



Southwest Airlines Co.
1975 Annual Report

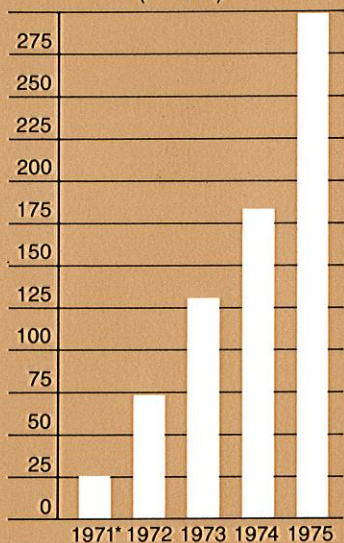
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Southwest Airlines Co. 1975 Annual Report

PASSENGER MILES FLOWN

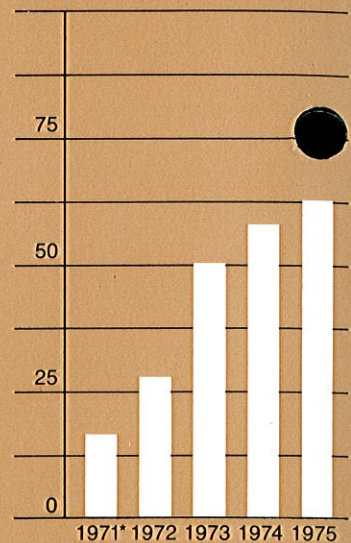
(millions)



*from 6/18

PASSENGER LOAD FACTOR

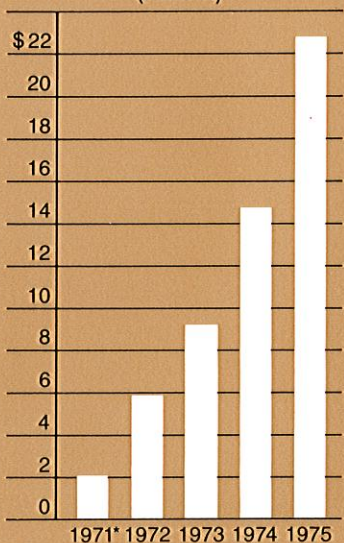
%



*from 6/18

OPERATING REVENUES

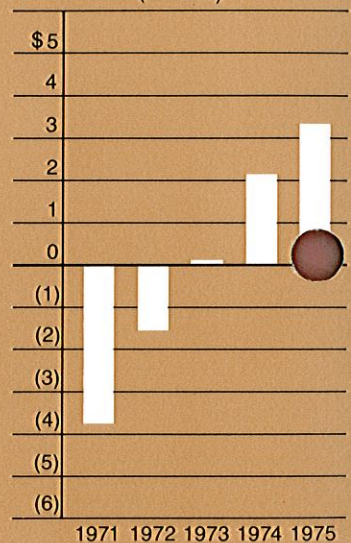
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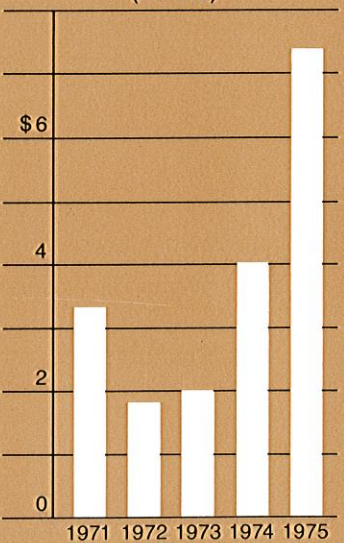
NET INCOME

(millions)



STOCKHOLDERS EQUITY

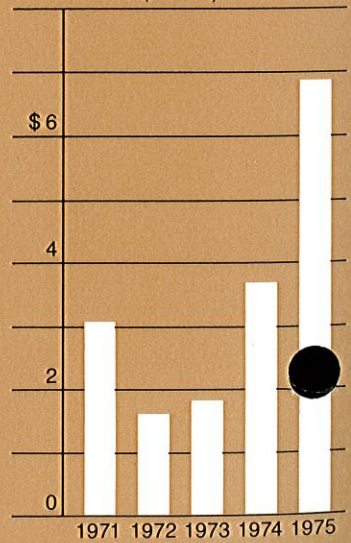
(millions)



year ended December 31

BOOK VALUE PER SHARE

(dollars)



year ended December 31

	<u>1975</u>	<u>1974</u>	<u>Percent Change</u>
OPERATING DATA			
Passengers carried	1,136,318	759,721	49.6%
Passenger miles flown (000)	298,458	183,596	62.6
Trips operated	17,552	12,382	41.8
Available seat miles flown (000)	477,166	314,407	51.8
Passenger load factor	62.5%	58.4%	7.0
Passenger revenue per psgr. mile	7.26¢	7.66¢	(5.2)

Income data (000)

Operating revenues	\$22,828	\$ 14,852	53.7%
Operating expenses	17,860	11,354	57.3
Operating income	4,968	3,498	42.0
Net income before extraordinary credit	2,164	1,045	107.1
Net income	3,400	2,140	58.8

Financial data (000)

Working capital	\$ 1,504	(\$ 84)	N/A
Total assets less current liabilities	22,344	16,370	36.5%
Stockholders' equity	7,415	4,072	82.1
Book value per share (dollars)	\$ 6.91	\$ 3.72	85.8



As reported in previous annual reports, Southwest Airlines turned the profit corner in 1973, it took off in 1974, and it can be said that in 1975 Southwest Airlines was flying high. The Company's net income increased during 1975 to \$3.4 million (after tax-loss carryforward credits) from the comparable figure of \$2.1 million during 1974. On a per share basis, 1975's net income was \$3.18 as compared to \$1.93 in 1974.

REVENUES

Operating revenues increased 54% to \$22.8 million as a result of a 50% increase in passengers carried, a 63% increase in passenger miles flown, and a 58% increase in cargo revenues. While our average ticket price went up 3% during 1975 as a result of our longer-haul Dallas/Harlingen passengers, our average yield per passenger mile flown was reduced 5% to 7.26¢ for the same reason.

EXPENSES

Operating expenses increased 57%, with total costs including interest payments increasing 51%. The increase in total operating expenses was attributable principally to three factors, those being (1) a 42% increase in the number of trips operated (resulting in 50% more passengers handled), (2) a further 38% increase in fuel costs to \$228 per trip flown, and (3) a 357% increase in landing fees paid to the municipal owners of the airports we serve.

The 42% increase in trips operated was facilitated by the delivery of our fourth Boeing 737 aircraft on October 1, 1974, and our fifth such aircraft on July 1, 1975.

