

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, 2003 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

(IRS 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 by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act.) 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 17, 2003:

778,897,115

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

Item 1. Financial Statements

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

	<u>March 31, 2003</u>	<u>December 31, 2002</u>
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 1,889	\$ 1,815
Accounts and other receivables	159	175
Inventories of parts and supplies, at cost	95	86
Fuel hedge contracts	97	113
Prepaid expenses and other current assets	36	43
Total current assets	<u>2,276</u>	<u>2,232</u>
Property and equipment, at cost:		
Flight equipment	8,110	8,025
Ground property and equipment	1,062	1,042
Deposits on flight equipment purchase contracts	468	389
	<u>9,640</u>	<u>9,456</u>
Less allowance for depreciation and amortization	2,906	2,810
	<u>6,734</u>	<u>6,646</u>
Other assets	94	76
	<u>\$ 9,104</u>	<u>\$ 8,954</u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 367	\$ 362
Accrued liabilities	514	529
Air traffic liability	535	412
Current maturities of long-term debt	132	131
Total current liabilities	<u>1,548</u>	<u>1,434</u>
Long-term debt less current maturities	1,547	1,553
Deferred income taxes	1,243	1,227
Deferred gains from sale and leaseback of aircraft	180	184
Other deferred liabilities	127	134
Stockholders' equity:		
Common stock	778	777
Capital in excess of par value	146	136
Retained earnings	3,476	3,455
Accumulated other comprehensive income	59	54
Total stockholders' equity	<u>4,459</u>	<u>4,422</u>
	<u>\$ 9,104</u>	<u>\$ 8,954</u>

See accompanying notes.

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

	<u>Three months ended March 31,</u>	
	<u>2003</u>	<u>2002</u>
OPERATING REVENUES:		
Passenger	\$ 1,306	\$ 1,215
Freight	22	21
Other	<u>23</u>	<u>21</u>
Total operating revenues	1,351	1,257
OPERATING EXPENSES:		
Salaries, wages, and benefits	516	462
Fuel and oil	208	170
Maintenance materials and repairs	106	97
Agency commissions	12	14
Aircraft rentals	45	47
Landing fees and other rentals	90	83
Depreciation and amortization	93	85
Other operating expenses	<u>235</u>	<u>250</u>
Total operating expenses	<u>1,305</u>	<u>1,208</u>
OPERATING INCOME	46	49
OTHER EXPENSES (INCOME):		
Interest expense	26	26
Capitalized interest	(7)	(4)
Interest income	(5)	(10)
Other (gains) losses, net	<u>(7)</u>	<u>2</u>
Total other expenses	<u>7</u>	<u>14</u>
INCOME BEFORE INCOME TAXES	39	35
PROVISION FOR INCOME TAXES	<u>15</u>	<u>14</u>
NET INCOME	<u>\$ 24</u>	<u>\$ 21</u>
 NET INCOME PER SHARE, BASIC	 \$.03	 \$.03
NET INCOME PER SHARE, DILUTED	\$.03	\$.03
 WEIGHTED AVERAGE SHARES OUTSTANDING:		
Basic	778	769
Diluted	808	811

See accompanying notes.

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

	<u>Three months ended March 31,</u>	
	<u>2003</u>	<u>2002</u>
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	\$ 24	\$ 21
Adjustments to reconcile net income to cash provided by operating activities:		
Depreciation and amortization	93	85
Deferred income taxes	12	14
Amortization of deferred gains on sale and leaseback of aircraft	(4)	(4)
Amortization of scheduled airframe inspections & repairs	12	11
Changes in certain assets and liabilities:		
Accounts and other receivables	16	(62)
Other current assets	(1)	17
Accounts payable and accrued liabilities	(7)	(86)
Air traffic liability	123	111
Other	(1)	(14)
Net cash provided by operating activities	<u>267</u>	<u>93</u>
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of property and equipment, net	(193)	(109)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Issuance of long-term debt	-	385
Proceeds from trust arrangement	-	59
Proceeds from Employee stock plans	12	20
Payments of long-term debt and capital lease obligations	(6)	(5)
Payments of trust arrangement	-	(123)
Payment of revolving credit facility	-	(475)
Payments of cash dividends	(7)	(7)
Other, net	1	(4)
Net cash used in financing activities	<u>-</u>	<u>(150)</u>
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	74	(166)
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	<u>1,815</u>	<u>2,280</u>
CASH AND CASH EQUIVALENTS AT END OF PERIOD	<u>\$ 1,889</u>	<u>\$ 2,114</u>
CASH PAYMENTS FOR:		
Interest, net of amount capitalized	\$ 22	\$ 17
Income taxes	\$ -	\$ -

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 or Southwest) 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 periods ended March 31, 2003 and 2002 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, 2002 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, 2003 are not necessarily indicative of the results that may be expected for the year ended December 31, 2003. 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, 2002.

