

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

☒ QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934

For the quarterly period ended March 31, 2002 or

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

For the transition period from _____ to _____

Commission file No. 1-7259

Southwest Airlines Co.

(Exact name of registrant as specified in its charter)

TEXAS

(State or other jurisdiction of
incorporation or organization)

74-1563240

(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) 792-4000**

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

Number of shares of Common Stock outstanding as of the close of business on April 26, 2002:

771,684,488

SOUTHWEST AIRLINES CO.
FORM 10-Q
Part I - FINANCIAL INFORMATION

Item 1. Financial Statements

Southwest Airlines Co.
Condensed Consolidated Balance Sheet
(in thousands)
(unaudited)

	<u>March 31, 2002</u>	<u>December 31, 2001</u>
ASSETS		
Current assets:		
Cash and cash equivalents	\$2,113,523	\$2,279,861
Accounts and other receivables	133,136	71,283
Inventories of parts and supplies, at cost	73,181	70,561
Deferred income taxes	46,400	46,400
Prepaid expenses and other current assets	79,060	52,114
Total current assets	<u>2,445,300</u>	<u>2,520,219</u>
Property and equipment, at cost:		
Flight equipment	7,654,679	7,534,119
Ground property and equipment	934,537	899,421
Deposits on flight equipment purchase contracts	398,572	468,154
	<u>8,987,788</u>	<u>8,901,694</u>
Less allowance for depreciation	<u>2,528,918</u>	<u>2,456,207</u>
	6,458,870	6,445,487
Other assets	64,608	31,435
	<u>\$8,968,778</u>	<u>\$8,997,141</u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$410,458	\$504,831
Accrued liabilities	532,841	547,540
Air traffic liability	561,304	450,407
Aircraft purchase obligations	198,601	221,840
Short-term borrowings	-	475,000
Current maturities of long-term debt	39,983	39,567
Total current liabilities	<u>1,743,187</u>	<u>2,239,185</u>
Long-term debt less current maturities	1,701,979	1,327,158
Deferred income taxes	1,109,750	1,058,143
Deferred gains from sale and leaseback of aircraft	188,547	192,342
Other deferred liabilities	114,196	166,260
Stockholders' equity:		
Common stock	771,250	766,774
Capital in excess of par value	66,579	50,409
Retained earnings	3,246,314	3,228,408
Accumulated other comprehensive income (loss)	26,976	(31,538)
Total stockholders' equity	<u>4,111,119</u>	<u>4,014,053</u>
	<u>\$8,968,778</u>	<u>\$8,997,141</u>

See accompanying notes.

Southwest Airlines Co.
Condensed Consolidated Statement of Income
(in thousands, except per share amounts)
(unaudited)

	Three months ended March 31,	
	2002	2001
OPERATING REVENUES:		
Passenger	\$1,214,785	\$1,381,276
Freight	20,789	25,781
Other	21,669	21,560
Total operating revenues	1,257,243	1,428,617
OPERATING EXPENSES:		
Salaries, wages, and benefits	461,650	447,431
Fuel and oil	170,369	209,584
Maintenance materials and repairs	96,594	98,524
Agency commissions	14,133	30,494
Aircraft rentals	47,435	48,045
Landing fees and other rentals	83,180	70,018
Depreciation	84,595	77,692
Other operating expenses	249,922	236,672
Total operating expenses	1,207,878	1,218,460
OPERATING INCOME	49,365	210,157
OTHER EXPENSES (INCOME):		
Interest expense	26,479	17,012
Capitalized interest	(4,387)	(6,199)
Interest income	(9,591)	(8,882)
Other (gains) losses, net	1,668	11,724
Total other expenses (income)	14,169	13,655
INCOME BEFORE INCOME TAXES	35,196	196,502
PROVISION FOR INCOME TAXES	13,811	75,457
NET INCOME	\$21,385	\$121,045
 NET INCOME PER SHARE, BASIC	 \$.03	 \$.16
 NET INCOME PER SHARE, DILUTED	 \$.03	 \$.15
 WEIGHTED AVERAGE SHARES OUTSTANDING:		
Basic	769,369	760,225
Diluted	810,763	807,744

See accompanying notes.