WORKING CAPITAL/CASH FLOW

During 1975 Southwest improved its working capital position from an \$84,000 deficit at 1974 year end to a positive working capital of \$1,504,000 at December 31, 1975. This improved working capital position was at-

tained even though Southwest made net additions to its flight and ground equipment in the amount of \$6,294,000, with a net increase in long-term debt of only \$2,303,000.

LONG-TERM DEBT

During 1975 and in early 1976, Southwest arranged bank loans from the Mercantile National Bank at Dallas with which it retired completely its debt to Boeing Financial Corporation incurred in connection with the original acquisition of our fleet of aircraft. The loan agreement provides the Company with sufficient flexibility to permit the Company to pay cash for its sixth Boeing 737 aircraft scheduled for delivery during the fourth quarter of 1976.

ROUTE EXPANSION

Southwest's first route expansion was inaugurated on February 11, 1975, when the Company extended its routes to the Rio Grande Valley area of the State of Texas served through the Harlingen Airport. During the remainder of the year Southwest carried 201,993 passengers into and out of that airport, representing 18% of our system passengers. At the Company's current level of traffic, we anticipate that we will serve nearly 300,000 passengers through the Harlingen Airport during 1976.

Southwest has filed applications with the Texas Aeronautics Commission seeking authority to further extend its Texas intrastate route system to include the metropolitan areas of Austin, Corpus Christi, El Paso, Lubbock, and Midland-Odessa. It is hoped that hearings before the Commission can be completed during 1976 with a favorable decision from the Texas Aeronautics Commission sometime in late 1976 or early 1977. A map showing the Company's present and proposed routes is depicted on the inside back cover of this annual report. Our fleet of aircraft which at that time will number six would need to be further expanded to ten aircraft to fully implement the services proposed to these new cities. It is anticipated

that the initial operations to be conducted to and from these new cities would produce traffic for Southwest Airlines at the annual level of approximately 850,000 passengers per year over average trip lengths somewhat longer than our present passengers fly with Southwest. It is further anticipated that Southwest's much lower fare structure would generate these new passengers in the air markets to be served and that the operations would be profitable to the Company during the first full year of service, if the Company is successful in obtaining the necessary authority through the issuance of a Certificate of Public Convenience and Necessity by the Texas Aeronautics Commission.

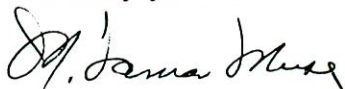
LEGAL PROCEEDINGS

Southwest is a defendant in two proceedings involving (1) its continued right to serve Love Field in Dallas, and (2) its legal right to continue providing service to the Rio Grande valley, which service was discussed in the preceding section of this letter. It is hoped that a favorable resolution of these matters can be achieved during 1976.

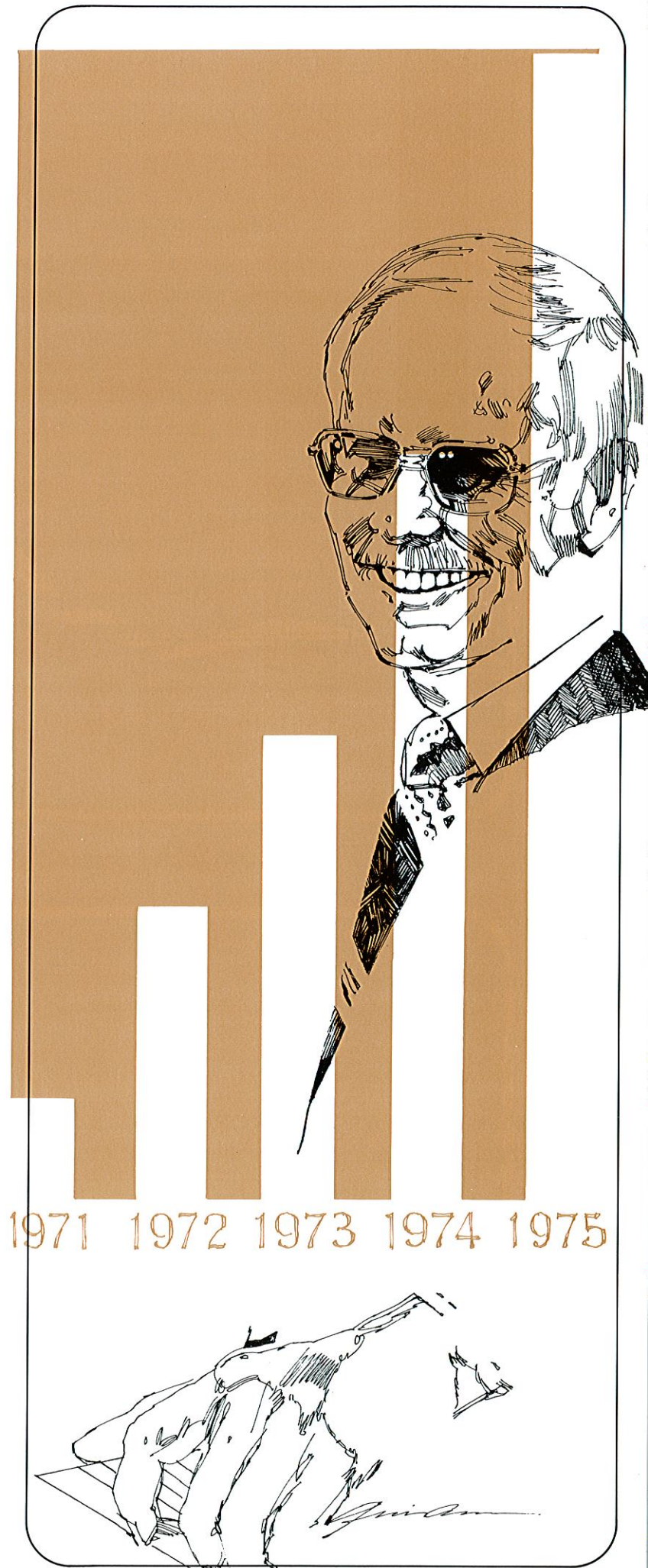
GOALS FOR 1976

In our 1974 annual report, we stated that our 1975 goals would be to (1) strengthen our dominant position in the markets we serve, (2) vastly expand business and pleasure travel in the Rio Grande Valley market, and (3) continue the very favorable net income and cash flow margins experienced during the preceding year. We have done that in spades, and we hereby established the same goals for 1976. With the continued support of our passengers, employees, and shareholders, we will meet these goals.

