

Item 8. Financial Statements and Supplementary Data

Southwest Airlines Co.
Consolidated Balance Sheet
(in millions, except share data)

	December 31, 2023	December 31, 2022
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 9,288	\$ 9,492
Short-term investments	2,186	2,800
Accounts and other receivables	1,154	1,040
Inventories of parts and supplies, at cost	807	790
Prepaid expenses and other current assets	520	686
Total current assets	13,955	14,808
Property and equipment, at cost:		
Flight equipment	26,060	23,725
Ground property and equipment	7,460	6,855
Deposits on flight equipment purchase contracts	236	376
Assets constructed for others	62	28
	33,818	30,984
Less allowance for depreciation and amortization	14,443	13,642
	19,375	17,342
Goodwill	970	970
Operating lease right-of-use assets	1,223	1,394
Other assets	964	855
	<u>\$ 36,487</u>	<u>\$ 35,369</u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 1,862	\$ 2,004
Accrued liabilities	3,606	2,043
Current operating lease liabilities	208	225
Air traffic liability	6,551	6,064
Current maturities of long-term debt	29	42
Total current liabilities	12,256	10,378
Long-term debt less current maturities	7,978	8,046
Air traffic liability - noncurrent	1,728	2,186
Deferred income taxes	2,044	1,985
Noncurrent operating lease liabilities	985	1,118
Other noncurrent liabilities	981	969
Stockholders' equity:		
Common stock, \$1.00 par value; 2,000,000,000 shares authorized; 888,111,634 shares issued in 2023 and 2022	888	888
Capital in excess of par value	4,153	4,037
Retained earnings	16,297	16,261
Accumulated other comprehensive income	—	344
Treasury stock, at cost: 291,599,001 and 294,111,813 shares in 2023 and 2022, respectively	(10,823)	(10,843)
Total stockholders' equity	<u>10,515</u>	<u>10,687</u>
	<u>\$ 36,487</u>	<u>\$ 35,369</u>

See accompanying notes.

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

	Year ended December 31,		
	2023	2022	2021
OPERATING REVENUES:			
Passenger	\$ 23,637	\$ 21,408	\$ 14,066
Freight	175	177	187
Other	2,279	2,229	1,537
Total operating revenues	26,091	23,814	15,790
OPERATING EXPENSES, NET:			
Salaries, wages, and benefits	11,152	9,376	7,743
Payroll support and voluntary Employee programs, net	—	—	(2,960)
Fuel and oil	6,217	5,975	3,310
Maintenance materials and repairs	1,188	852	854
Landing fees and airport rentals	1,789	1,508	1,456
Depreciation and amortization	1,522	1,351	1,272
Other operating expenses	3,999	3,735	2,394
Total operating expenses, net	25,867	22,797	14,069
OPERATING INCOME	224	1,017	1,721
OTHER EXPENSES (INCOME):			
Interest expense	259	340	467
Capitalized interest	(23)	(39)	(36)
Interest income	(583)	(217)	(13)
Loss on extinguishment of debt	—	193	28
Other (gains) losses, net	(62)	12	(50)
Total other expenses (income)	(409)	289	396
INCOME BEFORE INCOME TAXES	633	728	1,325
PROVISION FOR INCOME TAXES	168	189	348
NET INCOME	\$ 465	\$ 539	\$ 977
NET INCOME PER SHARE, BASIC	\$ 0.78	\$ 0.91	\$ 1.65
NET INCOME PER SHARE, DILUTED	\$ 0.76	\$ 0.87	\$ 1.61

See accompanying notes.

Southwest Airlines Co.
Consolidated Statement of Comprehensive Income
(in millions)

	Year ended December 31,		
	2023	2022	2021
NET INCOME	\$ 465	\$ 539	\$ 977
Unrealized gain (loss) on fuel derivative instruments, net of deferred taxes of (\$103), (\$44), and \$142	(337)	(143)	469
Unrealized gain on interest rate derivative instruments, net of deferred taxes of \$4, \$6, and \$2	13	19	7
Unrealized gain (loss) on defined benefit plan items, net of deferred taxes of (\$5), \$24, and \$25	(16)	80	84
Other, net of deferred taxes of \$4, \$—, and (\$13)	(4)	—	(47)
OTHER COMPREHENSIVE INCOME (LOSS)	\$ (344)	\$ (44)	\$ 513
COMPREHENSIVE INCOME	\$ 121	\$ 495	\$ 1,490

See accompanying notes.

Southwest Airlines Co.
Consolidated Statement of Stockholders' Equity
(in millions, except per share amounts)

	Year ended December 31, 2023, 2022, and 2021					
	Common Stock	Capital in excess of par value	Retained earnings	Accumulated other comprehensive income (loss)	Treasury stock	Total
Balance at December 31, 2020	\$ 888	\$ 4,191	\$ 14,777	\$ (105)	\$ (10,875)	\$ 8,876
Cumulative effect of adopting Accounting Standards Update No. 2016-01, Financial Instruments	—	—	20	(20)	—	—
Issuance of common and treasury stock pursuant to Employee stock plans	—	22	—	—	15	37
Share-based compensation	—	58	—	—	—	58
Stock warrants	—	45	—	—	—	45
Equity feature of partial extinguishment of convertible notes	—	(92)	—	—	—	(92)
Comprehensive income	\$ —	\$ —	\$ 977	\$ 513	\$ —	\$ 1,490
Balance at December 31, 2021	\$ 888	\$ 4,224	\$ 15,774	\$ 388	\$ (10,860)	\$ 10,414
Cumulative effect of adopting Accounting Standards Update No. 2020-06, Debt	—	(300)	55	—	—	(245)
Issuance of common and treasury stock pursuant to Employee stock plans	—	29	—	—	17	46
Share-based compensation	—	84	—	—	—	84
Cash dividends, \$0.18 per share	—	—	(107)	—	—	(107)
Comprehensive income (loss)	\$ —	\$ —	\$ 539	\$ (44)	\$ —	\$ 495
Balance at December 31, 2022	\$ 888	\$ 4,037	\$ 16,261	\$ 344	\$ (10,843)	\$ 10,687
Issuance of common and treasury stock pursuant to Employee stock plans	—	30	—	—	20	50
Share-based compensation	—	86	—	—	—	86
Cash dividends, \$0.18 per share	—	—	(429)	—	—	(429)
Comprehensive income (loss)	\$ —	\$ —	\$ 465	\$ (344)	\$ —	\$ 121
Balance at December 31, 2023	\$ 888	\$ 4,153	\$ 16,297	\$ —	\$ (10,823)	\$ 10,515

See accompanying notes.

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

	Year ended December 31,		
	2023	2022	2021
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net income	\$ 465	\$ 539	\$ 977
Adjustments to reconcile net income to cash provided by operating activities:			
Depreciation and amortization	1,522	1,351	1,272
Impairment of long-lived assets	—	35	12
Unrealized mark-to-market adjustment on available for sale securities	(4)	4	—
Unrealized/realized loss on fuel derivative instruments	—	(2)	(15)
Deferred income taxes	159	228	(21)
Loss on extinguishment of debt	—	193	28
Changes in certain assets and liabilities:			
Accounts and other receivables	(89)	422	(701)
Other assets	60	(66)	75
Accounts payable and accrued liabilities	1,386	936	38
Air traffic liability	29	525	591
Other liabilities	(137)	(334)	(103)
Cash collateral received from (provided to) derivative counterparties	(56)	(69)	141
Other, net	(171)	28	28
Net cash provided by operating activities	3,164	3,790	2,322
CASH FLOWS FROM INVESTING ACTIVITIES:			
Capital expenditures	(3,520)	(3,924)	(505)
Assets constructed for others	(33)	(22)	(6)
Purchases of short-term investments	(6,970)	(5,592)	(5,824)
Proceeds from sales of short-term and other investments	7,591	5,792	5,071
Net cash used in investing activities	(2,932)	(3,746)	(1,264)
CASH FLOWS FROM FINANCING ACTIVITIES:			
Proceeds from Payroll Support Program loan and warrants	—	—	1,136
Proceeds from Employee stock plans	48	45	51
Payments of long-term debt and finance lease obligations	(85)	(2,437)	(612)
Payments of cash dividends	(428)	—	—
Proceeds of terminated interest rate derivative instruments	23	—	—
Payments for repurchases and conversions of convertible debt	—	(648)	(293)
Other, net	6	8	77
Net cash provided by (used in) financing activities	(436)	(3,032)	359
NET CHANGE IN CASH AND CASH EQUIVALENTS	(204)	(2,988)	1,417
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	9,492	12,480	11,063
CASH AND CASH EQUIVALENTS AT END OF PERIOD	\$ 9,288	\$ 9,492	\$ 12,480
CASH PAYMENTS FOR:			
Interest, net of amount capitalized	\$ 228	\$ 305	\$ 336
Income taxes	\$ 18	\$ 20	\$ 445
SUPPLEMENTAL DISCLOSURE OF NON-CASH TRANSACTIONS:			
Adoption of Accounting Standards Update 2020-06, Debt	\$ —	\$ 245	\$ —
Right-of-use assets acquired under operating leases	\$ 82	\$ 58	\$ 327
Flight equipment acquired against supplier credit memo	\$ —	\$ —	\$ 569
Assets constructed for others	\$ —	\$ —	\$ 309
Remeasurement of right-of-use asset and lease liability	\$ —	\$ —	\$ 343

See accompanying notes.

Southwest Airlines Co.
Notes to Consolidated Financial Statements

1. Summary of Significant Accounting Policies
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1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

Southwest Airlines Co. (the "Company" or "Southwest") operates Southwest Airlines, a major domestic airline. The Consolidated Financial Statements include the accounts of the Company and its wholly owned subsidiaries. The accompanying Consolidated Financial Statements include the results of operations and cash flows for all periods presented and all significant inter-entity balances and transactions have been eliminated. The preparation of financial statements in conformity with generally accepted accounting principles in the United States ("GAAP") requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from these estimates.

In late December 2022, Winter Storm Elliott impacted a significant portion of the United States, leading to wide-scale operational disruptions for the Company. In attempting to recover from this weather event, the Company was challenged in its efforts to realign flight crews, flight schedules, and fleet for a period of days during this peak demand travel period. As a result, the Company canceled a significant number of flights between December 21 and December 29, before ultimately returning to a normal flight schedule on December 30, 2022. These canceled flights resulted in a significant reduction in Passenger revenues during this period and also created a deceleration in bookings, primarily isolated to January and February 2023. In addition, the Company incurred significant costs associated with this event and recorded these expenses during December 2022 and first quarter 2023, totaling approximately \$390 million and \$55 million, respectively, which are included in the accompanying Consolidated Statement of Income. These estimated items included reimbursements to Customers impacted by the cancellations for costs they incurred, the estimated value of Rapid Rewards points offered as a gesture of goodwill to Customers that are expected to be redeemed, and additional premium pay and additional compensation for Employees directly or indirectly impacted by the cancellations and recovery efforts. The financial impacts of the event to the Company also included lower fuel and oil and profitsharing expenses.

Based on the Company's wide-scale operational disruption, the Company could be subject to fines and/or penalties resulting from investigations by government agencies as well as litigation from Customers and Shareholders. On October 27, 2023, the Department of Transportation (the "DOT") notified the Company that it had determined the Company failed to provide adequate customer service assistance, prompt flight status notifications, and proper and prompt refunds and that the assessment of a civil penalty was warranted. During fourth quarter 2023, the Company accrued an expense of \$107 million associated with a settlement reached with the DOT in December 2023 based on their investigation into the disruption.

Cash and Cash Equivalents

Cash in excess of that necessary for operating requirements is invested in short-term, highly liquid, income-producing investments. Investments with original maturities of three months or less when purchased are classified as cash and cash equivalents, which primarily consist of certificates of deposit, money market funds, and investment grade commercial paper issued by major corporations and financial institutions. Cash and cash equivalents are stated at cost, which approximates fair value.

As of December 31, 2023 and 2022, \$50 million and \$106 million, respectively, in cash collateral deposits were held by the Company from its fuel hedge counterparties. As of December 31, 2023, the Company had no outstanding interest rate swap agreements and therefore no cash collateral deposits were provided by or held by the Company from interest rate hedge counterparties. Additionally, as of December 31, 2022, no cash collateral deposits were provided by or held by the Company based on its outstanding interest rate swap agreements. Cash collateral amounts provided or held associated with fuel and interest rate derivative instruments are not restricted in any way and earn interest income at an agreed upon rate that approximates the rates earned on short-term securities issued by the U.S. Government. Depending on the fair value of the Company's fuel and interest rate derivative instruments, the amounts of collateral deposits held or provided at any point in time can fluctuate significantly. See Note 11 for further information on these collateral deposits and fuel derivative instruments.

Short-term and Noncurrent Investments

Short-term investments consist of investments with original maturities of greater than three months but less than twelve months when purchased. These are primarily short-term securities issued by the U.S. Government and certificates of deposit issued by domestic banks. All of these investments are classified as available-for-sale securities and are stated at fair value, which approximates cost. For all short-term investments, at each reset period or upon reinvestment, the Company accounts for the transaction as Proceeds from sales of short-term and other investments for the security relinquished, and Purchases of short-term investments for the security purchased, in the accompanying Consolidated Statement of Cash Flows. Unrealized gains and losses, net of tax, if any, are recognized in Accumulated other comprehensive income (loss) ("AOCI") in the accompanying Consolidated Balance Sheet. Realized net gains and losses on specific investments, if any, are reflected in Interest income in the accompanying Consolidated Statement of Income. Both unrealized and realized gains and/or losses associated with investments were immaterial for all years presented.

Noncurrent investments consist of investments with maturities of greater than twelve months. Noncurrent investments are included as a component of Other assets in the Consolidated Balance Sheet.

Accounts and Other Receivables

Accounts and other receivables are initially recorded at cost and are evaluated for collectability in every period. They primarily consist of the amounts due from the Company's business partners and other suppliers, amounts due from credit card companies associated with sales of tickets for future travel, amounts due from business partners in the Company's loyalty program, and tax receivables from overpayment or net operating losses that are allowed to be carried back to prior periods to claim refunds against prior taxes paid. See Note 16 for further information. The allowance for doubtful accounts was immaterial as of December 31, 2023 and 2022. In addition, the provision for doubtful accounts and write-offs for 2023, 2022, and 2021 were each immaterial.

Inventories

Inventories primarily consist of aircraft fuel and flight equipment expendable parts, materials, and supplies. All of these items are carried at average cost, less an allowance for obsolescence. These items are generally charged to expense when issued for use. The reserve for obsolescence was immaterial as of December 31, 2023, and 2022. In addition, the Company's provision for obsolescence and write-offs for 2023, 2022, and 2021 were each immaterial.

Property and Equipment

Property and equipment is stated at cost. Capital expenditures include payments made for aircraft, other flight equipment, purchase deposits related to future aircraft deliveries, airport and other facility construction projects, and ground and other property and equipment. Depreciation is provided by the straight-line method to estimated residual values over periods of approximately 25 years for flight equipment, and 5 to 30 years for ground property and equipment. As of December 31, 2023, residual values estimated for aircraft range from 13 percent to 20 percent, and generally range from 0 to 10 percent for ground property and equipment. Assets constructed for others consists of airport improvement projects in which the Company is considered to have control of the asset during the construction period. Once construction is effectively completed, the sale-leaseback model would apply when control passes from the lessee to the lessor. See Note 5 for further information. Leasehold improvements are amortized as a component of depreciation expense over the estimated useful life of the asset or the remaining term of the underlying lease, whichever is less. In certain situations, the term of the lease may include periods covered by renewal options, if renewal is reasonably certain.