2. STOCK-BASED EMPLOYEE COMPENSATION

The Company has stock-based compensation plans covering the majority of its Employee groups, including plans adopted via collective bargaining, a plan covering the Company's Board of Directors, and plans related to employment contracts with certain Executive Officers of the Company. The Company accounts for stock-based compensation utilizing the intrinsic value method in accordance with the provisions of Accounting Principles Board Opinion No. 25 (APB 25), "Accounting for Stock Issued to Employees" and related Interpretations. Accordingly, no compensation expense is recognized for fixed option plans because the exercise prices of Employee stock options equal or exceed the market prices of the underlying stock on the dates of grant.

The following table represents the effect on net income and earnings per share if the Company had applied the fair value based method and recognition provisions of Statement of Financial Accounting Standards (SFAS) No. 123, "Accounting for Stock-Based Compensation," to stock-based Employee compensation (in millions, except per share amounts):

<u>(In millions, except per share amounts)</u>	<u>2003</u>	<u>2002</u>
Net income, as reported	\$ 24	\$ 21
Add: Stock-based Employee compensation expense included in reported income, net of related tax effects	-	-
Deduct: Total stock-based Employee compensation expense determined under fair value based methods for all awards, net of related tax effects	<u>(17)</u>	<u>(8)</u>
Pro forma net income	<u>\$ 7</u>	<u>\$ 13</u>
Net income per share		
Basic, as reported	\$.03	\$.03
Basic, pro forma	\$.01	\$.02
Diluted, as reported	\$.03	\$.03
Diluted, pro forma	\$.01	\$.02

As required, the pro forma disclosures above include options granted since January 1, 1995. Consequently, the effects of applying SFAS 123 for providing pro forma disclosures may not be representative of the effects on reported net income for future years until all options outstanding are included in the pro forma disclosures. For purposes of pro forma disclosures, the estimated fair value of stock-based compensation plans and other options is amortized to expense primarily over the vesting period.

In December 2002, the FASB issued SFAS No. 148, "Accounting for Stock-Based Compensation-Transition and Disclosure." SFAS No. 148 amends the transition and disclosure provisions of SFAS No. 123. The Company is currently evaluating SFAS No. 148 to determine if it will adopt SFAS No. 123 to account for Employee stock options using the fair value method and, if so, when to begin transition to that method. If the Company had adopted the prospective transition method prescribed by SFAS 148 in first quarter 2003, compensation expense of \$11 million would have been recorded. After related profitsharing and income tax effects, this would have reduced net income by \$6 million, or \$.01 per share, diluted.

3. DIVIDENDS

During the three months ended March 31, 2003, dividends of \$.0045 per share were declared on the 778 million shares of common stock then outstanding. During the three months ended March 31, 2002, dividends of \$.0045 per share were declared on the 771 million shares of common stock then outstanding.

4. NET INCOME PER SHARE

The following table sets forth the computation of basic and diluted net income per share (in millions except per share amounts):

	Three months ended March 31,	
	<u>2003</u>	<u>2002</u>
NUMERATOR:		
Net income available to common stockholders	<u>\$ 24</u>	<u>\$ 21</u>
DENOMINATOR:		
Weighted-average shares outstanding, basic	778	769
Dilutive effect of Employee stock options	<u>30</u>	<u>42</u>
Adjusted weighted-average shares outstanding, diluted	<u>808</u>	<u>811</u>
NET INCOME PER SHARE:		
Basic	\$.03	\$.03
Diluted	\$.03	\$.03

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 three months ended March 31, 2003 and 2002 represented approximately 15.9 percent and 14.1 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 jet fuel 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 utilizes financial derivative instruments as hedges 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. The Company was hedged for 100 percent of its first quarter 2003 fuel consumption. For second quarter 2003, the Company has fuel hedges in place for 100 percent of its expected fuel consumption with option contracts in the \$24 per barrel range. As of March 31, 2003, the Company also had agreements in place to hedge approximately 85 percent of its second half 2003 total anticipated jet fuel requirements with option contracts under \$24 per barrel, and approximately 80 percent of its anticipated 2004 requirements with option contracts approximating \$23 per barrel. As of March 31, 2003, the majority of the Company's remaining 2003 hedges are effectively heating oil-based positions in the form of option contracts. The majority of the remaining hedge positions are crude oil-based option contracts.