Cordially yours,

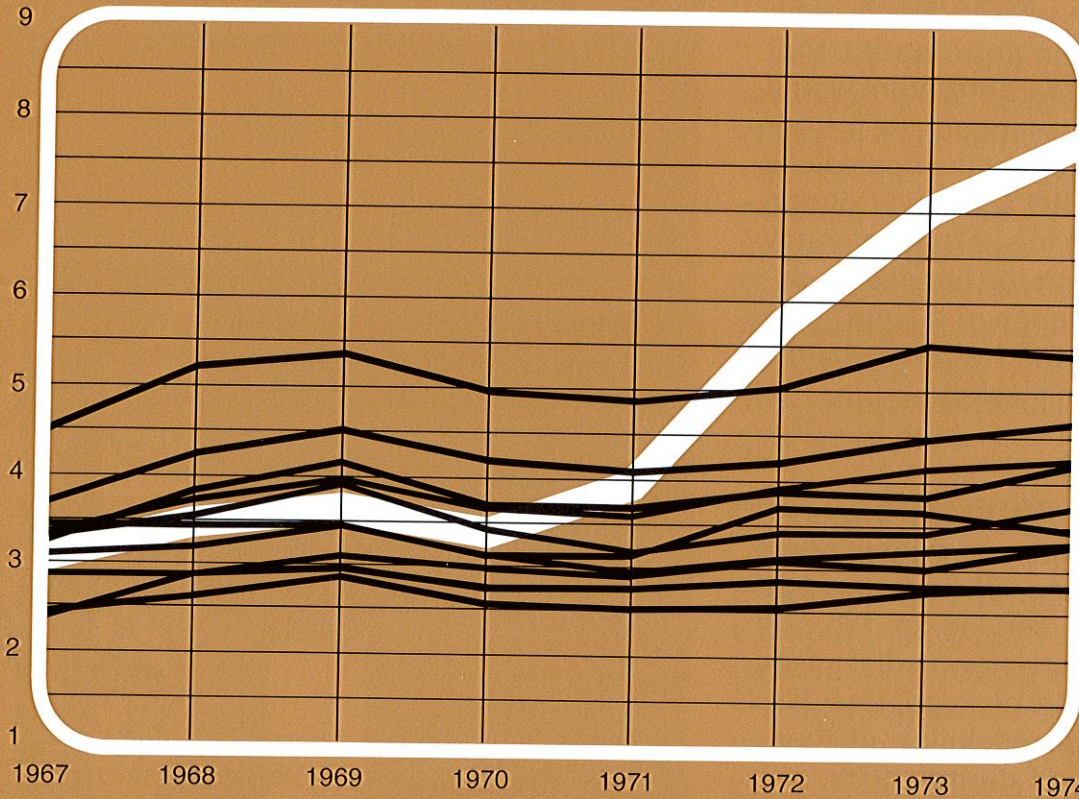


M. Lamar Muse
President and
Chief Executive Officer



Traffic Growth for Markets Served by Southwest as Compared to Similar Markets Under 500 Miles Served Exclusively by CAB Carriers

HUNDRED THOUSAND PASSENGERS PER YEAR



CITIES AND MILEAGE:

Dallas-Houston (241)

New York-Buffalo (289)

Chicago-St. Louis (256)

New York-Rochester (252)

Boston-Philadelphia (274)

Chicago-Cleveland (312)

New York-Syracuse (197)

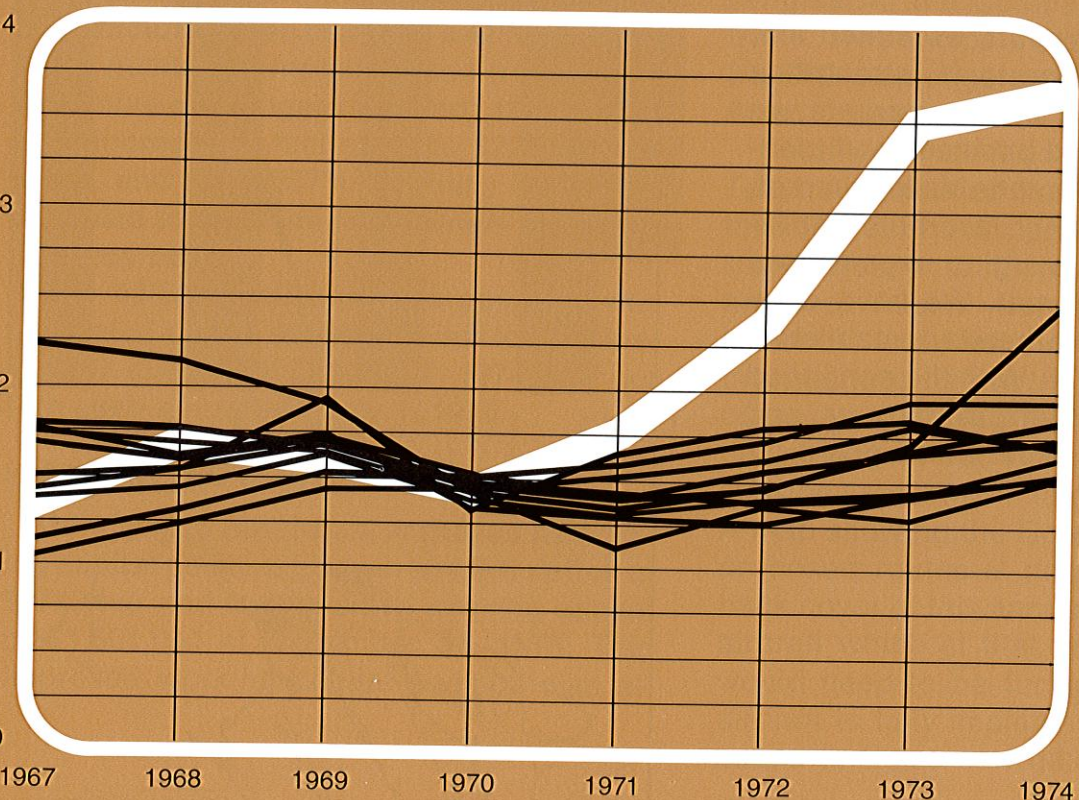
Los Angeles-Phoenix (370)

Philadelphia-Pittsburgh (274)

Chicago-Kansas City (407)

Chicago-Pittsburgh (404)

HUNDRED THOUSAND PASSENGERS PER YEAR



CITIES AND MILEAGE:

Dallas-San Antonio (249)

Seattle-Spokane (223)

New York-Rochester (425)

San Francisco-Reno (187)

San Francisco-Las Vegas (419)

New York-Greensboro (455)

New York-Norfolk (291)

Washington-Pittsburgh (194)

Cleveland-Philadelphia (365)

Washington-Cleveland (297)

New York-Albany (139)

WHY IS SOUTHWEST AIRLINES HEALTHY ... WHILE THE AIR TRANSPORT INDUS- TRY AS A WHOLE IS FINANCIALLY SICK?