Southwest Airlines Co.
Condensed Consolidated Statement of Cash Flows
(in thousands)
(unaudited)

	Three months ended March 31,	
	2002	2001
NET CASH PROVIDED BY OPERATING ACTIVITIES	\$92,553	\$420,598
INVESTING ACTIVITIES:		
Net purchases of property and equipment	(109,080)	(254,328)
FINANCING ACTIVITIES:		
Proceeds from long-term debt obligations	385,000	-
Payments of long-term debt and capital lease obligations	(5,419)	(5,019)
Payment of short term debt	(475,000)	-
Payment of trust arrangement	(122,971)	-
Payments of cash dividends	(6,916)	(6,570)
Proceeds from Employee stock plans	20,646	7,002
Proceeds from trust arrangement	59,193	-
Other, net	(4,344)	-
NET CASH USED IN FINANCING ACTIVITIES	(149,811)	(4,587)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(166,338)	161,683
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	2,279,861	522,995
CASH AND CASH EQUIVALENTS AT END OF PERIOD	\$2,113,523	\$684,678
CASH PAYMENTS FOR:		
Interest, net of amount capitalized	\$16,689	\$18,086
Income taxes	\$286	\$3,109

See accompanying notes.

Southwest Airlines Co.
Notes to Condensed Consolidated Financial Statements
(unaudited)

1. Basis of presentation - The accompanying unaudited condensed consolidated financial statements of Southwest Airlines Co. (Company) have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements. The unaudited condensed consolidated financial statements for the interim period ended March 31, 2002 and 2001 include all adjustments (which include only normal recurring adjustments) which are, in the opinion of management, necessary for a fair presentation of the results for the interim periods. The Condensed Consolidated Balance Sheet as of December 31, 2001 has been derived from the Company's audited financial statements as of that date but does not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. Operating results for the three months ended March 31, 2002 are not necessarily indicative of the results that may be expected for the year ended December 31, 2002. For further information, refer to the consolidated financial statements and footnotes thereto included in the Southwest Airlines Co. Annual Report on Form 10-K for the year ended December 31, 2001.

2. Dividends - During the three months ended March 31, 2002, dividends of \$.0045 per share were declared on the 770.7 million shares of common stock then outstanding. During the three months ended March 31, 2001, dividends of \$.0045 per share were declared on the 760.7 million shares of common stock then outstanding.

3. Net income per share - The following table sets forth the computation of basic and diluted net income per share (in thousands except per share amounts):

	Three months ended March 31,	
	2002	2001
NUMERATOR:		
Net income available to common stockholders	\$21,385	\$121,045
DENOMINATOR:		
Weighted-average shares		
outstanding, basic	769,369	760,225
Dilutive effect of Employee stock		
options	41,394	47,519
Adjusted weighted-average shares		
outstanding, diluted	810,763	807,744
NET INCOME PER SHARE:		
Basic	\$.03	\$.16
Diluted	\$.03	\$.15

4. Accounting changes - Effective January 1, 2001, the Company adopted Statement of Financial Accounting Standards No. 133, *Accounting for Derivative Instruments and Hedging Activities*, as amended (SFAS 133). SFAS 133 requires the Company to record all financial derivative instruments on its balance sheet at fair value. Derivatives that are not designated as hedges must be adjusted to fair value through income. If a derivative is designated as a hedge, depending on the nature of the hedge, changes in its fair value that are considered to be effective, as defined, either offset the change in fair value of the hedged assets, liabilities, or firm commitments through earnings or are recorded in "Accumulated other comprehensive income (loss)" until the hedged item is recorded in earnings. Any portion of a change in a derivative's fair value that is considered to be ineffective, as defined, is recorded immediately in "Other (gains) losses, net" in the Condensed Consolidated Statement of Income. Any portion of a change in a derivative's fair value that the Company elects to exclude from its measurement of effectiveness is required to be recorded immediately in earnings.

Upon adoption of SFAS 133, the Company recorded the fair value of its fuel derivative instruments in the Condensed Consolidated Balance Sheet and a deferred gain of \$46.1 million, net of tax, in "Accumulated other comprehensive income (loss)", of which \$45.5 million was recognized in earnings in 2001. See Note 6 for further information on Comprehensive income. The 2001 adoption of SFAS 133 has resulted in more volatility in the Company's financial statements than in the past due to the changes in market values of its derivative instruments and some ineffectiveness that has been experienced in its fuel hedges. See Note 5 for further information on the Company's derivative instruments.

5. Financial derivative instruments - Airline operators are inherently dependent upon energy to operate and, therefore, are impacted by changes in jet fuel prices. Jet fuel and oil consumed in the first quarters of 2002 and 2001 represented approximately 14.1 percent and 17.2 percent of Southwest's operating expenses, respectively. The Company endeavors to acquire jet fuel at the lowest possible prices. Because jet fuel is not traded on an organized futures exchange, liquidity for hedging is limited. However, the Company has found that both crude oil and heating oil contracts are effective commodities for hedging jet fuel. The Company has financial derivative instruments in the form of the types of hedges it utilizes to decrease its exposure to jet fuel price increases. The Company does not purchase or hold any derivative financial instruments for trading purposes.