The Company accounts for its fuel hedge derivative instruments as cash flow hedges, as defined, in Statement of Financial Accounting Standards No. 133, *Accounting for Derivative Instruments and Hedging Activities*, as amended (SFAS 133). All changes in fair value that are considered to be effective, as defined, are recorded in "Accumulated other comprehensive income" until the underlying jet fuel is consumed. The fair value of the Company's financial derivative instruments at

March 31, 2003, was a net asset of approximately \$162 million. The current portion of this net asset, approximately \$97 million, is classified as "Fuel hedge contracts" and the noncurrent portion, approximately \$65 million, 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 three months ended March 31, 2003 and 2002, the Company recognized \$64 million in gains and \$6 million in losses (expense) in "Fuel and oil" expense, respectively, from hedging activities. The Company also recognized approximately \$14 million and \$5 million in additional income in "Other (gains) losses, net," related to the ineffectiveness of its hedges during the three months ended March 31, 2003 and 2002, respectively. The Company recognized approximately \$7 million and \$6 million of net expense, related to amounts excluded from the Company's measurements of hedge effectiveness, in "Other (gains) losses, net" during the three months ended March 31, 2003 and 2002, respectively.

As of March 31, 2003, the Company had approximately \$63 million in unrealized gains, net of tax, in "Accumulated other comprehensive income" related to fuel hedges. Included in this total are approximately \$39 million in net unrealized gains that are expected to be realized in earnings during the twelve months following March 31, 2003.

6. COMPREHENSIVE INCOME

Comprehensive income included 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 \$29 million and \$80 million for the three months ended March 31, 2003 and 2002, respectively. The differences between net income and comprehensive income for each of these periods was as follows (in millions):

	Three months ended March 31,	
	<u>2003</u>	<u>2002</u>
Net income	\$ 24	\$ 21
Unrealized gain (loss) on derivative instruments, net of deferred taxes of \$4 and \$38	7	59
Other, net of deferred taxes of (\$1) and \$0	<u>(2)</u>	<u>-</u>
Total other comprehensive income	<u>5</u>	<u>59</u>
Comprehensive income	<u>\$ 29</u>	<u>\$ 80</u>

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

	Fuel hedge derivatives	Other	Accumulated other comprehensive income (loss)
Balance at December 31, 2002	\$ 56	(\$2)	\$ 54
2003 changes in value	44	(2)	42
Reclassification to earnings	(37)	-	(37)
Balance at March 31, 2003	<u>\$ 63</u>	<u>(\$4)</u>	<u>\$ 59</u>

7. REVOLVING CREDIT FACILITY

In April 2002, the Company entered into two unsecured revolving credit facilities from which it can borrow up to \$575 million from a group of banks. One of the facilities, for half of the total amount, was set to expire on April 23, 2003 but has been renewed for an additional year. This facility now expires in April 2004. The other facility, for half of the amount, expires in April 2005. The effective borrowing rate of the credit facility would vary depending on factors in place at the time funds were drawn, as defined in the agreements.

8. RECENTLY ISSUED ACCOUNTING STANDARDS

In November 2002, the Financial Accounting Standards Board (FASB) issued Interpretation No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others" (FIN 45). FIN 45 requires that a liability for the fair value of an obligation for guarantees issued or modified after December 31, 2002 be recorded in the financial statements of the guarantor. Guarantees pre-existing before the implementation of FIN 45 are required to be disclosed in financial statements issued after December 15, 2002. While the Company has various guarantees included in contracts in the normal course of business, primarily in the form of indemnities, these guarantees would only result in immaterial increases in future costs, and do not represent significant commitments or contingent liabilities of the indebtedness of others.

In January 2003, the FASB issued Interpretation No. 46, "Consolidation of Variable Interest Entities" (FIN 46) which requires the consolidation of variable interest entities, as defined. FIN 46 is applicable to variable interest entities created after January 31, 2003. Variable interest entities created prior to February 1, 2003, must be consolidated effective July 1, 2003. Disclosures are required currently if the Company expects to consolidate any variable interest entities. The Company does not currently believe that any material entities will be consolidated with Southwest as a result of FIN 46.