The successful operation of any enterprise involves many things. For an airline, quality of schedules, equipment and personnel are basic. Schedule completion, on-time performance, attitudes of employees toward their customers, a highly visible advertising and public relations message, all will encourage consumers to use a carrier's service. At the same time, deficiencies will not necessarily cause them to abandon it. Many air carriers besides Southwest offer good service in the markets they serve.

What, then, separates Southwest from the others? What is Southwest doing that makes it enjoy financial good health in an industry which, on an overall basis, is financially sick?

The answer, quite simply, is proper pricing of the product. While it is true that the regulatory body of the Federally certificated industry (Civil Aeronautics Board) has broad power over the fare level and fare structure of their carriers, the end result is that they just react to the various inputs of the carriers themselves; so in reality, the fares the C.A.B. carriers charge are their own and not fares mandated by their regulatory agency.

We believe that in short-haul markets of up to 500 miles, the private automobile is a worthy competitor for those consumers representing the great majority of us who cannot logically place a value on time commensurate with the air fares now charged in those markets. Except for the businessman and woman market, a fare which does not compete with the cost of personal auto-

mobile travel will not permit any air market to reach its potential.

With this basic economic fact in mind, Southwest utilizes a very simple two-fare structure throughout its system that provides for an approximate 40% discount from our regular weekday, daytime Executive Class fare for all flights operating from 7:00 pm on weekdays and on all flights operating on Saturdays and Sundays—times when the businessman is normally not flying and when the personal traveler is able to travel on the lower Pleasure Class fare.

It is really a chicken and egg question. Which comes first, a mass market incorporating all stratas of economic levels and reasons for travel, followed then by the lower fare levels and structure which such a market makes possible—or bold fare level reduction and price structuring for the business and pleasure or personal markets which serve to build prospectively the mass markets which then justify the low prices being offered.

We believe the latter course is the one that works as evidenced by the rapid growth of the markets Southwest serves when this price policy has been exercised.

In comparable air markets served exclusively by Federally certificated carriers, the historic growth rates average about two percent a year, whereas the markets in which Southwest participates have grown at annual compound rates of more than ten times that much.

Therefore, in summary, offer an attractive product, which any carrier with reasonably effective management can do, and couple that with a fare level and structure which all facets of the economy can profitably utilize, and success is assured.



DALLAS

DEPARTS:

San Antonio

★
AUSTIN

RIO GRANDE VALLEY



ARRIVES:

FLIGHT:

GATE:

HOUSTON

Southwest Airlines Co. (a Texas corporation) is an intrastate scheduled airline operating within the State of Texas between the cities of Dallas, Houston, San Antonio and the Lower Rio Grande Valley, served through the Harlingen Airport. The Company operates under the authority of a Certificate of Public Convenience and Necessity issued to it by the Texas Aeronautics Commission.

The Company operates frequent commuter-type schedules with 112-seat Boeing 737-200 aircraft serving the local passengers in Texas' various markets. Being an intrastate carrier, the Company does not carry United States mail, nor does it carry nor solicit interstate passengers.

Initial operations of the Company began on June 18, 1971, with three Boeing 737-200 aircraft, with a fourth aircraft being added to its schedules effective October 1, 1974, and a fifth aircraft effective July 1, 1975. A sixth aircraft has been ordered for delivery during the fourth quarter of 1976.

All of the Company's flights provide single-class

service with flights departing between 7:00 am and 6:59 pm on Mondays through Fridays, being "Executive Class" flights at a basic fare of \$25, including transportation taxes and security charges with all other flights being "Pleasure Class" flights at a basic fare of \$15, including Federal transportation taxes and security charges.

The Company has filed application with the Texas Aeronautics Commission to expand its intrastate network to five additional metropolitan areas within the State of Texas. These areas include the cities of Austin, Corpus Christi, El Paso, Lubbock and Midland-Odessa. It is not anticipated that any scheduled operations will be performed on these proposed route additions during calendar year 1976.

At year end the Company employed a staff of 392 employees, consisting of 108 flight personnel, 36 maintenance, 183 ground passenger service and 65 management, accounting, and marketing personnel.

Comparative Quarterly Information

QUARTERLY FINANCIAL SUMMARY (IN THOUSANDS)

FIRST QUARTER	1975	1974
Revenues	\$4,729	\$3,352
Expense	4,056	2,747
Net income — amount	673	605
— per share ...	\$.63	\$.55

SECOND QUARTER	1975	1974
Revenues	\$5,557	\$3,563
Expense	4,561	2,832
Net income — amount	996	731
— per share ...	\$.93	\$.66

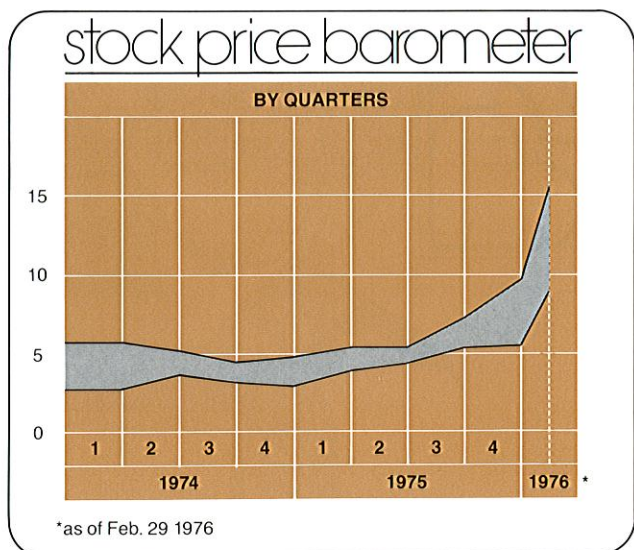
THIRD QUARTER	1975	1974
Revenues	\$6,263	\$3,752
Expense	5,360	3,150
Net income — amount	903	602
— per share ...	\$.85	\$.54

FOURTH QUARTER	1975	1974
Revenues	\$6,279	\$4,185
Expense	5,451	3,983
Net income — amount	828	202
— per share ...	\$.77	\$.18

COMMON STOCK PRICE — HIGH AND LOW BY QUARTER

QUARTER	1975	1974
1st High	5½	5⅞
Low	4	2⅞
2nd High	5½	5¼
Low	4½	3¾
3rd High	7¼	4⅝
Low	5½	3¼
4th High	9⅞	4⅞
Low	5⅝	3

The Common Stock of Southwest Airlines Co. began trading on the American Stock Exchange on October 24, 1975. As of December 31, 1975 the Company had paid no dividends on its Common Stock.