The Company evaluates its long-lived assets used in operations for impairment when events and circumstances indicate that the undiscounted cash flows to be generated by that asset group are less than the carrying amounts of the asset group and may not be recoverable. Factors that would indicate potential impairment include, but are not

limited to, significant decreases in the market value of the long-lived asset group, a significant change in the long-lived asset group's physical condition, and operating or cash flow losses associated with the use of the long-lived asset group. If an asset group is deemed to be impaired, an impairment loss is recorded for the excess of the asset group's book value in relation to its estimated fair value. During 2022 and 2021, the Company recorded impairment charges of \$28 million and \$12 million, respectively, associated with the accelerated retirement of 10 and 8 of its Boeing 737-700 ("700") aircraft. There were no material impairments in 2023 associated with the accelerated retirement of the Company's aircraft. However, the Company identified certain 700 aircraft that were retired early in 2023 or are planned for early retirement in 2024. This change in retirement dates, and the corresponding impact to depreciation expense, is considered a change in estimate and resulted in the following impact to expense in 2023:

(in millions, except per share amounts)	Year ended	
	December 31, 2023	
Depreciation and amortization expense	\$	28
Net income *		(17)
Net income per basic share		(0.03)
Net income per diluted share		(0.03)

* net of profitsharing benefit and income taxes

Leases

The Company determines if an arrangement is a lease at inception. Operating leases are included in Operating lease right-of-use assets, Current operating lease liabilities, and Noncurrent operating lease liabilities in the Consolidated Balance Sheet. Finance leases are included in Property and equipment, Current maturities of long-term debt, and Long-term debt less current maturities in the Consolidated Balance Sheet.

Right-of-use assets represent the Company's right to use an underlying asset for the lease term, and lease liabilities represent the Company's obligation to make lease payments arising from the lease. The lease liability is measured as the present value of the unpaid lease payments, and the right-of-use asset value is derived from the calculation of the lease liability. Lease payments include fixed and in-substance fixed payments, variable payments based on an index or rate, reasonably certain purchase options, termination penalties, fees paid by the lessee to the owners of a special-purpose entity for restructuring the transaction, and probable amounts the lessee will owe under a residual value guarantee. Lease payments do not include (i) variable lease payments other than those that depend on an index or rate, (ii) any guarantee by the lessee of the lessor's debt, or (iii) any amount allocated to non-lease components, if such election was made upon adoption, per the provisions of the Accounting Standards Codification ("ASC") 842. The Company uses its estimated incremental borrowing rate, which is derived from information available at the lease commencement date, in determining the present value of lease payments, since the Company does not know the actual implicit rates in its leases. The Company gives consideration to its most recent debt issuances as well as publicly available data for instruments with similar characteristics when calculating its incremental borrowing rate. Lease expense for operating lease payments is recognized on a straight-line basis over the lease term. The Company combines lease and non-lease components for all asset groups. The Company's lease term includes any option to extend the lease when it is reasonably certain to be exercised based on considering all relevant economic factors.

Aircraft and Engine Maintenance

The cost of scheduled inspections and repairs and routine maintenance costs for all aircraft and engines are charged to Maintenance materials and repairs expense within the accompanying Consolidated Statement of Income as incurred.

The Company has maintenance agreements related to certain aircraft engines with external service providers, including agreements that effectively transfer the risk of performance of such work to the service provider. Under the agreements where the risk of performance is deemed transferred to the counterparty, the appropriate expense is recorded commensurate with the period in which the corresponding level of service is provided. For its engine

maintenance contracts that do not transfer risk to the service provider, the Company records expense on a time and materials basis when an engine repair event takes place.

Modifications that significantly enhance the operating performance or extend the useful lives of aircraft or engines are capitalized and amortized over the remaining life of the asset.

Goodwill and Intangible Assets

The Company applies a fair value-based impairment test to the carrying value of goodwill and indefinite-lived intangible assets annually on October 1st, or more frequently if certain events or circumstances indicate that an impairment loss may have been incurred. The Company assesses the value of goodwill and indefinite-lived intangible assets under either a qualitative or quantitative approach. Under a qualitative approach, the Company considers various market factors, including applicable key assumptions also used in the quantitative assessment listed below. These factors are analyzed to determine if events and circumstances could reasonably have affected the fair value of goodwill and indefinite-lived intangible assets. If the Company determines that it is more likely than not that an indefinite-lived intangible asset or reporting unit goodwill is impaired, the quantitative approach is used to assess the asset or reporting unit fair value and the amount of the impairment. Under a quantitative approach, the fair value of the Company's indefinite-lived intangible asset or reporting unit is calculated based on key market participant assumptions. If the indefinite-lived intangible assets' carrying value exceeds the fair value calculated using the quantitative approach, an impairment charge is recorded for the difference in fair value and carrying value. If the reporting unit carrying value exceeds the reporting unit fair value calculated using the quantitative approach, an impairment charge is recorded for the difference between fair value and carrying value, limited to the amount of goodwill in the reporting unit.

The Company's intangible assets primarily consist of acquired rights to certain airport owned takeoff and landing slots (a "slot" is the right of an air carrier, pursuant to regulations of the Federal Aviation Administration ("FAA")), to operate a takeoff or landing at a specific time at certain airports) at certain domestic slot-controlled airports. Indefinite-lived slots of \$296 million are included as a component of Other assets in the Company's Consolidated Balance Sheet, as of December 31, 2023 and 2022.

The Company applied the qualitative approach during its 2023 impairment tests, and no impairment was determined to exist for Goodwill or indefinite-lived intangible assets.

Revenue Recognition

Tickets sold for Passenger air travel are initially deferred as Air traffic liability. Passenger revenue is recognized and Air traffic liability is reduced when the service is provided (i.e., when the flight takes place). Air traffic liability primarily represents tickets sold for future travel dates, flight credits that are expected to be used in the future, and loyalty benefits that are expected to be redeemed in the future. The majority of the Company's tickets sold are nonrefundable. Southwest has a No-Show policy that applies to fares that are not canceled or changed by a Customer at least ten minutes prior to a flight's scheduled departure. Nonrefundable tickets that are sold but not flown on the travel date, and are canceled in accordance with the No-Show policy, can be applied to future travel. Refundable tickets that are sold but not flown on the travel date can also be applied to future travel. A small percentage of tickets (or partial tickets) will go unused, which is sometimes referred to as breakage. The Company estimates the amount of tickets that will go unused and recognizes such amounts in Passenger revenue in proportion to the pattern of flights taken by the Customers, once the flight date has lapsed. Based on the Company's revenue recognition policy, revenue is recorded at the flight date for a Customer who does not change his/her itinerary or does not cancel in accordance with the No-Show policy as the Company has then fulfilled its performance obligation. Amounts collected from passengers for ancillary services are also recognized when the service is provided, which is typically the flight date.

Initial breakage estimates for both tickets and flight credits available for future use are routinely adjusted based on the likelihood that the ticket or flight credit will be used or refunded back to the Customer. During 2020 and in parts of 2021, the Company experienced a significantly higher number of Customer-driven flight cancellations as a result

of the COVID-19 pandemic. For all Customer flight credits created or that would have otherwise expired between March 1 and September 7, 2020, associated with flight cancellations, the Company previously extended the expiration date to September 7, 2022. On July 28, 2022, the Company modified its policy and announced that all unexpired flight credits as of that date, including flight credits previously extended as a result of the COVID-19 pandemic, will no longer have an expiration date and thus will be able to be redeemed by Customers indefinitely. This change in policy was considered a contract modification under ASC 606, and the Company accounted for such change prospectively in third quarter 2022. Breakage estimates are based on the Company's Customers' historical travel behavior as well as assumptions about the Customers' future travel behavior. Assumptions about the Customers' future travel behavior can be impacted by several factors including, but not limited to: fare increases; fare sales; changes to the Company's ticketing policies; changes to the Company's refund, exchange, and unused flight credit policies; seat availability; and economic factors. As a result of the Company's policy change for flight credits in 2022, as well as changes in Customer behavior during 2020 and 2021, the amount of breakage realized on a prospective basis is expected to be lower and more stable than it has been previously. See Note 6 for further information.

Approximately \$828 million, approximately \$811 million, and approximately \$475 million of the Company's Operating revenues in 2023, 2022, and 2021, respectively, were attributable to foreign operations. The remainder of the Company's Operating revenues, approximately \$25.0 billion, approximately \$23.0 billion, and approximately \$15.3 billion in 2023, 2022, and 2021, respectively, were attributable to domestic operations.

Loyalty Program

The Company records a liability for the relative fair value of providing free travel under its loyalty program for all points earned from flight activity or sold to business partners participating in the Company's Rapid Rewards loyalty program. The loyalty liability represents performance obligations that will be satisfied when a Rapid Rewards loyalty member redeems points for travel or other goods and services. Points earned from flight activity are valued at their relative standalone selling price by applying fair value based on historical redemption patterns. Points earned from business partner activity, which primarily consist of points sold, along with related marketing services, to companies participating in the Rapid Rewards loyalty program, are valued using a relative fair value methodology based on the contractual rate which partners pay to Southwest to award Rapid Rewards points to the business partner's customers. For points that are expected to remain unused, the Company recognizes breakage in proportion to the pattern of points used by the Customer, which approximates the average period over which the population of Rapid Reward Members redeem their points. The Company records passenger revenue related to air transportation when the transportation is delivered. The marketing elements are recognized as Other - net revenue when earned. The Company's liability for loyalty benefits includes a portion that is expected to be redeemed during the following twelve months (classified as a component of Air traffic liability), and a portion that is not expected to be redeemed during the following twelve months (classified as Air traffic liability - noncurrent). The Company continually updates this analysis and adjusts the split between current and non-current liabilities as appropriate. See Note 6 for further information.

Advertising

Advertising costs are charged to expense as incurred. Advertising and promotions expense for the years ended December 31, 2023, 2022, and 2021 was \$266 million, \$224 million, and \$185 million, respectively, and is included as a component of Other operating expense in the accompanying Consolidated Statement of Income.

Share-based Employee Compensation

The Company has share-based compensation plans covering certain Employees, including a plan that also covers the Company's Board of Directors. The Company accounts for share-based compensation based on its grant date fair value. See Note 10 for further information.

Financial Derivative Instruments

The Company accounts for financial derivative instruments at fair value and applies hedge accounting rules where appropriate. The Company utilizes various derivative instruments, including jet fuel, crude oil, unleaded gasoline, and heating oil-based derivatives, in an attempt to reduce the risk of its exposure to jet fuel price increases. These instruments are accounted for as cash flow hedges upon proper qualification. At times, the Company can have interest rate swap agreements, the primary objective of which is to hedge forecasted debt issuances. These interest rate hedges are appropriately designated as cash flow hedges.

Since the majority of the Company's financial derivative instruments are not traded on a market exchange, the Company estimates their fair values. Depending on the type of instrument, the values are determined by the use of present value methods or option value models with assumptions about commodity prices based on those observed in underlying markets.

All cash flows associated with purchasing and selling derivatives are classified as operating cash flows in the Consolidated Statement of Cash Flows, within Changes in certain assets and liabilities. The Company classifies its cash collateral provided to or held from counterparties in a "net" presentation on the Consolidated Balance Sheet against the fair value of the derivative positions with those counterparties. See Note 11 for further information.

Software Capitalization

The Company capitalizes certain internal and external costs related to the acquisition and development of internal use software during the application development stages of projects. The Company amortizes these costs using the straight-line method over the estimated useful life of the software, which is typically five to fifteen years. Costs incurred during the preliminary project or the post-implementation/operation stages of the project are expensed as incurred. Capitalized computer software, included as a component of Ground property and equipment in the accompanying Consolidated Balance Sheet, net of accumulated depreciation, was \$1 billion and \$928 million as of December 31, 2023, and 2022, respectively. Computer software depreciation expense was \$246 million, \$232 million, and \$213 million for the years ended December 31, 2023, 2022, and 2021, respectively, and is included as a component of Depreciation and amortization expense in the accompanying Consolidated Statement of Income. The Company evaluates internal use software for impairment on a quarterly basis, and if it is determined the value of an asset was not recoverable or it qualifies for impairment, a charge will be recorded to write down the software to the lower of its carrying value or fair value. The Company had no significant impairments during 2023, 2022, or 2021.

Insurance Reserves

The Company uses a combination of insurance and self-insurance mechanisms, including a wholly-owned captive insurance entity and participation in a reinsurance treaty, to provide for the potential liabilities associated with certain risks, including workers' compensation, healthcare benefits, general liability, and aviation liability. Liabilities associated with the risks that are retained by the Company are not discounted and are estimated, in part, by considering historical claims experience, demographics, exposure and severity factors and other actuarial assumptions.

Income Taxes

The Company accounts for deferred income taxes utilizing an asset and liability method, whereby deferred tax assets and liabilities are recognized based on the tax effect of temporary differences between the financial statements and the tax basis of assets and liabilities, as measured by current enacted tax rates. The Company also evaluates the need for a valuation allowance to reduce deferred tax assets to estimated recoverable amounts.

The Company uses the portfolio approach for releasing income tax effects associated with amounts reclassified out of Accumulated other comprehensive income (loss).

The Company's policy for recording interest and penalties associated with uncertain tax positions is to record such items as a component of Income (loss) before income taxes. Penalties are recorded in Other (gains) losses, net, and interest paid or received is recorded in Interest expense or Interest income, respectively, in the accompanying Consolidated Statement of Income. There were no material amounts recorded for penalties and interest related to uncertain tax positions for all years presented. See Note 15 for further information.

Concentration Risk

Approximately 83 percent of the Company's Employees are unionized and are covered by collective-bargaining agreements. A portion of the Company's unionized Employees, including its Pilots, Flight Attendants, and Ramp Agents, which had contracts that became amendable on or before December 31, 2023, were in discussions on labor agreements as of December 31, 2023. Those unionized Employee groups in discussions represented approximately 65 percent of the Company's Employees as of December 31, 2023. On January 22, 2024, the Company's nearly 11,000 Pilots, represented by the Southwest Airlines Pilots' Association ("SWAPA"), voted to ratify a five-year contract extension with the Company. The newly ratified agreement becomes amendable in January 2029.

The Company attempts to minimize its concentration risk with regards to its cash, cash equivalents, and its investment portfolio. This is accomplished by diversifying and limiting amounts among different counterparties, the type of investment, and the amount invested in any individual security or money market fund.

To manage risk associated with financial derivative instruments held, the Company selects and will periodically review counterparties based on credit ratings, limits its exposure to a single counterparty, and monitors the market position of the program and its relative market position with each counterparty. The Company also has agreements with counterparties containing early termination rights and/or bilateral collateral provisions whereby security is required if market risk exposure exceeds a specified threshold amount or credit ratings fall below certain levels. Collateral deposits provided to or held from counterparties serve to decrease, but not totally eliminate, the credit risk associated with the Company's hedging program. See Note 11 for further information.

As of December 31, 2023, the Company operated an all-Boeing fleet, all of which are variations of the Boeing 737. The Boeing 737 MAX aircraft ("MAX") are crucial to the Company's growth plans and fleet modernization initiatives. Boeing has in the past experienced, and may continue to experience, delays in fulfilling its commitments with regards to delivery of the Boeing 737-8 ("-8") to the Company as a result of supply chain constraints. Further, the Company's contractual delivery schedule for the Boeing 737-7 ("-7") is dependent on the FAA issuing required certifications and approvals to Boeing and the Company. The FAA will ultimately determine the timing of the -7 certification and entry into service, and the Company therefore offers no assurances that current estimations and timelines are correct.

Boeing no longer manufactures versions of the 737 other than the MAX family of aircraft. If the MAX aircraft were to become unavailable for the Company's flight operations, the Company's growth would be restricted unless and until it could procure and operate other types of aircraft from Boeing or another manufacturer, seller, or lessor, and the Company's operations would be materially adversely affected. In particular, if the Company's growth were to be dependent upon the introduction of a new aircraft make and model to the Company's fleet, the Company would need to, among other things, (i) develop and implement new maintenance, operating, and training programs, (ii) secure extensive regulatory approvals, and (iii) implement new technologies. The requirements associated with operating a new aircraft make and model could take an extended period of time to fulfill and would likely impose substantial costs on the Company. A shift away from a single fleet type could also add complexity to the Company's operations, present operational and compliance risks, and materially increase the Company's costs. Any of these events would have a material, adverse effect on the Company's business, operating results, and financial condition. The Company could also be materially adversely affected if the pricing or operational attributes of its aircraft were to become less competitive.

The Company is also dependent on sole or limited suppliers for aircraft engines and certain other aircraft parts and services. Therefore, it would also be materially adversely impacted in the event of the unavailability of engines,

parts and certain repair services, the inability to find adequate support at commercially reasonable terms, or mechanical or regulatory issues associated with such engines or other parts or services.