9. RECENT EVENTS

On April 16, 2003, the Emergency Wartime Supplemental Appropriations Act (Wartime Act) was signed into law. Among other items, the legislation includes a \$2.3 billion cash reimbursement for security fees remitted to the Transportation Security Administration since the 2001 terrorist attacks. Southwest expects to receive its proportional share of security fees paid, as defined, during second quarter 2003.

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, 2003 and 2002 are as follows:

	Three months ended March 31,		
	2003	2002	Change
Revenue passengers carried	15,077,537	14,463,282	4.2%
Revenue passenger miles (RPMs) (000s)	10,895,701	10,392,590	4.8%
Available seat miles (ASMs) (000s)	17,399,132	16,519,957	5.3%
Load factor	62.6%	62.9%	(.3) pts.
Average length of passenger haul	723	719	0.6%
Trips flown	233,087	231,195	0.8%
Average passenger fare	\$86.64	\$83.99	3.2%
Passenger revenue yield per RPM (cents)	11.99	11.69	2.6%
Operating revenue yield per ASM (cents)	7.77	7.61	2.1%
Operating expenses per ASM (cents)	7.50	7.31	2.6%
Operating expenses per ASM, excluding fuel (cents)	6.30	6.28	0.3%
Fuel costs per gallon, excluding fuel tax (cents)	74.8	63.3	18.2%
Fuel consumed, in gallons (millions)	277	268	3.4%
Number of Employees at period-end	33,140	32,244	2.8%
Size of fleet at period-end	377	359	5.0%

Material Changes in Results of Operations

Summary

Despite the decline in full-fare traffic brought about by the weak airline revenue and economic environment, the onset of war with Iraq, crude oil prices spiking near \$40 per barrel during the quarter, and considering the first quarter historically is the slowest of the year for air travel, turning a profit in first quarter 2003 was quite an accomplishment for any airline. For Southwest, this was achieved as a result of the Company's continuous efforts to control costs, maintain high productivity levels, and offer outstanding Customer service. While the Company's profitability levels continue to be considerably below pre-September 11, 2001 levels, Southwest has reported profitable earnings performances each quarter since September 11, 2001 through first quarter 2003. In fact, the Company's first quarter 2003 earnings performance represented its 48th consecutive quarterly profit.

Consolidated net income for first quarter 2003 was \$24 million (\$.03 per share, diluted), 14.3 percent above the first quarter 2002 net income of \$21 million (\$.03 per share, diluted). First quarter 2003 operating income was \$46 million compared to operating income of \$49 million in

2002 as higher revenues and lower commissions expense were offset by higher salaries, wages, and benefits expenses and higher fuel costs.

In addition to war-related revenue pressures, the Company's financial performance continues to be adversely affected by weak economic conditions and the lingering impact of the 2001 terrorist attacks. Although the Company continues to experience significantly higher costs for aviation insurance and airport security compared to pre-September 11, 2001, thus far, Southwest has been able to mitigate a portion of such increases through lower agency commissions and other cost reduction efforts implemented following the terrorist attacks. Barring any unforeseen event, the Company also expects to be profitable in second quarter 2003, excluding proceeds to be received from the Emergency Wartime Supplemental Appropriations Act (see Note 9 to the unaudited condensed consolidated financial statements). However, given the recent disruption in revenue trends attributable to the war with Iraq, the Company may not be able to match its second quarter 2002 profit of \$102 million, which included \$36 million (pretax), related to a reduction in air traffic liability.

Comparison of Three Months Ended March 31, 2003 to Three Months Ended March 31, 2002

Revenues

Consolidated operating revenues increased by \$94 million, or 7.5 percent, primarily due to a \$91 million, or 7.5 percent increase in passenger revenues. The increase in passenger revenues was primarily due to a 4.8 percent increase in revenue passenger miles (RPMs) flown.

First quarter 2003 capacity, as measured by available seat miles (ASMs), increased 5.3 percent compared to first quarter 2002. The capacity increase resulted from the net addition of 18 aircraft (net of one retirement) from March 2002 through March 2003. The first quarter 2003 load factor was 62.6 percent, a decrease of .3 points compared to 2002. The Company also experienced a 4.2 percent increase in revenue passengers carried compared to first quarter 2002.

First quarter 2003 passenger yield per RPM increased 2.6 percent to 11.99 cents from 11.69 cents in first quarter 2002. Operating revenue yield per ASM and average passenger fare increased 2.1 percent and 3.2 percent to 7.77 cents and \$86.64, respectively, compared to first quarter 2002.