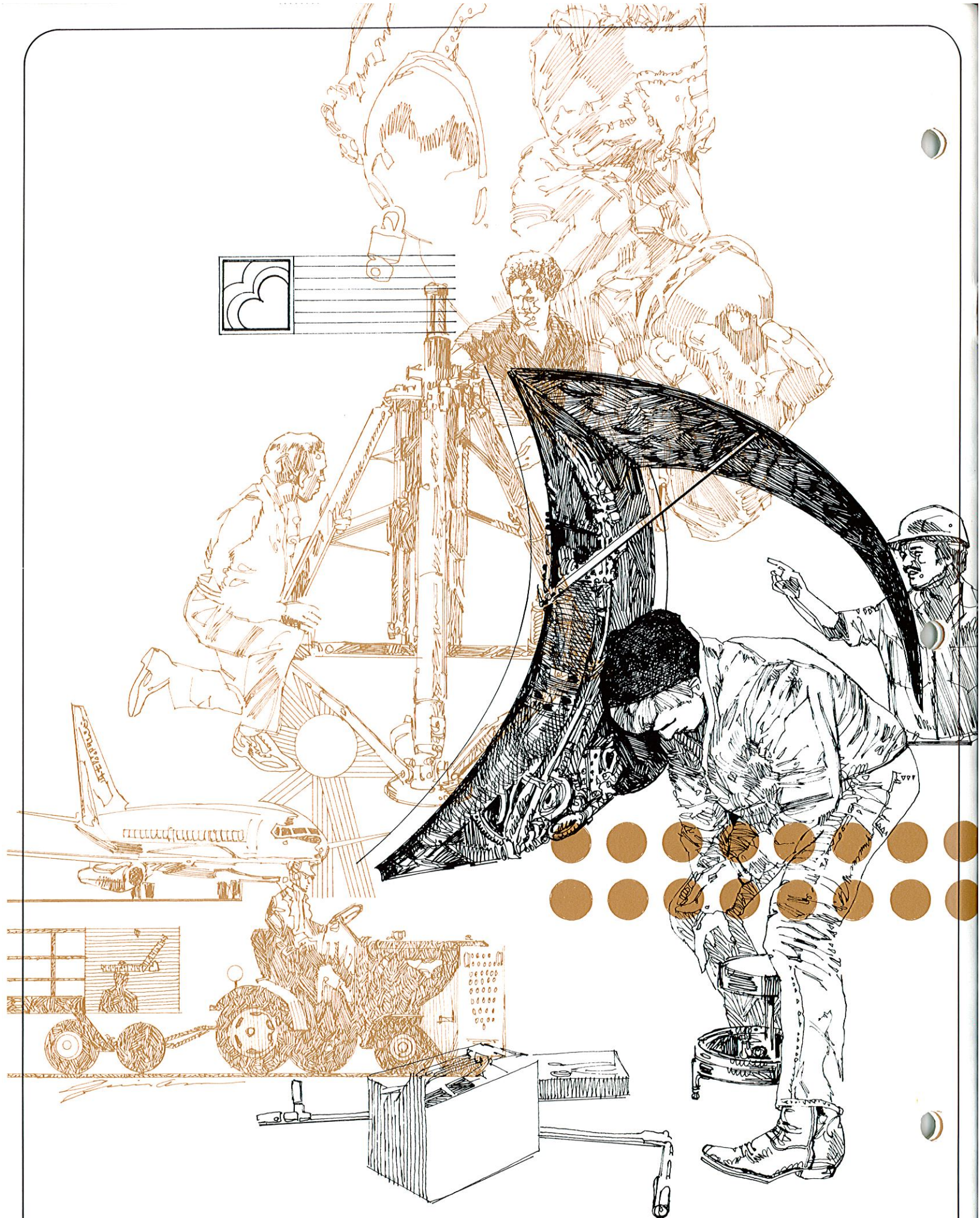
Supplemental Operating and Financial Data

	Year Ended December 31,				
	1975	1974	1973	1972	1971
OPERATING DATA					
Passengers carried	1,136,318	759,721	543,407	308,999	108,554
Passenger miles flown (000)	298,458	183,596	130,533	73,079	25,401
Trips operated	17,552	12,382	10,619	10,576	6,051
Available seat miles (000)	477,166	314,407	260,616	263,807	154,565
Passenger load factor	62.5%	58.4%	50.1%	27.7%	16.4%
Passenger revenue per passenger mile	7.26¢²	7.66¢	6.72¢ ¹	7.68¢	7.68¢

¹ Lower yield due to 60 day price war during February and March, 1973.

² Lower yield due to longer average length of passenger haul as a result of inauguration of service to Rio Grande Valley in February, 1975.

	Year Ended December 31,				
	1975	1974	1973	1972	1971
FINANCIAL DATA (000)					
Revenues	\$ 22,828	\$14,852	\$ 9,209	\$ 5,994	\$ 2,129
Expenses	19,157	12,712	9,034	8,118	4,842
Income (loss) before federal income tax	3,671	2,140	175	(2,124)	(2,713)
Provisions for federal income tax	1,507	1,095	122	—	—
Income (loss) before extraordinary item	\$ 2,164	\$ 1,045	\$ 53	\$ (2,124)	\$ (2,713)
Gain on sale of flight equip.	—	—	—	533	—
Write-off of pre-operating costs	—	—	—	—	(1,040)
Reduction of federal income tax arising from carryforward of prior years' operating losses	1,236	1,095	122	—	—
Net income (loss)	\$ 3,400	\$ 2,140	\$ 175	\$ (1,591)	\$ (3,753)
(Deficit) at beginning of period	(3,029)	(5,169)	(5,344)	(3,753)	—
Retained earnings (deficit) at end of period	\$ 371	\$ (3,029)	\$ (5,169)	\$ (5,344)	\$ (3,753)
Income (loss) per share — Before extraordinary item	\$ 2.02	\$.94	\$.05	\$ (2.00)	\$ (2.56)
Net income	\$ 3.18	\$ 1.93	\$.16	\$ (1.50)	\$ (3.54)



Statement of Income and Retained Earnings

	Year Ended December 31,	
	1975	1974
REVENUES		
Passenger	\$22,030,704	\$14,312,868
Package express	757,061	478,575
Interest	4,622	36,954
Other	35,143	23,846
	<u>22,827,530</u>	<u>14,852,243</u>
EXPENSES		
Operations and maintenance	11,582,483	6,832,875
Marketing and promotion	1,328,502	1,141,673
Insurance, taxes and administrative	2,838,617	1,811,211
Depreciation and amortization	2,110,868	1,568,697
Cost of borrowed funds (Note 3)	1,296,232	1,357,177
	<u>19,156,702</u>	<u>12,711,633</u>
Income before federal income tax and extraordinary item	3,670,828	2,140,610
Provision for deferred federal income tax (Note 7)	1,507,000	1,095,257
Income before extraordinary item	2,163,828	1,045,353
Reduction of federal income tax arising from carryforward of prior years' operating losses	1,236,000	1,095,257
NET INCOME	<u>3,399,828</u>	<u>2,140,610</u>
DEFICIT AT BEGINNING OF YEAR	(3,028,432)	(5,169,042)
RETAINED EARNINGS (DEFICIT) AT END OF YEAR	<u>\$ 371,396</u>	<u>\$ (3,028,432)</u>
INCOME PER SHARE OF COMMON STOCK		
Before extraordinary item	\$ 2.02	\$.94
Net income	<u>\$ 3.18</u>	<u>\$ 1.93</u>

See accompanying notes.