The Company has historically entered into agreements with some of its co-brand, payment, and loyalty partners that contain exclusivity aspects which place certain confidential restrictions on the Company from entering into certain arrangements with other payment and loyalty partners. These arrangements generally extend for the terms of the agreements, none of which currently extend beyond October 31, 2030. Some of these agreements automatically renew on an annual basis, unless either party objects to such extension. None of these agreements are more than 10 years in length. The Company believes the financial benefits generated by the exclusivity aspects of these arrangements outweigh the risks involved with such agreements.

2. WORLDWIDE PANDEMIC

As a result of the rapid spread of the novel coronavirus, COVID-19, throughout the world, including into the United States, on March 11, 2020, the World Health Organization classified the virus as a pandemic. The speed with which the effects of the COVID-19 pandemic changed the U.S. economic landscape, outlook, and in particular the travel industry, was swift and unexpected. The Company experienced significant disruptions in travel and reduced bookings throughout the remainder of 2020 and for the entirety of 2021 as a result of the pandemic and subsequent variants of COVID-19. Following a significant negative impact to revenues and bookings in January and February 2022, which included increased trip cancellations and staffing challenges associated with the Omicron variant, the Company saw improvements in revenue trends in March 2022 and throughout the remainder of 2022 as COVID-19 cases significantly trended downward and bookings for summer travel accelerated. Although there were no material noticeable impacts to revenues and bookings during 2023 associated with COVID-19, the Company continues to monitor demand for air travel and proactively adjust its published flight schedules and capacity in response to passenger travel patterns.

Since the start of the pandemic, the Company entered into definitive documentation with the United States Department of the Treasury ("Treasury") with respect to payroll funding support ("Payroll Support") pursuant to three separate Payroll Support programs: the "PSP1 Payroll Support Program" in April 2020 under the Coronavirus Aid, Relief, and Economic Security Act ("CARES Act"); the "PSP2 Payroll Support Program" in January 2021 under the Consolidated Appropriations Act, 2021; and the "PSP3 Payroll Support Program" in April 2021 under the American Rescue Plan Act of 2021.

As consideration for its receipt of funding under each of these Payroll Support programs, the Company issued a promissory note in favor of Treasury (classified as a component of Long term debt less current maturities in the Consolidated Balance Sheet) and entered into a warrant agreement with Treasury (classified as a component of Stockholders' equity in the Consolidated Balance Sheet). The following table provides the details from the PSP1, PSP2 and PSP3 Payroll Support programs:

(dollars in millions, shares in thousands)	Grant	Promissory Note	Warrants	Total Payroll Support Proceeds	Warrants (shares) as of December 31, 2023	Warrant Strike Price as of December 31, 2023	Promissory Note Maturity Date
PSP1	\$ 2,337	\$ 976	\$ 40	\$ 3,354	2,753	\$35.45/share	April 19, 2030
PSP2	\$ 1,393	\$ 566	\$ 27	\$ 1,987	1,258	\$44.99/share	January 15, 2031
PSP3	\$ 1,310	\$ 526	\$ 18	\$ 1,852	924	\$56.88/share	April 23, 2031
Total	\$ 5,040	\$ 2,068	\$ 85	\$ 7,193	4,935		

In connection with the receipt of Payroll Support, the Company was subject to certain restrictions, including the elimination of share repurchases and dividends through September 30, 2022 and limits on executive compensation until April 1, 2023.

Under each of the three Payroll Support programs, funds received were used solely to pay qualifying employee salaries, wages, and benefits. As of December 31, 2022, all grant portions of the Payroll Support programs received had been allocated and classified as a contra-expense line item in the Consolidated Statement of Income. Although there is no directly applicable U.S. GAAP guidance related to such government assistance received, the Company analogized its facts and circumstances, and utilized the accounting principles within International Accounting Standards 20, Accounting for Government Grants and Disclosure of Government Assistance, with respect to the Payroll Support funds received. The Company has an option to prepay the promissory notes at any time without premium or penalty. Warrants will be settled through net share settlement or net cash settlement, at the Company's option. The Company has also granted Treasury certain demand underwritten offering and piggyback registration rights with respect to the warrants and the underlying common stock. The warrants do not have voting rights and include adjustments for below market issuances, payment of dividends, and other customary anti-dilution provisions.

3. NEW ACCOUNTING PRONOUNCEMENTS AND ACCOUNTING CHANGES

On December 14, 2023, the Financial Accounting Standards Board (the "FASB") issued Accounting Standards Update ("ASU") 2023-09, Income Taxes (Topic 740): Improvements to Income Tax Disclosures. This standard increases transparency and decision usefulness of income tax disclosures for investors by requiring information to better assess how an entity's operations and related tax risks and tax planning and operational opportunities affect its tax rate and prospects for future cash flows. This standard requires entities to provide enhanced disclosures related to the income tax rate reconciliation and income taxes paid. This standard is effective for all entities that are subject to Topic 740, Income Taxes for annual periods beginning after December 15, 2024, but early adoption is permitted. The Company is evaluating this new standard but does not expect it to have a significant impact on its financial statement presentation or results. See Note 15 for further information on the Company's income taxes.

On November 27, 2023, the FASB issued ASU 2023-07, Segment Reporting (Topic 280): Improvements to Reportable Segment Disclosures. This standard improves reportable segment disclosures by adding and enhancing interim disclosure requirements, clarifying circumstances in which entities can disclose multiple segment measures of profit or loss, providing new segment disclosure requirements for entities with a single reportable segment, and adding other disclosure requirements. This standard is effective for all entities that are subject to Topic 280, Segment Reporting for annual periods beginning after December 15, 2023, but early adoption is permitted. The Company is evaluating this new standard but does not expect it to have a significant impact on its financial statement presentation or results.

On November 17, 2021, the FASB issued ASU 2021-10, Government Assistance (Topic 832): Disclosures by Business Entities about Government Assistance. The standard increases transparency of government assistance by focusing on the types of assistance given, an entity's accounting for the assistance, and the effect of the assistance on the entity's financial statements to allow for more comparable information for investors and other financial statement users. This standard was effective for all entities under the scope for financial statements issued for annual periods beginning after December 15, 2021, but early adoption was permitted. The Company adopted the standard early as of December 31, 2021. See Note 2 for further information on the Company's treatment of government assistance received.

On May 3, 2021, the FASB issued ASU 2021-04, Earnings Per Share (Topic 260), Debt—Modifications and Extinguishments (Subtopic 470-50), Compensation—Stock Compensation (Topic 718), and Derivatives and Hedging—Contracts in Entity's Own Equity (Subtopic 815-40): Issuer's Accounting for Certain Modifications or Exchanges of Freestanding Equity-Classified Written Call Options. This standard provides clarification and reduces diversity in an issuer's accounting for modifications or exchanges of freestanding equity-classified written call

options (such as warrants) that remain equity classified after modification or exchange. This standard was effective for fiscal years beginning after December 15, 2021, and the standard was adopted and applied prospectively by the Company as of January 1, 2022, but the adoption and application did not have a significant impact on the Company's financial statements and disclosures, including interim periods.

On January 7, 2021, the FASB issued ASU 2021-01, Reference Rate Reform (Topic 848). This standard provides optional temporary guidance for entities transitioning away from London Interbank Offered Rate ("LIBOR") to new reference interest rates so that derivatives affected by the discounting transition are explicitly eligible for certain optional expedients and exceptions with Topic 848. These amendments do not apply to any contract modifications made after December 31, 2024, any new hedging relationships entered into after December 31, 2024, or to existing hedging relationships evaluated for effectiveness existing as of December 31, 2024, that apply certain optional practical expedients. This standard was effective immediately and may be applied (i) on a full retrospective basis as of any date from the beginning of an interim period that includes or is subsequent to March 12, 2020, or (ii) on a prospective basis to new modifications from any date within an interim period that includes or is subsequent to the date of the issuance of a final update, up to the date that financial statements are available to be issued. The Company had no material LIBOR-related contract modifications during the twelve months ended December 31, 2023.

On August 5, 2020, the FASB issued ASU 2020-06, Debt—Debt with Conversion and Other Options (Subtopic 470-20) and Derivatives and Hedging—Contracts in Entity's Own Equity (Subtopic 815-40): Accounting for Convertible Instruments and Contracts in an Entity's Own Equity. This new standard reduced the number of accounting models for convertible debt instruments and convertible preferred stock, made targeted improvements to the disclosures for convertible instruments and earnings-per-share ("EPS") guidance, and amended the guidance for the derivatives scope exception for contracts in an entity's own equity to reduce form-over-substance-based accounting conclusions. This standard was effective for fiscal years beginning after December 15, 2021, and the Company adopted this standard as of January 1, 2022, utilizing the modified retrospective method. Under the modified approach, the Company applied guidance to all financial instruments that were outstanding as of the beginning of the year of adoption with the cumulative effect recognized as an adjustment to the opening balance of retained earnings. Upon adoption, the Company reclassified the remaining equity component of \$300 million, from Additional paid-in capital to Long-term debt associated with its 1.25% Convertible Senior Notes due 2025 (the "Convertible Notes"), and no longer records amortization of the debt discount to Interest expense. The cumulative effect from prior period amortization of the debt discount that has been recorded to Interest expense, offset by reductions to Capital in excess of par value related to the requisition of the equity component through previous repurchases, resulted in a \$55 million adjustment to the opening balance of Retained earnings upon adoption. The new standard requires the use of the if-converted method to calculate diluted EPS, which is generally more dilutive, rather than the treasury stock method as was the Company's policy pre-adoption. See Note 4.

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). Basic net income per share is calculated by dividing net income by the weighted average of shares outstanding during the period. Diluted net income per share reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock. An immaterial number of shares related to the Company's restricted stock units and stock warrants were excluded from the denominator for the fiscal years ended December 31, 2023, 2022, and 2021 because inclusion of such shares would

be antidilutive.

	Year ended December 31,		
	2023	2022	2021
NUMERATOR:			
Net income	\$ 465	\$ 539	\$ 977
Add: Interest expense (a)	19	22	—
Net income attributable to common stockholders	\$ 484	\$ 561	\$ 977
DENOMINATOR:			
Weighted-average shares outstanding, basic	595	593	592
Dilutive effects of convertible notes (a) (b)	43	47	15
Dilutive effects of stock warrants	—	—	1
Dilutive effect of restricted stock units	2	2	1
Adjusted weighted-average shares outstanding, diluted	640	642	609
NET INCOME PER SHARE:			
Basic	\$ 0.78	\$ 0.91	\$ 1.65
Diluted	\$ 0.76	\$ 0.87	\$ 1.61

(a) As of January 1, 2022, the Company adopted ASU 2020-06 using the modified retrospective method. The standard requires the Company to apply the if-converted method for purposes of diluted net income per share, which requires the Company to assume that all Convertible Notes were converted and outstanding for the entire period. Using this method, the numerator is affected by adding back interest expense and the denominator is affected by including the effect of potential share settlement, if the effect is more dilutive, regardless of the type of settlement. For the year ended December 31, 2023, all shares issuable on conversion were included in the denominator. See Notes 3 and 7 for further information regarding the Convertible Notes.

(b) Prior to the adoption of ASU 2020-06, the Convertible Notes were accounted for using the treasury stock method for the purposes of Net income per share. For the year ended December 31, 2021, the average market price of the Company's common stock exceeded the conversion price per share of \$38.48 and as such, the common shares underlying the Convertible Notes were included in the diluted calculation.

5. COMMITMENTS AND CONTINGENCIES

Commitments

The Company has contractual obligations and commitments primarily with regard to future purchases of aircraft, repayment of debt (see Note 7), and lease arrangements (see Note 8). During the year ended December 31, 2023, the Company entered into supplemental agreements with The Boeing Company ("Boeing") relating to its contractual order book for -7 and -8 aircraft. The revised agreement, which extends the order book to 2031, supports the Company's growth and fleet modernization plans, while also providing significant flexibility to manage its fleet size, including opportunities to accelerate fleet modernization efforts if growth opportunities do not materialize. The Company received 86 -8 aircraft deliveries from Boeing in 2023 and retired 39 -700 aircraft. The Company retains significant flexibility to manage its fleet size, including opportunities to accelerate fleet modernization efforts if growth opportunities do not materialize.

Boeing continues to experience delays in fulfilling its commitments with regards to delivery of certain MAX aircraft to the Company, as a result of both supply chain constraints as well as achieving FAA certification of one of its new aircraft types, the -7, for which Southwest expects to be the launch customer.

During fourth quarter 2023, the Company exercised eight -7 options for delivery in 2025, accelerated one 2024 -8 firm order into 2023, converted and shifted three 2025 -7 firm orders to three 2024 -8 firm orders, and shifted an additional three 2025 -8 firm orders into 2024. Therefore, as of December 31, 2023, the Company had the following firm orders and options for future periods:

	The Boeing Company			Total
	-7 Firm Orders	-8 Firm Orders	-7 or -8 Options	
2024	27	58	—	85 (c)
2025	59	—	15	74
2026	59	—	26	85
2027	19	46	25	90
2028	15	50	25	90
2029	38	34	18	90
2030	45	—	45	90
2031	45	—	45	90
	<u>307 (a)</u>	<u>188 (b)</u>	<u>199</u>	<u>694</u>

(a) The delivery timing for the -7 is dependent on the FAA issuing required certifications and approvals to Boeing and the Company. The FAA will ultimately determine the timing of the -7 certification and entry into service, and the Company therefore offers no assurances that current estimations and timelines are correct.

(b) The Company has flexibility to designate firm orders or options as -7s or -8s, upon written advance notification as stated in the contract.

(c) The Company currently plans for approximately 79 MAX aircraft deliveries in 2024.

Based on the Company's current agreement with Boeing, capital commitments associated with its firm orders as of December 31, 2023, were: \$2.2 billion in 2024, \$1.7 billion in 2025, \$1.9 billion in 2026, \$2.6 billion in 2027, \$2.9 billion in 2028, and \$5.3 billion thereafter.

Los Angeles International Airport

In April 2023, the Company executed a lease agreement with Los Angeles World Airports ("LAWA"), which owns and operates Los Angeles International Airport ("LAX"), for the ground lease and construction of a new concourse. In this agreement, the Company will manage the development, design, financing, and construction of nine new gates, along with additional features, at LAX. Construction of the concourse is estimated to be complete in late 2028 or early 2029 at a cost not to exceed \$2.3 billion.

Funding for this project will flow through a credit facility and the outstanding loans are expected to be paid off directly by LAWA to the credit facility at project completion, thus reimbursing the Company on all costs drawn on the credit facility. As of December 31, 2023, the credit facility has yet to be put into place and is expected to be established closer to the beginning of construction, which is anticipated to occur in 2025. The Company is expected to be reimbursed by the credit facility on prior payments made once in place.

Based on this agreement, the Company has determined that it does have control over the assets during this project for accounting purposes. As a result, the costs incurred to fund this project thus far, which totaled \$62 million as of December 31, 2023, are included within Assets constructed for others on the accompanying Consolidated Balance Sheet.

William P. Hobby Airport

In March 2022, the Company executed a Memorandum of Agreement ("MOA") with the City of Houston, Texas (the "City") which owns William P. Hobby Airport ("Hobby") that is managed and operated by the City's Houston Airport System. Under the MOA, the Company will manage the development, design, and construction of seven new gates in Hobby's West Concourse.

The project is currently estimated to be completed in 2026 at a cost of at least \$470 million. The Company will provide initial funding for the majority of the project, but is expected to be reimbursed for such funding from the City on a monthly basis and therefore the project should not significantly impact the Company's liquidity. The City

plans to fund these reimbursements utilizing rates and charges collected from current and future Hobby occupants, including the Company.

Based on the MOA, as well as a terminal lease amendment expected to be finalized prior to the beginning of significant construction, the Company has determined that it does not control the assets during the construction period for accounting purposes, and thus will record the amounts funded for the project as a receivable until reimbursed by the City, and the balance is derecognized. There were no material amounts recorded in the accompanying Consolidated Balance Sheet as of December 31, 2023.

