

SOUTHWEST AIRLINES CO  
Form 10-Q  
October 29, 2015

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2015

or

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File No. 1-7259

Southwest Airlines Co.

(Exact name of registrant as specified in its charter)

TEXAS

74-1563240

(State or other jurisdiction of incorporation or organization)

(IRS Employer Identification No.)

P.O. Box 36611

Dallas, Texas

75235-1611

(Address of principal executive offices)

(Zip Code)

Registrant's telephone number, including area code: (214) 792-4000

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

Non-accelerated filer  (Do not check if a smaller reporting company)

Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes

No

Number of shares of Common Stock outstanding as of the close of business on October 27, 2015: 650,355,108



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SOUTHWEST AIRLINES CO.  
FORM 10-Q  
PART I – FINANCIAL INFORMATION

## Item 1. Financial Statements

Southwest Airlines Co.

Condensed Consolidated Balance Sheet

(in millions)

(unaudited)

|  | September 30, 2015 | December 31, 2014 |
|--|--------------------|-------------------|
| <b>ASSETS</b>                                    |                    |                   |
| Current assets:                                  |                    |                   |
| Cash and cash equivalents                        | \$1,740            | \$1,282           |
| Short-term investments                           | 1,356              | 1,706             |
| Accounts and other receivables                   | 465                | 365               |
| Inventories of parts and supplies, at cost       | 308                | 342               |
| Deferred income taxes                            | 465                | 477               |
| Prepaid expenses and other current assets        | 239                | 232               |
| Total current assets                             | 4,573              | 4,404             |
| Property and equipment, at cost:                 |                    |                   |
| Flight equipment                                 | 19,244             | 18,473            |
| Ground property and equipment                    | 3,066              | 2,853             |
| Deposits on flight equipment purchase contracts  | 692                | 566               |
| Assets constructed for others                    | 823                | 621               |
|  | 23,825             | 22,513            |
| Less allowance for depreciation and amortization | 8,896              | 8,221             |
|  | 14,929             | 14,292            |
| Goodwill   | 970                | 970               |
| Other assets                                     | 687                | 534               |
|  | \$21,159           | \$20,200          |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>      |                    |                   |
| Current liabilities:                             |                    |                   |
| Accounts payable                                 | \$1,235            | \$1,203           |
| Accrued liabilities                              | 2,049              | 1,565             |
| Air traffic liability                            | 3,513              | 2,897             |
| Current maturities of long-term debt             | 287                | 258               |
| Total current liabilities                        | 7,084              | 5,923             |
| Long-term debt less current maturities           | 2,381              | 2,434             |
| Deferred income taxes                            | 3,111              | 3,259             |
| Construction obligation                          | 684                | 554               |
| Other noncurrent liabilities                     | 931                | 1,255             |
| Stockholders' equity:                            |                    |                   |
| Common stock                                     | 808                | 808               |
| Capital in excess of par value                   | 1,330              | 1,315             |
| Retained earnings                                | 8,922              | 7,416             |
| Accumulated other comprehensive loss             | (903               | ) (738            |

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|                            |          |          |   |
|----------------------------|----------|----------|---|
| Treasury stock, at cost    | (3,189   | ) (2,026 | ) |
| Total stockholders' equity | 6,968    | 6,775    |   |
|                            | \$21,159 | \$20,200 |   |

See accompanying notes.

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

|  | Three months ended September 30, |               | Nine months ended September 30, |               |
|--|----------------------------------|---------------|---------------------------------|---------------|
|  | 2015                             | 2014          | 2015                            | 2014          |
| <b>OPERATING REVENUES:</b>                 |                                  |               |                                 |               |
| Passenger                                  | \$4,716                          | \$4,564       | \$13,746                        | \$13,249      |
| Freight                                    | 44                               | 45            | 134                             | 128           |
| Special revenue adjustment                 | 172                              | —             | 172                             | —             |
| Other                                      | 386                              | 191           | 791                             | 600           |
| Total operating revenues                   | 5,318                            | 4,800         | 14,843                          | 13,977        |
| <b>OPERATING EXPENSES:</b>                 |                                  |               |                                 |               |
| Salaries, wages, and benefits              | 1,699                            | 1,363         | 4,725                           | 4,044         |
| Fuel and oil                               | 936                              | 1,386         | 2,818                           | 4,125         |
| Maintenance materials and repairs          | 259                              | 248           | 729                             | 734           |
| Aircraft rentals                           | 60                               | 71            | 179                             | 227           |
| Landing fees and other rentals             | 303                              | 289           | 887                             | 849           |
| Depreciation and amortization              | 258                              | 238           | 751                             | 687           |
| Acquisition and integration                | 6                                | 23            | 32                              | 78            |
| Other operating expenses                   | 572                              | 568           | 1,632                           | 1,628         |
| Total operating expenses                   | 4,093                            | 4,186         | 11,753                          | 12,372        |
| <b>OPERATING INCOME</b>                    | <b>1,225</b>                     | <b>614</b>    | <b>3,090</b>                    | <b>1,605</b>  |
| <b>OTHER EXPENSES (INCOME):</b>            |                                  |               |                                 |               |
| Interest expense                           | 31                               | 31            | 92                              | 97            |
| Capitalized interest                       | (9                               | ) (6          | ) (23                           | ) (18         |
| Interest income                            | (2                               | ) (2          | ) (5                            | ) (5          |
| Other (gains) losses, net                  | 272                              | 66            | 394                             | 16            |
| Total other expenses (income)              | 292                              | 89            | 458                             | 90            |
| <b>INCOME BEFORE INCOME TAXES</b>          | <b>933</b>                       | <b>525</b>    | <b>2,632</b>                    | <b>1,515</b>  |
| <b>PROVISION FOR INCOME TAXES</b>          | <b>349</b>                       | <b>196</b>    | <b>987</b>                      | <b>569</b>    |
| <b>NET INCOME</b>                          | <b>\$584</b>                     | <b>\$329</b>  | <b>\$1,645</b>                  | <b>\$946</b>  |
| <b>NET INCOME PER SHARE, BASIC</b>         | <b>\$0.89</b>                    | <b>\$0.48</b> | <b>\$2.47</b>                   | <b>\$1.37</b> |
| <b>NET INCOME PER SHARE, DILUTED</b>       | <b>\$0.88</b>                    | <b>\$0.48</b> | <b>\$2.45</b>                   | <b>\$1.36</b> |
| <b>COMPREHENSIVE INCOME</b>                | <b>\$345</b>                     | <b>\$126</b>  | <b>\$1,480</b>                  | <b>\$857</b>  |
| <b>WEIGHTED AVERAGE SHARES OUTSTANDING</b> |                                  |               |                                 |               |
| Basic                                      | 655                              | 683           | 665                             | 690           |

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|  |        |        |        |        |
|--|--------|--------|--------|--------|
| Diluted                                  | 663    | 691    | 673    | 699    |
| Cash dividends declared per common share | \$.075 | \$.060 | \$.210 | \$.160 |
| See accompanying notes.                  |        |        |        |        |

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

|  | Three months ended<br>September 30, |         | Nine months ended<br>September 30, |           |
|--|-------------------------------------|---------|------------------------------------|-----------|
|  | 2015                                | 2014    | 2015                               | 2014      |
| <b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>   |                                     |         |                                    |           |
| Net income   | \$584                               | \$329   | \$1,645                            | \$946     |
| Adjustments to reconcile net income to cash provided by<br>(used in) operating activities: |                                     |         |                                    |           |
| Depreciation and amortization  | 258                                 | 238     | 751                                | 687       |
| Unrealized/realized (gain) loss on fuel derivative instruments                             | 87                                  | 63      | 172                                | (4)       |
| Deferred income taxes  | (82)                                | ) 392   | (40)                               | ) 472     |
| Changes in certain assets and liabilities:   |                                     |         |                                    |           |
| Accounts and other receivables   | 4                                   | (22)    | ) (86)                             | ) (83)    |
| Other assets   | 33                                  | 6       | 40                                 | (7)       |
| Accounts payable and accrued liabilities   | 380                                 | (534)   | ) 424                              | (86)      |
| Air traffic liability  | (301)                               | ) (108) | ) 617                              | 806       |
| Cash collateral received from (provided to) derivative<br>counterparties                   | 181                                 | (98)    | ) (213)                            | ) 8       |
| Other, net   | (308)                               | ) (26)  | ) (396)                            | ) (41)    |
| Net cash provided by operating activities  | 836                                 | 240     | 2,914                              | 2,698     |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>   |                                     |         |                                    |           |
| Capital expenditures   | (230)                               | ) (406) | ) (1,231)                          | ) (1,282) |
| Assets constructed for others  | (32)                                | ) (27)  | ) (76)                             | ) (58)    |
| Purchases of short-term investments  | (506)                               | ) (415) | ) (1,383)                          | ) (2,344) |
| Proceeds from sales of short-term and other investments                                    | 509                                 | 805     | 1,732                              | 2,427     |
| Other, net   | —                                   | (1)     | ) (9)                              | ) (2)     |
| Net cash used in investing activities  | (259)                               | ) (44)  | ) (967)                            | ) (1,259) |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>   |                                     |         |                                    |           |
| Proceeds from Employee stock plans   | 9                                   | 23      | 30                                 | 96        |
| Proceeds from termination of interest rate derivative<br>instruments                       | —                                   | —       | 12                                 | —         |
| Reimbursement for assets constructed for others  | 9                                   | 26      | 14                                 | 26        |
| Payments of long-term debt and capital lease obligations                                   | (79)                                | ) (48)  | ) (170)                            | ) (167)   |
| Payments of cash dividends   | (49)                                | ) (41)  | ) (180)                            | ) (138)   |
| Repayment of construction obligation   | (3)                                 | ) (3)   | ) (8)                              | ) (8)     |
| Repurchase of common stock   | (500)                               | ) (200) | ) (1,180)                          | ) (755)   |
| Other, net   | 4                                   | (3)     | ) (7)                              | ) (16)    |
| Net cash used in financing activities  | (609)                               | ) (246) | ) (1,489)                          | ) (962)   |
| <b>NET CHANGE IN CASH AND CASH EQUIVALENTS</b>   | (32)                                | ) (50)  | ) 458                              | 477       |
| <b>CASH AND CASH EQUIVALENTS AT BEGINNING OF<br/>PERIOD</b>                                | 1,772                               | 1,882   | 1,282                              | 1,355     |



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|  |         |         |         |         |
|--|---------|---------|---------|---------|
| CASH AND CASH EQUIVALENTS AT END OF PERIOD         | \$1,740 | \$1,832 | \$1,740 | \$1,832 |
| CASH PAYMENTS FOR:                                 |         |         |         |         |
| Interest, net of amount capitalized                | \$33    | \$35    | \$86    | \$102   |
| Income taxes                                       | \$409   | \$132   | \$975   | \$144   |
| SUPPLEMENTAL DISCLOSURE OF NONCASH<br>TRANSACTIONS |         |         |         |         |
| Flight equipment under capital leases              | \$48    | \$31    | \$130   | \$94    |
| Assets constructed for others                      | \$46    | \$27    | \$126   | \$59    |
| See accompanying notes.                            |         |         |         |         |

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

1. BASIS OF PRESENTATION

Southwest Airlines Co. (the “Company”) operates Southwest Airlines, a major passenger airline that provides scheduled air transportation in the United States and near-international markets. The unaudited Condensed Consolidated Financial Statements include accounts of the Company and its wholly owned subsidiaries, which include AirTran Holdings, LLC, the parent company of AirTran Airways, Inc. (“AirTran Airways”). On May 2, 2011 (the “acquisition date”), the Company acquired all of the outstanding equity of AirTran Holdings, Inc. (“AirTran Holdings”), the former parent company of AirTran Airways. Throughout this Form 10-Q, the Company makes reference to AirTran, which is meant to be inclusive of the following: (i) for periods prior to the acquisition date, AirTran Holdings and its subsidiaries, including, among others, AirTran Airways; and (ii) for periods on and after the acquisition date, AirTran Holdings, LLC, the successor to AirTran Holdings, and its subsidiaries, including among others, AirTran Airways. AirTran's final passenger service was on December 28, 2014. Although the vast majority of integration costs were incurred in periods prior to 2015, the Company continues to incur costs associated with the integration of AirTran, and those costs are included in Acquisition and integration costs in the accompanying unaudited Condensed Consolidated Statement of Comprehensive Income.

The accompanying unaudited Condensed Consolidated Financial Statements of the Company and its subsidiaries have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles in the United States (“GAAP”) for complete financial statements. The unaudited Condensed Consolidated Financial Statements for the interim periods ended September 30, 2015 and 2014 include all adjustments which are, in the opinion of management, necessary for a fair presentation of the results for the interim periods. This includes all normal and recurring adjustments and elimination of significant intercompany transactions. Financial results for the Company and airlines in general can be seasonal in nature. In many years, the Company's revenues, as well as its operating income and net income, have been better in its second and third fiscal quarters than in its first and fourth fiscal quarters. Air travel is also significantly impacted by general economic conditions, the amount of disposable income available to consumers, unemployment levels, corporate travel budgets, and other factors beyond the Company's control. These and other factors, such as the price of jet fuel in some periods, the nature of the Company's fuel hedging program, the periodic volatility of commodities used by the Company for hedging jet fuel, and the requirements related to hedge accounting, have created, and may continue to create, significant volatility in the Company's financial results. See Note 3 for further information on fuel and the Company's hedging program. Operating results for the three and nine months ended September 30, 2015, are not necessarily indicative of the results that may be expected for future quarters or for the year ended December 31, 2015. For further information, refer to the Consolidated Financial Statements and footnotes thereto included in the Southwest Airlines Co. Annual Report on Form 10-K for the year ended December 31, 2014.

2. CHANGES IN ACCOUNTING OR ESTIMATES AND NEW ACCOUNTING PRONOUNCEMENTS

New accounting pronouncements

On February 18, 2015, the Financial Accounting Standards Board (“FASB”) and the International Accounting Standards Board issued a final standard that amends the current consolidation guidance. The standard amends both the variable interest entity and voting interest entity consolidation models. The standard is effective for public reporting entities in fiscal periods beginning after December 15, 2015, and early adoption is permitted. Once adopted, the Company will need to assess the potential for entity consolidation under a new consolidation model; however, the

Company does not believe this will result in changes to its previous consolidation conclusions. The Company will adopt this new standard during first quarter 2016, but does not expect it to have a significant impact.