Statement of Financial Position

	December 31,	
	1975	1974
CURRENT ASSETS		
Cash	\$ 1,310,566	\$ 886,221
Accounts receivable	1,112,725	890,343
Inventories of parts and supplies, at cost	245,134	183,619
Other	183,346	151,661
TOTAL CURRENT ASSETS	2,851,771	2,111,844
CURRENT LIABILITIES		
Accounts payable	695,710	474,792
Accrued liabilities	652,360	781,315
Current maturities of long-term debt (Note 3)	—	940,000
TOTAL CURRENT LIABILITIES	1,348,070	2,196,107
WORKING CAPITAL (DEFICIT)	1,503,701	(84,263)
Flight and ground equipment, at cost, less reserves (Notes 2 and 3)	20,787,430	16,172,699
Deferred charges	53,013	281,102
TOTAL ASSETS LESS CURRENT LIABILITIES	22,344,144	16,369,538
Less:		
Long-term debt less current maturities (Note 3)	14,500,000	12,197,423
Deferred federal income tax (Note 7)	271,000	—
Deferred compensation — officer (Note 5)	158,203	100,444
NET ASSETS	\$ 7,414,941	\$ 4,071,671
STOCKHOLDERS' EQUITY (Note 4)		
Common stock, \$1.00 par value, 2,000,000 shares authorized, 1,108,758 issued	\$ 1,108,758	\$ 1,108,758
Capital in excess of par value	6,103,812	6,062,105
Retained earnings (deficit)	371,396	(3,028,432)
	7,583,966	4,142,431
Less 36,067 shares of treasury stock, at cost (14,400 shares in 1974)	169,025	70,760
TOTAL STOCKHOLDERS' EQUITY	\$ 7,414,941	\$ 4,071,671

See accompanying notes.

Statement of Changes in Financial Position

	Year Ended December 31,	
	1975	1974
FINANCIAL RESOURCES WERE PROVIDED BY:		
Income before extraordinary item	\$ 2,163,828	\$ 1,045,353
Items not affecting working capital in the current period:		
Depreciation and reserve for maintenance	1,678,777	1,676,770
Amortization of certification and Love Field costs	228,089	228,088
Deferred compensation — officer	57,759	61,944
Deferred federal income tax	271,000	—
Working capital provided from operations for the period, exclusive of extraordinary item	4,399,453	3,012,155
Issuance of long-term debt	4,340,000	3,695,669
Reduction of federal income tax arising from carryforward of prior years' operating losses	1,236,000	1,095,257
Proceeds from sale and exchange of flight equipment	—	708,500
Reduction of treasury stock through contribution to profit- sharing trust (Note 6)	63,949	—
Increase in capital in excess of par value by the excess of fair market value over cost of treasury shares contributed to profit-sharing trust (Note 6)	41,707	—
	10,081,109	8,511,581
FINANCIAL RESOURCES WERE USED FOR:		
Net additions to flight and ground equipment	6,293,508	6,578,580
Reduction of long-term debt	2,037,423	2,353,697
Additions to deferred charges	—	95,319
Purchase of treasury stock	162,214	70,760
	8,493,145	9,098,356
INCREASE (DECREASE) IN WORKING CAPITAL	\$ 1,587,964	\$ (586,775)

CHANGES IN COMPONENTS OF WORKING CAPITAL

INCREASE IN CURRENT ASSETS:

Cash	\$ 424,345	\$ 126,400
Accounts receivable	222,382	281,579
Inventories	61,515	23,336
Other	31,685	47,174
	739,927	478,489

INCREASE (DECREASE) IN CURRENT LIABILITIES:

Accounts payable	220,918	251,320
Accrued liabilities	(128,955)	473,944
Current maturities of long-term debt	(940,000)	340,000
	(848,037)	1,065,264

INCREASE (DECREASE) IN WORKING CAPITAL	\$ 1,587,964	\$ (586,775)
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See accompanying notes.

December 31, 1975

1. Summary of significant accounting policies

Basis of presentation — Certain 1974 amounts have been reclassified in the accompanying financial statements to conform to the 1975 presentation.

Depreciation and overhaul allowances — Depreciation is provided by the straight-line method over the estimated useful lives of the various classes of depreciable assets after allowing for residual values. The estimated useful lives are 12 to 15 years for the Boeing 737-200 aircraft, related spare engines and support flight equipment and 3 to 10 years for ground equipment and other.

The Company is providing for future major maintenance and overhaul to be performed on its aircraft by accruing a reserve for airworthiness of \$100 for each flight hour. The Company charges against this reserve its actual expenditures for certain aircraft maintenance materials and outside repair costs. A net reserve for future major maintenance has been accumulated in the amount of \$1,195,399 at December 31, 1975. Routine aircraft maintenance inspections are charged to expense as incurred.

Deferred charges — Deferred charges at December 31, 1975 consist of certification costs which are being amortized over a five-year period ending June 30, 1976.

Per share amounts — Income per share computations are based upon the weighted average number of shares outstanding during the respective years. Shares potentially issuable in connection with common stock warrants are excluded from the computation as their effect is not material.

2. Property and equipment

The Company's investment in flight and ground equipment at December 31 is summarized as follows:

	1975	1974
Boeing 737-200 jet aircraft	\$22,195,849	\$16,128,976
Progress payments on additional aircraft	530,219	775,291

Support flight equipment	2,877,041	2,689,928
Ground equipment and other	1,423,616	1,171,386
	<u>27,026,725</u>	<u>20,765,581</u>

Less reserve for depreciation and maintenance	6,239,295	4,592,882
	<u>\$20,787,430</u>	<u>\$16,172,699</u>

During 1975 the Company committed \$6,943,081 to purchase a sixth Boeing 737-200 aircraft and one spare JT8D-9A engine to be delivered in late 1976. In compliance with the terms of these commitments, the Company at December 31, 1975, has made advance payments totaling \$530,219 with additional advance payments of \$530,333 each payable on January 2, March 1 and May 1, 1976, respectively.

3. Long-term debt

During 1975 and subsequent to December 31, 1975 the Company refinanced its long-term debt due to the Boeing Financial Corporation and the Boeing Company in connection with previous aircraft purchases.