Dallas Love Field

During 2008, the City of Dallas approved the Love Field Modernization Project ("LFMP"), a project to reconstruct Dallas Love Field with modern, convenient air travel facilities. Pursuant to a Program Development Agreement with the City of Dallas and the Love Field Airport Modernization Corporation (or the "LFAMC," a Texas non-profit "local government corporation" established by the City of Dallas to act on the City of Dallas' behalf to facilitate the development of the LFMP), the Company managed this project. Major construction was effectively completed in 2014. During second quarter 2017, the City of Dallas approved using the remaining bond funds for additional terminal construction projects, which were effectively completed in 2018.

Although the City of Dallas received commitments from various sources that helped to fund portions of the LFMP project, including the FAA, the Transportation Security Administration, and the City of Dallas' Aviation Fund, the majority of the funds used were from the issuance of bonds. The Company guaranteed principal and interest payments on bonds issued by the LFAMC, of which only the "Series 2012" bonds remain outstanding. Given the Company's guarantee associated with the Series 2012 bonds, the remaining debt service amount is considered a minimum lease payment under ASC Topic 842, Leases, and therefore remains a lease liability with a corresponding right-of-use asset within the Company's Consolidated Balance Sheet.

As of December 31, 2023, \$59 million of principal remained outstanding associated with the Series 2012 bonds. The net present values of the future principal and interest payments associated with the bonds were \$65 million and \$77 million as of December 31, 2023 and 2022, respectively, and were reflected as part of the Company's operating lease right-of-use assets and lease obligations in the Consolidated Balance Sheet.

Contingencies

The Company is from time to time subject to various legal proceedings and claims arising in the ordinary course of business and records a liability for such claims when it is probable that a loss will be incurred and the amount is reasonably estimable.

The Company is a defendant in class action litigation asserting it has not provided paid short-term military leave to certain employees, in violation of the federal Uniformed Services Employment and Reemployment Rights Act ("USERRA"). The United States District Court for the Northern District of California previously issued an order to effectively stay the action, pending an appeal from an order by the United States District Court for the Eastern District of Washington granting summary judgment in favor of an airline in a separate case involving substantially the same claims at issue in this action. On February 1, 2023, the Ninth Circuit reversed the district court's grant of summary judgment and remanded the separate airline case to the District Court. The Ninth Circuit's decision may adversely affect the Company's defenses in the USERRA proceeding and may give rise to additional litigation in this or other areas. The Company is currently not able to estimate a range of possible loss with regards to the litigation to which it is a defendant.

6. REVENUE

Passenger Revenues

The Company's contracts with its Customers primarily consist of its tickets sold, which are initially deferred as Air traffic liability. Passenger revenue associated with tickets is recognized when the performance obligation to the Customer is satisfied, which is primarily when travel is provided.

Revenue is categorized by revenue source as the Company believes it best depicts the nature, amount, timing, and uncertainty of revenue and cash flow. The following table provides the components of Passenger revenue recognized for the years ended December 31, 2023, 2022, and 2021:

(in millions)	Year ended December 31,		
	2023	2022	2021
Passenger non-loyalty	\$ 19,073	\$ 17,645	\$ 11,377
Passenger loyalty - air transportation	3,639	3,028	2,136
Passenger ancillary sold separately	925	735	553
Total passenger revenues	\$ 23,637	\$ 21,408	\$ 14,066

Passenger non-loyalty includes all revenues recognized from Passengers for flights purchased primarily with cash or credit card. All Customers purchasing a ticket on Southwest Airlines are generally able to check up to two bags at no extra charge (with certain exceptions as stated in the Company's published Contract of Carriage), and the Company also does not charge a fee for a Customer to make a change to their flight after initial purchase, although fare differences may apply. Passenger loyalty - air transportation primarily consists of the revenue associated with award flights taken by loyalty program members upon redemption of loyalty points. Passenger ancillary sold separately includes any revenue associated with ancillary fees charged separately, such as in-flight purchases, EarlyBird Check-In[®], and Upgraded Boarding.

In order to determine the value of each loyalty point, certain assumptions must be made at the time of measurement, which include the following:

- *Allocation of Passenger Revenue* - Revenues from Passengers, related to travel, who also earn Rapid Rewards Points have been allocated between flight (recognized as revenue when transportation is provided) and Rapid Rewards Points (deferred until points are redeemed) based on each obligation's relative standalone selling price. The Company utilizes historical earning patterns to assist in this allocation.
- *Fair Value of Rapid Rewards Points* - Determined from the base fare value of tickets which were purchased using prior point redemptions for travel and other products and services, which the Company believes to be indicative of the fair value of points as perceived by Customers and representative of the value of each point at the time of redemption. The Company's booking site allows a Customer to toggle between fares utilizing either cash or point redemptions, which provides the Customer with an approximation of the equivalent value of their points. The value can differ, however, based on demand, the amount of time prior to the flight, and other factors. The mix of fare classes during the period measured represents a constraint, which could result in the assumptions above changing at the measurement date, as fare classes can have different coefficients used to determine the total loyalty points needed to purchase an award ticket. The mixture of these fare classes and changes in the coefficients used by the Company could cause the fair value per point to fluctuate.

For points that are expected to remain unused, the Company recognizes breakage in proportion to the pattern of points used by the Customer, which approximates the average period over which the population of Rapid Reward Members redeem their points. The Company utilizes historical behavioral data to develop a predictive statistical model to analyze the amount of breakage expected for points sold to business partners and earned through flight. The Company continues to evaluate expected breakage annually and applies appropriate adjustments in the fourth quarter of each year, or other times, if significant changes in Customer behavior are detected. Changes to breakage estimates impact revenue recognition prospectively. Due to the size of the Company's liability for loyalty benefits,

changes in Customer behavior and/or expected future redemption patterns could result in significant variations in Passenger revenue.

The Company allocates consideration received to performance obligations based on the relative fair value of those obligations. The Company has a co-branded credit card agreement (“Agreement”) with Chase Bank USA, N.A. (“Chase”), through which the Company sells loyalty points and certain marketing components, which consist of the use of the Southwest Airlines brand and access to Rapid Rewards Member lists, licensing and advertising elements, and the use of the Company’s resource team. In fourth quarter 2021, Chase and the Company executed a multi-year extension of the Agreement, extending the decades-long relationship between the parties. The Company estimated the selling prices and volumes over the term of the Agreement in order to determine the allocation of proceeds to each of the two performance obligations identified in the Agreement, which have been characterized as a transportation component and a marketing component. The allocations utilized are reviewed to determine if adjustment is necessary any time there is a modification to the Agreement. The Company records Passenger revenue related to loyalty point redemptions for air travel when the travel is delivered, and the marketing elements are recognized as Other revenue when the performance obligations related to those services are satisfied, which is generally the same period consideration is received from Chase.

As performance obligations to Customers are satisfied, the related revenue is recognized. The events that result in revenue recognition that are associated with performance obligations identified as a part of the Rapid Rewards Program are as follows:

- *Tickets and Rapid Rewards Points* - When a flight occurs, the related performance obligation is satisfied and the related value provided by the Customer, whether from purchased tickets or Rapid Rewards Points, is recognized as revenue.
- *Loyalty points redeemed for goods and/or services other than travel* - Rapid Rewards Members have the option to redeem points for goods and services offered through a third party vendor, who acts as principal. The performance obligation related to the purchase of these goods and services is satisfied when the good and/or service is delivered to the Customer.
- *Marketing Royalties* - As part of its Agreement with Chase, Southwest provides certain deliverables, including use of the Southwest Airlines’ brand, access to Rapid Rewards Member lists, advertising elements, and the Company’s resource team. These performance obligations are satisfied each month that the Agreement is active.

As of the years ended December 31, 2023 and 2022, the components of Air traffic liability, including contract liabilities based on tickets sold and unused flight credits available to the Customer, both of which are net of recorded breakage, and loyalty points available for redemption, within the Consolidated Balance Sheet were as follows:

(in millions)	Balance as of	
	December 31, 2023	December 31, 2022
Air traffic liability - passenger travel and ancillary passenger services	\$ 3,363	\$ 3,061
Air traffic liability - loyalty program	4,916	5,189
Total Air traffic liability	\$ 8,279	\$ 8,250

The balance in Air traffic liability - passenger travel and ancillary passenger services also includes flight credits not currently associated with a ticket that can be applied by Customers towards the purchase of future travel. These flight credits are typically created as a result of a prior ticket cancellation or exchange, and are reflected net of associated breakage. Rollforwards of the Company’s Air traffic liability - loyalty program for the years ended December 31, 2023 and 2022 were as follows (in millions):

	Year ended December 31,	
	2023	2022
Air traffic liability - loyalty program - beginning balance	\$ 5,189	\$ 4,789
Amounts deferred associated with points awarded	3,466	3,506
Revenue recognized from points redeemed - Passenger	(3,639)	(3,028)
Revenue recognized from points redeemed - Other	(100)	(78)
Air traffic liability - loyalty program - ending balance	<u>\$ 4,916</u>	<u>\$ 5,189</u>

Air traffic liability includes consideration received for ticket and loyalty related performance obligations which have not been satisfied as of a given date. Rollforwards of the amounts included in Air traffic liability as of December 31, 2023 and 2022 were as follows (in millions):

	Air traffic liability
Balance at December 31, 2022	\$ 8,250
Current period sales (passenger travel, ancillary services, flight loyalty, and partner loyalty)	23,766
Revenue from amounts included in contract liability opening balances	(5,031)
Revenue from current period sales	(18,706)
Balance at December 31, 2023	<u>\$ 8,279</u>
	Air traffic liability
Balance at December 31, 2021	\$ 7,725
Current period sales (passenger travel, ancillary services, flight loyalty, and partner loyalty)	22,012
Revenue from amounts included in contract liability opening balances	(4,976)
Revenue from current period sales	(16,511)
Balance at December 31, 2022	<u>\$ 8,250</u>

On July 28, 2022, the Company announced that all existing Customer flight credits as of that date, as well as any future flight credits issued, will no longer expire and will thus remain redeemable by Customers. Prior to this change, flight credits would expire twelve months from the original fare purchase date. Flight credits for non-refundable fares will be issued as long as the flight is cancelled more than 10 minutes prior to the scheduled departure. This announcement was considered a contract modification under applicable accounting guidance and the Company accounted for such change prospectively in third quarter 2022. The Company's balance of existing Customer flight credits as of the modification date was approximately \$1.9 billion, including a portion of the extended flight credits issued during the early portion of the COVID-19 pandemic, that had been set to expire on September 7, 2022. See Note 2 for further information. As the Company continues to believe that a portion of Customer flight credits issued after July 28, 2022, will not be redeemed, it continues to estimate and record breakage associated with such amounts. The amount of breakage realized on a prospective basis, however, is expected to be lower and more stable than it has been during the pandemic as a result of this policy change.

The amount of Customer flight credits represents approximately 8 percent and 9 percent of the total Air traffic liability balance as of December 31, 2023, and December 31, 2022, respectively, compared to approximately 2 percent of the Air traffic liability balance as of December 31, 2019.

Recognition of revenue associated with the Company's loyalty liability can be difficult to predict, as the number of award seats available to Members is not currently restricted and they could choose to redeem their points at any time that a seat is available. The performance obligations classified as a current liability related to the Company's loyalty program were estimated based on expected redemptions utilizing historical redemption patterns, and forecasted flight availability and fares. The entire balance classified as Air traffic liability—noncurrent relates to loyalty points that were estimated to be redeemed in periods beyond the twelve months following the representative balance sheet date. Based on historical experience as well as current forecasted redemptions, the Company expects the majority of loyalty points to be redeemed within approximately one year of the date the points are issued.

Despite the Company's policy change with regards to flight credits, it has not experienced significant flight credit redemptions beyond twelve months and it currently does not expect the amount of flight credits that will be redeemed beyond twelve months to be material as of the financial statement date.

All performance obligations related to freight services sold are completed within twelve months or less; therefore, the Company has elected to not disclose the amount of the remaining transaction price and its expected timing of recognition for freight shipments.

Other revenues primarily consist of marketing royalties associated with the Company's co-brand Chase® Visa credit card program, but also include commissions and advertising associated with Southwest.com®. All amounts classified as Other revenues are paid monthly, coinciding with the Company fulfilling its deliverables; therefore, the Company has elected to not disclose the amount of the remaining transaction price and its expected timing of recognition for such services provided.

The Company recognized revenue related to the marketing, advertising, and other travel-related benefits of the revenue associated with various loyalty partner agreements including, but not limited to, the Agreement with Chase, within Other operating revenues. For the years ended December 31, 2023, 2022, and 2021 the Company recognized \$2.1 billion, \$2.1 billion, and \$1.4 billion, respectively.

The Company is also required to collect certain taxes and fees from Customers on behalf of government agencies and remit these back to the applicable governmental entity on a periodic basis. These taxes and fees include foreign and U.S. federal transportation taxes, federal security charges, and airport passenger facility charges. These items are collected from Customers at the time they purchase their tickets, are excluded from the contract transaction price, and are therefore not included in Passenger revenue. The Company records a liability upon collection from the Customer and relieves the liability when payments are remitted to the applicable governmental agency.

7. FINANCING ACTIVITIES

(in millions)	December 31, 2023		December 31, 2022	
<i>Unsecured</i>				
5.25% Notes due 2025	\$	1,302	\$	1,302
1.25% Convertible Notes due 2025		1,611		1,611
3.00% Notes due 2026		300		300
7.375% Debentures due 2027		111		114
3.45% Notes due 2027		300		300
5.125% Notes due 2027		1,727		1,727
2.625% Notes due 2030		500		500
1.000% Payroll Support Program Loan due 2030 (See Note 2)		976		976
1.000% Payroll Support Program Loan due 2031 (See Note 2)		566		566
1.000% Payroll Support Program Loan due 2031 (See Note 2)		526		526
Finance leases		104		189
	\$	8,023	\$	8,111
Less current maturities		29		42
Less debt discount and issuance costs		16		23
	\$	7,978	\$	8,046

During 2020, the Company issued \$2.0 billion of unsecured notes due 2027, of which \$1.3 billion was issued June 8, 2020 (the "\$1.3 billion 2027 Notes") and \$700 million was issued July 31, 2020 (the "\$700 million 2027 Notes"). The notes bear interest at 5.125%. Interest is payable semi-annually in arrears. The \$700 million 2027 Notes were offered as an additional issuance of the Company's \$1.3 billion 2027 Notes issued on June 8, 2020. The \$700 million 2027 Notes were issued at a premium and this premium has been included within Capitalized financing items in the Consolidated Statement of Cash Flows. The Company made early prepayments on the notes of \$272 million throughout 2022, utilizing available cash on hand.

During 2020, the Company issued \$1.55 billion of unsecured notes due 2025, of which \$1.25 billion was issued May 4, 2020 (the “\$1.25 billion 2025 Notes”) and \$300 million was issued July 31, 2020 (the “\$300 million 2025 Notes”). The notes bear interest at 5.250%. Interest is payable semi-annually in arrears. The \$300 million 2025 Notes were offered as an additional issuance of the Company’s \$1.25 billion 2025 Notes issued on May 4, 2020. The \$300 million 2025 Notes were issued at a premium and this premium has been included within Capitalized financing items in the Consolidated Statement of Cash Flows. The Company made early prepayments on the notes of \$248 million throughout 2022, utilizing available cash on hand.

On May 1, 2020, the Company completed the public offering of \$2.3 billion aggregate principal amount of Convertible Senior Notes (the “Convertible Notes”). The Convertible Notes bear interest at a rate of 1.25% and will mature on May 1, 2025. Interest on the notes is payable semi-annually in arrears.