On May 28, 2014, the FASB issued Accounting Standards Update ("ASU") No. 2014-09, Revenue from Contracts with Customers. Following the FASB's finalization of a one year deferral of this standard, the ASU is now effective

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

for fiscal years, and interim periods within those years, beginning on or after December 15, 2017, with early adoption permitted for fiscal years, and interim periods within those years, beginning on or after December 15, 2016. The Company believes the most significant impact of this ASU on its accounting will be the elimination of the incremental cost method for frequent flyer accounting, which will require the Company to re-value its liability earned by Customers associated with flight points with a relative fair value approach. The Company is continuing to evaluate the new guidance and plans to provide additional information about its expected financial impact at a future date.

Changes in accounting or estimates

During July 2015, the Company executed an amended co-branded credit card agreement ("Agreement") with Chase Bank USA, N.A. ("Chase"), through which the Company sells loyalty points and other items to Chase. The Company's Rapid Rewards program members ("Members") are able to accrue loyalty points based on purchases using the Chase co-branded Southwest Visa credit card. The Agreement materially modifies the previously existing agreement between Chase and the Company. Consideration received as part of this Agreement is subject to ASU 2009-13, "Multiple-Deliverable Revenue Arrangements - a consensus of the FASB Emerging Issues Task Force".

Historically, funds received from the sale of points associated with these agreements were accounted for under the residual method. Under the residual method, the Company estimated the portion from frequent flyer points sold associated with Southwest's co-branded Chase Visa credit card that related to free travel. The estimated amounts associated with free travel were deferred and recognized as Passenger revenue when the ultimate free travel awards were flown. Under the residual method, the Company estimated that 100 percent of the amount received from frequent flyer points sold were related to free travel.

The modified Agreement has the following multiple elements: travel points to be awarded; use of the Southwest Airlines' brand and access to Rapid Reward Member lists; advertising elements; and the Company's resource team. Under ASU 2009-13, these deliverables are accounted for separately, and allocation of consideration from the Agreement is determined based on the relative stand-alone selling price of each deliverable. As compared to the residual method, the application of ASU 2009-13 to the Agreement decreases the relative value of the air transportation deliverables that the Company records as deferred revenue (and ultimately Passenger revenues when redeemed awards are flown) and increases the relative value of the marketing-related deliverables recorded in Other revenues at the time these marketing-related deliverables are provided.

Significant management judgment was used to estimate the stand-alone selling price of each of the deliverables. The Company determined the best estimate of selling price by considering multiple inputs and methods including, but not limited to, the estimated selling price of comparable travel, discounted cash flows, brand value, published selling prices, number of points awarded, and the number of points redeemed. 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 multiple deliverables.

The Company records Passenger revenue related to (i) air transportation and (ii) certificates for discounted companion travel when the transportation is delivered. The other elements are recognized as Other - net revenue when earned.

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

The Company followed the transition approach of ASU 2009-13, which required that the Company's existing deferred revenue balance, classified within Air traffic liability, be adjusted to reflect the value, on a relative selling price basis, of any undelivered element remaining at the date of contract modification. The relative selling price of the undelivered element (air transportation) is lower than the rate at which it had been deferred under the previous contract and the Company recorded a one-time, non-cash adjustment to decrease frequent flyer deferred revenue and increase Special revenue adjustment. In addition, the Agreement and the resulting application of ASU 2009-13 are expected to result in an acceleration of the timing of Operating revenues on a prospective basis relative to the Company's previous application of the residual method due to assigning a higher value to the non-transportation elements of the Agreement than under the residual method. The impacts on revenue and earnings from this change in accounting principle are as follows:

| (in millions, except per share amounts) | Three months ended<br>September 30, 2015 | Nine months ended<br>September 30, 2015 |
|---|--|---|
| Passenger revenue                       | \$(40                                    | ) \$(40                                 |
| Special revenue adjustment              | 172                                      | 172                                     |
| Other revenue                           | 171                                      | 171                                     |
| Operating revenues                      | \$303                                    | \$303                                   |
| Net income                              | \$161                                    | \$161                                   |
| Net income per basic share              | \$0.25                                   | \$0.24                                  |
| Net income per diluted share            | \$0.24                                   | \$0.24                                  |

During fourth quarter 2014, the Company increased the amount of spoilage recorded associated with frequent flyer points sold to business partners as a result of continued monitoring of Member redemption activity and behavior under its Rapid Rewards program. Based on a sufficient amount of historical data and Member attributes observed since the new program was launched in 2011, the Company developed a predictive statistical model to analyze the amount of spoilage expected. In estimating spoilage, the Company takes into account the Member's past behavior, as well as several factors that are expected to be indicative of the likelihood of future point redemption. These factors include, but are not limited to, tenure with program, points accrued in the program, and whether or not the Customer has a co-branded credit card. This change in estimate was recorded on a prospective basis, effective October 1, 2014. As a result of its annual update the Company will prospectively apply a slight decrease in the rate beginning as of October 1, 2015; however, the precise revenue impact will not be determinable until the actual number of point redemptions for the period is known. The Company will continue to monitor all factors that influence spoilage and Member behavior in order to determine its best estimate of expected spoilage. The impacts on revenue and earnings for the lower rate applied in fourth quarter 2014 are as follows:

| (in millions, except per share amounts) | Three months ended<br>September 30, 2015 | Nine months ended<br>September 30, 2015 |
|---|--|---|
| Passenger revenue                       | \$30                                     | \$115                                   |
| Net income                              | \$16                                     | \$61                                    |
| Net income per basic share              | \$0.02                                   | \$0.09                                  |
| Net income per diluted share            | \$0.02                                   | \$0.09                                  |

### 3. 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 represent 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 time frames and primarily uses 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.

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 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.

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

For the three months ended September 30, 2015, the Company had fuel derivative instruments that settled. Although a portion of these instruments finished "out of the money" and did not result in a payment to or from the counterparty at settlement, the instruments in place could have represented an "economic" hedge for up to 43 percent of its fuel consumption if prices had increased to significantly higher levels. During third quarter 2015, the Company reduced its hedge position related to future periods. This reduction in the Company's hedge position primarily was accomplished through entering into offsetting derivatives that will also settle in the same periods as the economic hedge derivative. Prior to third quarter 2015, the Company had paid \$39 million to counterparties to purchase offsetting derivatives that also settled during third quarter 2015. These transactions are reflected in the total economic fuel hedge settlement losses of \$245 million recognized in Fuel and oil expense during third quarter 2015. The Company also paid \$294 million to counterparties during third quarter 2015 to purchase offsetting derivatives that will settle in fourth quarter 2015 and first half 2016. Therefore, as of September 30, 2015, the Company no longer had an "economic" hedge in place for its remaining 2015 estimated fuel consumption. However, in periods prior to third quarter, the Company did have fourth quarter 2015 hedges in place that were subsequently offset. The following table provides information about the Company's volume of fuel hedging for the years 2015 through 2018 on an "economic" basis:

| Period (by year)    | Fuel hedged as of<br>September 30, 2015<br>(gallons in millions) | Derivative underlying commodity type as of<br>September 30, 2015 |
|---------------------|--|--|
| Fourth quarter 2015 | —  | (a)  |
| 2016                | 1,188  | (b) Brent crude oil, Heating oil, and Gulf Coast jet fuel        |
| 2017                | 1,294  | (b) WTI crude and Brent crude oil                                |
| 2018                | 466  | (b) Brent crude oil  |

(a) The Company is effectively unhedged for fourth quarter 2015 at current price levels. While the Company still holds derivative contracts as of September 30, 2015, that will settle during fourth quarter 2015, the losses associated with those contracts are substantially locked in. However, if market prices were to increase or decrease significantly related to the fourth quarter 2015 positions prior to these contracts settling, the losses incurred at settlement could be slightly lower or higher than currently expected amounts during that period.

(b) Due to the types of derivatives and commodities utilized by the Company and different price levels of those contracts, this volume represents the maximum "economic" net hedge in place. The Company's average "economic" net hedge of estimated fuel consumption covered by fuel derivative contracts is lower than this maximum volume, may vary significantly as market prices fluctuate, and begins to provide hedge coverage at price levels above current market prices.

Upon proper qualification, the Company accounts for its fuel derivative instruments as cash flow hedges. Generally, utilizing hedge accounting, all periodic changes in fair value of the derivatives designated as hedges that are considered to be effective are recorded in Accumulated other comprehensive income (loss) ("AOCI") until the underlying jet fuel is consumed. See Note 4. The Company's results are subject to the possibility that periodic changes will not be effective, as defined, or that the derivatives will no longer qualify for hedge accounting. Ineffectiveness results when the change in the fair value of the derivative instrument exceeds the change in the value of the Company's expected future cash outlay to purchase and consume jet fuel. To the extent that the periodic changes in the fair value of the derivatives are ineffective, the ineffective portion is recorded to Other (gains) losses, net, in the unaudited Condensed Consolidated Statement of Comprehensive Income. Likewise, if a hedge ceases to qualify for hedge accounting, any change in the fair value of derivative instruments since the last reporting period is recorded to Other (gains) losses, net, in the unaudited Condensed Consolidated Statement of Comprehensive 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. 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 earnings. 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



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that have been recorded to AOCI would be required to be immediately reclassified into earnings. The Company did not have any such situations occur during 2014, or during the nine months ended September 30, 2015.

In some situations, an entire commodity type used in hedging may cease to qualify for special hedge accounting treatment. As an example, from July 2013 to July 2015, the Company's routine statistical analysis performed to determine which commodities qualified for special hedge accounting treatment on a prospective basis dictated that WTI crude oil based derivatives no longer qualified for hedge accounting. This was primarily due to the fact that the correlation between WTI crude oil prices and jet fuel prices during recent periods had not been as strong as in the past, and therefore the Company could no longer demonstrate that derivatives based on WTI crude oil prices would result in effective hedges on a prospective basis. As such, the changes in fair value of all of the Company's derivatives based in WTI were recorded directly to Other (gains) losses. The Company's routine statistical analysis performed for the three months ended September 30, 2015, dictated that WTI crude oil based derivatives again qualified for hedge accounting.

All cash flows associated with purchasing and selling fuel derivatives are classified as Other operating cash flows in the unaudited Condensed 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 unaudited Condensed Consolidated Balance Sheet:

| (in millions)                              | Balance Sheet location       | Asset derivatives       |                          | Liability derivatives   |                          |
|--|------------------------------|-------------------------|--------------------------|-------------------------|--------------------------|
|  |                              | Fair value at 9/30/2015 | Fair value at 12/31/2014 | Fair value at 9/30/2015 | Fair value at 12/31/2014 |
| Derivatives designated as hedges*          |                              |                         |                          |                         |                          |
| Fuel derivative contracts (gross)          | Accrued liabilities          | \$36                    | \$—                      | \$414                   | \$—                      |
| Fuel derivative contracts (gross)          | Other noncurrent liabilities | 54                      | —                        | 596                     | 643                      |
| Interest rate derivative contracts         | Other assets                 | 6                       | 13                       | —                       | —                        |
| Interest rate derivative contracts         | Other noncurrent liabilities | —                       | —                        | 54                      | 61                       |
| Total derivatives designated as hedges     |                              | \$96                    | \$13                     | \$1,064                 | \$704                    |
| Derivatives not designated as hedges*      |                              |                         |                          |                         |                          |
| Fuel derivative contracts (gross)          | Accrued liabilities          | \$1,358                 | \$1,190                  | \$1,536                 | \$1,432                  |
| Fuel derivative contracts (gross)          | Other noncurrent liabilities | 282                     | 157                      | 414                     | 273                      |
| Total derivatives not designated as hedges |                              | \$1,640                 | \$1,347                  | \$1,950                 | \$1,705                  |
| Total derivatives                          |                              | \$1,736                 | \$1,360                  | \$3,014                 | \$2,409                  |

\* 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 unaudited Condensed Consolidated Balance Sheet:



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| (in millions)   | Balance Sheet location                      | September 30, 2015 | December 31, 2014 |
|---|---|--------------------|-------------------|
| Cash collateral deposits provided to counterparties for fuel contracts - current    | Offset against Accrued liabilities          | \$15               | \$68              |
| Cash collateral deposits provided to counterparties for fuel contracts - noncurrent | Offset against Other noncurrent liabilities | 463                | 198               |
| Due to third parties for fuel contracts   | Accounts payable                            | 41                 | 16                |

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 unaudited Condensed 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 unaudited Condensed Consolidated Balance Sheet.

The Company's application of its netting policy associated with cash collateral differs depending on whether its derivative instruments are in a net asset position or a net liability position. 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 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. If the Company's fuel derivative instruments are in a net liability position with the counterparty, cash collateral amounts provided are first netted against noncurrent outstanding derivative amounts associated with that counterparty until that balance is zero, and then any remainder is applied against the fair value of current outstanding derivative instruments.

The Company has 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)

| Description               | Balance Sheet location | September 30, 2015                     |  |   | December 31, 2014                      |  |   |
|---------------------------|------------------------|--|--|---|--|--|---|
|                           |                        | (i) Gross amounts of recognized assets | (ii) Gross amounts offset in the Balance Sheet | (iii) = (i) + (ii) Net amounts of assets presented in the Balance Sheet (a) | (i) Gross amounts of recognized assets | (ii) Gross amounts offset in the Balance Sheet | (iii) = (i) + (ii) Net amounts of assets presented in the Balance Sheet (a) |
| Fuel derivative contracts | Accrued liabilities    | \$1,409                                | \$(1,409)                                      | \$—   | \$1,258                                | \$(1,258)                                      | \$—   |
| Fuel derivative           | Other noncurrent       | \$799                                  | \$(799)  | \$—   | \$355                                  | \$(355)  | \$—   |

|               |              |     |     |     |      |     |      |
|---------------|--------------|-----|-----|-----|------|-----|------|
| contracts     | liabilities  |     |     |     |      |     |      |
| Interest rate |              |     |     |     |      |     |      |
| derivative    | Other assets | \$6 | \$— | \$6 | \$13 | \$— | \$13 |
| contracts     |              |     |     |     |      |     |      |

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Offsetting of derivative liabilities  
(in millions)

| Description                        | Balance Sheet location       | (i)                                     | (ii)                                      | (iii) = (i) + (ii)  | (i)                                     | (ii)                                      | (iii) = (i) + (ii)  |
|------------------------------------|------------------------------|---|---|---|---|---|---|
|                                    |                              | September 30, 2015                      |   |   | December 31, 2014                       |   |   |
|                                    |                              | Gross amounts of recognized liabilities | Gross amounts offset in the Balance Sheet | Net amounts of liabilities presented in the Balance Sheet (a) | Gross amounts of recognized liabilities | Gross amounts offset in the Balance Sheet | Net amounts of liabilities presented in the Balance Sheet (a) |
| Fuel derivative contracts          | Accrued liabilities          | \$1,950                                 | \$(1,409)                                 | ) \$541   | \$1,432                                 | \$(1,258)                                 | ) \$174   |
| Fuel derivative contracts          | Other noncurrent liabilities | \$1,010                                 | \$(799)                                   | ) \$211   | \$916                                   | \$(355)                                   | ) \$561   |
| Interest rate derivative contracts | Other noncurrent liabilities | \$54                                    | \$—                                       | \$54  | \$61                                    | \$—                                       | \$61  |

(a) The net amounts of derivative assets and liabilities are reconciled to the individual line item amounts presented in the unaudited Condensed Consolidated Balance Sheet in Note 5.