At December 31, 1975 (after reflecting financing completed in February 1976), the Company's long-term debt consisted of (1) an \$8,500,000 installment note payable to a bank, due in sixteen equal quarterly installments of \$531,250 beginning March 31, 1978 plus interest at 1½ % above the bank's prime rate payable quarterly beginning March 31, 1976, and (2) a \$6,000,000 installment note payable to the same bank due in twelve equal quarterly installments of \$500,000 beginning March 31, 1977 plus interest at 1½ % above the bank's prime rate payable in quarterly amounts beginning March 31, 1976. The bank notes are secured by the Company's aircraft including the aircraft to be delivered in late 1976. The loan agreements relating to the bank loans provide, among other things, for the maintenance of certain minimums for net worth, working capital ratio and for certain restrictions as to additional borrowings, capital expenditures and cash dividend payments.

4. Stockholders' equity

The Company has 115,000 shares of its common stock reserved for issuance on exercise of warrants at \$6.05 per share and 10,000 shares reserved for issuance on exercise of warrants at \$4.00 per share on or before March 10, 1976 and 1978, respectively.

5. Deferred compensation

Under a deferred compensation agreement with the President of the Company adopted by the Board of Directors on October 29, 1974, the Company is obligated to accrue for the benefit of the President, in addition to his regular salary, deferred compensation of \$250,000 over the five-year term of his current agreement ending September 30, 1979, or five percent of the net pretax earnings of the Company (as defined by the agreement) whichever is lower, for the period October 1, 1974 through September 30, 1979. During 1975, \$51,596 was accrued and charged to operations in connection with this agreement.

Total deferred compensation, including amounts pursuant to a prior agreement, will be paid at a rate not to exceed \$50,000 per year, commencing in the year following termination of the President's employment with the Company. Until such time as this deferred compensation is paid, the Company is accruing interest at the rate of 7% compounded annually on the unpaid balance beginning October 1, 1974 on the prior agreement and October 1, 1975 on the current agreement.

6. Employee profit-sharing and bonus plan

Under a noncontributory employee profit-sharing and cash bonus plan adopted by the Company in 1973 and amended in 1975, each regular Company employee on January 1, 1973, became eligible to become a member as of such date. Other regular employees are eligible to become members as of January 1 following their date of employment. The Plan provides that the Company may contribute, as determined by the Board of Directors, up to 15 percent of its adjusted pretax income (as defined in the Plan) in excess of \$1,150,000 for the year except that the Company contribution in any year

shall not exceed the maximum amount deductible for federal income tax purposes for such year.

The Plan as amended permits the Company to pay currently a portion of each eligible employee's profit-sharing in the form of a cash bonus based on a bonus formula, and the remainder is contributed to the employees' profit-sharing trust to be invested in the common stock of the Company. The Plan may be terminated at any time at the discretion of the Company's Board of Directors.

Charges to income under the provisions of the Plan amounted to \$444,845 and \$174,818 in 1975 and 1974, respectively.

7. Federal income tax

Deferred federal income taxes arise from timing differences between financial and tax reporting, principally for depreciation, and provisions made for future maintenance and overhaul costs which are not deductible for income tax purposes until actually incurred. The provision for federal income tax varies from the amount computed by multiplying income before federal income tax by the statutory federal income tax rate (48%) due primarily to the amortization of deferred certification costs, which costs are not deductible for federal income tax purposes and the utilization (flow-through method) of \$296,329 of current year investment tax credit.

The Company has unused investment tax credit carryovers of approximately \$1,143,000 at December 31, 1975, which expire in the years 1978 through 1982, if not previously utilized. During 1975 the Company utilized the remainder of its prior year net operating loss carryforward in the amount of \$2,576,000.

8. Contingencies

In 1973 the United States District Court for the Northern District of Texas declared that the cities of Dallas and Fort Worth and the Dallas-Fort Worth Regional Airport Board could not prevent the Company from serving Dallas Love Field as long as Love Field remained open as an airport. This deci-

sion was affirmed by the Fifth Circuit Court of Appeals, and the United States Supreme Court declined to grant review.

Subsequently, in December 1974 a CAB carrier (the Carrier) filed an action in the Travis County, Texas District Court seeking to exclude the Company from Love Field or, as one of the alternatives, to close Love Field as an airport. The other airlines serving DFW Airport joined the Carrier in requesting this relief. The United States District Court for the Northern District of Texas entered a temporary injunction prohibiting the Carrier and the other CAB air carriers serving DFW from proceeding with that portion of the State Court suit which seeks to relitigate the right of the Company to remain at Love Field. Those carriers have appealed the entry of the temporary injunction to the Fifth Circuit Court of Appeals, and, at present, all action in the State Court suit is suspended pending the outcome of the Fifth Circuit Appeal.

The management of the Company and its legal counsel expect to prosecute and defend success-

fully both the Federal and State Court actions, but, in the event of an adverse decision, no financial liability is indicated, although the effect on future operations is not predictable at this time.

During 1975 the CAB carrier mentioned above initiated an action in State Court against the Company and the Texas Aeronautics Commission to set aside a February 1975 TAC Certificate of Public Convenience and Necessity allowing the Company to provide service to the Lower Rio Grande Valley through Harlingen, Texas. The trial of this action has recently been completed, and although the outcome cannot be predicted at this time, no actual or contingent monetary liability against the Company has been claimed.

Total rental expense charged to income was \$946,185 in 1975 and \$332,204 in 1974 which includes landing fees of \$701,513 and \$153,405, respectively. Landing fees are set by the governing bodies of the airports served by the Company and are based upon usage. Lease commitments relating to noncancellable long-term leases are not material.

Auditor's Report

ARTHUR YOUNG & COMPANY

The Board of Directors and Stockholders
Southwest Airlines Co.

We have examined the accompanying statement of financial position of Southwest Airlines Co. at December 31, 1975 and the related statements of income and retained earnings and changes in financial position for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances. We have previously

January 30, 1976
Houston, Texas

made a similar examination of the financial statements for the prior year.

In our opinion, the statements mentioned above present fairly the financial position of Southwest Airlines Co. at December 31, 1975 and 1974 and the results of its operations and the changes in its financial position for the years then ended, in conformity with generally accepted accounting principles applied on a consistent basis during the period.