Holders may convert their Convertible Notes at their option at any time prior to the close of business on the business day immediately preceding February 1, 2025, in the event certain conditions are met, as stated in the offering documents. The Convertible Notes did not meet the criteria to be converted as of the date of the financial statements, and thus are classified as Long-term debt in the accompanying Consolidated Balance Sheet as of December 31, 2023. Upon conversion, the Company will pay or deliver, as the case may be, cash, shares of the Company’s common stock or a combination of cash and shares of common stock, at the Company’s election. The Company intends to settle conversions by paying cash up to the principal amount of the Convertible Notes, with any excess conversion value settled in cash or shares of common stock. The initial conversion rate was 25.9909 shares of common stock per \$1,000 principal amount of Convertible Notes (equivalent to an initial conversion price of approximately \$38.48 per share of common stock). However, based on the Company’s most recent cash dividends declared in November 2023, the bond conversion rate changed, and was 26.7188 as of December 31, 2023. As of December 31, 2023, the if-converted value of the Convertible Notes was less than the principal amount by \$368 million, using the Company’s closing stock price.

Upon issuance, the Company bifurcated the Convertible Notes for accounting purposes between a liability component and an equity component utilizing applicable guidance. The liability component was determined by estimating the fair value of a hypothetical issuance of an identical offering excluding the conversion feature of the Convertible Notes. The initial carrying amount of the equity component was calculated as the difference between the liability component and the face amount of the Convertible Notes. The Company adopted ASU 2020-06, as of January 1, 2022, utilizing the modified retrospective method approach. See Note 3 for further information. Upon adoption, the Company reclassified the remaining equity component, of \$300 million, from Additional paid-in capital to Long-term debt associated with its Convertible Notes, and no longer records amortization of the debt discount to Interest expense. The net carrying amount and principal amount of the Convertible Notes was \$1.6 billion as of December 31, 2023 and 2022.

The Company recognized interest expense associated with the Convertible Notes as follows:

(in millions)	December 31, 2023		December 31, 2022	
Non-cash amortization of debt issuance costs	\$	10	\$	12
Contractual coupon interest		20		22
Total interest expense	\$	30	\$	34

The unamortized debt issuance costs are being recognized as non-cash interest expense based on the 5-year term of the notes, through May 1, 2025, less amounts that were or will be required to be accelerated immediately upon conversion or repurchases. The Company had no changes to contingencies for the year ended December 31, 2023. The effective interest rate associated with the Convertible Notes was approximately 1.9 percent for the year ended December 31, 2023.

The following table presents the impact of the partial extinguishment of the Company's Convertible Notes and early prepayment of debt (excluding payments on finance leases) for the year ended December 31, 2022. No such instances of partial extinguishment or early prepayment of debt occurred for the year ended December 31, 2023. Additionally, there were no Convertible Note conversions exercised or settled during 2022 or 2023.

(in millions)	Year ended December 31, 2022				
	Cash paid for debt and interest	Principal repayment	Loss on extinguishment	Non-cash amortization of debt discount and (issuance) costs	Accrued Interest
1.25% Convertible Notes due 2025	\$ 649	\$ 486	\$ 171	\$ (9)	\$ 1
5.125% Notes due 2027	285	272	7	2	4
4.75% Notes due 2023	1,278	1,250	9	—	19
5.25% Notes due 2025	258	248	6	—	4
Total	\$ 2,470	\$ 2,256	\$ 193	\$ (7)	\$ 28

The Company has access to \$1.0 billion under its amended and restated revolving credit facility (the "Amended Credit Agreement"). In August 2023, this facility was amended to (i) extend the maturity to August 4, 2028, (ii) release all aircraft and other assets constituting collateral securing the loans made under the Amended Credit Agreement, (iii) delete all provisions and terminate all agreements, in each case, relating to the grant of such collateral, (iv) eliminate the role of "Collateral Agent" under the Amended Credit Agreement after giving effect to the amendment, terminations, and releases, (v) eliminate the minimum liquidity covenant, (vi) add a Coverage Ratio financial covenant, (vii) amend the Collateral Coverage Test covenant requiring that a pool of lien-free specified aircraft and related assets have a minimum aggregate appraised value, and add certain covenants with respect to such pool of assets, (viii) amend the pricing and fees, (ix) increase certain materiality thresholds, (x) grant longer grace periods for certain defaults, and (xi) update and amend certain other provisions. For the twelve months ended December 31, 2023 and 2022 there were no amounts outstanding under the Amended Credit Agreement.

Generally, amounts outstanding under the Amended Credit Agreement bear interest at rates based on either the SOFR rate (selected by the Company for designated interest periods) or the "alternate base rate" (being the highest of (1) the Wall Street Journal prime rate, (2) one-month adjusted SOFR (one-month SOFR plus 0.1 percent) plus 1 percent, and (3) the Federal Reserve Bank of New York Rate, plus 0.5 percent). The underlying SOFR rate is subject to a floor of 1 percent per annum and the "alternate base rate" is subject to a floor of 1 percent per annum.

The Amended Credit Agreement has an accordion feature that would allow the Company, subject to, among other things, the procurement of incremental commitments, to increase the size of the facility to \$1.5 billion. The facility contains a financial covenant requiring a minimum coverage ratio of adjusted pre-tax income to fixed obligations, as defined. As of December 31, 2023, the Company was in compliance with this covenant and all other covenants in the Amended Credit Agreement.

During February 2020, the Company issued \$500 million senior unsecured notes due 2030. The notes bear interest at 2.625 percent. Interest is payable semi-annually in arrears.

During November 2017, the Company issued \$300 million senior unsecured notes due 2027. The notes bear interest at 3.45 percent. Interest is payable semi-annually in arrears.

During November 2016, the Company issued \$300 million senior unsecured notes due 2026. The notes bear interest at 3.00 percent. Interest is payable semi-annually in arrears.

On February 28, 1997, the Company issued \$100 million of senior unsecured 7.375 percent debentures due March 1, 2027. Interest is payable semi-annually. The debentures may be redeemed, at the option of the Company, in whole at any time or in part from time to time, at a redemption price equal to the greater of the principal amount

of the debentures plus accrued interest at the date of redemption or the sum of the present values of the remaining scheduled payments of principal and interest thereon, discounted to the date of redemption at the comparable treasury rate plus 20 basis points, plus accrued interest at the date of redemption.

The Company is required to provide standby letters of credit to support certain obligations that arise in the ordinary course of business. Although the letters of credit are an off-balance sheet item, the majority of the obligations to which they relate are reflected as liabilities in the Consolidated Balance Sheet. Outstanding letters of credit totaled \$110 million as of December 31, 2023.

The Company had no assets pledged as collateral for its borrowings as of December 31, 2023. The net book value of the assets pledged as collateral for the Company's secured borrowings, primarily aircraft, was \$2.0 billion as of December 31, 2022. This included aircraft with net book values of approximately \$296 million, in which the associated debt had been repaid as of December 31, 2022, but for which the liens were formally removed in 2023.

As of December 31, 2023, aggregate annual principal maturities of debt and finance leases (not including amounts associated with interest on finance leases) are as follows:

(in millions)		
2024	\$	29
2025		2,934
2026		315
2027		2,142
2028		11
Thereafter		2,581
Total	\$	8,012

8. LEASES

The Company enters into leases for aircraft, property, and other types of equipment in the normal course of business. As allowed under ASC 842, Leases, the Company has elected a practical expedient to exclude from recognition lease assets and lease liabilities associated with leases that have an initial term of twelve months or less. Such expense was not material for the twelve months ended December 31, 2023, 2022, and 2021.

As of December 31, 2023, the Company held aircraft leases with remaining terms extending up to 10 years. The aircraft leases generally can be renewed for three months to three years at rates based on the fair market value at the end of the lease term. Residual value guarantees included in the Company's lease agreements are not material.

In fourth quarter 2022, the Company signed an aircraft sale agreement with AerCap Ireland Limited ("AerCap") to purchase 39 -700 aircraft, all of which were already in the Company's fleet under finance lease terms. As each aircraft purchase was finalized, the Company relieved its related lease liability and continued to recognize the cost of the aircraft within Property and equipment section in the Consolidated Balance Sheet. The Company completed the purchase of 31 of these aircraft during fourth quarter 2022, and the remaining eight aircraft during first quarter 2023. The Company paid the lessor \$365 million and \$88 million in fourth quarter 2022 and first quarter 2023, respectively, as part of this transaction, of which \$191 million and \$50 million were recorded as the elimination of the Company's remaining finance lease obligation for the aircraft, and which was also reflected within Payments of long-term debt and finance lease obligations in the accompanying Consolidated Statement of Cash Flows. The remaining \$174 million and \$38 million was the net purchase price of the aircraft and is included as part of the Company's Capital expenditures for fourth quarter 2022 and first quarter 2023, respectively.

In second and third quarter 2023, the Company also entered into additional transactions with third parties to purchase four -700 aircraft, all of which were already in the Company's fleet under finance lease terms. The Company paid the lessors \$44 million in 2023, of which \$3 million was recorded as the elimination of the Company's remaining finance lease obligation for the aircraft, and which was also reflected within Payments of

long-term debt and finance lease obligations in the accompanying Consolidated Statement of Cash Flows. The remaining \$41 million was the net purchase price of the aircraft and is included as part of the Company's Capital expenditures for 2023. There was no gain or loss recorded as a result of these transactions. As of December 31, 2023, the Company has 24 finance leased aircraft remaining.

At each airport where the Company conducts flight operations, the Company has lease agreements, generally with a governmental unit or authority, for the use of airport terminals, airfields, office space, cargo warehouses, gates, and/or maintenance facilities. These leases are classified as operating lease agreements and have remaining lease terms extending up to 37 years. Certain leases can be renewed from one year to 11 years. The majority of the airport terminal leases contain certain provisions for periodic adjustments to rates that depend upon airport operating costs or use of the facilities, and are reset at least annually. Because of the variable nature of these rates, these leases are not recorded as a right-of-use asset or a lease liability on the Consolidated Balance Sheet.

The Company also leases certain technology assets, fuel storage tanks, and various other equipment that qualify as leases under the applicable accounting guidance with lease terms extending up to three years. Certain leases can be renewed from six months to one year.

Lease-related assets and liabilities recorded on the Consolidated Balance Sheet were as follows:

(in millions)	Balance Sheet location	December 31, 2023	December 31, 2022
Assets			
Operating	Operating lease right-of-use assets (net)	\$ 1,223	\$ 1,394
Finance	Property and equipment (net of allowance for depreciation and amortization of \$477 million and \$634 million)	125	297
Total lease assets		<u>\$ 1,348</u>	<u>\$ 1,691</u>
Liabilities			
Current			
Operating	Current operating lease liabilities	\$ 208	\$ 225
Finance	Current maturities of long-term debt	29	42
Noncurrent			
Operating	Noncurrent operating lease liabilities	985	1,118
Finance	Long-term debt less current maturities	75	147
Total lease liabilities		<u>\$ 1,297</u>	<u>\$ 1,532</u>

The components of lease costs, included in the Consolidated Statement of Income, were as follows:

(in millions)	Year ended December 31, 2023	Year ended December 31, 2022	Year ended December 31, 2021
Operating lease cost - aircraft (a)	\$ 186	\$ 188	\$ 204
Operating lease cost - other	89	84	81
Short-term lease cost	2	2	1
Variable lease cost	1,733	1,447	1,406
Amortization of finance lease liabilities	44	106	112
Interest on finance lease liabilities	5	15	19
Total net lease cost	<u>\$ 2,059</u>	<u>\$ 1,842</u>	<u>\$ 1,823</u>

(a) Net of sublease income of \$7 million, \$17 million, and \$41 million for the years ended December 31, 2023, 2022, and 2021.

Supplemental cash flow information related to leases, included in the Consolidated Statement of Cash Flows, was as follows:

(in millions)	Year ended December 31, 2023		Year ended December 31, 2022		Year ended December 31, 2021	
Cash paid for amounts included in the measurement of lease liabilities:						
Operating cash flows for operating leases	\$	251	\$	303	\$	346
Operating cash flows for finance leases		5		16		19
Financing cash flows for finance leases		32		78		83
Right-of-use assets obtained in exchange for lease obligations:						
Operating leases		82		58		327

As of December 31, 2023, maturities of lease liabilities were as follows:

(in millions)	Operating leases		Finance leases	
2024	\$	242	\$	33
2025		201		24
2026		186		16
2027		179		16
2028		168		12
Thereafter		431		13
Total lease payments	\$	1,407	\$	114
Less imputed interest		(214)		(10)
Total lease obligations		1,193		104
Less current obligations		(208)		(29)
Long-term lease obligations	\$	985	\$	75

The table below presents additional information related to the Company's leases:

Weighted average remaining lease term	December 31, 2023	December 31, 2022
Operating leases	8 years	8 years
Finance leases	5 years	6 years
Weighted average discount rate		
Operating leases	4.0 %	3.6 %
Finance leases	3.9 %	3.9 %

9. COMMON STOCK

The Company has one class of capital stock, its common stock. Holders of shares of common stock are entitled to receive dividends when and if declared by the Board of Directors and are entitled to one vote per share on all matters submitted to a vote of the Shareholders. As of December 31, 2023, the Company had 75 million shares of common stock reserved for issuance pursuant to Employee equity plans (of which 30 million shares had not been granted) through various share-based compensation arrangements. Additionally, as part of the consideration for its receipt of funding under the Payroll Support programs, the Company entered into warrant agreements with Treasury. Warrants will be settled through net share settlement or net cash settlement, at the Company's option. The warrants do not have voting rights and include adjustments for below market issuances, payment of dividends, and other customary anti-dilution provisions. See Notes 2 and 10 to the Consolidated Financial Statements for information regarding the Company's warrant agreements and equity plans, respectively.

10. STOCK PLANS

Share-based Compensation

The Company accounts for share-based compensation utilizing fair value, which is determined on the date of grant for all instruments. The Consolidated Statement of Income for the years ended December 31, 2023, 2022, and 2021, reflects share-based compensation expense of \$86 million, \$84 million, and \$58 million, respectively. The total tax impact recognized in earnings from share-based compensation arrangements for the years ended December 31, 2023, 2022, and 2021, was not material. As of December 31, 2023, there was \$60 million of total unrecognized compensation cost related to share-based compensation arrangements, which is expected to be recognized over a weighted-average period of 1.7 years. The Company expects substantially all unvested shares associated with time-based restricted stock unit awards to vest.

Restricted Stock Units and Stock Grants

Under the Company's Amended and Restated 2007 Equity Incentive Plan ("2007 Equity Plan"), which was approved by Shareholders, the Company granted restricted stock units ("RSUs") and performance-based restricted stock units ("PBRsUs") to certain Employees during 2023, 2022, and 2021.

The RSUs are scheduled to vest with respect to one-third of the shares covered thereby annually. Other than in connection with death or disability, vesting is subject to the individual's continued service as an Employee, Board member, or advisor through the vesting date. However, with respect to the RSUs granted in 2021, 2022, and 2023, provided that the individual's service has terminated no earlier than 12 months after the date of grant, in the event of a "qualified retirement," any outstanding unvested RSUs will remain outstanding as if the individual's service has not terminated and will continue to vest in accordance with the schedule set forth in the notice of the grant. An individual's termination of service will be considered a "qualified retirement" if (a) the individual has completed at least 10 years of continuous service; (b) the individual's age plus completed years of continuous service equal at least 65 at the time of the individual's termination of service; and (c) the individual has not been terminated for cause.

With respect to PBRsUs granted in 2021, the number of PBRsUs vesting on the vesting date will be interpolated based on the Company's cumulative Adjusted Earnings Before Interest, Taxes, Depreciation, and Amortization (EBITDA) for the years 2022 and 2023 and ranges from 10 percent of granted PBRsUs to 300 percent of granted PBRsUs, only after a minimum performance level has been achieved. Vesting is also subject generally to the individual's continued employment or service. However, in the event the Company's pre-tax average return on invested capital for 2021 and 2022 exceeds the median (i.e., 50th percentile) average return on invested capital of certain of the Company's peer group of domestic mainline carriers subject to the Securities and Exchange Commission's reporting requirements, the minimum number of PBRsUs that will vest, as of the vesting date, will be equal to the grant amount times 50 percent. Based on cumulative EBITDA for the years 2022 and 2023, the number of PBRsUs expected to vest for the 2021 grants is equal to approximately 276 percent of the PBRsUs granted.