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The following tables present the impact of derivative instruments and their location within the unaudited Condensed Consolidated Statement of Comprehensive Income for the three and nine months ended September 30, 2015 and 2014:

Derivatives in cash flow hedging relationships

| (in millions)             | (Gain) loss recognized in AOCI on derivatives (effective portion) Three months ended September 30, |       | (Gain) loss reclassified from AOCI into income (effective portion) (a) Three months ended September 30, |        | (Gain) loss recognized in income on derivatives (ineffective portion) (b) Three months ended September 30, |       |
|---------------------------|--|-------|---|--------|--|-------|
|                           | 2015   | 2014  | 2015  | 2014   | 2015   | 2014  |
|                           | Fuel derivative contracts  | \$315 | * \$214   | * \$79 | * \$4  | * \$— |
| Interest rate derivatives | 3  | * (2) | * 3   | * 4    | * —  | (2)   |
| Total                     | \$318  | \$212 | \$82  | \$8    | \$—  | \$9   |

\*Net of tax

(a) Amounts related to fuel derivative contracts and interest rate derivatives are included in Fuel and oil and Interest expense, respectively.

(b) Amounts are included in Other (gains) losses, net.

Derivatives in cash flow hedging relationships

| (in millions)             | (Gain) loss recognized in AOCI on derivatives (effective portion) Nine months ended September 30, |       | (Gain) loss reclassified from AOCI into income (effective portion)(a) Nine months ended September 30, |         | (Gain) loss recognized in income on derivatives (ineffective portion)(b) Nine months ended September 30, |          |
|---------------------------|---|-------|---|---------|--|----------|
|                           | 2015  | 2014  | 2015  | 2014    | 2015   | 2014     |
|                           | Fuel derivative contracts   | \$330 | * \$104   | * \$166 | * \$3  | * \$(15) |
| Interest rate derivatives | 6   | * 2   | * 9   | * 10    | * (2)  | (3)      |
| Total                     | \$336   | \$106 | \$175   | \$13    | \$(17)   | \$(34)   |

\*Net of tax

(a) Amounts related to fuel derivative contracts and interest rate derivatives are included in Fuel and oil and Interest expense, respectively.

(b) Amounts are included in Other (gains) losses, net.

Derivatives not in cash flow hedging relationships

| (in millions) | (Gain) loss recognized in income on derivatives Three months ended September 30, |       | Location of (gain) loss recognized in income on derivatives |
|---------------|--|-------|---|
|               | 2015   | 2014  |   |
|               | Fuel derivative contracts  | \$239 |   |

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Derivatives not in cash flow hedging relationships

| (in millions)             | (Gain) loss<br>recognized in income on<br>derivatives |      | Location of (gain) loss<br>recognized in income<br>on derivatives |
|---------------------------|---|------|---|
|                           | Nine months ended<br>September 30,<br>2015            | 2014 |   |
| Fuel derivative contracts | \$330   | \$(1 | ) Other (gains) losses, net                                       |

The Company also recorded expense associated with premiums paid for fuel derivative contracts that settled/expired during the three months ended September 30, 2015 and 2014 of \$33 million and \$15 million, respectively, and the nine months ended September 30, 2015 and 2014 of \$81 million and \$49 million, respectively. These amounts are excluded from the Company's measurement of effectiveness for related hedges and are included as a component of Other (gains) losses, net, in the unaudited Condensed Consolidated Statement of Comprehensive Income.

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 net unrealized losses from fuel hedges as of September 30, 2015, recorded in AOCI, were approximately \$471 million in unrealized losses, net of taxes, which are expected to be realized in earnings during the twelve months subsequent to September 30, 2015.

Interest rate swaps

The Company is party to certain interest rate swap agreements that are accounted for as either fair value hedges or cash flow hedges, as defined in the applicable accounting guidance for derivative instruments and hedging. Two of the Company's interest rate swap agreements qualify for the "shortcut" method of accounting for hedges, which dictates that the hedges are assumed to be perfectly effective, and, thus, there is no ineffectiveness to be recorded in earnings. For the Company's interest rate swap agreements that do not qualify for the "shortcut" method of accounting, ineffectiveness is required to be measured at each reporting period. The ineffectiveness associated with all of the Company's, including AirTran's, interest rate hedges for all periods presented was not material.

In February 2015, the Company terminated the fixed-to-floating interest rate swap agreements related to its \$300 million 5.75% unsecured notes due 2016. The effect of this termination is such that the interest associated with the debt prospectively reverts back to its original fixed rate. As a result of the approximate \$12 million gain realized on this transaction, which will be amortized over the remaining term of the corresponding unsecured notes, and based on projected interest rates at the date of termination, the Company does not believe its future interest expense associated with these unsecured notes will significantly differ from the expense it would have recorded had the unsecured notes remained at floating rates.

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. At September 30, 2015, 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 credit rating. The Company also had agreements with counterparties in which cash deposits, letters of credit, and/or pledged aircraft are required to be posted as collateral whenever the net fair value of derivatives associated with those counterparties exceeds specific thresholds. The



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following table provides the fair values of fuel derivatives, amounts posted as collateral, and applicable collateral posting threshold amounts as of September 30, 2015, at which such postings are triggered:

| (in millions)   | Counterparty (CP)       |                         |                   |                            |          |         | Other (a) | Total     |
|---|-------------------------|-------------------------|-------------------|----------------------------|----------|---------|-----------|-----------|
|   | A                       | B                       | C                 | D                          | E        | F       |           |           |
| Fair value of fuel derivatives  | \$(514 )                | \$(179 )                | \$(153 )          | \$(206 )                   | \$(108 ) | \$(37 ) | \$(33 )   | \$(1,230) |
| Cash collateral held (by) CP  | (238 )                  | (50 )                   | (39 )             | (146 )                     | —        | (5 )    | —         | (478 )    |
| Aircraft collateral pledged to CP   | (210 )                  | (90 )                   | —                 | —                          | —        | —       | —         | (300 )    |
| Letters of credit (LC)  | —                       | —                       | —                 | —                          | —        | —       | —         | —         |
| Option to substitute LC for aircraft  | (200) to (600)(h)       | (100) to (500)(d)       | N/A               | (150) to (550)(d)          | N/A      | N/A     |           |           |
| Option to substitute LC for cash  | N/A                     | >(500)(e)               | (225) to (275)(e) | (75) to (150) or >(550)(e) | (g)      | (g)     |           |           |
| If credit rating is investment grade, fair value of fuel derivative level at which:     |                         |                         |                   |                            |          |         |           |           |
| Cash is provided to CP  | (50) to (200) or >(600) | (50) to (100) or >(500) | >(125)            | (75) to (150) or >(550)    | >(125)   | >(50)   |           |           |
| Cash is received from CP  | >50                     | >150                    | >175(c)           | >250                       | >75      | >50     |           |           |
| Aircraft or cash can be pledged to CP as collateral                                     | (200) to (600)(f)       | (100) to (500)(d)       | N/A               | (150) to (550)(d)          | N/A      | N/A     |           |           |
| If credit rating is non-investment grade, fair value of fuel derivative level at which: |                         |                         |                   |                            |          |         |           |           |
| Cash is provided to CP  | (0) to (200) or >(600)  | (0) to (100) or >(500)  | (b)               | (0) to (150) or >(550)     | (b)      | (b)     |           |           |
| Cash is received from CP  | (b)                     | (b)                     | (b)               | (b)                        | (b)      | (b)     |           |           |
| Aircraft or cash can be pledged to CP as collateral                                     | (200) to (600)          | (100) to (500)          | N/A               | (150) to (550)             | N/A      | N/A     |           |           |

(a) Individual counterparties with fair value of fuel derivatives <\$30 million.

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

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

(d) The Company has the option of providing cash, letters of credit, or pledging aircraft as collateral.

(e) The Company has the option of providing cash or letters of credit as collateral.

(f) The Company has the option of providing cash or pledging aircraft as collateral.

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

(h) The Company has the option of providing letters of credit in addition to aircraft collateral if the appraised value of the aircraft does not meet the collateral requirements.



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## 4. COMPREHENSIVE INCOME

Comprehensive income includes changes in the fair value of certain financial derivative instruments that qualify for hedge accounting, unrealized gains and losses on certain investments, and actuarial gains/losses arising from the Company's postretirement benefit obligation. The differences between Net income and Comprehensive income for the three and nine months ended September 30, 2015 and 2014, were as follows:

| (in millions)   | Three months ended September 30, |          |
|---|----------------------------------|----------|
|   | 2015                             | 2014     |
| NET INCOME  | \$584                            | \$329    |
| Unrealized loss on fuel derivative instruments, net of deferred taxes of (\$139) and (\$124)  | (236                             | ) (210   |
| Unrealized gain on interest rate derivative instruments, net of deferred taxes of \$- and \$3 | —                                | 6        |
| Other, net of deferred taxes of (\$2) and \$1   | (3                               | ) 1      |
| Total other comprehensive loss  | \$(239                           | ) \$(203 |
| COMPREHENSIVE INCOME  | \$345                            | \$126    |
|   |                                  |          |
| (in millions)   | Nine months ended September 30,  |          |
|   | 2015                             | 2014     |
| NET INCOME  | \$1,645                          | \$946    |
| Unrealized loss on fuel derivative instruments, net of deferred taxes of (\$97) and (\$60)    | (164                             | ) (101   |
| Unrealized gain on interest rate derivative instruments, net of deferred taxes of \$2 and \$4 | 3                                | 8        |
| Other, net of deferred taxes of (\$1) and \$4   | (4                               | ) 4      |
| Total other comprehensive loss  | \$(165                           | ) \$(89  |
| COMPREHENSIVE INCOME  | \$1,480                          | \$857    |

A rollforward of the amounts included in AOCI, net of taxes, is shown below for the three and nine months ended September 30, 2015:

| (in millions)                 | Fuel derivatives | Interest rate derivatives | Defined benefit plan items | Other | Deferred tax | Accumulated other comprehensive income (loss) |
|-------------------------------|------------------|---------------------------|----------------------------|-------|--------------|---|
| Balance at June 30, 2015      | \$(1,063         | ) \$(40                   | ) \$41                     | \$8   | \$390        | \$(664  |
| Changes in fair value         | (501             | ) (5                      | ) —                        | (5    | ) 190        | (321  |
| Reclassification to earnings  | 126              | 5                         | —                          | —     | (49          | ) 82  |
| Balance at September 30, 2015 | \$(1,438         | ) \$(40                   | ) \$41                     | \$3   | \$531        | \$(903  |
|                               |                  |                           |                            |       |              |   |
| (in millions)                 | Fuel derivatives | Interest rate derivatives | Defined benefit plan items | Other | Deferred tax | Accumulated other comprehensive income (loss) |
| Balance at December 31, 2014  | \$(1,177         | ) \$(45                   | ) \$41                     | \$8   | \$435        | \$(738  |
| Changes in fair value         | (525             | ) (10                     | ) —                        | (5    | ) 200        | (340  |

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|                                  |          |         |        |     |       |        |   |
|----------------------------------|----------|---------|--------|-----|-------|--------|---|
| Reclassification to earnings     | 264      | 15      | —      | —   | (104  | ) 175  |   |
| Balance at September 30,<br>2015 | \$(1,438 | ) \$(40 | ) \$41 | \$3 | \$531 | \$(903 | ) |

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The following tables illustrate the significant amounts reclassified out of each component of AOCI for the three and nine months ended September 30, 2015:

Three months ended September 30, 2015  
(in millions)

| AOCI components   | Amounts reclassified from AOCI | Affected line item in the unaudited Condensed Consolidated Statement of Comprehensive Income |
|---|--------------------------------|--|
| Unrealized loss on fuel derivative instruments          | \$126                          | Fuel and oil expense   |
|   | 47                             | Less: Tax Expense  |
|   | \$79                           | Net of tax   |
| Unrealized loss on interest rate derivative instruments | \$5                            | Interest expense   |
|   | 2                              | Less: Tax Expense  |
|   | \$3                            | Net of tax   |
| Total reclassifications for the period                  | \$82                           | Net of tax   |

Nine months ended September 30, 2015  
(in millions)

| AOCI components   | Amounts reclassified from AOCI | Affected line item in the unaudited Condensed Consolidated Statement of Comprehensive Income |
|---|--------------------------------|--|
| Unrealized loss on fuel derivative instruments          | \$264                          | Fuel and oil expense   |
|   | 98                             | Less: Tax Expense  |
|   | \$166                          | Net of tax   |
| Unrealized loss on interest rate derivative instruments | \$15                           | Interest expense   |
|   | 6                              | Less: Tax Expense  |
|   | \$9                            | Net of tax   |
| Total reclassifications for the period                  | \$175                          | Net of tax   |

## 5. SUPPLEMENTAL FINANCIAL INFORMATION

| Other assets (in millions) | September 30, 2015 | December 31, 2014 |
|----------------------------|--------------------|-------------------|
| Derivative contracts       | \$6                | \$13              |
| Intangible assets (a)      | 469                | 363               |
| Non-current investments    | 40                 | 35                |
| Other                      | 172                | 123               |
| Other assets               | \$687              | \$534             |

(a) Intangible assets primarily consist of acquired leasehold rights to certain airport owned gates at Chicago's Midway International Airport, 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, and certain intangible assets recognized from the AirTran acquisition. The increase in Intangible assets during 2015 was primarily due to the acquisition of two additional airport gate rights at Dallas Love Field, which were subleased from United Airlines. The purchase price paid for these airport gate rights was included as a component of Capital expenditures in the accompanying unaudited Condensed Consolidated Statement of Cash Flows.



