above, the Optionee shall have the right to exercise any Option prior to such expiration to the extent it was exercisable at the date of such termination of employment and shall not have been exercised.

8. EXERCISE OF OPTIONS.  
-----

(a) Procedure. The option granted herein shall be exercised by the  
-----  
Optionee (or by the person who acquires such options by will or the laws of descent and distribution or otherwise by reason of the death of the Optionee) as to all or part of the shares covered by the option (but in no event less than 100 shares, unless such exercise is for all remaining shares) by giving written notice of the exercise thereof (the "Notice") to the Company. From time to time the Committee may establish

=====

1995 SWAPA NON-QUALIFIED STOCK OPTION PLAN

Page 3

procedures relating to effecting such exercises. No fractional shares shall be issued as a result of exercising an Option.

(b) Payment. In the Notice, the Optionee shall elect whether he or she is  
-----  
to pay for his or her shares in cash or in Common Stock of the Company, or both. If payment is to be made in cash, the Optionee shall deliver to the Company a cashier's check or electronic funds transfer in the amount of the exercise price on or before the exercise date. If payment is to be made in Common Stock, (a) it shall be valued at its fair market value on the date of such notice, as

determined pursuant to Paragraph 4 hereof; (b) such Common Stock must have been owned by the Optionee for at least six months prior to the exercise date; and (c) the Notice shall be accompanied by a certificate for at least the number of shares of Common Stock to be used as payment.

(c) Irrevocable Election. The giving of such written notice to the

-----  
Company shall constitute an irrevocable election to purchase the number of shares specified in the notice on the date specified in the notice.

(d) Withholding Taxes. To the extent that the exercise of any Option

-----  
granted pursuant to this Plan or the disposition of shares of Common Stock acquired by exercise of an Option results in compensation income to the Optionee for federal or state income tax purposes, the Optionee shall deliver to the Company at the time of such exercise or disposition such amount of money as the Company may require to meet its obligation under applicable tax laws or regulations, and, if the Optionee fails to do so, the Company is authorized to (a) withhold delivery of certificates upon exercise and (b) withhold from remuneration then or thereafter payable to Optionee any tax required to be withheld by reason of such resulting compensation income.

(e) Delivery of Shares. The Company shall cause shares to be delivered to

-----  
the Optionee (or the person exercising the Optionee's options in the event of death) as soon as practicable after the exercise date.

9. NONTRANSFERABILITY OF OPTIONS. No option granted under this Plan or

-----  
any right evidenced thereby shall be transferable by the Optionee other than by will or the laws of descent and distribution. During the lifetime of an Optionee, only the Optionee (or his or her guardian or legal representative) may exercise his or her options.

In the event of the Optionee's death during his or her employment with the Company, during the three-month period following the date of termination of such employment, or during the 24-month period following FAA-mandated retirement, the Optionee's options shall thereafter be exercisable, as provided in paragraph 7(b), by his or her executor or administrator, or by the person who acquires such options by will or the laws of descent and distribution or otherwise by reason of the death of the Optionee.

=====

1995 SWAPA NON-QUALIFIED STOCK OPTION PLAN

Page 4

10. RIGHTS OF OPTIONEE. Neither the Optionee nor his or her executors,

-----  
administrators, or legal representatives shall have any of the rights of a shareholder of the Company with respect to the shares subject to an option granted under this Plan until certificates for such shares shall have been issued upon the exercise of such option.

11. RIGHT TO TERMINATE EMPLOYMENT. Nothing in this Plan or in any option

-----  
granted under this Plan shall confer upon any Optionee the right to continue in the employment of the Company or affect the right of the Company or any of its subsidiaries to terminate the Optionee's employment at any time; subject, however, to the provisions of the Agreement.

12. ADJUSTMENT UPON CHANGES IN CAPITALIZATION, ETC.

-----  
(a) The existence of the Plan and the options granted hereunder shall not affect in any way the right or power of the Board of Directors or the shareholders of the Company to make or authorize any adjustment, recapitalization, reorganization or other change in the Company's capital structure or its business, any merger or consolidation of the Company, any issue of debt or equity securities ahead of or affecting Common Stock or the rights thereof, the dissolution or liquidation of the Company or any sale, lease, exchange or other disposition of all or any part of its assets or business or any other corporate act or proceeding.

(b) The shares with respect to which options may be granted are shares of Common Stock as presently constituted, but if, and whenever, prior to the expiration of an option theretofore granted, the Company shall effect a subdivision or consolidation of shares of Common Stock or the payment of a stock dividend on Common Stock without receipt of consideration by the Company, the number of shares of Common Stock with respect to which such option may thereafter be exercised (i) in the event of an increase in the number of outstanding shares shall be proportionately increased, and the purchase price per share shall be proportionately reduced, and (ii) in the event of a reduction in the number of outstanding shares shall be proportionately reduced, and the purchase price per share shall be proportionately increased; likewise, the

number of shares to be granted pursuant to the schedule set forth in Exhibit A shall be appropriately adjusted. In the event of any such change in the outstanding Common Stock, the aggregate number of shares available under the Plan shall be appropriately adjusted by the Board of Directors of the Company, whose determination shall be conclusive.