Under the 2022 grants, the number of PBRsUs vesting on the vesting date will be interpolated based on the Company's Adjusted ROIC performance, as defined, and ranges from zero PBRsUs to 300 percent of granted PBRsUs, only after a minimum performance level has been achieved. Adjusted ROIC for the Performance Period is the average of the ROIC over the three full fiscal years within the Performance Period (2022, 2023, and 2024), and vesting is also subject generally to the individual's continued employment or service. However, in the event the Company's average Adjusted ROIC is greater than zero and exceeds the median (i.e., 50th percentile) return on invested capital of certain of the Company's peer group of domestic mainline carriers subject to the Securities and Exchange Commission's reporting requirements, the minimum number of PBRsUs that will vest, as of the vesting date, will be equal to the grant amount times 50 percent. If the Company's relative Adjusted ROIC ranks highest compared to the Company's Peer Group, the minimum number of PBRsUs that will vest, as of the vesting date, will be equal to the grant amount times 100 percent.

Under the 2023 grants, the number of PBRsUs vesting on the vesting date will be interpolated based on the Company's Adjusted ROIC performance, as defined, and ranges from zero PBRsUs to 200 percent of granted PBRsUs, only after a minimum performance level has been achieved. Adjusted ROIC for the Performance Period is the average of the ROIC, using an assumed federal tax rate of 24 percent, over the three full fiscal years within the Performance Period (2023, 2024, and 2025), and vesting is also subject generally to the individual's continued employment or service. However, in the event the Company's average Adjusted ROIC is greater than zero and exceeds the median (i.e., 50th percentile) return on invested capital of certain of the Company's peer group of domestic mainline carriers subject to the Securities and Exchange Commission's reporting requirements, the minimum number of PBRsUs that will vest, as of the vesting date, will be equal to the grant amount times 50 percent. If the Company's relative Adjusted ROIC ranks highest compared to the Company's Peer Group, the minimum number of PBRsUs that will vest, as of the vesting date, will be equal to the grant amount times 100 percent.

With respect to PBRsUs granted in 2021, 2022, and 2023, provided that the individual's service has terminated no earlier than 12 months after the date of grant, in the event of a "qualified retirement," such individual's PBRsUs will remain outstanding as if the individual's service has not terminated and will otherwise be settleable in accordance with the notice of grant and applicable terms and conditions; however, the number of shares received upon settlement will be prorated based on the individual's number of days of service between the date of grant and the end of the performance period.

For all RSU and PBRsU grants, forfeiture rates are estimated at the time of grant based on historical actuals for similar grants, and are trued-up to actuals over the vesting period. For all RSU and PBRsU grants, the Company recognizes all expense on a straight-line basis over the vesting period, as adjusted for qualified retirement provisions, with any changes in expense due to the number of RSUs and PBRsUs expected to vest being modified on a prospective basis.

Aggregated information regarding the Company's RSUs and PBRsUs is summarized below:

	All Restricted Stock Units		Wtd. Average Fair Value (per share)
	Units (000)		
Outstanding December 31, 2020	1,962	\$	57.81
Granted	1,463	(a)	46.58
Vested	(790)		59.48
Surrendered	(74)		51.36
Outstanding December 31, 2021	2,561		51.81
Granted	1,041	(b)	44.88
Vested	(559)		51.85
Surrendered	(100)		48.59
Outstanding December 31, 2022	2,943		47.97
Granted	1,750	(c)	35.37
Vested	(650)		48.45
Surrendered	(80)		39.69
Outstanding December 31, 2023	3,963		39.97

(a) Includes 466 thousand PBRsUs

(b) Includes 700 thousand PBRsUs

(c) Includes 1.1 million PBRsUs

In addition, the Company granted approximately 73 thousand shares of unrestricted stock at a weighted average grant price of \$30.12 in 2023, approximately 42 thousand shares at a weighted average grant price of \$44.23 in

2022, and approximately 27 thousand shares at a weighted average grant price of \$60.39 in 2021, to members of its Board of Directors.

A remaining balance of up to 13 million shares of the Company's common stock may be issued pursuant to grants under the 2007 Equity Plan.

Employee Stock Purchase Plan

Under the Amended and Restated 1991 Employee Stock Purchase Plan ("ESPP"), which has been approved by Shareholders, the Company is authorized to issue up to a remaining balance of 17 million shares of the Company's common stock to Employees of the Company. These shares may be issued at a price equal to 90 percent of the market value at the end of each monthly purchase period. Common stock purchases are paid for through periodic payroll deductions.

The following table provides information about the Company's ESPP activity during 2023, 2022, and 2021:

Employee Stock Purchase Plan				(a)	
Year ended	Total number of shares purchased (in thousands)		Average price paid per share	Weighted-average fair value of each purchase right under the ESPP	
December 31, 2021	1,083	\$	47.31	\$	5.19
December 31, 2022	1,453	\$	36.10	\$	4.02
December 31, 2023	1,972	\$	27.46	\$	3.05

(a) The weighted-average fair value of each purchase right under the ESPP granted is equal to a ten percent discount from the market value of the Common Stock at the end of each monthly purchase period.

Taxes

Grants of RSUs result in the creation of a deferred tax asset, which is a temporary difference, until the time the RSU vests. All excess tax benefits and tax deficiencies are recorded through the income statement. Due to the treatment of RSUs for tax purposes, the Company's effective tax rate from year to year is subject to variability.

11. FINANCIAL DERIVATIVE INSTRUMENTS

Fuel Contracts

Airline operators are inherently dependent upon energy to operate and, therefore, are impacted by changes in jet fuel prices. Furthermore, jet fuel and oil typically represents one of the largest operating expenses for airlines. The Company endeavors to acquire jet fuel at the lowest possible cost and to reduce volatility in operating expenses through its fuel hedging program. Although the Company may periodically enter into jet fuel derivatives for short-term timeframes, because jet fuel is not widely traded on an organized futures exchange, there are limited opportunities to hedge directly in jet fuel for time horizons longer than approximately 24 months into the future. However, the Company has found that financial derivative instruments in other commodities, such as West Texas Intermediate ("WTI") crude oil, Brent crude oil, and refined products, such as heating oil and unleaded gasoline, can be useful in decreasing its exposure to jet fuel price volatility. The Company does not purchase or hold any financial derivative instruments for trading or speculative purposes.

The Company has used financial derivative instruments for both short-term and long-term timeframes, and historically has used a mixture of purchased call options, collar structures (which include both a purchased call option and a sold put option), call spreads (which include a purchased call option and a sold call option), put spreads (which include a purchased put option and a sold put option), and fixed price swap agreements in its portfolio. Although the use of collar structures and swap agreements can reduce the overall cost of hedging, these instruments carry more risk than purchased call options in that the Company could end up in a liability position when the collar structure or swap agreement settles. With the use of purchased call options and call spreads, the Company cannot be in a liability position at settlement, but does not have coverage once market prices fall below the strike price of the purchased call option.

For the purpose of evaluating its net cash spend for jet fuel and for forecasting its future estimated jet fuel expense, the Company evaluates its hedge volumes strictly from an "economic" standpoint and thus does not consider whether the hedges have qualified or will qualify for hedge accounting. The Company defines its "economic" hedge as the net volume of fuel derivative contracts held, including the impact of positions that have been offset through sold positions, regardless of whether those contracts qualify for hedge accounting. The level at which the Company is economically hedged for a particular period is also dependent on current market prices for that period, as well as the types of derivative instruments held and the strike prices of those instruments. For example, the Company may enter into "out-of-the-money" option contracts (including "catastrophic" protection, which the Company defines as prices significantly higher than historical average levels), which may not generate intrinsic gains at settlement if market prices do not rise above the option strike price. Therefore, even though the Company may have an economic hedge in place for a particular period, that hedge may not produce any hedging gains at settlement and may even produce hedging losses depending on market prices, the types of instruments held, and the strike prices of those instruments.

As of December 31, 2023, the Company had fuel derivative instruments in place to provide coverage at varying price levels. The following table provides information about the Company's volume of fuel hedging on an economic basis:

Period (by year)	Maximum fuel hedged as of December 31, 2023 (gallons in millions) (a)	Derivative underlying commodity type as of December 31, 2023
2024	1,265	WTI crude oil and Brent crude oil
2025	1,033	Brent crude oil
2026	358	Brent crude oil

(a) Due to the types of derivatives utilized by the Company and different price levels of those contracts, these volumes represent the maximum economic hedge in place and may vary significantly as market prices and the Company's flight schedule fluctuate.

Upon proper qualification, the Company accounts for its fuel derivative instruments as cash flow hedges. Qualification is re-evaluated quarterly, and all periodic changes in fair value of the derivatives designated as hedges are recorded in AOCI until the underlying jet fuel is consumed. See Note 13.

If a derivative initially does not qualify or ceases to qualify for hedge accounting, any change in the fair value of derivative instruments since the last reporting period would be recorded in Other (gains) losses, net, in the Consolidated Statement of Income in the period of the change; however, any amounts previously recorded to AOCI would remain there until such time as the original forecasted transaction occurs, at which time these amounts would be reclassified to Fuel and oil expense. Factors that have and may continue to lead to the loss of hedge accounting include: significant fluctuation in energy prices or volumes of fuel purchased, significant weather events affecting refinery capacity and the production of refined products, and the volatility of the different types of products the Company uses in hedging. Certain types of derivative instruments do not qualify for hedge accounting, including those that result in a net sold position (sold gallons exceeding purchased gallons). Increased volatility in certain commodity markets for an extended period of time, especially if such volatility were to worsen, could cause the Company to lose hedge accounting altogether for the commodities used in its fuel hedging program, which would create further volatility in the Company's GAAP financial results. However, even though certain derivatives may not qualify for hedge accounting, the Company continues to hold the instruments as management believes they continue to afford the Company the opportunity to stabilize jet fuel costs. When the Company has sold derivative positions in order to effectively "close" or offset a derivative already held as part of its fuel derivative instrument portfolio, any subsequent changes in fair value of those positions are marked to market through earnings. Likewise, any changes in fair value of those positions that were offset by entering into the sold positions and were de-designated as hedges are concurrently marked to market through the Consolidated Statement of Income. However, any changes in value related to hedges that were deferred as part of AOCI while designated as a hedge would remain until the originally forecasted transaction occurs. In a situation where it becomes probable that a fuel hedged forecasted transaction will not occur, any gains and/or losses that have been recorded to AOCI would be required to be immediately reclassified into the Consolidated Statement of Income. The Company did not have any such situations where a derivative ceased to qualify for hedge accounting during 2022 and 2023.

Accounting pronouncements pertaining to derivative instruments and hedging are complex with stringent requirements, including the documentation of a Company hedging strategy, statistical analysis to qualify a commodity for hedge accounting both on a historical and a prospective basis, and strict contemporaneous documentation that is required at the time each hedge is designated by the Company. This statistical analysis involves utilizing regression analyses that compare changes in the price of jet fuel to changes in the prices of the commodities used for hedging purposes.

All cash flows associated with purchasing and selling fuel derivatives are classified as Other operating cash flows in the Consolidated Statement of Cash Flows. The following table presents the location of all assets and liabilities associated with the Company's derivative instruments within the Consolidated Balance Sheet:

(in millions)	Balance Sheet location	Asset derivatives		Liability derivatives	
		Fair value at 12/31/2023	Fair value at 12/31/2022	Fair value at 12/31/2023	Fair value at 12/31/2022
Derivatives designated as hedges (a)					
Fuel derivative contracts (gross)	Prepaid expenses and other current assets	\$ 86	\$ 352	\$ —	\$ —
Fuel derivative contracts (gross)	Other assets	137	160	—	—
Interest rate derivative contracts	Other assets	—	14	—	—
Total derivatives designated as hedges		<u>\$ 223</u>	<u>\$ 526</u>	<u>\$ —</u>	<u>\$ —</u>

(a) Represents the position of each trade before consideration of offsetting positions with each counterparty and does not include the impact of cash collateral deposits provided to or received from counterparties. See discussion of credit risk and collateral following in this Note.

In addition, the Company had the following amounts associated with fuel derivative instruments and hedging activities in its Consolidated Balance Sheet:

(in millions)	Balance Sheet location	December 31, 2023	December 31, 2022
Cash collateral deposits held from counterparties for fuel contracts - current	Offset against Prepaid expenses and other current assets	\$ 15	\$ 106
Cash collateral deposits held from counterparties for fuel contracts - noncurrent	Offset against Other assets	35	—
Receivable from third parties for fuel contracts	Accounts and other receivables	12	34

All of the Company's fuel derivative instruments and interest rate swaps are subject to agreements that follow the netting guidance in the applicable accounting standards for derivatives and hedging. The types of derivative instruments the Company has determined are subject to netting requirements in the accompanying Consolidated Balance Sheet are those in which the Company pays or receives cash for transactions with the same counterparty and in the same currency via one net payment or receipt. For cash collateral held by the Company or provided to counterparties, the Company nets such amounts against the fair value of the Company's derivative portfolio by each counterparty. The Company has elected to utilize netting for both its fuel derivative instruments and interest rate swap agreements and also classifies such amounts as either current or noncurrent, based on the net fair value position with each of the Company's counterparties in the Consolidated Balance Sheet. If its fuel derivative instruments are in a net asset position with a counterparty, cash collateral amounts held are first netted against current outstanding derivative asset amounts associated with that counterparty until that balance is zero, and then any remainder is applied against the fair value of noncurrent outstanding derivative instruments. As of December 31, 2023, the Company had no outstanding interest rate swap agreements and therefore no cash collateral deposits provided or held.

The Company had the following recognized financial assets and financial liabilities resulting from those transactions that meet the scope of the disclosure requirements as necessitated by applicable accounting guidance for balance sheet offsetting:

Offsetting of derivative assets

(in millions)		(i)			(ii)			(iii) = (i) + (ii)		
		December 31, 2023			December 31, 2022					
Description	Balance Sheet location	Gross amounts of recognized assets	Gross amounts offset in the Balance Sheet	Net amounts of assets presented in the Balance Sheet	Gross amounts of recognized assets	Gross amounts offset in the Balance Sheet	Net amounts of assets presented in the Balance Sheet	Gross amounts of recognized assets	Gross amounts offset in the Balance Sheet	Net amounts of assets presented in the Balance Sheet
Fuel derivative contracts	Prepaid expenses and other current assets	\$ 86	\$ (15)	\$ 71	\$ 352	\$ (106)	\$ 246			
Fuel derivative contracts	Other assets	\$ 137	\$ (35)	\$ 102 (a)	\$ 160	\$ —	\$ 160 (a)			
Interest rate derivative contracts	Other assets	\$ —	\$ —	\$ — (a)	\$ 14	\$ —	\$ 14 (a)			

(a) The net amounts of derivative assets and liabilities are reconciled to the individual line item amounts presented in the Consolidated Balance Sheet in Note 16.

Offsetting of derivative liabilities

(in millions)

Description	Balance Sheet location	(i)			(ii)			(iii) = (i) + (ii)		
		December 31, 2023			December 31, 2022			December 31, 2022		
		Gross amounts of recognized liabilities	Gross amounts offset in the Balance Sheet	Net amounts of liabilities presented in the Balance Sheet	Gross amounts of recognized liabilities	Gross amounts offset in the Balance Sheet	Net amounts of liabilities presented in the Balance Sheet	Gross amounts of recognized liabilities	Gross amounts offset in the Balance Sheet	Net amounts of liabilities presented in the Balance Sheet
Fuel derivative contracts	Prepaid expenses and other current assets	\$ 15	\$ (15)	\$ —	\$ 106	\$ (106)	\$ —	\$ —	\$ —	\$ —
Fuel derivative contracts	Other assets	\$ 35	\$ (35)	\$ — (a)	\$ —	\$ —	\$ —	\$ —	\$ —	\$ — (a)

(a) The net amounts of derivative assets and liabilities are reconciled to the individual line item amounts presented in the Consolidated Balance Sheet in Note 16.