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|  |                    |                   |
|--|--------------------|-------------------|
| Accounts payable (in millions)                     | September 30, 2015 | December 31, 2014 |
| Accounts payable trade                             | \$170              | \$123             |
| Salaries payable                                   | 340                | 160               |
| Excise and other tax withholdings payable          | 157                | 163               |
| Aircraft maintenance payable                       | 162                | 314               |
| Fuel payable                                       | 46                 | 85                |
| Other payables                                     | 360                | 358               |
| Accounts payable                                   | \$1,235            | \$1,203           |
| Accrued liabilities (in millions)                  | September 30, 2015 | December 31, 2014 |
| ProfitSharing and savings plans                    | \$506              | \$374             |
| Aircraft and other lease related obligations       | 86                 | 159               |
| Vacation pay                                       | 310                | 292               |
| Health   | 77                 | 84                |
| Derivative contracts                               | 541                | 174               |
| Workers compensation                               | 181                | 165               |
| Property and income taxes                          | 129                | 81                |
| Other  | 219                | 236               |
| Accrued liabilities                                | \$2,049            | \$1,565           |
| Other noncurrent liabilities (in millions)         | September 30, 2015 | December 31, 2014 |
| Postretirement obligation                          | \$179              | \$169             |
| Non-current lease-related obligations              | 164                | 193               |
| Other deferred compensation                        | 171                | 174               |
| Deferred gains from sale and leaseback of aircraft | 45                 | 53                |
| Derivative contracts                               | 265                | 622               |
| Other  | 107                | 44                |
| Other noncurrent liabilities                       | \$931              | \$1,255           |

For further details on fuel derivative and interest rate derivative contracts, see Note 3.

#### Other Operating Expenses

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

## 6. LEASES

On July 9, 2012, the Company signed an agreement with Delta Air Lines, Inc. and Boeing Capital Corp. to lease or sublease all 88 of AirTran's Boeing 717-200 aircraft ("B717s") to Delta at agreed-upon lease rates. The first converted B717 was delivered to Delta in September 2013, and as of September 30, 2015, the Company had delivered a total of 80 B717s to Delta. As the Company has previously disclosed, all B717s remaining at the Company were grounded on December 28, 2014. The Company currently expects the remaining eight B717s to be converted and delivered to Delta by early 2016. A total of 76 of the B717s are on operating lease, ten are owned, and two are on capital lease.

The Company has paid and will continue to pay the majority of the costs to convert the aircraft to the Delta livery and perform certain maintenance checks prior to the delivery of each aircraft. The agreement to pay these conversion and

maintenance costs for the leased aircraft is a “lease incentive” under applicable accounting guidance. The sublease terms for the 76 B717s on operating lease and the two B717s on capital lease coincide with the Company's remaining

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lease terms for these aircraft from the original lessor, which range from approximately three to nine years. The leasing of the ten B717s owned by the Company is subject to certain conditions, and the lease terms are for up to seven years, after which Delta has the option to purchase the aircraft at the then-prevailing market value. The Company accounts for the lease and sublease transactions with Delta as operating leases, sales type leases, and direct financing leases. The ten owned B717s will be accounted for as sales type leases, the two B717s classified by the Company as capital leases will be accounted for as direct financing leases, and the remaining 76 subleases will be accounted for as operating leases. With respect to the 80 B717s delivered to Delta as of September 30, 2015, the Company had 73 operating leases, five sales type leases, and two direct financing leases. There are no contingent payments and no significant residual value conditions associated with the transaction.

The accounting for this transaction is based on the guidance provided for lease transactions. For the components of this transaction finalized in third quarter 2012 and with respect to which the lease inception has been deemed to occur, the Company recorded a charge of approximately \$137 million during third quarter 2012. The charge represented the remaining estimated cost, at the scheduled date of delivery of each B717 to Delta (including the conversion, maintenance, and other contractual costs to be incurred), of the Company's lease of the 76 B717s that are accounted for as operating leases, net of the future sublease income from Delta and the remaining unfavorable aircraft lease liability established as of the acquisition date. The charges recorded by the Company for this transaction were included as a component of Acquisition and integration costs in the Company's unaudited Condensed Consolidated Statement of Comprehensive Income and were included as a component of Other, net in Cash flows from operating activities in the Company's unaudited Condensed Consolidated Statement of Cash Flows, and the corresponding liability for this transaction is included as a component of Current liabilities in the Company's unaudited Condensed Consolidated Balance Sheet. A rollforward of the Company's B717 lease/sublease liability for 2015 and 2014 is shown below:

| (in millions)                     | B717 lease/sublease liability |
|-----------------------------------|-------------------------------|
| Balance at December 31, 2013      | \$122                         |
| Lease/sublease accretion          | 5                             |
| Lease/sublease expense adjustment | 22                            |
| Lease/sublease payments, net (a)  | (86)                          |
| Balance at December 31, 2014      | \$63                          |
| Lease/sublease accretion          | 1                             |
| Lease/sublease expense adjustment | 5                             |
| Lease/sublease payments, net (a)  | (39)                          |
| Balance at September 30, 2015     | \$30                          |

(a) Includes lease conversion cost payments

## 7. COMMITMENTS AND CONTINGENCIES

### Fort Lauderdale-Hollywood International Airport

In December 2013, the Company entered into an agreement with Broward County, Florida, which owns and operates Fort Lauderdale-Hollywood International Airport, to oversee and manage the design and construction of the airport's Terminal 1 Modernization Project at a cost not to exceed \$295 million. In addition to significant improvements to the existing Terminal 1, the project includes the design and construction of a new five-gate Concourse A with an international processing facility. Funding for the project will come directly from Broward County sources, but will flow through the Company in its capacity as manager of the project. Major construction on the project began during third quarter 2015 and is estimated to be completed during 2017. The Company believes that due to its agreed upon

role in overseeing and managing the project, it is considered the owner of the project for accounting purposes. As such, during construction the Company records expenditures as Assets constructed for others in the unaudited Condensed Consolidated Balance Sheet, along with a corresponding outflow within Assets constructed for others in the unaudited Condensed Consolidated Statement of Cash Flows, and an increase to Construction obligation (with a corresponding cash inflow from Financing activities in the unaudited Condensed Consolidated Statement of Cash Flows) as reimbursements are

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received from Broward County. As of September 30, 2015, the Company had recorded construction costs related to the project of \$17 million.

Houston William P. Hobby Airport

The Company entered into a Memorandum of Agreement (“MOA”) with the City of Houston (“City”), effective June 2012, to expand the existing Houston Hobby airport facility. As provided in the MOA, the Company and the City have entered into an Airport Use and Lease Agreement (“Lease”) to control the execution of this expansion and the financial terms thereof. Per the MOA and Lease, this project provides for a new five-gate international terminal with international passenger processing facilities, expansion of the existing security checkpoint, and upgrades to the Southwest Airlines ticket counter area. The project was estimated to cost \$156 million, and the Company agreed to provide the funding for, as well as management over, the project. In return, the capital cost portion of the rent the Company pays for the international facility will be waived from the initial occupancy until the expiration of the Lease. However, after completion of the project, the City has the option to buy out the Company's investment at the then-unamortized cost of the facility. This purchase would trigger payment of the previously waived capital cost component of rents owed the City. Additionally, some portion of the project is expected to qualify for rental credits that would be utilized upon completion of the facility against the Company's lease payments at the airport. Construction began during third quarter 2013 and was effectively completed in October 2015, on time and under budget, at which time the Company began operating from the new facility.

As a result of its significant involvement in the Houston Hobby project, the Company has evaluated its ongoing accounting requirements in consideration of accounting guidance provided for lessees involved in asset construction, and has determined that it is the owner of the facility for accounting purposes during the construction period. As such, during construction, the Company records expenditures as Assets constructed for others in the unaudited Condensed Consolidated Balance Sheet, along with a corresponding outflow within Assets constructed for others, in the unaudited Condensed Consolidated Statement of Cash Flows. As of September 30, 2015, the Company had recorded construction costs related to Houston Hobby of \$128 million.

Los Angeles International Airport

In March 2013, the Company executed a lease agreement with Los Angeles World Airports (“LAWA”), which owns and operates Los Angeles International Airport. Under the lease agreement, which was amended in June 2014, the Company is overseeing and managing the design, development, financing, construction and commissioning of the airport's Terminal 1 Modernization Project (the “Project”) at a cost not to exceed \$526 million. The Project is being funded primarily using the Regional Airports Improvement Corporation (“RAIC”), which is a quasi-governmental special purpose entity that acts as a conduit borrower under a syndicated credit facility provided by a group of lenders. Loans made under the credit facility are being used to fund the development of the Project, and the outstanding loans will be repaid with the proceeds of LAWA's payments to purchase completed Project phases. The Company has guaranteed the obligations of the RAIC under the credit facility. Construction on the Project began during 2014 and is estimated to be completed during 2018. The Company believes that due to its agreed upon role in overseeing and managing the Project, it is considered the owner of the Project for accounting purposes. LAWA will reimburse the Company for the non-proprietary renovations, while the Company will not be reimbursed for proprietary renovations. As a result, all of the costs incurred to fund the Project are included within Assets constructed for others and all amounts that have been or will be reimbursed will be included within Construction obligation on the accompanying unaudited Condensed Consolidated Balance Sheet. As of September 30, 2015, the Company had recorded construction costs related to the Project of \$151 million, which were classified and included in Assets constructed for others and as Construction obligation in the accompanying unaudited Condensed Consolidated Balance Sheet.

Dallas Love Field

During 2008, the City of Dallas approved the Love Field Modernization Program (“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 “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 commenced during 2010, and the project was effectively completed by December 31, 2014. The project consists of the complete replacement of gate facilities with

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a new 20-gate facility, including infrastructure, systems and equipment, aircraft parking apron, fueling system, roadways and terminal curbside, baggage handling systems, passenger loading bridges and support systems, and other supporting infrastructure. New ticketing and check-in areas opened during fourth quarter 2012, 12 new gates and new concessions opened in 2013, and the remaining gates opened during October 2014.

Although the City of Dallas has received commitments from various sources that are helping 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 are from the issuance of bonds. During fourth quarter 2010, \$310 million of such bonds were issued by the LFAMC, and the Company has guaranteed principal and interest payments on the bonds. An additional tranche of such bonds totaling \$146 million was issued during second quarter 2012, and the Company has guaranteed the principal and interest payments on these bonds as well. The Company currently expects that as a result of the funding commitments from the above mentioned sources and the bonds that have been issued thus far, no further bond issuances and related guarantees from the Company will be required to complete the LFMP project.

In conjunction with the Company's significant presence at Dallas Love Field and other factors, the Company agreed to manage the LFMP project. Based on these facts, the Company has evaluated its ongoing accounting requirements in consideration of accounting guidance provided for lessees involved in asset construction. The Company has recorded and will continue to record an asset and corresponding obligation for the cost of the LFMP project as the construction of the facility occurs. As of September 30, 2015, the Company had recorded LFMP gross construction costs, including capitalized interest, of \$527 million within Assets constructed for others and had recorded a net liability of \$516 million within Construction obligation in its unaudited Condensed Consolidated Balance Sheet. Upon completion of different phases of the LFMP project, the Company has placed the associated assets in service and has begun depreciating the assets over their estimated useful lives. In addition, upon the effective completion of construction, the Company noted the project assets did not meet the qualifications for sale and leaseback accounting due to the Company's continuing involvement with the facility, as defined; therefore, for financial reporting purposes, these assets will remain on the Company's books until the bonds issued by the City of Dallas are repaid. The corresponding LFMP liabilities will be reduced primarily through the Company's airport rental payments to the City of Dallas as the construction costs of the project are passed through to the Company via recurring airport rates and charges. These payments are reflected as Repayment of construction obligation in the unaudited Condensed Consolidated Statement of Cash Flows.

#### Contingencies

The Company is from time to time subject to various legal proceedings and claims arising in the ordinary course of business, including, but not limited to, examinations by the IRS. The Company's management does not expect that the outcome in any of its currently ongoing legal proceedings or the outcome of any adjustments presented by the IRS, individually or collectively, will have a material adverse effect on the Company's financial condition, results of operations, or cash flow.

#### 8. 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 September 30, 2015, 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 and certificates of deposit), certain noncurrent investments, interest rate derivative contracts, fuel derivative contracts, and available-for-sale securities. The majority of the Company's short-term investments consist of instruments classified as Level 1. However, the Company has certificates of deposit, commercial paper, and Eurodollar 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. Noncurrent investments consist of certain auction rate securities, primarily those collateralized by student loan portfolios, which are guaranteed by the U.S. Government. Other available-for-sale securities primarily consist of investments 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 include swaps, as well as different types of option contracts, whereas interest rate derivatives consist solely of swap agreements. See Note 3 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 the same 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 excess benefit plan which consist of investment funds for which market prices are readily available. This plan is a non-qualified deferred compensation plan designed to hold Employee contributions in excess of limits established by Section 415 of the Internal Revenue Code of 1986, as amended. Payments under this plan are made based on the participant's distribution election and plan balance. Assets related to the funded portion of the deferred compensation plan are held in a rabbi trust, and the Company remains liable to these participants for the unfunded portion of the plan. The Company records changes in the fair value of the asset in the Company's earnings.

All of the Company's auction rate security instruments, totaling \$27 million (net) at September 30, 2015, are classified as available-for-sale securities and are reflected at their estimated fair value in the unaudited Condensed Consolidated

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Balance Sheet. The Company's Treasury Department determines the estimated fair values of these securities utilizing a discounted cash flow analysis. The Company has performed, and routinely updates, a valuation for each of its auction rate security instruments, considering, among other items, the collateralization underlying the security investments, the expected future cash flows, including the final maturity, associated with the securities, estimates of the next time the security is expected to have a successful auction or return to full par value, forecasted reset rates based on the LIBOR or the issuer's net loan rate, and a counterparty credit spread. To validate the reasonableness of the Company's discounted cash flow analyses, the Company compares its valuations to third party valuations on a quarterly basis.