The Company utilizes financial derivative instruments for both short-term and long-term time frames when it appears the Company can take advantage of market conditions. At March 31, 2002, the Company had a mixture of purchased call options, collar structures, and fixed price swap agreements in place to hedge approximately 50 percent, 65 percent, and 80 percent of its second quarter, third quarter, and fourth quarter 2002 total anticipated jet fuel requirements, respectively. The Company also has agreements in place to hedge approximately 50 percent of its 2003 total anticipated jet fuel requirements, and a small portion of its 2004-2005 total anticipated jet fuel requirements. As of March 31, 2002, the majority of the Company's remaining 2002 hedges are effectively heating oil-based positions in the form of option contracts. The majority of the remaining hedge positions are crude oil-based.

The Company accounts for its fuel hedge derivative instruments as cash flow hedges, as defined in SFAS 133. Therefore, all changes in fair value that are considered to be effective are recorded in "Accumulated other comprehensive income (loss)" until the underlying jet fuel is consumed. The fair value of the Company's financial derivative instruments at March 31, 2002, was a net asset of approximately \$78.5 million. The current portion of this net asset is classified in "Prepaid expenses and other current assets" and the noncurrent portion is classified in "Other assets" in the Condensed Consolidated Balance Sheet. The fair value of the derivative instruments, depending on the type of instrument, was determined by the use of present value methods or standard option value models with assumptions about commodity prices based on those observed in underlying markets.

During the first quarters of 2002 and 2001, the Company recognized \$6.1 million in losses (expense) and \$24.4 million in gains in "Fuel and oil" expense, respectively, from hedging activities. The Company recognized approximately \$5.9 million and \$8.4 million of net expense, related to amounts excluded from the Company's measurements of hedge effectiveness, in "Other (gains) losses, net" during the first quarters of 2002 and 2001, respectively. The Company recognized approximately \$4.6 million as additional income and \$2.5 million as net expense in "Other (gains) losses, net," related to the ineffectiveness of its hedges during the first quarters of 2002 and 2001, respectively.

As of March 31, 2002, the Company had approximately \$27.8 million in unrealized gains, net of tax, in "Accumulated other comprehensive income (loss)" related to fuel hedges. Included in this total are approximately \$15.4 million in net unrealized gains that are expected to be realized in earnings during the twelve months following March 31, 2002.

6. Comprehensive income - Comprehensive income includes changes in the fair value of certain financial derivative instruments, which qualify for hedge accounting, and unrealized gains and losses on certain investments. Comprehensive income totaled \$79.9 million and \$156.8 million for the first quarters of 2002 and 2001, respectively. The differences between Net income and Comprehensive income for each of these periods was as follows (in thousands):

	Three months ended March 31,	
	2002	2001
Net income	\$21,385	\$121,045
Unrealized gain (loss) on derivative instruments, net of deferred taxes of \$38,021 and \$23,575	58,858	36,494
Other, net of deferred taxes of (\$222) and (\$452)	(344)	(699)
Total other comprehensive income	58,514	35,795
Comprehensive income	\$79,899	\$156,840

A rollforward of the amounts included in "Accumulated other comprehensive income (loss)," net of taxes, is shown below (in thousands):

	Fuel hedge derivatives	Other	Accumulated other comprehensive income
Balance at December 31, 2001	(\$31,063)	(\$475)	(\$31,538)
2002 changes in value	54,853	(344)	54,509
Reclassification to earnings	4,005	-	4,005
Balance at March 31, 2002	\$ 27,795	(\$819)	\$ 26,976

7. September 11, 2001 Terrorist Attacks - On September 11, 2001, terrorists hijacked and used two American Airlines, Inc. aircraft and two United Air Lines, Inc. aircraft in terrorist attacks on the United States (terrorist attacks). As a result of these terrorist attacks, the Federal Aviation Administration (FAA) immediately suspended all commercial airline flights. The Company resumed flight activity on September 14 and was operating its normal pre-September 11 flight schedule by September 18, 2001. From September 11 until the Company resumed flight operations on September 14, Southwest cancelled approximately 9,000 flights.

Once the Company resumed operations, load factors (percentage of seats filled) and yields (revenue per mile flown) were severely impacted, along with increased ticket refund activity. Although load factors returned to somewhat normal levels during fourth quarter 2001, yields have continued to be significantly below prior year levels.