The following tables present the impact of derivative instruments and their location within the Consolidated Statement of Income for the years ended December 31, 2023 and 2022:

Location and amount recognized in income on cash flow hedging relationships

(in millions)	Year ended December 31, 2023		Year ended December 31, 2022	
	Fuel and oil	Other operating expenses	Fuel and oil	Other operating expenses
Total	\$ (128)	\$ 7	\$ (832)	\$ 7
(Gain) loss on cash flow hedging relationships				
Commodity contracts:				
Amount of gain reclassified from AOCI into income	(128)	—	(832)	—
Interest contracts:				
Amount of loss reclassified from AOCI into income	—	7	—	7

Derivatives designated and qualified in cash flow hedging relationships

(in millions)	(Gain) Loss recognized in AOCI on derivatives, net of tax	
	Year ended December 31,	
	2023	2022
Fuel derivative contracts	\$ 238	\$ (494)
Interest rate derivatives	(7)	(14)
Total	\$ 231	\$ (508)

Derivatives not designated as hedges

		(Gain) Loss recognized in income on derivatives		
		Year ended December 31,		
(in millions)		2023	2022	Location of (gain) loss recognized in income on derivatives
Fuel derivative contracts	\$	(17)	\$ (41)	Other (gains) losses, net

The Company also recorded expense (benefit) associated with premiums paid (received) for fuel derivative contracts that settled/expired during 2023, 2022 and 2021. Gains and/or losses associated with fuel derivatives that qualify for hedge accounting are ultimately recorded to Fuel and oil expense. Gains and/or losses associated with fuel derivatives that do not qualify for hedge accounting are recorded to Other (gains) and losses, net. The following table presents the impact of premiums paid (received) for fuel derivative contracts and their location within the Consolidated Statement of Income during the period the contract settles:

	Premium (benefit) expense recognized in income on derivatives						
	Year ended December 31,						Location of premium (benefit) expense recognized in income on derivatives
	2023		2022		2021		
(in millions)							
Fuel derivative contracts designated as hedges	\$	121	\$	105	\$	57	Fuel and oil
Fuel derivative contracts not designated as hedges	\$	—	\$	(28)	\$	43	Other (gains) losses, net

The fair values of the derivative instruments, depending on the type of instrument, were determined by the use of present value methods or option value models with assumptions about commodity prices based on those observed in underlying markets or provided by third parties. Included in the Company's cumulative unrealized gains from fuel hedges as of December 31, 2023, recorded in AOCI, were approximately \$55 million in unrealized losses, net of taxes, which are expected to be realized in earnings during the twelve months subsequent to December 31, 2023.

Interest Rate Swaps

The Company is at times party to certain interest rate swap agreements that are accounted for as cash flow hedges, but had none in place as of December 31, 2023. The Company did not have any interest rate swap agreements designated as fair value hedges, as defined, during the periods presented. During the periods presented, all of the Company's interest rate swap agreements have qualified for the "shortcut" or "critical terms match" methods of accounting for hedges, which dictate that the hedges were assumed to be perfectly effective at origination, and, thus, there was no ineffectiveness to be recorded in the Consolidated Statement of Income.

During fourth quarter 2023, the Company terminated \$150 million notional value of forward-starting interest rate swap agreements. These swap agreements had been classified as cash flow hedges, and all fair market value changes were recorded to AOCI prior to their termination. The effect of this termination is that the value of the swaps originally recorded in AOCI, a gain of \$23 million, will be amortized to Interest expense over the life of the debt, which will be within the years 2024-2027.

Credit Risk and Collateral

Credit exposure related to fuel derivative instruments is represented by the fair value of contracts that are an asset to the Company at the reporting date. At such times, these outstanding instruments expose the Company to credit loss in the event of nonperformance by the counterparties to the agreements. However, the Company has not experienced any significant credit loss as a result of counterparty nonperformance in the past. To manage credit risk, the Company selects and periodically reviews counterparties based on credit ratings, limits its exposure with respect to each counterparty, and monitors the market position of the fuel hedging program and its relative market position with each counterparty. As of December 31, 2023, the Company had agreements with all of its active counterparties containing early termination rights and/or bilateral collateral provisions whereby security is required if market risk exposure exceeds a specified threshold amount based on the counterparty's credit rating. The Company also had agreements with counterparties in which cash deposits and letters of credit were required to be posted as collateral whenever the net fair value of derivatives associated with those counterparties exceeds specific thresholds. In certain cases, the Company has the ability to substitute among these different forms of collateral at its discretion.

The following table provides the fair values of fuel derivatives, amounts posted as collateral, and applicable collateral posting threshold amounts as of December 31, 2023, at which such postings are triggered:

(in millions)	Counterparty (CP)										Total
	A	B	C	D	E	F	G	H			
Fair value of fuel derivatives	\$ 53	\$ 21	\$ 36	\$ 10	\$ 39	\$ 15	\$ 31	\$ 18	\$ 223		
Cash collateral held from CP	50	—	—	—	—	—	—	—	50		
Option to substitute LC for cash	N/A	N/A	(a)	(a)	(a)	N/A	(a)	N/A			
If credit rating is investment grade, fair value of fuel derivative level at which:											
Cash is provided to CP	>(100)	>(50)	>(75)	>(125)	>(40)	>(65)	>(100)	>(100)			
Cash is received from CP	>0(b)	>150(b)	>250(b)	>125(b)	>100(b)	>70(b)	>100(b)	>100(b)			
If credit rating is non-investment grade, fair value of fuel derivative level at which:											
Cash is received from CP	(c)	(c)	(c)	(c)	(c)	(c)	(c)	(c)			

(a) The Company has the option to substitute letters of credit for 100 percent of cash collateral requirement.

(b) Thresholds may vary based on changes in credit ratings within investment grade.

(c) Cash collateral is provided at 100 percent of fair value of fuel derivative contracts.

12. FAIR VALUE MEASUREMENTS

Accounting standards pertaining to fair value measurements establish a three-tier fair value hierarchy, which prioritizes the inputs used in measuring fair value. These tiers include: Level 1, defined as observable inputs such as quoted prices in active markets; Level 2, defined as inputs other than quoted prices in active markets that are either directly or indirectly observable; and Level 3, defined as unobservable inputs in which little or no market data exists, therefore requiring an entity to develop its own assumptions.

As of December 31, 2023, the Company held certain items that are required to be measured at fair value on a recurring basis. These included cash equivalents, short-term investments (primarily treasury bills), fuel derivative contracts, and available-for-sale securities. The majority of the Company's cash equivalents and short-term investments consist of instruments classified as Level 1. However, the Company has certificates of deposit, commercial paper, and time deposits that are classified as Level 2, due to the fact that the fair value for these instruments is determined utilizing observable inputs in non-active markets. Equity securities primarily consist of investments with readily determinable market values associated with the Company's excess benefit plan.

The Company's fuel and interest rate derivative instruments consist of over-the-counter contracts, which are not traded on a public exchange. Fuel derivative instruments currently consist solely of option contracts, whereas interest rate derivatives consist solely of swap agreements. See Note 11 for further information on the Company's derivative instruments and hedging activities. The fair values of swap contracts are determined based on inputs that are readily available in public markets or can be derived from information available in publicly quoted markets. Therefore, the Company has categorized these swap contracts as Level 2. The Company's Treasury Department, which reports to the Chief Financial Officer, determines the value of option contracts utilizing an option pricing model based on inputs that are either readily available in public markets, can be derived from information available in publicly quoted markets, or are provided by financial institutions that trade these contracts. The option pricing model used by the Company is an industry standard model for valuing options and is a similar model used by the broker/dealer community (i.e., the Company's counterparties). The inputs to this option pricing model are the option strike price, underlying price, risk free rate of interest, time to expiration, and volatility. Because certain inputs used to determine the fair value of option contracts are unobservable (principally implied volatility), the Company has categorized these option contracts as Level 3. Volatility information is obtained from external sources, but is analyzed by the Company for reasonableness and compared to similar information received from other external sources. The fair value of option contracts considers both the intrinsic value and any remaining time value associated with those derivatives that have not yet settled. The Company also considers counterparty credit risk and its own credit risk in its determination of all estimated fair values. To validate the reasonableness of the Company's option pricing model, on a monthly basis, the Company compares its option valuations to third party valuations. If any significant differences were to be noted, they would be researched in order to determine the reason. However, historically, no significant differences have been noted. The Company has consistently applied these valuation techniques in all periods presented and believes it has obtained the most accurate information available for the types of derivative contracts it holds.

Included in Other available-for-sale securities are the Company's investments associated with its deferred compensation plans, which consist of mutual funds that are publicly traded and for which market prices are readily available. These plans are non-qualified deferred compensation plans designed to hold contributions in excess of limits established by the Internal Revenue Code of 1986, as amended. The distribution timing and payment amounts under these plans are made based on the participant's distribution election and plan balance. Assets related to the funded portions of the deferred compensation plans are held in a rabbi trust, and the Company remains liable to these participants for the unfunded portion of the plans. The Company records changes in the fair value of plan obligations and plan assets, which net to zero, within the Salaries, wages, and benefits line and Other (gains) losses, net line, respectively, of the Consolidated Statement of Income.

The following tables present the Company's assets and liabilities that are measured at fair value on a recurring basis as of December 31, 2023, and December 31, 2022:

Description	December 31, 2023	Fair value measurements at reporting date using:		
		Quoted prices in active markets for identical assets	Significant other observable inputs	Significant unobservable inputs
		(Level 1)	(Level 2)	(Level 3)
Assets		(in millions)		
Cash equivalents:				
Cash equivalents (a)	\$ 9,032	\$ 9,032	\$ —	\$ —
Commercial paper	135	—	135	—
Certificates of deposit	21	—	21	—
Time deposits	100	—	100	—
Short-term investments:				
Treasury bills	1,983	1,983	—	—
Certificates of deposit	203	—	203	—
Fuel derivatives:				
Option contracts (b)	223	—	—	223
Equity Securities	280	280	—	—
Total assets	\$ 11,977	\$ 11,295	\$ 459	\$ 223

(a) Cash equivalents are primarily composed of money market investments and treasury bills.

(b) In the Consolidated Balance Sheet amounts are presented as an asset. See Note 11.

Description	December 31, 2022	Fair value measurements at reporting date using:		
		Quoted prices in active markets for identical assets	Significant other observable inputs	Significant unobservable inputs
		(Level 1)	(Level 2)	(Level 3)
Assets		(in millions)		
Cash equivalents:				
Cash equivalents (a)	\$ 9,040	\$ 9,040	\$ —	\$ —
Commercial paper	179	—	179	—
Certificates of deposit	23	—	23	—
Time deposits	250	—	250	—
Short-term investments:				
Treasury bills	2,226	2,226	—	—
Certificates of deposit	124	—	124	—
Time deposits	450	—	450	—
Fuel derivatives:				
Option contracts (b)	512	—	—	512
Interest rate derivatives (see Note 11)	\$ 14	\$ —	\$ 14	\$ —
Equity Securities	235	235	—	—
Total assets	\$ 13,053	\$ 11,501	\$ 1,040	\$ 512

(a) Cash equivalents are primarily composed of money market investments.

(b) In the Consolidated Balance Sheet amounts are presented as an asset. See Note 11.

The Company did not have any material assets or liabilities measured at fair value on a nonrecurring basis as of December 31, 2023 or 2022. The following tables present the Company's activity for items measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for 2023 and 2022:

Fair value measurements using significant unobservable inputs (Level 3)		
(in millions)		Fuel derivatives
Balance as of December 31, 2022	\$	512
Total gains (losses) for the period		
Included in earnings		17 (a)
Included in other comprehensive income		(312)
Purchases		273 (b)
Settlements		(267)
Balance as of December 31, 2023	\$	223
The amount of total losses for the period included in other comprehensive income attributable to the change in unrealized gains or losses relating to assets still held as of December 31, 2023	\$	209

(a) Included in Other (gains) losses, net, within the Consolidated Statement of Income.

(b) The purchase of fuel derivatives is recorded on a gross basis based on the structure of the derivative instrument and whether a contract with multiple derivatives was purchased as a single instrument or separate instruments.

Fair value measurements using significant unobservable inputs (Level 3)		
(in millions)		Fuel derivatives
Balance as of December 31, 2021	\$	696
Total gains for the period		
Included in earnings		41 (a)
Included in other comprehensive income		645
Purchases		79 (b)
Settlements		(949)
Balance as of December 31, 2022	\$	512
The amount of total gains for the period included in other comprehensive income attributable to the change in unrealized gains or losses relating to assets still held as of December 31, 2022	\$	122

(a) Included in Other (gains) losses, net, within the Consolidated Statement of Income.

(b) The purchase and sale of fuel derivatives is recorded on a gross basis based on the structure of the derivative instrument and whether a contract with multiple derivatives was purchased as a single instrument or separate instruments.

The significant unobservable input used in the fair value measurement of the Company's derivative option contracts is implied volatility. Holding other inputs constant, an increase (decrease) in implied volatility would have resulted in a higher (lower) fair value measurement, respectively, for the Company's derivative option contracts.

The following table presents a range and weighted average of the unobservable inputs utilized in the fair value measurements of the Company's fuel derivatives classified as Level 3 as of December 31, 2023:

Quantitative information about Level 3 fair value measurements				
	Valuation technique	Unobservable input	Period (by year)	Weighted Average (a)
Fuel derivatives	Option model	Implied volatility	2024	20-41%
			2025	26-28%
			2026	26-27%

(a) Implied volatility weighted by the notional amount (barrels of underlying commodity) that will settle in respective period.

The carrying amounts and estimated fair values of the Company's short-term and long-term debt (including current maturities), as well as the applicable fair value hierarchy tier, as of December 31, 2023, are presented in the table below. The fair values of the Company's publicly held long-term debt are determined based on inputs that are readily available in public markets or can be derived from information available in publicly quoted markets; therefore, the Company has categorized these agreements as Level 2. All privately held debt agreements are categorized as Level 3. The Company has determined the estimated fair value of this debt to be Level 3, as certain inputs used to determine the fair value of these agreements are unobservable. The Company utilizes indicative pricing from counterparties and a discounted cash flow method to estimate the fair value of the Level 3 items.

(in millions)	Carrying value	Estimated fair value	Fair value level hierarchy
5.25% Notes due 2025	1,302	1,303	Level 2
1.25% Convertible Notes due 2025	1,611	1,640	Level 2
3.00% Notes due 2026	300	285	Level 2
7.375% Debentures due 2027	111	117	Level 2
3.45% Notes due 2027	300	284	Level 2
5.125% Notes due 2027	1,727	1,737	Level 2
2.625% Notes due 2030	500	438	Level 2
1.000% Payroll Support Program Loan due 2030 (a)	976	932	Level 3
1.000% Payroll Support Program Loan due 2031 (a)	566	522	Level 3
1.000% Payroll Support Program Loan due 2031 (a)	526	481	Level 3

(a) The interest rate will change to Secured Overnight Financing Rate plus two percent on the fifth anniversary of the loans.

13. ACCUMULATED OTHER COMPREHENSIVE INCOME

Comprehensive income includes changes in the fair value of certain financial derivative instruments that qualify for hedge accounting and actuarial gains/losses arising from the Company's postretirement benefit obligation. A rollforward of the amounts included in AOCI, net of taxes, is shown below for 2023 and 2022:

(in millions)	Fuel derivatives	Interest rate derivatives	Defined benefit plan items	Deferred tax impact	Accumulated other comprehensive income
Balance at December 31, 2021	\$ 492	\$ (57)	\$ 66	\$ (113)	\$ 388
Changes in fair value	645	18	106	(179)	590
Reclassification to earnings	(832)	7	(2)	193	(634)
Balance at December 31, 2022	\$ 305	\$ (32)	\$ 170	\$ (99)	\$ 344
Changes in fair value	(312)	10	(11)	73	(240)
Reclassification to earnings	(128)	7	(10)	27	(104)
Balance at December 31, 2023	<u>\$ (135)</u>	<u>\$ (15)</u>	<u>\$ 149</u>	<u>\$ 1</u>	<u>\$ —</u>

The following table illustrates the significant amounts reclassified out of each component of AOCI for the year ended December 31, 2023:

Year ended December 31, 2023			
(in millions)			
AOCI components	Amounts reclassified from AOCI	Affected line item in the Consolidated Statement of Income	
Unrealized (gain) on fuel derivative instruments	\$ (128)	Fuel and oil expense	
	(29)	Less: Tax expense	
	<u>\$ (99)</u>	Net of tax	
Unrealized loss on interest rate derivative instruments	7	Other operating expenses	
	1	Less: Tax expense	
	<u>\$ 6</u>	Net of tax	
Unrealized (gain) on defined benefit plan	\$ (10)	Other (gains) losses, net	
	(3)	Less: Tax expense	
	<u>\$ (7)</u>	Net of tax	
Other	\$ —	Other	
	4	Less: Tax expense	
	<u>\$ (4)</u>	Net of tax	
Total reclassifications for the period	<u><u>\$ (104)</u></u>	Net of tax	

14. EMPLOYEE RETIREMENT PLANS

Defined Contribution Plans

The Company has defined contribution plans covering substantially all of its Employees. Contributions under all defined contribution plans are primarily based on Employee compensation and performance of the Company. The Company sponsors Employee savings plans under section 401(k) of the Internal Revenue Code of 1986, as

amended. The Southwest Airlines Co. 401(k) Plan includes Company matching contributions and the Southwest Airlines Pilots Retirement Saving Plan has non-elective Company contributions. In addition, the Southwest Airlines Co. ProfitSharing Plan (the "ProfitSharing Plan") is a defined contribution plan to which the Company may contribute a percentage of its eligible pre-tax profits, as defined, on an annual basis. No Employee contributions to the ProfitSharing Plan are allowed.