(c) If the Company recapitalizes or otherwise changes its capital structure, thereafter upon any exercise of an option theretofore granted the Optionee shall be entitled to purchase under such option, in lieu of the number of shares of Common Stock as to which such option shall then be exercisable, the number and class of shares of stock and securities to which the Optionee would have been entitled pursuant to the terms of the recapitalization if, immediately prior to such recapitaliza-

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1995 SWAPA NON-QUALIFIED STOCK OPTION PLAN

Page 5

tion, the Optionee had been the holder of record of the number of shares of Common Stock as to which such option is then exercisable. If the Company shall not be the surviving entity in any merger or consolidation (or survives only as a subsidiary of an entity other than a previously wholly-owned subsidiary of the Company) or if the Company is to be dissolved or liquidated, then unless a surviving corporation assumes or substitutes new options for Options then outstanding hereunder (i) the time at which such Options may be exercised shall be accelerated and such Options shall become exercisable in full on or before a date fixed by the Company prior to the effective date of such merger or consolidation or such dissolution or liquidation, and (ii) upon such effective date Options shall expire.

(d) Except as hereinbefore expressly provided, the issuance by the Company of shares of stock of any class or securities convertible into shares of stock of any class, property, labor or services, upon direct sale, upon the exercise of rights or warrants to subscribe therefor, or upon conversion of shares or obligations of the Company convertible into such shares or other securities, and in any case whether or not for fair value, shall not affect, and no adjustment by reason thereof shall be made with respect to, the number of shares of Common Stock subject to options theretofore granted or to be granted or the purchase price per share.

13. PURCHASE FOR INVESTMENT AND LEGALITY. The Optionee, by acceptance of

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any option granted under this Plan, shall represent and warrant to the Company that the purchase or receipt of shares of Common Stock upon the exercise thereof shall be for investment and not with a view to distribution, provided that such representation and warranty shall be inoperative if, in the opinion of counsel to the Company, a proposed sale or distribution of such shares is pursuant to an applicable effective registration statement under the Securities Act of 1933 or is, without such representation and warranty, exempt from registration under such Act. The Company shall file a Registration Statement on Form S-8 pursuant to the Securities Act of 1933, as amended, covering the shares to be offered pursuant to the Plan and will use its best efforts to maintain such registration at all times necessary to permit holders of options to exercise them.

The obligation of the Company to issue shares upon the exercise of an option shall also be subject as conditions precedent to compliance with applicable provisions of the Securities Act of 1933, the Securities Exchange Act of 1934, state securities laws, rules and regulations under any of the foregoing and applicable requirements of any securities exchange upon which the Company's securities shall be listed.

The Company may endorse an appropriate legend referring to the foregoing restrictions upon the certificate or certificates representing any shares issued or transferred to the Optionee upon the exercise of any option granted under this Plan.

14. EFFECTIVE DATE OF PLAN. This Plan shall become effective on January

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12, 1995 upon its adoption by the Board of Directors of the Company.

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1995 SWAPA NON-QUALIFIED STOCK OPTION PLAN

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Southwest Airlines Co.  
Computation of Earnings Per Share  
For the Year Ended December 31, 1994

<TABLE>  
<CAPTION>

|                                                                                    | Primary       | Fully Diluted |
|------------------------------------------------------------------------------------|---------------|---------------|
|                                                                                    | -----         | -----         |
| <S>                                                                                | <C>           | <C>           |
| Weighted average shares outstanding                                                | 143,046,509   | 143,046,509   |
| Shares issuable upon exercise of outstanding stock options (treasury stock method) | 4,258,865     | 4,259,233     |
|                                                                                    | -----         | -----         |
| Weighted average common and common equivalent shares                               | 147,305,374   | 147,305,742   |
|                                                                                    | =====         | =====         |
| Earnings for per share computations                                                | \$179,331,000 | \$179,331,000 |
|                                                                                    | =====         | =====         |
| Earnings per common and common equivalent share                                    | \$1.22        | \$1.22        |
|                                                                                    | =====         | =====         |

</TABLE>

Southwest Airlines Co.  
Computation of Earnings Per Share  
For the Year Ended December 31, 1993