Although the Company's revenues had shown signs of recovery during fourth quarter 2002 and early first quarter 2003, those trends were disrupted with the commencement of the war with Iraq. Since the beginning of the war, bookings for second quarter 2003 have softened further. Currently, the Company expects only modest revenue growth, if any, compared to second quarter 2002's operating revenue of \$1.47 billion, which included \$36 million in additional revenue related to a reduction in estimated refunds and exchanges included in air traffic liability.

Consolidated freight revenues increased by \$1 million, or 4.8 percent as a 13.6 percent increase in freight and cargo revenues more than offset a 13.2 percent decrease in U.S. mail revenues. The increase in freight and cargo revenues was primarily due to moderate rate increases taken by the Company. The decrease in U.S. Mail revenue was due to the U.S. Postal Service diverting more of its mail shipments to freight carriers and away from commercial airlines. For second quarter 2003,

the Company expects a year-over-year increase in consolidated freight revenues compared to second quarter 2002 primarily due to increases in capacity and cargo shipments. Other revenues increased in first quarter 2003 by \$2 million, or 9.5 percent, 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

To a large extent, changes in operating expenses for airlines are driven by changes in capacity, or ASMs. The following presents Southwest's operating expenses per ASM for the three months ended March 31, 2003 and 2002 followed by explanations of changes on a per ASM basis:

	Three months ended March 31, 2003	2002	Per ASM Change	Percent Change
Salaries, wages, and benefits	2.97	2.80	.17	6.1
Fuel and oil	1.20	1.03	.17	16.5
Maintenance materials and repairs	.61	.58	.03	5.2
Agency commissions	.07	.09	(.02)	(22.2)
Aircraft rentals	.26	.29	(.03)	(10.3)
Landing fees and other rentals	.51	.50	.01	2.0
Depreciation	.53	.51	.02	3.9
Other operating expenses	1.35	1.51	(.16)	(10.6)
Total	7.50	7.31	.19	2.6

Operating expenses per ASM were 7.50 cents, a 2.6 percent increase compared to 7.31 cents for first quarter 2002. This increase was primarily due to higher labor and jet fuel costs, net of fuel hedging gains. Excluding fuel expense from both periods, operating expenses per ASM were 6.30 cents, approximately the same as first quarter 2002 as the increase in labor costs was offset primarily by decreases in security costs and aviation insurance costs. Based on first quarter 2003 costs, the Company expects modest year over year unit cost growth again in second quarter 2003.

Salaries, wages, and benefits expense per ASM increased 6.1 percent due to a 7.1 percent increase in salaries and wages per ASM, a 3.7 percent increase in benefits expense per ASM, and a 2.9 percent increase in Employee retirement plans expense per ASM. The majority of the increase in salaries and wages was due to higher average wage rates. The increase in benefits expense per ASM was primarily due to higher health care costs. The increase in Employee retirement plans expense per ASM was primarily due to a slight increase in Company earnings available for profitsharing. The Company also expects an increase in salaries, wages, and benefits per ASM in second quarter 2003 due to the continued impact of higher average wage rates and higher anticipated health care costs.

Fuel and oil expense per ASM increased 16.5 percent primarily due to an increase in average fuel cost per gallon. The average fuel cost per gallon in first quarter 2003 was 74.8 cents, an 18.2 percent increase compared to 63.3 cents per gallon in first quarter 2002, including the effects of hedging activities. The Company's fuel hedging program resulted in the recognition of \$77 million in fuel hedging gains during first quarter 2003, of which \$64 million was recorded in "Fuel and oil."

The remaining gains are included in “Other (gains) losses, net.” For second quarter 2003, the Company has fuel hedges in place for 100 percent of its expected fuel consumption with option contracts in the \$24 per barrel range. The majority of the Company's near term hedge positions are in the form of option contracts. See Note 5 to the unaudited condensed consolidated financial statements for further discussion of the Company's hedging activities.

Maintenance materials and repairs per ASM increased 5.2 percent primarily due to an increase in contract rates for outsourced engine maintenance. The Company outsources all of its engine maintenance work for 737-300 and 737-500 aircraft and expense is based on the number of hours flown for those aircraft and the rate charged per hour flown. The number of hours flown for the 737-300 and 737-500 aircraft was comparable to the prior year. The Company expects second quarter 2003 maintenance materials and repairs per ASM to be higher than second quarter 2002 expense due to the increase in contract rates for outsourced engine maintenance.