On September 22, 2001, President Bush signed into law the Air Transportation Safety and System Stabilization Act (the Act). The Act provides for up to \$5 billion in cash grants to qualifying U.S. airlines and freight carriers to compensate for direct and incremental losses, as defined in the Act, from September 11, 2001 through December 31, 2001, associated with the terrorist attacks. Each airline's total eligible grant is determined based on that airline's percentage of ASMs during August 2001 to total eligible carriers' ASMs for August 2001, less an amount set aside for eligible carriers for whom the use of ASM formula would result in an insufficient representation of their share of direct and incremental losses. The Department of Transportation (DOT) will make the final determination of the amount of eligible direct and incremental losses incurred by each airline. Direct and incremental losses, while defined generally in the Act, are subject to interpretation by the DOT. The DOT issued its final rules with respect to the Act on April 16, 2002. Final applications for grants, which are due to the DOT on or before May 16, 2002, must be accompanied by Agreed Upon Procedures reports from independent auditors and may be subject to additional audit or review by the DOT and Congress.

During the third and fourth quarters of 2001, the Company recognized a total of \$235 million from grants under the Act as "Other gains." The Company believes its actual direct and incremental losses related to the September 11 terrorist attacks exceed the total amount for which the Company will be ultimately eligible. The Company expects to recognize approximately \$40 million in additional grants during second quarter 2002 under the Act upon completion and approval of the final application based on the DOT's final interpretations of the Act. However, due to remaining

uncertainties regarding the interpretation of the Act, no amounts have been accrued as a receivable at March 31, 2002.

The Company recorded total special charges of \$48 million during the third and fourth quarters of 2001 arising from the terrorist attacks. Total special charges included a \$30 million reduction in "Passenger revenue" resulting from refunds of nonrefundable fares, \$13 million in charges to "Other operating expenses" for write-downs of various assets due to impairment, and other charges that are included in "Other (gains) losses, net."

8. Credit facility - In September 2001, the Company borrowed the full \$475 million available under its unsecured revolving credit line with a group of banks. Borrowings under the credit line bore interest at six-month LIBOR plus 15.5 basis points. The Company repaid this unsecured revolving credit line in full, plus accrued interest, in March 2002.

9. Issuance of debt - During first quarter 2002, the Company issued \$385 million 10-year senior unsecured Notes (Notes). The Notes bear interest at 6.5 percent, payable semi-annually in arrears, with the first payment due on September 1, 2002. The Notes mature on March 1, 2012. Southwest will use the net proceeds from the issuance of the Notes, approximately \$380.2 million, for general corporate purposes.

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

Comparative Consolidated Operating Statistics

Relevant Southwest comparative operating statistics for the three months ended March 31, 2002 and 2001 are as follows:

	Three months ended March 31,		Change
	2002	2001	
Revenue passengers carried	14,463,282	15,716,020	(8.0)%
Revenue passenger miles (RPMs) (000s)	10,392,590	10,662,391	(2.5)%
Available seat miles (ASMs) (000s)	16,519,957	15,852,999	4.2%
Load factor	62.9%	67.3%	(4.4) pts.
Average length of passenger haul	719	678	6.0%
Trips flown	231,195	231,793	(0.3)%
Average passenger fare	\$83.99	\$87.89	(4.4)%
Passenger revenue yield per RPM (cents)	11.69	12.95	(9.7)%
Operating revenue yield per ASM (cents)	7.61	9.01	(15.5)%
Operating expenses per ASM (cents)	7.31	7.69	(4.9)%
Operating expenses per ASM, excluding fuel (cents)	6.28	6.36	(1.3)%
Fuel costs per gallon, excluding fuel tax (cents)	63.28	78.53	(19.4)%
Number of Employees at period-end	32,244	29,563	9.1%
Size of fleet at period-end	359	352	2.0%

Southwest operating expenses per ASM for the three months ended March 31, 2002 and 2001 are as follows (in cents except percent change):

	Three months ended March 31,		Percent Change
	2002	2001	
Salaries, wages, and benefits	2.64	2.49	6.0
Employee retirement plans	.16	.33	(51.5)
Fuel and oil	1.03	1.32	(22.0)
Maintenance materials and repairs	.58	.62	(6.5)
Agency commissions	.09	.19	(52.6)
Aircraft rentals	.29	.30	(3.3)
Landing fees and other rentals	.50	.44	13.6
Depreciation	.51	.49	4.1
Other operating expenses	1.51	1.51	-
Total	7.31	7.69	(4.9)

Material Changes in Results of Operations

Summary

The operating environment for the airline industry continues to be a challenging one. The combination of a weak domestic economic climate, additional airport security regulations, dramatically increasing costs for aviation insurance, and volatility in fuel prices, are expected to result in billions of dollars in losses for the airline industry in 2002. During the first quarter 2002, the Company was able to overcome these obstacles and report a profit, albeit a small one.