The following tables present the Company's assets and liabilities that are measured at fair value on a recurring basis at September 30, 2015, and December 31, 2014:

| Description                         | September 30, 2015<br>(in millions) | Fair value measurements at reporting date using:                        |  |  |
|-------------------------------------|-------------------------------------|---|--|--|
|                                     |                                     | Quoted prices in<br>active markets<br>for identical assets<br>(Level 1) | Significant<br>other observable<br>inputs<br>(Level 2) | Significant<br>unobservable<br>inputs<br>(Level 3) |
| <b>Assets</b>                       |                                     |   |  |  |
| Cash equivalents                    |                                     |   |  |  |
| Cash equivalents (a)                | \$1,528                             | \$1,528   | \$—  | \$—  |
| Commercial paper                    | 125                                 | —   | 125  | —  |
| Certificates of deposit             | 25                                  | —   | 25   | —  |
| Eurodollar time deposits            | 62                                  | —   | 62   | —  |
| Short-term investments:             |                                     |   |  |  |
| Treasury bills                      | 1,149                               | 1,149   | —  | —  |
| Certificates of deposit             | 207                                 | —   | 207  | —  |
| Noncurrent investments (b)          |                                     |   |  |  |
| Auction rate securities             | 27                                  | —   | —  | 27   |
| Interest rate derivatives           | 6                                   | —   | 6  | —  |
| Fuel derivatives:                   |                                     |   |  |  |
| Swap contracts (c)                  | 818                                 | —   | 818  | —  |
| Option contracts (c)                | 912                                 | —   | —  | 912  |
| Other available-for-sale securities | 62                                  | 62  | —  | —  |
| <b>Total assets</b>                 | <b>\$4,921</b>                      | <b>\$2,739</b>  | <b>\$1,243</b>   | <b>\$939</b>                                       |
| <b>Liabilities</b>                  |                                     |   |  |  |
| Fuel derivatives:                   |                                     |   |  |  |
| Swap contracts (c)                  | \$(679)                             | ) \$—   | \$(679)  | ) \$—  |
| Option contracts (c)                | (2,281)                             | ) —   | —  | ) (2,281)  |
| Interest rate derivatives           | (54)                                | ) —   | (54)   | ) —  |
| <b>Total liabilities</b>            | <b>\$(3,014)</b>                    | <b>) \$—</b>  | <b>\$(733)</b>   | <b>) \$(2,281)</b>                                 |

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

(b) Noncurrent investments are included in Other assets in the unaudited Condensed Consolidated Balance Sheet.

(c) In the unaudited Condensed Consolidated Balance Sheet amounts are presented as a net liability.

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| Description                         | December 31, 2014<br>(in millions) | Fair value measurements at reporting date using:                        |  |  |
|-------------------------------------|------------------------------------|---|--|--|
|                                     |                                    | Quoted prices in<br>active markets<br>for identical assets<br>(Level 1) | Significant<br>other observable<br>inputs<br>(Level 2) | Significant<br>unobservable<br>inputs<br>(Level 3) |
| <b>Assets</b>                       |                                    |   |  |  |
| Cash equivalents                    |                                    |   |  |  |
| Cash equivalents (a)                | \$1,110                            | \$1,110   | \$—  | \$—  |
| Commercial paper                    | 70                                 | —   | 70   | —  |
| Certificates of deposit             | 4                                  | —   | 4  | —  |
| Eurodollar time deposits            | 98                                 | —   | 98   | —  |
| <b>Short-term investments:</b>      |                                    |   |  |  |
| Treasury bills                      | 1,450                              | 1,450   | —  | —  |
| Certificates of deposit             | 256                                | —   | 256  | —  |
| <b>Noncurrent investments (b)</b>   |                                    |   |  |  |
| Auction rate securities             | 27                                 | —   | —  | 27   |
| Interest rate derivatives           | 13                                 | —   | 13   | —  |
| <b>Fuel derivatives:</b>            |                                    |   |  |  |
| Swap contracts (c)                  | 455                                | —   | 455  | —  |
| Option contracts (c)                | 892                                | —   | —  | 892  |
| Other available-for-sale securities | 68                                 | 63  | —  | 5  |
| <b>Total assets</b>                 | <b>\$4,443</b>                     | <b>\$2,623</b>  | <b>\$896</b>   | <b>\$924</b>                                       |
| <b>Liabilities</b>                  |                                    |   |  |  |
| <b>Fuel derivatives:</b>            |                                    |   |  |  |
| Swap contracts (c)                  | \$(365)                            | ) \$—   | \$(365)  | ) \$—  |
| Option contracts (c)                | (1,983)                            | ) —   | —  | ) (1,983)  |
| Interest rate derivatives           | (61)                               | ) —   | (61)   | ) —  |
| <b>Total liabilities</b>            | <b>\$(2,409)</b>                   | <b>) \$—</b>  | <b>\$(426)</b>   | <b>) \$(1,983)</b>                                 |

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

(b) Noncurrent investments are included in Other assets in the unaudited Condensed Consolidated Balance Sheet.

(c) In the unaudited Condensed Consolidated Balance Sheet amounts are presented as a net liability.



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The Company had no transfers of assets or liabilities between any of the above levels during the nine months ended September 30, 2015, or the year ended December 31, 2014. 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 the three and nine months ended September 30, 2015:

| (in millions)   | Fair value measurements using significant unobservable inputs (Level 3) |                         |                  |            |
|---|---|-------------------------|------------------|------------|
|   | Fuel derivatives  | Auction rate securities | Other securities | Total      |
| Balance at June 30, 2015  | \$(1,055 )  | \$27                    | \$—              | \$(1,028 ) |
| Total losses (realized or unrealized)   |   |                         |                  |            |
| Included in earnings  | (405 )  | —                       | —                | (405 )     |
| Included in other comprehensive income  | (488 )  | —                       | —                | (488 )     |
| Purchases   | 408 (a)   | —                       | —                | 408        |
| Sales   | (11 ) (a)   | —                       | —                | (11 )      |
| Settlements   | 182   | —                       | —                | 182        |
| Balance at September 30, 2015   | \$(1,369 )  | \$27                    | (b) \$—          | \$(1,342 ) |
| The amount of total losses for the period included in earnings attributable to the change in unrealized gains or losses relating to assets still held at September 30, 2015 | \$(317 )  | \$—                     | \$—              | \$(317 )   |

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

(b) Included in Other assets in the unaudited Condensed Consolidated Balance Sheet.

| (in millions)   | Fair value measurements using significant unobservable inputs (Level 3) |                         |                  |            |
|---|---|-------------------------|------------------|------------|
|   | Fuel derivatives  | Auction rate securities | Other securities | Total      |
| Balance at December 31, 2014  | \$(1,091 )  | \$27                    | \$5              | \$(1,059 ) |
| Total losses (realized or unrealized)   |   |                         |                  |            |
| Included in earnings  | (413 )  | —                       | (1 )             | (414 )     |
| Included in other comprehensive income  | (517 )  | —                       | —                | (517 )     |
| Purchases   | 652 (a)   | —                       | —                | 652        |
| Sales   | (182 ) (a)  | —                       | (4 )             | (186 )     |
| Settlements   | 182   | —                       | —                | 182        |
| Balance at September 30, 2015   | \$(1,369 )  | \$27                    | (b) \$—          | \$(1,342 ) |
| The amount of total losses for the period included in earnings attributable to the change in unrealized gains or losses relating to assets still held at September 30, 2015 | \$(324 )  | \$—                     | \$—              | \$(324 )   |

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

(b) Included in Other assets in the unaudited Condensed Consolidated Balance Sheet.

The significant unobservable input used in the fair value measurement of the Company's derivative option contracts is implied volatility. Holding other inputs constant, a significant increase (decrease) in implied volatility would result in a significantly higher (lower) fair value measurement, respectively, for the Company's derivative option contracts. The significant unobservable inputs used in the fair value measurement of the Company's auction rate securities are time to principal recovery, an illiquidity premium, and counterparty credit spread. Holding other inputs constant, a

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significant increase (decrease) in such unobservable inputs would result in a significantly lower (higher) fair value measurement, respectively.

The following table presents a range of the unobservable inputs utilized in the fair value measurements of the Company's assets and liabilities classified as Level 3 at September 30, 2015:

Quantitative information about Level 3 fair value measurements

|                         | Valuation technique  | Unobservable input         | Period (by year)    | Range   |
|-------------------------|----------------------|----------------------------|---------------------|---------|
| Fuel derivatives        | Option model         | Implied volatility         | Fourth quarter 2015 | 21-41%  |
|                         |                      |                            | 2016                | 24-41%  |
|                         |                      |                            | 2017                | 22-34%  |
|                         |                      |                            | 2018                | 16-29%  |
| Auction rate securities | Discounted cash flow | Time to principal recovery |                     | 8 years |
|                         |                      | Illiquidity premium        |                     | 3-4%    |
|                         |                      | Counterparty credit spread |                     | 1-2%    |

The carrying amounts and estimated fair values of the Company's long-term debt (including current maturities), as well as the applicable fair value hierarchy tier, at September 30, 2015, 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. Six of the Company's debt agreements are not publicly held. 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 |
|--|----------------|----------------------|----------------------------|
| 5.75% Notes due 2016                                       | \$308          | \$324                | Level 2                    |
| 5.25% Convertible Senior Notes due 2016                    | 112            | 294                  | Level 2                    |
| 5.125% Notes due 2017                                      | 310            | 326                  | Level 2                    |
| French Credit Agreements due 2018 - 1.15%                  | 31             | 31                   | Level 3                    |
| Fixed-rate 737 Aircraft Notes payable through 2018 - 7.02% | 18             | 19                   | Level 3                    |
| 2.75% Notes due 2019                                       | 308            | 313                  | Level 2                    |
| Term Loan Agreement due 2019 - 6.315%                      | 152            | 158                  | Level 3                    |
| Term Loan Agreement due 2019 - 4.84%                       | 36             | 38                   | Level 3                    |
| Term Loan Agreement due 2020 - 5.223%                      | 340            | 337                  | Level 3                    |
| Floating-rate 737 Aircraft Notes payable through 2020      | 267            | 261                  | Level 3                    |
| Pass Through Certificates due 2022 - 6.24%                 | 339            | 380                  | Level 2                    |
| 7.375% Debentures due 2027                                 | 132            | 160                  | Level 2                    |

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## 9. NET INCOME PER SHARE

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

|  | Three months ended<br>September 30, |        | Nine months ended<br>September 30, |        |
|--|-------------------------------------|--------|------------------------------------|--------|
|  | 2015                                | 2014   | 2015                               | 2014   |
| <b>NUMERATOR:</b>  |                                     |        |                                    |        |
| Net income   | \$584                               | \$329  | \$1,645                            | \$946  |
| Incremental income effect of interest on 5.25% convertible notes     | 1                                   | 1      | 3                                  | 3      |
| Net income after assumed conversion                                  | \$585                               | \$330  | \$1,648                            | \$949  |
| <b>DENOMINATOR:</b>  |                                     |        |                                    |        |
| Weighted-average shares outstanding, basic                           | 655                                 | 683    | 665                                | 690    |
| Dilutive effect of Employee stock options and restricted stock units | 2                                   | 2      | 2                                  | 3      |
| Dilutive effect of 5.25% convertible notes                           | 6                                   | 6      | 6                                  | 6      |
| Adjusted weighted-average shares outstanding, diluted                | 663                                 | 691    | 673                                | 699    |
| <b>NET INCOME PER SHARE:</b>   |                                     |        |                                    |        |
| Basic  | \$0.89                              | \$0.48 | \$2.47                             | \$1.37 |
| Diluted  | \$0.88                              | \$0.48 | \$2.45                             | \$1.36 |

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

Relevant comparative operating statistics for the three and nine months ended September 30, 2015 and 2014 are included below. The Company provides these operating statistics because they are commonly used in the airline industry and, as such, allow readers to compare the Company's performance against its results for the prior year period, as well as against the performance of the Company's peers.

|  | Three months ended September 30, |            | Change |     |
|--|----------------------------------|------------|--------|-----|
|  | 2015                             | 2014       |        |     |
| Revenue passengers carried   | 30,559,019                       | 28,391,882 | 7.6    | %   |
| Enplaned passengers  | 37,765,903                       | 35,255,248 | 7.1    | %   |
| Revenue passenger miles (RPMs) (000s) <sup>(1)</sup>                 | 31,052,660                       | 28,522,164 | 8.9    | %   |
| Available seat miles (ASMs) (000s) <sup>(2)</sup>                    | 36,360,340                       | 33,785,824 | 7.6    | %   |
| Load factor <sup>(3)</sup>   | 85.4                             | % 84.4     | % 1.0  | pts |
| Average length of passenger haul (miles)                             | 1,016                            | 1,005      | 1.1    | %   |
| Average aircraft stage length (miles)                                | 754                              | 728        | 3.6    | %   |
| Trips flown  | 325,301                          | 319,250    | 1.9    | %   |
| Seats flown <sup>(4)</sup>   | 47,470,059                       | 45,824,276 | 3.6    | %   |
| Seats per trip <sup>(5)</sup>  | 145.93                           | 143.54     | 1.7    | %   |
| Average passenger fare <sup>(11)</sup>                               | \$ 154.33                        | \$ 160.74  | (4.0)  | %   |
| Passenger revenue yield per RPM (cents) <sup>(6)(11)</sup>           | 15.19                            | 16.00      | (5.1)  | %   |
| Operating revenues per ASM (cents) <sup>(7)</sup>                    | 14.15                            | 14.21      | (0.4)  | %   |
| Passenger revenue per ASM (cents) <sup>(8)(11)</sup>                 | 12.97                            | 13.51      | (4.0)  | %   |
| Operating expenses per ASM (cents) <sup>(9)</sup>                    | 11.26                            | 12.39      | (9.1)  | %   |
| Operating expenses per ASM, excluding fuel (cents)                   | 8.68                             | 8.29       | 4.7    | %   |
| Operating expenses per ASM, excluding fuel and profitsharing (cents) | 8.19                             | 7.99       | 2.5    | %   |
| Fuel costs per gallon, including fuel tax                            | \$ 1.89                          | \$ 2.97    | (36.4) | %   |
| Fuel costs per gallon, including fuel tax, economic                  | \$ 2.20                          | \$ 2.94    | (25.2) | %   |
| Fuel consumed, in gallons (millions)                                 | 493                              | 466        | 5.8    | %   |
| Active fulltime equivalent Employees                                 | 48,642                           | 45,750     | 6.3    | %   |
| Aircraft at end of period <sup>(10)</sup>                            | 692                              | 685        | 1.0    | %   |