Agency commissions per ASM decreased 22.2 percent primarily due to a decline in commissionable revenues. The percentage of commissionable revenues decreased from approximately 22 percent in first quarter 2002 to approximately 17 percent in first quarter 2003. Approximately 50 percent of revenues in first quarter 2003 were derived through the Company's web site at www.southwest.com versus 46 percent of revenues in first quarter 2002. Based on recent trends, the Company currently expects commissionable revenues to remain in the 17 percent range in second quarter 2003.

Aircraft rentals per ASM decreased 10.3 percent compared to first quarter 2002 primarily due to the increase in ASMs relative to the number of leased aircraft. Although ASMs increased 5.3 percent, the number of leased aircraft declined by one, as a result of a retirement in second quarter 2002. All of the aircraft acquired in 2002 and 2003 have been purchased. Approximately 23.9 percent of the Company's aircraft fleet was under operating lease at March 31, 2003, compared to 25.3 percent at March 31, 2002.

Landing fees and other rentals per ASM increased 2.0 percent compared to first quarter 2002 as a 6.5 percent increase in other rentals per ASM was partially offset by a 2.5 percent decrease in landing fees per ASM. The increase in other rentals expense per ASM was primarily due to the Company's expansion of gate and counter space at several airports such as Houston William P. Hobby Airport (HOU) and Las Vegas McCarran International Airport (LAS). The decrease in landing fees expense per ASM primarily was due to first quarter 2003 credits from airports' audits of prior periods. The amount of credits received in first quarter 2003 was more than the credits received in the same prior year period.

Depreciation expense per ASM increased 3.9 percent primarily due to an increase in owned aircraft. All 19 of the aircraft put into service by the Company over the past twelve months have been purchased. This, along with the retirement of one leased aircraft, has increased the Company's percentage of aircraft owned or on capital lease to 76.1 percent at March 31, 2003 from 74.7 percent at March 31, 2002.

Other operating expenses per ASM decreased 10.6 percent. Approximately half of the decrease was attributable to a decrease in security expense. In first quarter 2002, the Company incurred a substantial increase in costs due to additional procedures instituted by the federal

government following the 2001 terrorist attacks. During first quarter 2002, however, the newly established Transportation Security Administration took over many of those procedures. The other half of the decrease in other operating expenses per ASM was attributable to a decrease in aviation insurance costs. Following the terrorist attacks, commercial aviation insurers dramatically increased the premiums and reduced the amount of war-risk coverage available to commercial carriers. The federal government stepped in to provide supplemental third-party war-risk insurance coverage to commercial carriers for renewable 60-days periods, at substantially lower premiums than prevailing commercial rates and for levels of coverage not available in the commercial market. In November 2002, Congress passed the Homeland Security Act of 2002, which mandated the federal government provide third party, passenger, and hull war-risk insurance coverage to commercial carriers through August 31, 2003, and which permits such coverage to be extended by the government through December 31, 2003. The Emergency Wartime Supplemental Appropriations Act (see Note 9 to the unaudited condensed consolidated financial statements) extends the government's mandate to provide war-risk insurance until August 31, 2004 and permits such coverage to be extended until December 31, 2004. As a result of more coverage from government insurance programs and a more stable aviation insurance market, the Company was able to negotiate lower 2003 aviation insurance premiums than 2002. However, aviation insurance remains substantially higher than before September 11, 2001. The Company currently expects a year-over-year decrease in other operating expenses per ASM for second quarter 2003, primarily from lower aviation insurance costs; however, second quarter 2003 other operating unit costs are expected to exceed first quarter's performance of 1.35 cents.

Other

Interest expense was flat compared to the prior year as an increase in interest expense caused by the March 1, 2002 issuance of \$385 million in unsecured notes was offset by a decrease in interest from the repayment of the Company's \$475 million revolving credit facility in March 2002 and from a decrease in year-over-year interest rates on the Company's floating rate debt in 2003.

Capitalized interest increased by \$3 million, primarily due to an increase in progress payment balances for future aircraft deliveries.

Interest income decreased by \$5 million, or 50.0 percent, primarily due to a decrease in rates earned on investments.

In first quarter 2003 and 2002, "Other (gains) losses, net" primarily included amounts recorded in accordance with SFAS 133. See Note 5 to the unaudited condensed consolidated financial statements for more information on the Company's hedging activities. The Company recognized \$7 million and \$6 million of expense related to amounts excluded from the Company's measurements of hedge effectiveness, during the first quarters of 2003 and 2002, respectively. Also, the Company recognized approximately \$14 million and \$5 million in additional income related to the ineffectiveness of its hedges during the first quarters of 2003 and 2002, respectively.