Consolidated net income for first quarter 2002 was \$21.4 million (\$.03 per share, diluted), as compared to first quarter 2001 net income of \$121.0 million (\$.15 per share, diluted). Operating income was \$49.4 million compared to operating income of \$210.2 million in 2001. The decreases in net income and operating income were due to the decrease in revenues. Substantial discounting of airfares by the Company and the entire industry has stimulated demand, but has also resulted in a much lower passenger revenue yield per RPM (passenger yield) versus the prior year. In total, operating expenses declined slightly from the same year ago period. Operating expenses per ASM decreased 4.9 percent to \$.0731 primarily due to lower jet fuel prices, agency commissions and profitsharing. These decreases more than offset increases in airport security and aviation insurance costs.

While the Company's recent promotional activity has been successful in generating second quarter 2002 bookings, the Company expects its April load factor to continue to trail year ago levels. (The immediately preceding sentence is a forward-looking statement that involves uncertainties that could result in actual results differing materially from expected results. Some significant factors include, but may not be limited to, additional incidents that could cause the public to question the safety and/or efficiency of air travel, competitive pressure such as fare sales and capacity changes by other carriers, general economic conditions, and variations in advance booking trends.)

Security. Over the past several months, the Company has had to respond and react swiftly to numerous new and changing Federal Security Directives. These directives have dramatically changed the manner in which Customers, luggage, and airplanes are protected and cleared for flight and have created various challenges at each of the 59 airports we currently serve. However, these enhanced security measures have not diminished our aircraft productivity or impaired Southwest's reliable ontime performance record. Although, early on, our Customers had to experience longer checkin lines during this transition period, the Company has quickly implemented significant changes across our network to reduce wait times. Although significant progress has been made since the weeks following September 11, improving the overall airport experience remains one of our primary operational goals and we have a number of projects still underway to further expedite the checkin process.

Comparison of Three Months Ended March 31, 2002 to Three Months Ended March 31, 2001

Consolidated operating revenues decreased 12.0 percent primarily due to a 12.1 percent decrease in passenger revenues. As a result of heavy promotional activities and weak business travel, the Company is carrying a greater proportion of lower yielding discount fare passengers than in recent years. However, the airline industry has continued to recover from the aftermath of the September 11, 2001 terrorist attacks (terrorist attacks), and, as expected, revenue yield trends improved from fourth quarter 2001. First quarter 2002 capacity, as measured by available seat miles (ASMs), increased 4.2 percent. The increase in ASMs primarily resulted from the net addition of 7 aircraft (net of five retirements) from April 2001 through March 2002. The first quarter 2002 load factor was 62.9 percent, a decrease of 4.4 points compared to 2001. The Company experienced an 8.0 percent decrease in revenue passengers carried, a 2.5 percent decrease in RPMs, and a 9.7 percent decrease in passenger yield.

As a result of the terrorist attacks and weak economic conditions throughout first quarter 2002, consolidated freight revenues decreased 19.4 percent. Subsequent to the resumption of service after the terrorist attacks, the U.S. Postal Service made a decision to divert more of its mail shipments to freight carriers and away from commercial airlines. As a result, the Company expects year-over-year declines in freight revenues to continue throughout the near term. (The immediately preceding sentence is a forward-looking statement that involves uncertainties that could result in actual results differing materially from expected results. Some significant factors include, but may not be limited to, decisions by major freight customers on how they allocate freight deliveries among different types of carriers, general economic conditions, etc.) Other revenues increased slightly primarily due to an increase in commissions earned from programs the Company sponsors with certain business partners, such as the Company sponsored First USA Visa card. That increase was partially offset by a decline in charter revenues.

Operating expenses per ASM were \$.0731, a 4.9 percent decrease compared to \$.0769 for 2001. Excluding fuel expense, operating expenses per ASM declined 1.3 percent to \$.0628. However, if the Company's business continues to improve, second quarter 2002 unit costs, excluding fuel, are expected to increase modestly compared to second quarter 2001. (The immediately preceding sentence is a forward-looking statement that involves uncertainties that could result in actual results differing materially from expected results. Some significant factors include, but may not be limited to, capacity changes by the Company and its competitors, changing security requirements, labor issues, etc.)

Salaries, wages, and benefits per ASM increased 6.0 percent. Approximately two-thirds of the increase was in salaries and wages, as the Company's headcount growth exceeded the increase in ASMs. The Company has increased headcount in certain operational areas in order to alleviate excessive overtime and to comply with enhanced federal security regulations. Approximately one-third of the increase was in benefits, primarily due to increasing health care costs. Based on the Company's recent hiring, the overall rise in health care costs, and the expected growth in ASMs, we are expecting an increase in salaries, wages, and benefits per ASM in second quarter 2002 compared to 2001. (The immediately preceding sentence is a forward-looking statement that involves

uncertainties that could result in actual results differing materially from expected results. Some significant factors include, but may not be limited to, Employee hiring and retention rates, the results of Employee labor contract negotiations, costs for health care, capacity decisions made by the Company, etc.)