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|  | Nine months ended September 30, |             |        | Change |     |
|--|---------------------------------|-------------|--------|--------|-----|
|  | 2015                            | 2014        |        |        |     |
| Revenue passengers carried   | 87,802,757                      | 82,602,805  | 6.3    | %      |     |
| Enplaned passengers  | 107,535,145                     | 101,701,969 | 5.7    | %      |     |
| Revenue passenger miles (RPMs) (000s) <sup>(1)</sup>                 | 87,771,907                      | 81,267,478  | 8.0    | %      |     |
| Available seat miles (ASMs) (000s) <sup>(2)</sup>                    | 105,133,835                     | 98,356,618  | 6.9    | %      |     |
| Load factor <sup>(3)</sup>   | 83.5                            | % 82.6      | % 0.9  |        | pts |
| Average length of passenger haul (miles)                             | 1,000                           | 984         | 1.6    | %      |     |
| Average aircraft stage length (miles)                                | 750                             | 721         | 4.0    | %      |     |
| Trips flown  | 948,180                         | 946,231     | 0.2    | %      |     |
| Seats flown <sup>(4)</sup>   | 138,326,878                     | 135,033,197 | 2.4    | %      |     |
| Seats per trip <sup>(5)</sup>  | 145.89                          | 142.71      | 2.2    | %      |     |
| Average passenger fare <sup>(11)</sup>                               | \$ 156.55                       | \$ 160.39   | (2.4)  | %      |     |
| Passenger revenue yield per RPM (cents) <sup>(6)(11)</sup>           | 15.66                           | 16.30       | (3.9)  | %      |     |
| Operating revenues per ASM (cents) <sup>(7)</sup>                    | 13.95                           | 14.21       | (1.8)  | %      |     |
| Passenger revenue per ASM (cents) <sup>(8)(11)</sup>                 | 13.07                           | 13.47       | (3.0)  | %      |     |
| Operating expenses per ASM (cents) <sup>(9)</sup>                    | 11.18                           | 12.58       | (11.1) | %      |     |
| Operating expenses per ASM, excluding fuel (cents)                   | 8.50                            | 8.38        | 1.4    | %      |     |
| Operating expenses per ASM, excluding fuel and profitsharing (cents) | 8.04                            | 8.12        | (1.0)  | %      |     |
| Fuel costs per gallon, including fuel tax                            | \$ 1.98                         | \$ 3.03     | (34.7) | %      |     |
| Fuel costs per gallon, including fuel tax, economic                  | \$ 2.08                         | \$ 3.01     | (30.9) | %      |     |
| Fuel consumed, in gallons (millions)                                 | 1,420                           | 1,357       | 4.6    | %      |     |
| Active fulltime equivalent Employees                                 | 48,642                          | 45,750      | 6.3    | %      |     |
| Aircraft at period-end <sup>(10)</sup>                               | 692                             | 685         | 1.0    | %      |     |

(1) A revenue passenger mile is one paying passenger flown one mile. Also referred to as "traffic," which is a measure of demand for a given period.

(2) An available seat mile is one seat (empty or full) flown one mile. Also referred to as "capacity," which is a measure of the space available to carry passengers in a given period.

(3) Revenue passenger miles divided by available seat miles.

(4) Seats flown is calculated using total number of seats available by aircraft type multiplied by the total trips flown by the same aircraft type during a particular period.

(5) Seats per trip is calculated using seats flown divided by trips flown. Also referred to as "gauge."

(6) Calculated as passenger revenue divided by revenue passenger miles. Also referred to as "yield," this is the average cost paid by a paying passenger to fly one mile, which is a measure of revenue production and fares.

(7) Calculated as operating revenues, excluding special items, divided by available seat miles. Also referred to as "operating unit revenues," this is a measure of operating revenue production based on the total available seat miles flown during a particular period. Third quarter 2015 RASM excludes a \$172 million one-time non-cash special revenue adjustment. Additional information regarding this special item is provided in the Note Regarding Use of Non-GAAP Financial Measures and a reconciliation of revenue excluding special items related to accounting changes in the accompanying pages.

(8) Calculated as passenger revenue divided by available seat miles. Also referred to as "passenger unit revenues," this is a measure of passenger revenue production based on the total available seat miles flown during a particular period.

(9) Calculated as operating expenses divided by available seat miles. Also referred to as "unit costs" or "cost per available seat mile," this is the average cost to fly an aircraft seat (empty or full) one mile, which is a measure of cost efficiencies.

(10) Aircraft in the Company's fleet at period end, less Boeing 717-200s removed from service in preparation for transition out of the fleet.

(11) Refer to Note 2 to the unaudited Condensed Consolidated Financial Statements for additional information regarding the impact from the July 2015 amended co-branded credit card agreement with Chase.

Reconciliation of Reported Amounts to Non-GAAP Financial Measures (unaudited)  
(in millions, except per share and per ASM amounts)

|   | Three months ended |         | Percent<br>Change | Nine months ended |          | Percent<br>Change |
|---|--------------------|---------|-------------------|-------------------|----------|-------------------|
|   | September 30,      |         |                   | September 30,     |          |                   |
|   | 2015               | 2014    |                   | 2015              | 2014     |                   |
| Total operating revenues, as reported   | \$5,318            | \$4,800 |                   | \$14,843          | \$13,977 |                   |
| Deduct: Special revenue adjustment  | (172 )             | —       |                   | (172 )            | —        |                   |
| Operating Revenues, Non-GAAP  | \$5,146            | \$4,800 | 7.2%              | \$14,671          | \$13,977 | 5.0%              |
| Fuel and oil expense, unhedged  | \$843              | \$1,395 |                   | \$2,634           | \$4,171  |                   |
| Add (Deduct): Fuel hedge (gains) losses included in Fuel and oil expense  | 93                 | (9 )    |                   | 184               | (46 )    |                   |
| Fuel and oil expense, as reported   | \$936              | \$1,386 |                   | \$2,818           | \$4,125  |                   |
| Add (Deduct): Net impact from fuel contracts  | 152                | (12 )   |                   | 143               | (27 )    |                   |
| Fuel and oil expense, non-GAAP (economic)   | \$1,088            | \$1,374 | (20.8)%           | \$2,961           | \$4,098  | (27.7)%           |
| Total operating expenses, as reported   | \$4,093            | \$4,186 |                   | \$11,753          | \$12,372 |                   |
| Add (Deduct): Reclassification between Fuel and oil and Other (gains) losses, net, associated with current period settled contracts | 61                 | (5 )    |                   | 61                | (5 )     |                   |
| Add (Deduct): Contracts settling in the current period, but for which gains have been recognized in a prior period*                 | 91                 | (7 )    |                   | 82                | (22 )    |                   |
| Deduct: Acquisition and integration costs   | (6 )               | (23 )   |                   | (32 )             | (78 )    |                   |
| Add: Litigation settlement  | —                  | —       |                   | 37                | —        |                   |
| Deduct: Labor ratification bonuses  | (140 )             | —       |                   | (195 )            | —        |                   |
| Total operating expenses, non-GAAP  | \$4,099            | \$4,151 | (1.3)%            | \$11,706          | \$12,267 | (4.6)%            |
| Operating income, as reported   | \$1,225            | \$614   |                   | \$3,090           | \$1,605  |                   |
| Add (Deduct): Reclassification between Fuel and oil and Other (gains) losses, net, associated with current period settled contracts | (61 )              | 5       |                   | (61 )             | 5        |                   |
| Add (Deduct): Contracts settling in the current period, but for which gains have been recognized in a prior period*                 | (91 )              | 7       |                   | (82 )             | 22       |                   |
| Add: Acquisition and integration costs  | 6                  | 23      |                   | 32                | 78       |                   |
| Deduct: Litigation settlement   | —                  | —       |                   | (37 )             | —        |                   |
| Add: Labor ratification bonuses   | 140                | —       |                   | 195               | —        |                   |
| Deduct: Special revenue adjustment  | (172 )             | —       |                   | (172 )            | —        |                   |
| Operating income, non-GAAP  | \$1,047            | \$649   | 61.3%             | \$2,965           | \$1,710  | 73.4%             |





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|  | Three months ended |         | Percent | Nine months ended |         | Percent |
|--|--------------------|---------|---------|-------------------|---------|---------|
|  | September 30,      |         |         | September 30,     |         |         |
|  | 2015               | 2014    | Change  | 2015              | 2014    | Change  |
| Net income, as reported  | \$584              | \$329   |         | \$1,645           | \$946   |         |
| Add: Mark-to-market impact from fuel contracts settling in future periods  | 179                | 44      |         | 271               | 5       |         |
| Add (Deduct): Ineffectiveness from fuel hedges settling in future periods  | (1                 | ) 11    |         | (16               | ) (31   | )       |
| Add (Deduct): Other net impact of fuel contracts settling in the current or a prior period (excluding reclassifications) | (91                | ) 7     |         | (82               | ) 22    |         |
| Add (Deduct): Income tax impact of fuel contracts  | (32                | ) (23   | )       | (65               | ) 2     |         |
| Add: Acquisition and integration costs (a)   | 4                  | 14      |         | 20                | 49      |         |
| Deduct: Litigation settlement (a)  | —                  | —       |         | (23               | ) —     |         |
| Add: Labor ratification bonuses (a)  | 88                 | —       |         | 122               | —       |         |
| Deduct: Special revenue adjustment (a)   | (108               | ) —     |         | (108              | ) —     |         |
| Net income, non-GAAP   | \$623              | \$382   | 63.1%   | \$1,764           | \$993   | 77.6%   |
| Net income per share, diluted, as reported   | \$0.88             | \$0.48  |         | \$2.45            | \$1.36  |         |
| Add (Deduct): Net impact to net income above from fuel contracts divided by dilutive shares (a)                          | 0.08               | 0.05    |         | 0.15              | (0.01   | )       |
| Add (Deduct): Impact of special items (a)  | (0.02              | ) 0.02  |         | 0.03              | 0.07    |         |
| Net income per share, diluted, non-GAAP  | \$0.94             | \$0.55  | 70.9%   | \$2.63            | \$1.42  | 85.2%   |
| Operating expenses per ASM (cents)   | 11.26              | ¢ 12.39 | ¢       | 11.18             | ¢ 12.58 | ¢       |
| Deduct: Fuel and oil expense divided by ASMs   | (2.58              | ) (4.10 | )       | (2.68             | ) (4.20 | )       |
| Deduct: Impact of special items  | (0.40              | ) (0.07 | )       | (0.19             | ) (0.08 | )       |
| Operating expenses per ASM, non-GAAP, excluding Fuel and oil and special items (cents)                                   | 8.28               | ¢ 8.22  | ¢ 0.7%  | 8.31              | ¢ 8.30  | ¢ 0.1%  |

\* As a result of prior hedge ineffectiveness and/or contracts marked to market through earnings.

(a) Amounts net of tax.

Return on Invested Capital (ROIC) (unaudited)  
(in millions)

|   | Twelve Months Ended<br>September 30, 2015 | Twelve Months Ended<br>September 30, 2014 |   |
|---|---|---|---|
| Operating income, as reported             | \$3,711                                   | \$1,991                                   |   |
| Net impact from fuel contracts            | (142)                                     | 40  | ) |
| Acquisition and integration costs         | 80  | 97  |   |
| Labor ratification bonuses                | 204                                       | —   |   |
| Special revenue adjustment                | (172)                                     | —   | ) |
| Litigation settlement                     | (37)                                      | —   | ) |
| Operating income, non-GAAP                | \$3,644                                   | \$2,128                                   |   |
| Net adjustment for aircraft leases (1)    | 113                                       | 136                                       |   |
| Adjustment for fuel hedge premium expense | (94)                                      | (70)                                      | ) |
| Adjusted Operating income, non-GAAP       | \$3,663                                   | \$2,194                                   |   |
| <br>                                      |   |   |   |
| Average invested capital (2)              | \$11,011                                  | \$11,616                                  |   |
| Equity adjustment for hedge accounting    | 761                                       | (61)                                      | ) |
| Adjusted average invested capital         | \$11,772                                  | \$11,555                                  |   |
| <br>                                      |   |   |   |
| ROIC, pre-tax                             | 31.1                                      | % 19.0                                    | % |

(1) Net adjustment related to presumption that all aircraft in fleet are owned (i.e., the impact of eliminating aircraft rent expense and replacing with estimated depreciation expense for those same aircraft).

(2) Average Invested Capital is an average of the five most recent quarter end balances of debt, net present value of aircraft leases, and equity adjusted for hedge accounting.

#### Note Regarding Use of Non-GAAP Financial Measures

The Company's unaudited Condensed Consolidated Financial Statements are prepared in accordance with accounting principles generally accepted in the United States ("GAAP"). These GAAP financial statements include (i) unrealized non-cash adjustments and reclassifications, which can be significant, as a result of accounting requirements and elections made under accounting pronouncements relating to derivative instruments and hedging and (ii) other charges the Company believes are not indicative of its ongoing operational performance.

As a result, the Company also provides financial information in this filing that was not prepared in accordance with GAAP and should not be considered as an alternative to the information prepared in accordance with GAAP. The Company provides supplemental non-GAAP financial information, including results that it refers to as "economic," which the Company's management utilizes to evaluate its ongoing financial performance and the Company believes provides greater transparency to investors as supplemental information to its GAAP results. The Company's economic financial results differ from GAAP results in that they only include the actual cash settlements from fuel hedge contracts - all reflected within Fuel and oil expense in the period of settlement. Thus, Fuel and oil expense on an economic basis reflects the Company's actual net cash outlays for fuel during the applicable period, inclusive of settled fuel derivative contracts. Any net premium costs paid related to option contracts are reflected as a component of Other (gains) losses, net, for both GAAP and non-GAAP (including economic) purposes in the period of contract settlement. The Company believes these economic results provide a better measure of the impact of the Company's fuel hedges on its operating performance and liquidity since they exclude the unrealized, non-cash adjustments and reclassifications that are recorded in GAAP results in accordance with accounting guidance relating to derivative instruments, and they reflect all cash settlements related to fuel derivative contracts within Fuel and oil expense. This enables the Company's management, as well as investors, to consistently assess the Company's operating performance on a year-over-year or quarter-over-quarter basis after considering all efforts in place to manage fuel expense. However, because these measures are not determined in accordance with GAAP, such measures are susceptible to varying calculations, and not all companies calculate the measures in the same manner. As a result, the aforementioned measures, as presented, may not be directly comparable to similarly titled measures presented by other companies.