Arthur Young & Company



Directors

Sidney A. Adger
Vice President
Milchem, Inc.
Houston, Texas

Todd Alexander
Retired Investment Banker
Berkeley Heights, New Jersey

Samuel E. Barshop
President and Chairman of the
Board of Directors
LaQuinta Motor Inns, Inc.
San Antonio, Texas

A. A. Bradford
Investor
Midland, Texas

Rollin W. King
Captain,
Southwest Airlines Co.
Dallas, Texas

John D. Murchison
Partner
Murchison Brothers Investments
2300 First National Bank Bldg.
Dallas, Texas

M. Lamar Muse
President
Southwest Airlines Co.
Dallas, Texas

Officers

Corporate

M. Lamar Muse President
Herbert D. Kelleher Secretary and General Counsel
Herman H. Farr Treasurer
Sherry Phelps Assistant Secretary

Administrative

Jess R. Coker Vice President – Marketing
William W. Franklin Vice President – Ground Operations
J. L. Herring Vice President – Inflight Services
Donald G. Ogden Vice President – Flight Operations
John A. Vidal Vice President – Maintenance & Engineering

Camille Keith Asst. Vice President – Public Relations
Gary Kratochvil Asst. Vice President – Rio Grande Valley
Dennis Lardon Asst. Vice President – San Antonio
Jack Mercer Asst. Vice President – Dallas
Harold Reilly Asst. Vice President – Flight Control
Karen Wallace Asst. Vice President – Reservations
Carl Warrell Asst. Vice President – Houston
Nancy Weitzel Asst. Vice President – Inflight Services

Transfer Agent and Registrar

First National Bank in Dallas
Dallas, Texas

Stock Exchange Listing

American Stock Exchange
Ticker Symbol: LUV

Auditors

Arthur Young & Company
Houston, Texas

General Offices

1820 Regal Row
Dallas, Texas 75235

Annual Meeting

The Annual Meeting of
Shareholders of Southwest
Airlines Co. will be held at
10:00 a.m. on Tuesday, April
27, 1976 in the Auditorium of the
Mercantile National Bank
located on its fourth floor at
1704 Main Street, Dallas, Texas.

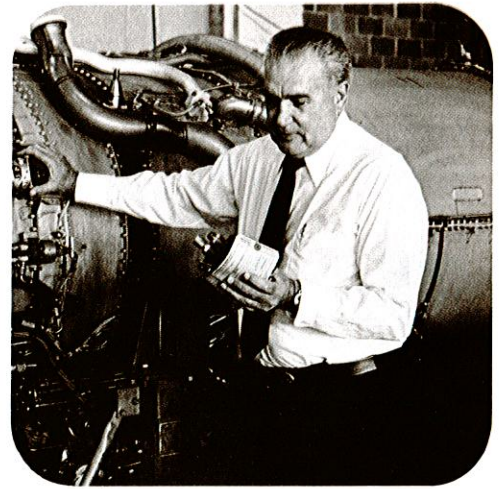
SEC Form 10-K

For additional information, see
Statement of Income covering
the five year period since start
of operation filed with the
Securities and Exchange
Commission as part of Annual
Report Form 10-K. A copy of
this report is available upon
written request to the Treasurer
of the Company.





Kelleher, Muse, Phelps and Farr



Vidal



Keith and Coker



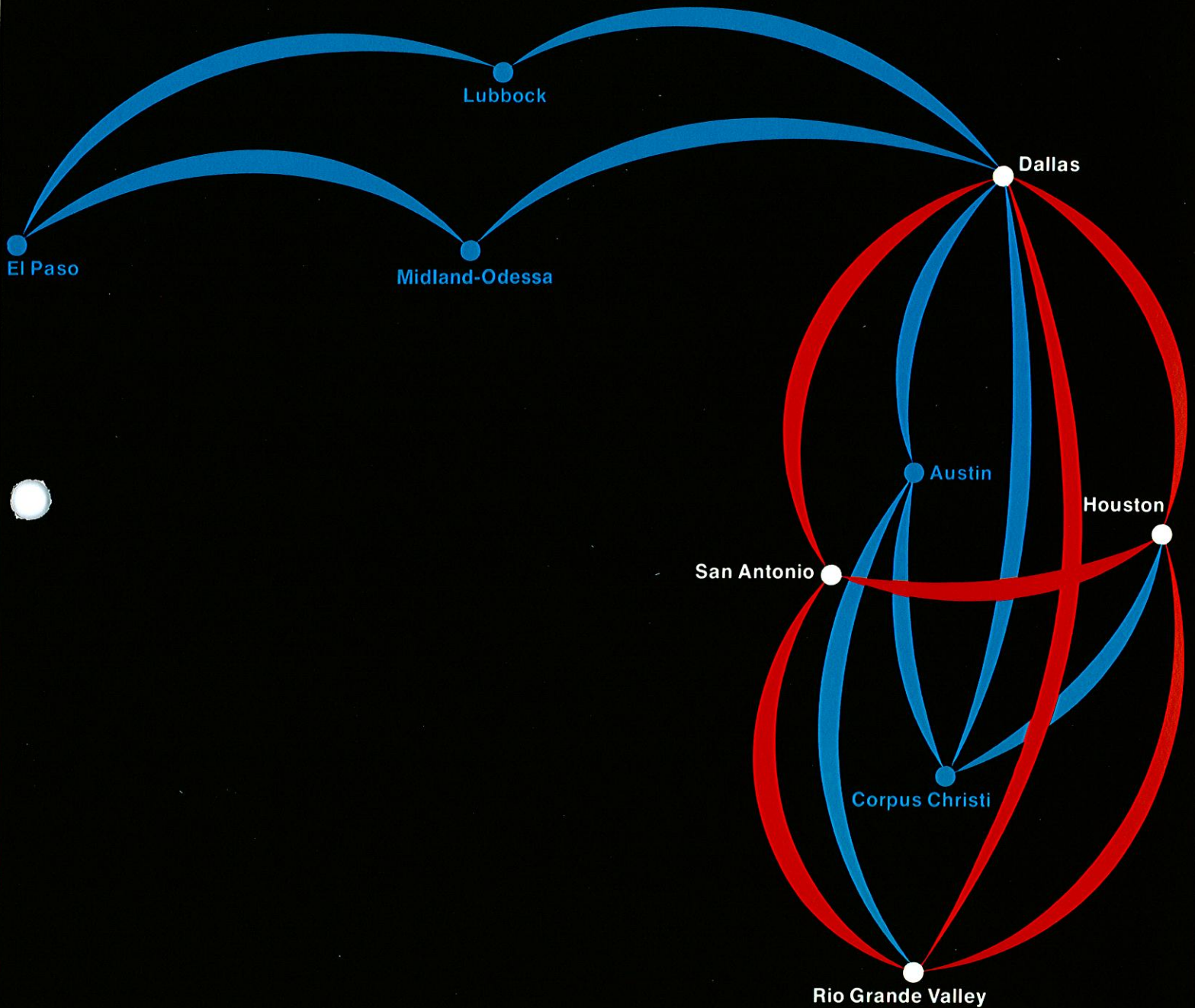
Weitzel and Herring



Warrell, Mercer, Franklin, Wallace, Kratochvil and Lardon



Reilly and Ogden



Southwest Airlines Co. Route Map

routes currently in operation



proposed additional routes



SOUTHWEST  **AIRLINES**

1820 Regal Row
Dallas, Texas 75235