Employee retirement plans expense per ASM decreased 51.5 percent, primarily due to the decrease in Company earnings available for profitsharing.

Fuel and oil expense per ASM decreased 22.0 percent due to a 19.4 percent decrease in the average jet fuel cost per gallon compared to 2001. The average jet fuel cost per gallon in first quarter 2002 was \$.6328 compared to \$.7853 in first quarter 2001, including the effects of hedging activities. See Note 5 to the unaudited condensed consolidated financial statements. As of March 31, 2002, the Company had fuel derivatives in place to hedge approximately 50 percent, 65 percent, and 80 percent of its second quarter, third quarter, and fourth quarter 2002 total anticipated jet fuel requirements. The majority of the Company's near term hedge positions are in the form of option contracts, which should enable the Company to benefit to a large extent from a decline in jet fuel prices. (The immediately preceding sentence is a forward-looking statement, which involves uncertainties that could result in actual results differing materially from expected results. Such uncertainties include, but may not be limited to, the largely unpredictable prices of jet fuel, crude oil, and heating oil prices, the continued effectiveness of the Company's fuel hedges, and changes in the Company's overall fuel hedging strategy.)

Maintenance materials and repairs per ASM decreased 6.5 percent primarily due to a decrease in engine repair expense per ASM. Virtually all the Company's first quarter capacity growth versus the prior year was accomplished with new aircraft, most of which have not yet begun to incur any meaningful engine repair costs. The Company expects second quarter 2002 maintenance materials and repairs per ASM to be slightly lower than second quarter 2001 expense due to a decrease in scheduled engine repairs for the Company's 737-200 aircraft. (The immediately preceding sentence is a forward-looking statement involving uncertainties that could result in actual results differing materially from expected results. Such uncertainties include, but may not be limited to, any unscheduled required aircraft airframe or engine repairs and regulatory requirements.)

Agency commissions per ASM decreased 52.6 percent. Approximately 60 percent of the decrease was due to a change in the Company's commission rate policy, and approximately 40 percent was due to the overall decline in revenues and the mix of commissionable revenues. Effective October 15, 2001, the Company reduced the commission paid to travel agents to five percent (with no cap), regardless of the type of ticket sold. Previously, the Company paid an eight percent commission rate on ticketless bookings by travel agents. The percentage of commissionable revenues decreased from approximately 28 percent in first quarter 2001 to approximately 22 percent in first quarter 2002. Due to the commission policy change in October 2001, the Company expects agency commissions to show a year-over-year decrease in second quarter 2002 on a per-ASM basis. (The immediately preceding sentence is a forward-looking statement involving uncertainties that could result in actual results differing materially from expected results. Such uncertainties include, but may not be limited to, changes in consumer ticket purchasing habits.)

Aircraft rentals per ASM decreased 3.3 percent compared to first quarter 2001 due to a lower percentage of the aircraft fleet being leased. The Company retired two leased aircraft in fourth

quarter 2001 and one leased aircraft in first quarter 2002. Approximately 25.3 percent of the Company's aircraft fleet was under operating lease at March 31, 2002, compared to 26.7 percent at March 31, 2001.

Landing fees and other rentals per ASM increased 13.6 percent. Approximately 60 percent of the increase was due to an increase in other rentals primarily as a result of the Company's expansion of facilities in several airports, most notably Chicago Midway Airport and Baltimore/Washington International Airport. Approximately 40 percent of the increase was due to an increase in landing fee rates at certain airports as a result of capacity reductions by other airlines. As a result of the terrorist attacks, most major airlines reduced their flight schedules and/or have retired aircraft early due to the decrease in demand for air travel. Since Southwest did not reduce the number of flights it offers, the Company expects that the airport costs it shares with other airlines on the basis of flights offered or passengers carried, such as landing fees, will also show an increase on a per ASM basis in second quarter 2002 compared to the prior year. However, due to the recent reinstatement of certain routes by other carriers, the Company does not expect the second quarter 2002 increase to be as large as the first quarter 2002 increase. (The immediately preceding two sentences are forward-looking statements involving uncertainties that could result in actual results differing materially from expected results. Such uncertainties include, but may not be limited to, changes in competitors' flight schedules, demand for air travel, etc.)

Depreciation expense per ASM increased 4.1 percent primarily due to a higher percentage of owned aircraft. All 12 of the aircraft put in service by the Company over the past twelve months have been purchased. This, along with the retirement of five aircraft, three of which were leased, has increased the Company's percentage of aircraft owned or on capital lease to 74.7 percent at March 31, 2002 from 73.3 percent at March 31, 2001.