Further information on (i) the Company's fuel hedging program, (ii) the requirements of accounting for derivative instruments, and (iii) the causes of hedge ineffectiveness and/or mark-to-market gains or losses from derivative instruments is included in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2014, and Note 3 to the unaudited Condensed Consolidated Financial Statements.

In addition to its "economic" financial measures, as defined above, the Company has also provided other non-GAAP financial measures, including results that it refers to as "excluding special items," as a result of items that the Company believes are not indicative of its ongoing operations. These include a one-time Special revenue adjustment due to the July 2015 amended co-branded credit card agreement (the "Agreement") with Chase Bank USA, N.A. ("Chase") and the resulting change in accounting methodology, expenses associated with the Company's acquisition and integration of AirTran, a gain resulting from a litigation settlement received in January 2015, and collective bargaining ratification bonuses for certain workgroups. The Company believes that evaluation of its financial performance can be enhanced by a presentation of results that exclude the impact of these items in order to evaluate the results on a comparative basis with results in prior periods that do not include such items and as a basis for evaluating operating results in future periods. As a result of the Company's acquisition of AirTran, which closed on May 2, 2011, the Company has incurred substantial charges associated with integration of the two companies. Given that the AirTran integration process has been effectively completed, the Company does not anticipate significant future integration expenditure requirements, but may incur smaller incremental costs associated primarily with the continuing conversion and sublease of the Boeing 717 fleet throughout 2015. See Note 6 to the unaudited Condensed Consolidated Financial Statements. While the Company cannot predict the exact timing or amounts of such charges, it

does expect to treat these charges as special items in its future presentation of non-GAAP results. The Company has also provided return on invested capital, which is a non-GAAP financial measure. The Company believes return on invested capital is a meaningful measure because it quantifies how well the Company generates operating income relative to the capital it has invested in its business. Although return on invested capital is commonly

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used as a measure of capital efficiency, definitions of return on invested capital may differ; therefore, the Company is providing an explanation of its calculation for return on invested capital (before taxes and excluding special items) in the accompanying reconciliation.

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## Financial Overview

The Company recorded third quarter and year-to-date GAAP and non-GAAP results for 2015 and 2014 as follows:

| (in millions, except per share amounts) | Three months ended |        |                | Nine months ended |         |                |   |
|---|--------------------|--------|----------------|-------------------|---------|----------------|---|
|   | September 30,      |        |                | September 30,     |         |                |   |
| GAAP                                    | 2015               | 2014   | Percent Change | 2015              | 2014    | Percent Change |   |
| Operating income                        | \$1,225            | \$614  | 99.5           | % \$3,090         | \$1,605 | 92.5           | % |
| Net income                              | \$584              | \$329  | 77.5           | % \$1,645         | \$946   | 73.9           | % |
| Net income per share, diluted           | \$0.88             | \$0.48 | 83.3           | % \$2.45          | \$1.36  | 80.1           | % |
| Non-GAAP                                |                    |        |                |                   |         |                |   |
| Operating income                        | \$1,047            | \$649  | 61.3           | % \$2,965         | \$1,710 | 73.4           | % |
| Net income                              | \$623              | \$382  | 63.1           | % \$1,764         | \$993   | 77.6           | % |
| Net income per share, diluted           | \$0.94             | \$0.55 | 70.9           | % \$2.63          | \$1.42  | 85.2           | % |

Third quarter 2015 Net income was a Company third quarter record of \$584 million, or \$0.88 per diluted share, a 77.5 percent increase year-over-year. This increase was primarily attributable to a 32.5 percent reduction in fuel expense due to decreases in market prices, coupled with a 10.8 percent increase in Operating revenues, driven by strong demand for low-fare air travel, 7.6 percent year-over-year capacity growth, and the impact of the July 2015 amended Agreement with Chase and the resulting change in accounting methodology. See Note 2 to the unaudited Condensed Consolidated Financial Statements for further information. The Company's Operating expenses decreased 2.2 percent, primarily as a result of lower fuel prices offsetting increases in certain cost categories discussed below under "Material Changes in Results of Operations." Excluding special items in both years, third quarter 2015 non-GAAP Net income was a third quarter record of \$623 million, or \$0.94 per diluted share, a 63.1 percent increase year-over-year. This marked the tenth consecutive quarter during which the Company produced record non-GAAP Net income for the applicable fiscal quarter. Third quarter 2015 Operating income was \$1.2 billion and third quarter 2015 non-GAAP Operating income was \$1.0 billion. Both GAAP and non-GAAP Operating income results were also Company third quarter records and significantly surpassed the prior year performance.

For the twelve months ended September 30, 2015, the Company's exceptional earnings performance, combined with its actions to prudently manage invested capital, produced a 31.1 percent pre-tax Return on invested capital, excluding special items ("ROIC"). This represents a significant increase compared with the Company's pre-tax ROIC of 19.0 percent for the twelve months ended September 30, 2014.

For the nine months ended September 30, 2015, Net income was \$1.6 billion, or \$2.45 per diluted share, a 73.9 percent increase year-over-year, and non-GAAP Net income was \$1.8 billion, or \$2.63 per diluted share, a 77.6 percent increase year-over-year. These increases primarily were due to a 31.7 percent reduction in fuel expense due to decreases in market prices, coupled with a 6.2 percent increase in Operating revenues, driven by strong demand for low-fare air travel, 6.9 percent year-over-year capacity growth, and the impact of the July 2015 amended Agreement with Chase and the resulting change in accounting methodology. Operating expenses for the nine months ended September 30, 2015, decreased 5.0 percent year-over-year as a result of lower jet fuel prices offsetting the increase in Salaries, wages, and benefits, as well as small increases in certain cost categories. Operating income for the nine months ended September 30, 2015, was \$3.1 billion, and non-GAAP Operating income for the nine months ended September 30, 2015, was \$3.0 billion.

See Note Regarding Use of Non-GAAP Financial Measures and the Reconciliation of Reported Amounts to Non-GAAP Financial Measures for additional detail regarding non-GAAP financial measures.



### Company Overview

During third quarter 2015, the Company began daily nonstop service to eight new cities from Dallas Love Field, including Boston, Charlotte, Detroit, Omaha, Philadelphia, Pittsburgh, Raleigh/Durham, and Salt Lake City, marking the Company's most robust schedule ever offered at Dallas Love Field, with 180 daily departures to 50 nonstop destinations. Additionally, during October 2015, the all-new international terminal at Houston Hobby opened and the Company commenced service from Houston Hobby to Mexico (Cancun, Mexico City, Puerto Vallarta, Cabo San Lucas/Los Cabos), Belize City, Belize, and San Jose, Costa Rica.

During September 2015, the Company's Pilots, represented by the Southwest Airlines Pilots' Association, reached a tentative collective-bargaining agreement with the Company. If ratified by the Pilots, the new agreement will become amendable April 1, 2019. The ratification vote is scheduled to close November 4, 2015.

The Company plans to continue its route network and schedule optimization efforts. For 2015, the Company continues to manage to a baseline of roughly 700 aircraft and an approximate seven percent year-over-year increase in ASMs, primarily due to more efficient flying of its existing fleet through increased seats per trip ("gauge") and stage length, with a modest increase in trips. The Company currently expects its fourth quarter 2015 ASMs to increase approximately eight to nine percent, compared with fourth quarter 2014. The Company expects to continue to optimize its network through the addition of new markets and itineraries, while also pruning less profitable flights from its schedule.

During third quarter 2015, the Company took delivery of three pre-owned Boeing 737-700 aircraft from third parties. The Company currently expects to take delivery of an additional six 737-800 aircraft from Boeing and eight pre-owned 737-700 aircraft from other parties during the remainder of 2015. Following AirTran's final passenger service on December 28, 2014, the Company removed all remaining Boeing 717-200 aircraft ("B717s") from service. As of September 30, 2015, 80 of AirTran's 88 B717 aircraft had been delivered to Delta pursuant to a lease/sublease agreement and eight B717 aircraft were undergoing or awaiting conversion in preparation for delivery to Delta. See Note 6 to the unaudited Condensed Consolidated Financial Statements for further information.

During third quarter 2015, the Company continued to return significant value to its Shareholders through a \$500 million accelerated share repurchase program, which was launched in July 2015 with a financial institution in a privately negotiated transaction ("Third Quarter ASR Program") and through dividend payments totaling \$49 million. The Third Quarter ASR Program is expected to be completed on October 30, 2015, and brings total repurchases of common stock in 2015 to nearly \$1.2 billion. The Company has \$700 million remaining under its existing \$1.5 billion share repurchase program. See Part II, Item 2 for further information on the Company's share repurchase authorization.

### Material Changes in Results of Operations

#### Comparison of three months ended September 30, 2015 and September 30, 2014

##### Operating revenues

Passenger revenues for third quarter 2015 increased \$152 million, or 3.3 percent, year-over-year. Holding all other factors constant, the increase was primarily attributable to a 7.6 percent increase in capacity, as strong Customer demand for low-fare air travel enabled the Company to fill the additional seats, as evidenced by a Company record Load factor of 85.4 percent. On a unit basis, Passenger revenue decreased 4.0 percent, year-over-year, largely driven by a 5.1 percent decrease in Passenger revenue yield, year-over-year.

Freight revenues for third quarter 2015 decreased by \$1 million, or 2.2 percent, compared with third quarter 2014, primarily due to a decline in the Company's fuel surcharge per pound as jet fuel prices have decreased. Based on current trends, the Company expects fourth quarter 2015 Freight revenues to remain flat, compared with fourth quarter

2014.

The Company recorded a Special revenue adjustment during third quarter 2015 of \$172 million. This adjustment represented a one-time non-cash reduction to the deferred revenue liability as a result of the July 2015 amended Agreement with Chase and the resulting change in accounting methodology, and is classified as a special item and

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thus excluded from the Company's Non-GAAP financial results. See Note 2 to the unaudited Condensed Consolidated Financial Statements and the Note Regarding Use of Non-GAAP Financial Measures for further information.

Other revenues for third quarter 2015 increased 102.1 percent year-over-year, primarily as a result of the July 2015 amended Agreement with Chase and the resulting change in accounting methodology. The Agreement resulted in an acceleration of the timing of Operating revenues on a prospective basis beginning as of July 1, 2015. The transportation element of the consideration received is now allocated a lower relative value, resulting in a reduction in the revenues classified as Passenger on a prospective basis, and the higher relative value associated with the non-transportation elements results in an increase in the portion of revenues classified as Other within the unaudited Condensed Consolidated Statement of Comprehensive Income; however, the precise revenue impact for future periods is not determinable until the volume of future transactions for the period is known. Ancillary revenues increased slightly year-over-year primarily due to an increase in Southwest Airlines ancillary revenues, such as EarlyBird Check-in® and A1-15 select boarding positions sold at the gate, which was partially offset by the decrease in revenues from the termination of AirTran passenger service and related ancillary fees. See Note 2 to the unaudited Condensed Consolidated Financial Statements for further information.

While some yield softness has continued into October, demand for low-fare air travel, thus far, remains strong. Based on favorable booking and revenue trends, and including the approximate \$130 million estimated fourth quarter 2015 effect of the amended Agreement with Chase and the resulting change in accounting methodology, the Company is currently expecting fourth quarter 2015 operating unit revenues to increase approximately one percent from fourth quarter 2014.

#### Operating expenses

Operating expenses for third quarter 2015 decreased by \$93 million, or 2.2 percent, compared with third quarter 2014, while capacity increased 7.6 percent over the same period. Historically, except for changes in the price of fuel, changes in Operating expenses for airlines have been driven by changes in capacity, or ASMs. The following table presents the Company's Operating expenses per ASM for the third quarter of 2015 and 2014, followed by explanations of these changes on a per ASM basis and dollar basis:

| (in cents, except for percentages) | Three months ended September 30, |         | Per ASM<br>change | Percent<br>change |    |
|------------------------------------|----------------------------------|---------|-------------------|-------------------|----|
|                                    | 2015                             | 2014    |                   |                   | %  |
| Salaries, wages, and benefits      | 4.67                             | ¢ 4.04  | ¢ 0.63            | ¢ 15.6            | %  |
| Fuel and oil                       | 2.58                             | 4.10    | (1.52)            | ) (37.1           | )  |
| Maintenance materials and repairs  | 0.71                             | 0.73    | (0.02)            | ) (2.7            | )  |
| Aircraft rentals                   | 0.16                             | 0.21    | (0.05)            | ) (23.8           | )  |
| Landing fees and other rentals     | 0.83                             | 0.86    | (0.03)            | ) (3.5            | )  |
| Depreciation and amortization      | 0.71                             | 0.70    | 0.01              | 1.4               |    |
| Acquisition and integration        | 0.02                             | 0.07    | (0.05)            | ) (71.4           | )  |
| Other operating expenses           | 1.58                             | 1.68    | (0.10)            | ) (6.0            | )  |
| Total                              | 11.26                            | ¢ 12.39 | ¢ (1.13           | )¢ (9.1           | )% |

Operating expenses per ASM decreased 9.1 percent for third quarter 2015 compared with third quarter 2014 primarily due to lower jet fuel prices. Operating expenses per ASM for third quarter 2015, excluding fuel and special items (a non-GAAP financial measure), increased 0.7 percent year-over-year primarily due to higher Salaries, wages, and benefits expense, partially offset by decreases in certain cost categories discussed below. Based on current cost trends, the Company expects its unit costs, excluding fuel and oil expense, profitsharing expense, and special items for fourth quarter 2015 to be comparable to fourth quarter 2014. See Note Regarding Use of Non-GAAP Financial Measures and the Reconciliation of Reported Amounts to Non-GAAP Financial Measures for additional detail regarding non-GAAP

financial measures.

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Salaries, wages, and benefits expense for third quarter 2015 increased by \$336 million, or 24.7 percent, compared with third quarter 2014. On a per ASM basis, third quarter 2015 Salaries, wages, and benefits expense increased 15.6 percent, compared with third quarter 2014. On both a dollar and per ASM basis, approximately 65 percent of the increase was the result of higher salaries, primarily due to increased training, additional headcount, contractual increases, and the proposed ratification bonuses included in the tentative collective-bargaining agreement reached with the Company's Pilots. On both a dollar and per ASM basis, approximately 25 percent of the year-over-year increase was due to higher profitsharing expense due to increased profits in third quarter 2015. The Company's profitsharing expense is based on profits that exclude the unrealized gains and/or losses the Company records for its fuel hedging program. Additionally, pursuant to the terms of the Company's ProfitSharing Plan (the "Plan"), acquisition and integration costs were excluded from the calculation of profitsharing expense from April 1, 2011, through December 31, 2013. These costs, totaling \$385 million, are being amortized on a pro rata basis as a reduction of operating profits, as defined by the Plan, from 2014 through 2018. In addition, Acquisition and integration costs incurred during current and in future periods will reduce operating profits, as defined, in the calculation of profitsharing expense. Based on current cost trends and anticipated capacity, the Company expects fourth quarter 2015 Salaries, wages, and benefits expense per ASM, excluding profitsharing expense and special items, to decrease compared with fourth quarter 2014.