Liquidity and Capital Resources

Net cash provided by operating activities was \$267 million for the three months ended March 31, 2003 compared to \$93 million in the prior year first quarter. The increase was primarily due to the first quarter 2002 payment of \$186 million in excise tax payments that had been deferred from fourth quarter 2001 as provided for in the Air Transportation Safety and System Stabilization Act. Net cash provided by operating activities was \$694 million for the 12 months ended March 31, 2003. Cash generated from operating activities for the 12 months ended March 31, 2003 was primarily used to finance aircraft-related capital expenditures.

Cash flows used in investing activities in first quarter 2003 totaled \$193 million compared to \$109 million in 2002. Investing activities in both years consisted primarily of payments for new 737-700 aircraft delivered to the Company and progress payments for future aircraft deliveries. Cash flows used in investing activities for the 12 months ended March 31, 2003 totaled \$687 million.

There was no net cash used in financing activities in first quarter 2003 compared to \$150 million used in 2002. Cash used in financing activities during first quarter 2002 was primarily for the repayment of the Company's \$475 million revolving credit facility that the Company drew down in September 2001 and for the repayment of a special purpose trust through which the Company had financed the purchase of 19 new aircraft during 2001 and 2002. The trust was dissolved prior to December 31, 2002. These investing activities were partially offset by cash generated from the issuance of \$385 million in unsecured notes in March 2002.

Contractual Obligations and Contingent Liabilities and Commitments

Southwest has contractual obligations and commitments primarily with regards to future purchases of aircraft, payment of debt, and lease arrangements. Following the receipt of two new 737-700 aircraft from Boeing in the first quarter 2003, the Company has 15 remaining 737-700 aircraft deliveries for 2003. Also, during first quarter 2003, the Company exercised options to acquire four more 737-700 aircraft from Boeing in 2004. This change brings the Company's total firm orders to 25 for 2004 with options for nine additional aircraft. The Company's commitment beyond 2004 has not changed and includes firm orders, options, and purchase rights for 362 aircraft for 2005 through 2012. 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. Aggregate funding needed for firm commitments, as of March 31, 2003, is approximately \$3.2 billion, subject to adjustments for inflation, due as follows: \$501 million in 2003, \$725 million in 2004, \$727 million in 2005, \$645 million in 2006, \$523 million in 2007, and \$95 million thereafter.

The Company has various options available to meet its capital and operating commitments, including cash on hand at March 31, 2003 of \$1.9 billion and internally generated funds. The Company has two available unsecured revolving credit facilities from which it can borrow up to \$575 million from a group of banks. One of the facilities, for half of the amount, was set to expire on April 23, 2003 but has been renewed for an additional year. This facility now expires in April 2004. The other facility, for half of the amount, expires in April 2005. The Company will also consider various borrowing or leasing options to maximize earnings and supplement cash requirements.

The Company currently has outstanding shelf registrations for the issuance of up to \$1.0 billion in public debt securities and pass through certificates, which it may utilize for aircraft financings in the future.

Forward looking statements

Some statements in this Form 10-Q (or otherwise made by the Company or on the Company's behalf from time to time in other reports, filings with the Securities and Exchange Commission, news releases, conferences, World Wide Web postings or otherwise) which are not historical facts may be "forward-looking statements" within the meaning of Section 21E of the Securities Exchange Act of 1934 and the Private Securities Litigation Reform Act of 1995. Forward-looking statements include statements about Southwest's estimates, expectations, beliefs, intentions or strategies for the future, and the assumptions underlying these forward-looking statements. Southwest uses the words "anticipates," "believes," "estimates," "expects," "intends," "forecasts", "may," "will," "should" and similar expressions to identify these forward-looking statements. Forward-looking statements involve risks and uncertainties that could cause actual results to differ materially from historical experience or the Company's present expectations. Factors that could cause these differences include, but are not limited to:

- Items directly linked to the September 11, 2001 terrorist attacks, such as the adverse impact of new airline and airport security directives on the Company's costs and Customer demand for travel, changes in the Transportation Security Administration's scope for managing U.S. airport security, the availability and cost of war-risk and other aviation insurance, including the federal government's provision of third party war-risk coverage, and the possibility of further terrorist attacks or additional incidents that could cause the public to question the safety and/or efficiency of air travel.
- War or other military actions by the U.S. or others.
- Competitive factors, such as fare sales and capacity decisions by the Company and its competitors, changes in competitors' flight schedules, mergers and acquisitions, codesharing programs, and airline bankruptcies.
- General economic conditions, which could adversely affect the demand for travel in general and consumer ticket purchasing habits, as well as decisions by major freight Customers on how they allocate freight deliveries among different types of carriers.
- Factors that could affect the Company's ability to control its costs, such as the results of Employee labor contract negotiations, Employee hiring and retention rates, costs for health care, the largely unpredictable prices of jet fuel, crude oil, and heating oil, the continued effectiveness of the Company's fuel hedges, changes in the Company's overall fuel hedging strategy, capacity decisions by the Company and its competitors, unscheduled required aircraft airframe or engine repairs and regulatory requirements, changes in commission policy, availability of capital markets, and future financing decisions made by the Company.

- Disruptions to operations due to adverse weather conditions and air traffic control-related constraints.

Caution should be taken not to place undue reliance on the Company's forward-looking statements, which represent the Company's views only as of the date this report is filed. The Company undertakes no obligation to update publicly or revise any forward-looking statement, whether as a result of new information, future events or otherwise.

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, 2002 and Note 4 to the unaudited condensed consolidated financial statements.

Item 4. Controls and Procedures

Disclosure Controls and Procedures

The Company maintains disclosure controls and procedures designed to ensure that it is able to collect the information it is required to disclose in the reports it files with the Securities and Exchange Commission (SEC), and to process, summarize and disclose this information within the time periods specified in the rules of the SEC. Based on their evaluation of the Company's disclosure controls and procedures which took place as of a date within 90 days of the filing date of this report, the Chief Executive and Chief Financial Officers believe that these controls and procedures are effective to ensure that the Company is able to collect, process and disclose the information it is required to disclose in the reports it files with the SEC within the required time periods.

The Company also maintains a system of internal controls designed to provide reasonable assurance that: transactions are executed in accordance with management's general or specific authorization; transactions are recorded as necessary (1) to permit preparation of financial statements in conformity with generally accepted accounting principles, and (2) to maintain accountability for assets; access to assets is permitted only in accordance with management's general or specific authorization; and the recorded accountability for assets is compared with the existing assets at reasonable intervals and appropriate action is taken with respect to any differences.

Since the date of the most recent evaluation of the Company's internal controls by the Chief Executive and Chief Financial Officers, there have been no significant changes in such controls or in other factors that could have significantly affected those controls, including any corrective actions with regard to significant deficiencies and material weaknesses.

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 proceedings 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

None

Item 3. Defaults upon Senior Securities

None

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

None

Item 5. Other Information

None

Item 6. Exhibits and Reports on Form 8-K

a) Exhibits

10.1 Amendment No. 1 to Southwest Airlines Co. 2002 Customer Service/Reservations Non-Qualified Stock Option Plan (incorporated by reference to Exhibit 4.3 to Registration Statement on Form S-8 (File No. 333-104245)).

99.1 Certifications Pursuant to 18 U.S.C. Section 1350, as adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2003

b) Reports on Form 8-K

On April 21, 2003, Southwest filed a current report on Form 8-K to furnish the Company's public announcement of its first quarter 2003 earnings.

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 22, 2003

By /s/ Gary C. Kelly

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

CERTIFICATION

I, Gary C. Kelly, Executive Vice President and Chief Financial Officer of Southwest Airlines Co., certify that:

1. I have reviewed this quarterly report on Form 10-Q of Southwest Airlines Co.;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:
 - a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
 - b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and
 - c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):
 - a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
 - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
6. The registrant's other certifying officer and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could

significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

April 22, 2003

By /s/ Gary C. Kelly

Gary C. Kelly
*Executive Vice President - Chief
Financial Officer*

CERTIFICATION

I, James F. Parker, Chief Executive Officer of Southwest Airlines Co., certify that:

1. I have reviewed this quarterly report on Form 10-Q of Southwest Airlines Co.;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:
 - a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
 - b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and
 - c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):
 - a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
 - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
6. The registrant's other certifying officer and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could

significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

April 22, 2003

By /s/ James F. Parker

James F. Parker
Chief Executive Officer

EXHIBIT INDEX

<u>Exhibit No.</u>	<u>Description</u>
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Exhibit 99.1	- Certifications Pursuant to 18 U.S.C. Section 1350, as adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2003