<TABLE>  
<CAPTION>

|                                                                                                   | Primary       | Fully Diluted |
|---------------------------------------------------------------------------------------------------|---------------|---------------|
|                                                                                                   | -----         | -----         |
| <S>                                                                                               | <C>           | <C>           |
| Weighted average shares outstanding                                                               | 142,622,160   | 142,622,160   |
| Shares issuable upon exercise of outstanding stock options (treasury stock method)                | 4,522,408     | 4,676,476     |
|                                                                                                   | -----         | -----         |
| Weighted average common and common equivalent shares                                              | 147,144,568   | 147,298,636   |
|                                                                                                   | =====         | =====         |
| Earnings for per share computation before cumulative effect of accounting changes                 | \$154,284,000 | \$154,284,000 |
| Cumulative effect of accounting change                                                            | 15,259,000    | 15,259,000    |
|                                                                                                   | -----         | -----         |
| Earnings for per share computation after cumulative effect of accounting changes                  | \$169,543,000 | \$169,543,000 |
|                                                                                                   | =====         | =====         |
| Earnings for per common and common equivalent share before cumulative effect of accounting change | \$1.05        | \$1.05        |
|                                                                                                   | =====         | =====         |
| Earnings for per common and common equivalent share after cumulative effect of accounting change  | \$1.15        | \$1.15        |
|                                                                                                   | =====         | =====         |

</TABLE>

Note: The share and per share amounts have been adjusted to reflect the three-

for-two stock split distributed July 15, 1993.

Exhibit 11  
Page 3 of 3

Southwest Airlines Co.  
Computation of Earnings Per Share  
For the Year Ended December 31, 1992

<TABLE>  
<CAPTION>

|                                                                                                             | Primary       | Fully Diluted |
|-------------------------------------------------------------------------------------------------------------|---------------|---------------|
|                                                                                                             | -----         | -----         |
| <S>                                                                                                         | <C>           | <C>           |
| Weighted average shares outstanding                                                                         | 138,967,858   | 138,967,858   |
| Shares issuable upon exercise of outstanding stock options (treasury stock method)                          | 3,978,032     | 4,148,157     |
| Shares applicable to subordinated debentures converted in first quarter 1992                                | --            | 1,013,918     |
|                                                                                                             | -----         | -----         |
| Weighted average common and common equivalent shares                                                        | 142,945,890   | 144,129,933   |
|                                                                                                             | =====         | =====         |
| Pro forma earnings before cumulative effect of accounting change                                            | \$ 97,385,000 | \$ 97,385,000 |
| Add: Interest on \$35,000,000 convertible debentures                                                        | N/A           | 443,000       |
| Less: Tax effect @ 38.5%                                                                                    | N/A           | (170,000)     |
|                                                                                                             | -----         | -----         |
| Pro forma earnings for per share computations before cumulative effect of accounting change                 | \$ 97,385,000 | \$ 97,658,000 |
| Cumulative effect of accounting change                                                                      | 12,538,000    | 12,538,000    |
|                                                                                                             | -----         | -----         |
| Pro forma earnings for per share computations after cumulative effect of accounting change                  | \$109,923,000 | \$110,196,000 |
|                                                                                                             | =====         | =====         |
| Pro forma earnings for per common and common equivalent share before cumulative effect of accounting change | \$0.68        | \$0.68        |
|                                                                                                             | =====         | =====         |
| Pro forma earnings for per common and common equivalent share after cumulative effect of accounting change  | \$0.77        | \$0.76        |
|                                                                                                             | =====         | =====         |

</TABLE>

Note: The share and per share amounts have been adjusted to reflect the three-for-two stock and the two-for-one stock splits distributed July 15, 1993 and July 15, 1992, respectively.

Southwest Airlines Co.  
Subsidiaries of the Company

Southwest Airlines Co. has five wholly owned subsidiaries:

TranStar Airlines Corporation, Southwest Jet Fuel Co., Southwest ABQ RES Center, Inc., which are incorporated under the laws of Texas; Southwest Airlines Eurofinance N.V., which is incorporated under the laws of Netherlands Antilles; and Morris Air Corporation, which is incorporated under the laws of Delaware.

CONSENT OF ERNST & YOUNG LLP, INDEPENDENT AUDITORS

We consent to the incorporation by reference in the Registration Statements Form S-3 (Nos. 33-54587 and 33-52155) and Form S-8 (Nos. 33-48178, 33-57327, 33-40652 and 33-40653) and in the related Prospectuses of our report dated January 26, 1995, with respect to the Consolidated Financial Statements of Southwest Airlines Co. included in this Annual Report (Form 10-K) for the year ended December 31, 1994.

ERNST & YOUNG LLP

Dallas, Texas  
March 28, 1995

<TABLE> <S> <C>

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| <S>                          | <C>         |
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| <INCOME-TAX>                 | 120,192     |
| <INCOME-CONTINUING>          | 179,331     |
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| <EXTRAORDINARY>              | 0           |
| <CHANGES>                    | 0           |
| <NET-INCOME>                 | 179,331     |
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| <EPS-DILUTED>                | 1.22        |

</TABLE>