Amounts associated with the Company's defined contribution plans expensed in 2023, 2022, and 2021, reflected as a component of Salaries, wages, and benefits, were \$941 million, \$793 million, and \$749 million, respectively.

Postretirement Benefit Plans

The Company provides postretirement benefits to qualified retirees in the form of medical and dental coverage. Employees must meet minimum levels of service and age requirements as set forth by the Company, or as specified in collective-bargaining agreements with specific workgroups. Employees meeting these requirements, as defined, may use accrued unused sick time to pay for medical and dental premiums from the age of retirement until age 65.

The following table shows the change in the accumulated postretirement benefit obligation ("APBO") for the years ended December 31, 2023 and 2022:

(in millions)	2023	2022
APBO at beginning of period	\$ 241	\$ 330
Service cost	14	19
Interest cost	12	9
Benefits paid	(9)	(11)
Actuarial (gain) loss	11	(106)
APBO at end of period	<u>\$ 269</u>	<u>\$ 241</u>

During 2023, the Company recorded an \$11 million actuarial loss as an increase to the APBO with an offset to AOCI. This 2023 actuarial loss is reflected above and resulted from changes in certain key assumptions used to determine the Company's year-end obligation. The assumption change that resulted in the largest portion of the actuarial loss was a decrease in the discount rate used.

All plans are unfunded, and benefits are paid as they become due. Estimated future benefit payments expected to be paid are \$15 million in 2024, \$18 million in 2025, \$19 million in 2026, \$20 million in 2027, \$21 million in 2028, and \$127 million for the next five years thereafter.

The following table reconciles the funded status of the plans to the accrued postretirement benefit cost recognized in Other noncurrent liabilities on the Company's Consolidated Balance Sheet as of December 31, 2023 and 2022.

(in millions)	2023	2022
Funded status	\$ (269)	\$ (241)
Unrecognized net actuarial gain	(151)	(173)
Unrecognized prior service cost	2	3
Accumulated other comprehensive income	149	170
Consolidated Balance Sheet liability	<u>\$ (269)</u>	<u>\$ (241)</u>

The consolidated periodic postretirement benefit cost for the years ended December 31, 2023, 2022, and 2021, included the following:

(in millions)	2023	2022	2021
Service cost	\$ 14	\$ 19	\$ 25
Interest cost	12	9	10
Amortization of net gain	(10)	(2)	—
Net periodic postretirement benefit cost	<u>\$ 16</u>	<u>\$ 26</u>	<u>\$ 35</u>

Service cost is recognized within Salaries, wages, and benefits expense, and all other costs are recognized in Other (gains) losses, net in the Consolidated Statement of Income. Unrecognized prior service cost is expensed using a straight-line amortization of the cost over the average future service of Employees expected to receive benefits under the plans. Actuarial gains are amortized utilizing the minimum amortization method. The following actuarial assumptions were used to account for the Company's postretirement benefit plans at December 31, 2023, 2022, and 2021:

	2023	2022	2021
Weighted-average discount rate	5.20 %	5.60 %	2.90 %
Assumed healthcare cost trend rate (a)	6.25 %	6.50 %	6.25 %

(a) The assumed healthcare cost trend rate is expected to be 6.25% for 2024, then decline gradually to 4.75% by 2030 and remain level thereafter.

The selection of a discount rate is made annually and is selected by the Company based upon comparison of the expected future cash flows associated with the Company's future payments under its consolidated postretirement obligations to a yield curve created using high quality bonds that closely match those expected future cash flows. This rate decreased during 2023 due to market conditions. The assumed healthcare trend rate is also reviewed at least annually and is determined based upon both historical experience with the Company's healthcare benefits paid and expectations of how those trends may or may not change in future years.

15. INCOME TAXES

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. The components of deferred tax assets and liabilities as of December 31, 2023 and 2022, are as follows:

(in millions)	2023	2022
DEFERRED TAX LIABILITIES:		
Accelerated depreciation	\$ 3,595	\$ 3,279
Prepaid insurance	258	238
Operating lease right-of-use assets	276	311
Other	91	154
Total deferred tax liabilities	4,220	3,982
DEFERRED TAX ASSETS:		
Accrued employee benefits	757	424
Loyalty program and flight credit liability	599	659
Operating lease liabilities	279	313
Net operating losses and tax credits (a)	309	310
Other	232	291
Total deferred tax assets	2,176	1,997
Net deferred tax liability	\$ 2,044	\$ 1,985

(a) As of December 31, 2023 and 2022, the Company had approximately \$36 million and \$43 million, respectively, of state net operating loss carryforwards (tax effected) to reduce future state taxable income. These state net operating loss carryforwards will expire in years 2025 through 2041 if unused. As of December 31, 2023 and 2022, the Company had \$268 million and \$275 million, respectively, of federal net operating loss carryforwards (tax effected) that may be carried forward indefinitely.

The provision (benefit) for income taxes is composed of the following:

(in millions)	2023	2022	2021
CURRENT:			
Federal	\$ (10)	\$ (36)	\$ 337
State	19	(3)	33
Change in federal statutory rate	—	—	(2)
Total current	9	(39)	368
DEFERRED:			
Federal	140	208	(43)
State	19	20	23
Total deferred	159	228	(20)
Income tax provision (benefit)	\$ 168	\$ 189	\$ 348

The effective tax rate on Income (loss) before income taxes differed from the federal income tax statutory rate for the following reasons:

(in millions)	2023	2022	2021
Tax at statutory U.S. tax rates	\$ 133	\$ 153	\$ 278
State income taxes, net of federal benefit	30	12	45
Change in federal statutory tax rate	—	—	(2)
Convertible debt repurchases	—	31	21
DOT settlement	22	—	—
Federal tax credits	(19)	(13)	(2)
Other, net	2	6	8
Total income tax provision (benefit)	<u>\$ 168</u>	<u>\$ 189</u>	<u>\$ 348</u>

The only periods subject to examination for the Company's federal tax return are tax years 2020-2023. The Company is also subject to various examinations from state and local income tax jurisdictions in the ordinary course of business. These examinations are not expected to have a material effect on the financial results of the Company.

16. SUPPLEMENTAL FINANCIAL INFORMATION

(in millions)	December 31, 2023	December 31, 2022
Trade receivables	\$ 104	\$ 117
Credit card receivables	200	85
Business partners and other suppliers	501	478
Taxes receivable	35	133
Fuel hedging and receivables	12	34
Other	302	193
Accounts and other receivables	<u>\$ 1,154</u>	<u>\$ 1,040</u>

(in millions)	December 31, 2023	December 31, 2022
Derivative contracts	\$ 102	\$ 174
Intangible assets, net	296	296
Equity Securities	280	235
Prepaid Maintenance	258	119
Other	28	31
Other assets	<u>\$ 964</u>	<u>\$ 855</u>

(in millions)	December 31, 2023	December 31, 2022
Accounts payable trade	\$ 265	\$ 277
Salaries, withholdings and payroll taxes	400	456
Ticket taxes and fees	302	242
Aircraft maintenance payable	140	65
Fuel payable	161	188
Dividends payable	107	107
Customer reimbursements and refunds (a)	8	311
Accrued third party services	269	196
Other payable	210	162
Accounts payable	<u>\$ 1,862</u>	<u>\$ 2,004</u>

(in millions)	December 31, 2023	December 31, 2022
Voluntary Separation Program (c)	65	72
Profitsharing and savings plans	141	167
Vacation pay	516	484
Health	163	261
Workers compensation	133	164
Property and income taxes	63	37
Interest	34	45
Bonus and incentive pay (b)	2,022	563
Other	469	250
Accrued liabilities	\$ 3,606	\$ 2,043

(in millions)	December 31, 2023	December 31, 2022
Voluntary Separation Program (c)	61	147
Postretirement obligation	269	241
Other deferred compensation	358	331
Other	293	250
Other noncurrent liabilities	\$ 981	\$ 969

(a) As of December 31, 2022, included customer reimbursement expenses due to the Company's December 2022 operational disruption and refund submissions that had yet to be processed. As of December 31, 2023, amounts primarily consist of normal current activity.

(b) Primarily consists of anticipated contract labor ratification bonuses and/or accruals. Also includes non-contract incentive pay. Included in Salaries, wages and benefits expense for the year ended December 31, 2023, are incremental expenses of \$180 million for changes in estimate related to the contract ratification bonus for the Company's Flight Attendants, and \$354 million related to the contract ratification bonus for the Company's Pilots. The cumulative \$534 million is included in the balance as of December 31, 2023. The Company began accruing for these open labor contracts on April 1, 2022. The incremental \$180 million expense related to the contract ratification bonuses for Flight Attendants extends the timeframe covered by the ratification bonus to the date the contract became amendable on November 1, 2018. The incremental \$354 million expense related to the contract ratification bonuses for Pilots is primarily to increase pay rates for all periods to the date the contract became amendable, which was September 1, 2020. These bonuses for both Flight Attendants and Pilots serve to compensate for missed wage increases over these time periods.

(c) The purpose of Voluntary Separation Program and Extended ETO was to maintain a reduced workforce to operate at reduced capacity relative to the Company's operations prior to the COVID-19 pandemic. In accordance with the accounting guidance in Accounting Standards Codification Topic 712 (Compensation — Nonretirement Postemployment Benefits), the Company accrued charges related to the special termination benefits described above upon Employees accepting Voluntary Separation Program or Extended ETO offers. The Company accrued expenses totaling \$1.4 billion for its Voluntary Separation Program and Extended ETO program in 2020, which are being reduced as program benefits are paid. For both the Voluntary Separation Program and Extended ETO programs combined, approximately \$93 million and \$109 million of the liability balances were relieved during 2023 and 2022, respectively, through payments to Employees. During 2021, the Company determined that it was no longer probable that the remaining portion of the Employees on Extended ETO would remain on such leave for their entire elected term. Therefore, a portion of the accruals previously recorded were reversed, resulting in a net \$140 million credit to expense during 2021, and the entire liability was fully relieved at March 31, 2022. Both the initial charge and the partial reversal were classified within Payroll support and voluntary Employee programs, net, in the accompanying Consolidated Statement of Income, and are in addition to the allocation of the PSP2 Payroll Support Program and PSP3 Payroll Support Program funds utilized to fund salaries, wages, and benefits, which totaled \$2.7 billion for the year ended December 31, 2021.

For further information on fuel derivative and interest rate derivative contracts, see Note 11.

Other Operating Expenses

Other operating expenses consist of aircraft rentals, distribution costs, advertising expenses, personnel expenses, professional fees, and other operating costs, none of which individually exceed 10 percent of Total operating expenses, net.

Report of Independent Registered Public Accounting Firm

To the Shareholders and the Board of Directors of Southwest Airlines Co.

Opinion on the Financial Statements

We have audited the accompanying consolidated balance sheets of Southwest Airlines Co. (the Company) as of December 31, 2023 and 2022, the related consolidated statements of income, comprehensive income, stockholders' equity and cash flows for each of the three years in the period ended December 31, 2023, and the related notes (collectively referred to as the "financial statements"). In our opinion, the financial statements present fairly, in all material respects, the consolidated financial position of the Company at December 31, 2023 and 2022, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2023, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the Company's internal control over financial reporting as of December 31, 2023, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013 framework), and our report dated February 6, 2024 expressed an unqualified opinion thereon.

Adoption of ASU No. 2020-06

As discussed in Note 3 to the consolidated financial statements, the Company changed its method of accounting for convertible debt instruments in 2022 due to the adoption of ASU 2020-06, Debt—Debt with Conversion and Other Options (Subtopic 470-20) and Derivatives and Hedging—Contracts in Entity's Own Equity (Subtopic 815-40): Accounting for Convertible Instruments and Contracts in an Entity's Own Equity.

Basis for Opinion

These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the Company's financial statements based on our audits. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. Our audits included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.

Critical audit matter

The critical audit matter communicated below is a matter arising from the current period audit of the financial statements that was communicated or required to be communicated to the audit committee and that: (1) relates to accounts or disclosures that are material to the financial statements and (2) involved our especially challenging, subjective or complex judgments. The communication of the critical audit matter does not alter in any way our opinion on the consolidated financial statements, taken as a whole, and we are not, by communicating the critical

audit matter below, providing a separate opinion on the critical audit matter or on the accounts or disclosures to which it relates.

Valuation of fuel derivative instruments

Description of the Matter

As described in Notes 1, 11, and 12 to the consolidated financial statements, the Company's fuel derivative instruments consist of over-the-counter contracts, which are not traded on a public exchange and require the Company to estimate their fair values. The fair value of fuel option contracts is determined using option pricing models with inputs such as commodity prices, strike prices, risk-free interest rates, term to expiration and volatility. Because certain inputs used to determine the fair value of option contracts are unobservable (principally implied volatility), the Company has categorized these option contracts as Level 3 fair value measures. The Company analyzes volatility information for reasonableness and compares it to similar information received from external sources and limited observable market data. The fair value of the option contracts considers both the intrinsic value and any remaining time value associated with the derivatives that have not settled.

Auditing the fair value measurement of fuel option contracts is complex and requires significant judgment in order to evaluate the application of the option pricing model and evaluating the reasonableness of the unobservable input of implied volatility used in the fair value measurement of the Company's fuel option contracts.

How We Addressed the Matter in Our Audit

We obtained an understanding, evaluated the design and tested the operating effectiveness of controls over the Company's process to calculate the fair value of fuel option contracts, including controls that related to the volatility input.

To test the valuation of fuel derivative instruments, our audit procedures included, among others, involving internal valuation specialists to assist in the testing of the significant inputs into the option pricing model by comparing the market data inputs, including volatility, to external sources. With the support of our specialists, we also tested the application of and the computational accuracy of the option pricing model by performing independent corroborative calculations. Additionally, we compared the Company's fuel option contract valuations to the counterparty valuations, which were independently obtained as part of our audit procedures.

/s/ Ernst & Young LLP

We have served as the Company's auditor since 1971.

Dallas, Texas
February 6, 2024

Report of Independent Registered Public Accounting Firm

To the Shareholders and the Board of Directors of Southwest Airlines Co.

Opinion on Internal Control over Financial Reporting

We have audited Southwest Airlines Co.'s internal control over financial reporting as of December 31, 2023, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013 Framework), (the COSO criteria). In our opinion, Southwest Airlines Co. (the Company) maintained, in all material respects, effective internal control over financial reporting as of December 31, 2023, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the consolidated balance sheets of Southwest Airlines Co. as of December 31, 2023 and 2022, the related consolidated statements of income, comprehensive income, stockholders' equity and cash flows for each of the three years in the period ended December 31, 2023, and the related notes (collectively referred to as the "financial statements") of the Company and our report dated February 6, 2024 expressed an unqualified opinion thereon.

Basis for Opinion

The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying "Management's Annual Report on Internal Control Over Financial Reporting". Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audit in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects.

Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

Definition and Limitations of Internal Control over Financial Reporting

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/ Ernst & Young LLP

Dallas, Texas
February 6, 2024