Other operating expenses per ASM was flat compared to the prior year. The Company incurred substantial increases in aviation insurance costs from increased rates imposed on airlines to counterbalance the losses insurers incurred associated with the terrorist attacks and in airport security costs due to additional procedures instituted by the federal government following the terrorist attacks. The Company was able to offset these increases in first quarter 2002 through cost control measures implemented immediately following the terrorist attacks. The Company expects the heightened costs of aviation insurance to continue for the foreseeable future. This increase is expected to total in excess of \$85 million for the full year 2002 compared to 2001. There is no assurance the Company will continue to offset such increases with cost reductions in other areas in future periods. The increases in airport security costs are expected to subside in second quarter 2002 due to the newly established Transportation Security Administration's overtaking of the majority of U.S. airport security in February 2002, and all U.S. airport security during second quarter 2002. (The immediately preceding four sentences are forward-looking statements involving uncertainties that could result in actual results differing materially from expected results. Such uncertainties include, but may not be limited to, results of the Company's cost control efforts, changes in the Transportation Security Administration's schedule or scope for taking over U.S. airport security, etc.)

Interest expense increased 55.6 percent primarily due to three separate borrowings executed by the Company over the past several months. Following the terrorist attacks, the Company borrowed the full \$475 million available under its revolving credit facility. This borrowing was fully repaid in March 2002. During the fourth quarter 2001, the Company issued \$614.3 million in

long-term debt in the form of Pass-Through Certificates and in first quarter 2002 issued \$385 million in unsecured notes (see Note 9 to the unaudited condensed consolidated financial statements). The increase in expense caused by these borrowings was partially offset by a decrease in interest rates on the Company's floating rate debt and the July 2001 redemption of \$100 million of unsecured notes. Based on the Company's recent borrowings, we expect interest expense to be higher on a year-over-year basis throughout 2002. (The immediately preceding sentence is a forward-looking statement involving uncertainties that could result in actual results differing materially from expected results. Such uncertainties include, but may not be limited to, subsequent financing decisions made by the Company.)

Capitalized interest decreased 29.2 percent primarily due to a reduction in progress payment balances for future aircraft deliveries.

Interest income increased 8.0 percent as substantially higher invested cash balances were partially offset by a decrease in rates earned on investments.

Other losses in first quarter 2002 and 2001 are primarily related to net charges recorded in accordance with SFAS 133, which the Company adopted January 1, 2001. The Company recognized approximately \$5.9 million and \$8.4 million of net expense, related to amounts excluded from the Company's measurements of hedge effectiveness, in "Other (gains) losses, net" during the first quarters of 2002 and 2001, respectively. The Company recognized approximately \$4.6 million as additional income and \$2.5 million as net expense in "Other (gains) losses, net," related to the ineffectiveness of its hedges during the first quarters of 2002 and 2001, respectively. See Note 5 to the unaudited condensed consolidated financial statements. As detailed in Note 7 to the unaudited condensed consolidated financial statements, the Company may recognize gains from additional grants from the Air Transportation Safety and System Stabilization Act (the Act) of up to approximately \$40 million during second quarter 2002. (The immediately preceding sentence is a forward-looking statement involving uncertainties that could result in actual results differing materially from expected results. Such uncertainties include, but may not be limited to, subsequent modifications or amendments to the Act, changes in the expected requirements for or schedule of distributing grant funds, etc.)

Liquidity and Capital Resources

Net cash provided by operating activities was \$92.6 million for the three months ended March 31, 2002 and \$1,156.6 million for the 12 months then ended. In addition, the Company issued \$385 million in unsecured notes and repaid its \$475 million revolving credit facility during first quarter 2002. See Notes 8 and 9 to the unaudited condensed consolidated financial statements. Cash generated for the 12 months ended March 31, 2002 was primarily used to finance aircraft-related capital expenditures and provide working capital.

During the 12 months ended March 31, 2002, net capital expenditures were \$852.6 million, which primarily related to the purchase of new 737-700 aircraft and progress payments for future aircraft deliveries.

The Company's contractual purchase commitments consist primarily of scheduled aircraft acquisitions. As a result of the terrorist attacks, the Company modified its future delivery dates to defer the acquisition of 19 new 737-700 aircraft that were either already in production at Boeing or were scheduled to be built through April 2002 through an arrangement with a special purpose trust (the Trust). Through the Trust, the Company accepted six of these 19 aircraft in first quarter 2002 and has announced its intention to accept delivery of eight more aircraft in second quarter 2002. The remaining five aircraft are scheduled for delivery in the first half of 2003, although the Company has the ability to accelerate the delivery of these aircraft at any time before their scheduled delivery dates. For these 19 aircraft, the Company has recorded the associated assets ("Flight equipment" or "Deposits on flight equipment purchase contracts") and liabilities ("Aircraft purchase obligations") in its financial statements as the aircraft have been completed by Boeing and delivered to the Trust. As of March 31, 2002, 15 of the 19 aircraft have been delivered by Boeing to the Trust.

In addition to the aircraft that are part of the Trust, the Company has contractual purchase commitments, aircraft purchase options, and aircraft purchase rights with Boeing for a total of 417 aircraft through 2012. This total has not changed since the terrorist attacks. The Company has the option, which must be exercised two years prior to the contractual delivery date, to substitute 737-600s or 737-800s for the 737-700s. Including the amounts associated with the Trust that are, or will be, included as liabilities in the Company's Condensed Consolidated Balance Sheet, aggregate (cash basis) funding needed for firm commitments, as of March 31, 2002, is approximately \$3.6 billion, subject to adjustments for inflation, due as follows: \$359 million in 2002, \$603 million in 2003, \$643 million in 2004, \$719 million in 2005, \$632 million in 2006, and \$614 million thereafter.

The Company has various options available to meet its capital and operating commitments, including cash on hand at March 31, 2002 of \$2.1 billion and internally generated funds. On April 23, 2002, the Company entered into new unsecured revolving credit facility agreements totaling \$575 million with a group of banks. Half of the total amount of these agreements is available to the Company for three renewable one-year terms from April 23, 2002. The other half of the agreements is available to the Company for a full three-year term. The Company's existing \$475 million revolving credit facility, which was fully repaid in March 2002 (See Note 8 to the financial statements) was simultaneously cancelled on April 23, 2002. The Company will also consider various borrowing or leasing options to maximize earnings and supplement cash requirements.

The Company has outstanding shelf registrations for the issuance of an additional \$319 million in public debt securities and pass through certificates. The Company could utilize these to finance aircraft during 2002 and 2003.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

See Item 7A. Quantitative and Qualitative Disclosures About Market Risk in the Company's Annual Report on Form 10-K for the year ended December 31, 2001 and Note 5 to the unaudited condensed consolidated financial statements.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

The Company is subject to various legal proceedings and claims arising in the ordinary course of business, including, but not limited to, examinations by the Internal Revenue Service (IRS). The IRS regularly examines the Company's federal income tax returns and, in the course of which, proposes adjustments to the Company's federal income tax liability reported on such returns. It is the Company's practice to vigorously contest those proposed adjustments that it deems lacking of merit.

The Company's management does not expect that the outcome in any of its currently ongoing legal proceeding or the outcome of any proposed adjustments presented to date by the IRS, individually or collectively, will have a material adverse effect on the Company's financial condition, results of operations or cash flow.

Item 2. Changes in Securities and Use of Proceeds

Recent Sales of Unregistered Securities

During the first quarter of 2002, Herbert D. Kelleher exercised unregistered options to purchase Southwest Airlines Co. Common Stock as follows:

Number of Shares Purchased	Option Price	Date of Exercise
415,528	\$1.00	1/15/2002
437,032	\$2.24	1/15/2002

The issuance of the above shares to Mr. Kelleher was exempt from the registration provisions of the Securities Act of 1933, as amended (the "Act"), by reason of the provision of Section 4(2) of the Act because, among other things, of the limited number of participants in such transactions and the agreement and representation of Mr. Kelleher that he was acquiring such securities for investment and not with a view to distribution thereof. The certificates representing the shares issued to Mr. Kelleher contain a legend to the effect that such shares are not registered under the Act and may not be transferred except pursuant to a registration statement that has become effective under the Act or to an exemption from such registration. The issuance of such shares was not underwritten.

Item 3. Defaults upon Senior Securities

None

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

None

Item 5. Other Information

None

Item 6. Exhibits and Reports on Form 8-K

a) Exhibits

10.1 Southwest Airlines Co. Outside Director Incentive Plan

b) Reports on Form 8-K

On March 1, 2002, Southwest filed a current report on Form 8-K to file, under Item 7 - Financial Statements and Exhibits, certain documents related to the public offering of \$385 million of its 6 1/2% Notes due 2012.

SIGNATURES

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

SOUTHWEST AIRLINES CO.

April 30, 2002

By /s/ Gary C. Kelly

Gary C. Kelly
*Executive Vice President -
Chief Financial Officer
(Principal Financial and
Accounting Officer)*

EXHIBIT INDEX

<u>Exhibit No.</u>	<u>Description</u>
Exhibit 10.1	- Southwest Airlines Co. Outside Director Incentive Plan