Fuel and oil expense for third quarter 2015 decreased by \$450 million, or 32.5 percent, compared with third quarter 2014. On a per ASM basis, third quarter 2015 Fuel and oil expense decreased 37.1 percent, compared with third quarter 2014. Excluding the impact of hedging, both the dollar and unit cost decreases were attributable to lower jet fuel prices. The Company's average economic jet fuel cost per gallon decreased 25.2 percent year-over-year, from \$2.94 for third quarter 2014 to \$2.20 for third quarter 2015. The Company also slightly improved its fuel efficiency in third quarter 2015 compared with the same prior year period, when measured on the basis of ASMs generated per gallon of fuel. Fuel gallons consumed increased 5.8 percent as compared with third quarter 2014, while year-over-year capacity increased 7.6 percent as a result of fleet modernization and a 1.1 percent increase in Average length of passenger haul. As a result of the Company's fuel hedging program, the Company recognized net losses totaling \$93 million in Fuel and oil expense for third quarter 2015, compared with net gains totaling \$9 million for third quarter 2014. These totals include cash settlements realized from the settlement of fuel derivative contracts, associated with the Company's "economic" fuel hedge, totaling \$245 million provided to counterparties for third quarter 2015, compared with \$21 million received from counterparties for third quarter 2014. Additionally, these totals exclude gains and/or losses from hedge ineffectiveness and from derivatives that do not qualify for hedge accounting. Those items are recorded as a component of Other (gains) losses, net. See Note 3 to the unaudited Condensed Consolidated Financial Statements.

As of October 19, 2015, on an economic basis, the Company had derivative contracts in place related to expected future fuel consumption as follows:

| Period                  | Average percent of estimated fuel consumption covered by fuel derivative contracts at varying WTI/Brent Crude Oil, Heating Oil, and Gulf Coast Jet Fuel-equivalent price levels |
|-------------------------|---|
| Fourth quarter 2015 (1) | —   |
| 2016 (2)                | Approx. 35%   |
| 2017 (2)                | Approx. 65%   |
| 2018 (2)                | Approx. 25%   |

(1) The Company is effectively unhedged for the fourth quarter 2015. A majority of the financial impact of the derivative contracts currently held for the quarter is locked in and is included in the economic jet fuel price simulations below.

(2) Given the Company has entered into different derivative contracts at various prices, these percentages are an average based on the assumption that Brent crude oil prices settle above current market prices. See Note 3 to the

unaudited Condensed Consolidated Financial Statements for further information.

As a result of applying hedge accounting in prior periods, including related to hedge positions that have either been offset or settled early on a cash basis, the Company has amounts “frozen” in Accumulated other comprehensive income (loss) (“AOCI”), and these amounts will be recognized in earnings in future periods when the underlying fuel derivative contracts settle. The following table displays the Company's estimated fair value of remaining fuel derivative contracts (not considering the impact of the cash collateral provided to or received from counterparties—see Note 3 to the

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unaudited Condensed Consolidated Financial Statements for further information), as well as the amount of deferred gains/losses in AOCI at September 30, 2015, and the expected future periods in which these items are expected to settle and/or be recognized in earnings (in millions):

| Year                | Fair value (liability) of fuel derivative contracts at September 30, 2015 | Amount of gains (losses) deferred in AOCI at September 30, 2015 (net of tax) |
|---------------------|---|--|
| Fourth quarter 2015 | \$(114)   | )(a) \$(71)  |
| 2016                | (634)   | ) (509)  |
| 2017                | (493)   | ) (308)  |
| 2018                | 11  | ) (17)   |
| Total               | \$(1,230)   | ) \$(905)  |

(a) The Company has previously offset the majority of its fourth quarter 2015 fuel derivative portfolio and remains effectively unhedged for fourth quarter 2015 at current price levels. While the Company still holds derivative contracts as of October 19, 2015, that will settle during fourth quarter 2015, the losses associated with those contracts are substantially locked in. However, if market prices were to increase or decrease significantly related to the fourth quarter 2015 positions prior to these contracts settling, the losses incurred at settlement could be slightly lower or higher than currently expected amounts during that period.

Based on forward market prices and the amounts in the above table (and excluding any other subsequent changes to the fuel hedge portfolio), the Company's jet fuel costs per gallon could exceed market (i.e., unhedged) prices during some of these future periods. This is based primarily on expected future cash settlements associated with fuel derivatives, but excludes any impact associated with the ineffectiveness of fuel hedges or fuel derivatives that are marked to market because they do not qualify for hedge accounting. See Note 3 to the unaudited Condensed Consolidated Financial Statements for further information. Assuming no changes to the Company's current fuel derivative portfolio, but including all previous hedge activity for fuel derivatives that have not yet settled, and considering only the expected net cash payments related to hedges that will settle, the Company is providing a sensitivity table for fourth quarter 2015 jet fuel prices at different crude oil assumptions as of October 19, 2015, and for expected premium costs associated with settling contracts.

| Average Brent Crude Oil price per barrel | Estimated economic jet fuel price per gallon, including taxes |
|--|---|
|  | 4Q 2015 (2)   |
| \$30                                     | \$1.45 - \$1.50   |
| \$40                                     | \$1.75 - \$1.80   |
| Current Market (1)                       | \$2.05 - \$2.10   |
| \$60                                     | \$2.30 - \$2.35   |
| \$70                                     | \$2.65 - \$2.70   |
| Estimated Premium Costs (3)              | \$40M - \$45M   |

(1) Brent crude oil average market price as of October 19, 2015, was approximately \$49 per barrel for fourth quarter 2015.

(2) The economic fuel price per gallon sensitivities provided assume the relationship between Brent crude oil and refined products based on market prices as of October 19, 2015.

(3) Fuel hedge premium expense is recognized as a component of Other (gains) losses, net.

Maintenance materials and repairs expense for third quarter 2015 increased by \$11 million, or 4.4 percent, compared with third quarter 2014. On a per ASM basis, Maintenance materials and repairs expense decreased 2.7 percent, compared with third quarter 2014, as the dollar increases were offset by the 7.6 percent increase in capacity. On a

dollar basis, approximately 50 percent of the increase was attributable to an increase in Boeing 737-300, 737-500, and 737-700 engine maintenance due to more inductions, and the remaining increase was primarily related to an increase in heavy maintenance expense due to the timing of regular maintenance checks. These increases were partially offset by reduced engine and avionic repair expense as a result of the B717 aircraft transitioning out of the Company's fleet.



The Company currently expects Maintenance materials and repairs expense per ASM for fourth quarter 2015 to be comparable to fourth quarter 2014.

Aircraft rentals expense for third quarter 2015 decreased by \$11 million, or 15.5 percent, compared with third quarter 2014. On a per ASM basis, Aircraft rentals expense decreased by 23.8 percent, compared with third quarter 2014. On both a dollar and per ASM basis, the decrease was primarily due to the transition of leased B717s out of the Company's fleet for conversion and delivery to Delta. The majority of these leased aircraft removed from service have been replaced by owned or capital leased Boeing 737 aircraft. The Company currently expects Aircraft rentals expense per ASM for fourth quarter 2015 to decrease compared with fourth quarter 2014 for the same reason.

Landing fees and other rentals expense for third quarter 2015 increased by \$14 million, or 4.8 percent, compared with third quarter 2014. On a per ASM basis, Landing fees and other rentals expense decreased 3.5 percent, compared with third quarter 2014, as the slight dollar increases were offset by the 7.6 percent increase in capacity. On a dollar basis, the majority of the increase was due to heavier landing weights for the Company's higher capacity 737-800 aircraft, which now make up a larger portion of the Company's fleet. The Company currently expects Landing fees and other rentals expense per ASM for fourth quarter 2015 to increase slightly, compared with fourth quarter 2014.

Depreciation and amortization expense for third quarter 2015 increased by \$20 million, or 8.4 percent, compared with third quarter 2014. On a per ASM basis, Depreciation and amortization expense increased 1.4 percent, compared with third quarter 2014. On both a dollar and per ASM basis, the majority of the increase was due to the purchase and capital lease of new and used aircraft since third quarter 2014, the majority of which have replaced leased B717s removed from service. The Company currently expects Depreciation and amortization expense per ASM for fourth quarter 2015 to decrease compared with fourth quarter 2014.

The Company incurred \$6 million of Acquisition and integration costs during third quarter 2015 related to the AirTran integration, compared with \$23 million in third quarter 2014. The third quarter 2015 expense primarily consisted of certain expenses associated with the grounding and conversion costs resulting from the transition of B717s to Delta. See Note 6 to the unaudited Condensed Consolidated Financial Statements for further information.

Other operating expenses for third quarter 2015 increased by \$4 million, or 0.7 percent, compared with third quarter 2014. On a per ASM basis, Other operating expenses decreased 6.0 percent, compared with third quarter 2014, as the dollar increases were offset by the 7.6 percent increase in capacity. On a dollar basis, the majority of the increase was the result of higher personnel expenses. The Company currently expects Other operating expenses per ASM for fourth quarter 2015 to increase compared with fourth quarter 2014.

## Other

Other expenses (income) include interest expense, capitalized interest, interest income, and other gains and losses.

Other (gains) losses, net, primarily includes amounts recorded as a result of the Company's hedging activities. See Note 3 to the unaudited Condensed Consolidated Financial Statements for further information on the Company's hedging activities. The following table displays the components of Other (gains) losses, net, for the three months ended September 30, 2015 and 2014:

| (in millions)  | Three months ended September 30, |      |   |
|--|----------------------------------|------|---|
|  | 2015                             | 2014 |   |
| Mark-to-market impact from fuel contracts settling in future periods | \$179                            | \$44 |   |
| Ineffectiveness from fuel hedges settling in future periods          | (1                               | ) 11 |   |
| Realized ineffectiveness and mark-to-market (gains) or losses        | 61                               | (5   | ) |
| Premium cost of fuel contracts                                       | 33                               | 15   |   |
| Other  | —                                | 1    |   |
|  | \$272                            | \$66 |   |

## Income Taxes

The Company's effective tax rate was approximately 37.4 percent in third quarter 2015, compared with 37.3 percent in third quarter 2014. The Company projects a full year 2015 effective tax rate of 37 to 38 percent based on currently forecasted financial results.

## Comparison of nine months ended September 30, 2015 to nine months ended September 30, 2014

Passenger revenues for the nine months ended September 30, 2015, increased \$497 million, or 3.8 percent, compared with the first nine months of 2014. Holding other factors constant, the majority of the increase was attributable to a 6.9 percent increase in capacity, as strong Customer demand for low-fare air travel enabled the Company to fill the additional seats, as evidenced by an 83.5 percent Load factor. On a unit basis, Passenger revenue decreased 3.0 percent, year-over-year, largely driven by a 3.9 percent decrease in Passenger revenue yield, year-over-year.

Freight revenues for the nine months ended September 30, 2015, increased by \$6 million, or 4.7 percent, compared with the first nine months of 2014, primarily due to increased pounds shipped.

The Company recorded a Special revenue adjustment during the nine months ended September 30, 2015, of \$172 million. This adjustment represented a one-time non-cash reduction to the deferred revenue liability as a result of the July 2015 amended Agreement with Chase and the resulting change in accounting methodology, and is classified as a special item and thus excluded from the Company's Non-GAAP financial results. See Note 2 to the unaudited Condensed Consolidated Financial Statements and the Note Regarding Use of Non-GAAP Financial Measures for further information.

Other revenues for the nine months ended September 30, 2015, increased by \$191 million, or 31.8 percent, compared with the first nine months of 2014, primarily as a result of the July 2015 amended Agreement with Chase and the resulting change in accounting methodology. See Note 2 to the unaudited Condensed Consolidated Financial Statements for further information. Ancillary revenues were flat year-over-year as the decrease in revenues from the termination of AirTran passenger service and related ancillary fees was almost entirely offset by the increase in certain Southwest Airlines ancillary revenues, such as EarlyBird Check-in<sup>®</sup> and A1-15 select boarding positions sold at the

gate.

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## Operating expenses

Operating expenses for the nine months ended September 30, 2015, decreased by \$619 million, or 5.0 percent, compared with the first nine months of 2014, while capacity increased 6.9 percent over the same period. Historically, except for changes in the price of fuel, changes in Operating expenses for airlines are largely driven by changes in capacity, or ASMs. The following table presents the Company's Operating expenses per ASM for the first nine months of 2015 and 2014, followed by explanations of these changes on a per ASM basis and dollar basis:

| (in cents, except for percentages) | Nine months ended September 30, |         | Per ASM<br>change | Percent<br>change |    |
|------------------------------------|---------------------------------|---------|-------------------|-------------------|----|
|                                    | 2015                            | 2014    |                   |                   |    |
| Salaries, wages, and benefits      | 4.49                            | ¢ 4.10  | ¢ 0.39            | ¢ 9.5             | %  |
| Fuel and oil                       | 2.68                            | 4.20    | (1.52)            | ) (36.2           | )  |
| Maintenance materials and repairs  | 0.69                            | 0.75    | (0.06)            | ) (8.0            | )  |
| Aircraft rentals                   | 0.17                            | 0.23    | (0.06)            | ) (26.1           | )  |
| Landing fees and other rentals     | 0.84                            | 0.86    | (0.02)            | ) (2.3            | )  |
| Depreciation and amortization      | 0.71                            | 0.70    | 0.01              | 1.4               |    |
| Acquisition and integration        | 0.03                            | 0.08    | (0.05)            | ) (62.5           | )  |
| Other operating expenses           | 1.57                            | 1.66    | (0.09)            | ) (5.4            | )  |
| Total                              | 11.18                           | ¢ 12.58 | ¢ (1.40)          | )¢ (11.1          | )% |

Operating expenses per ASM decreased 11.1 percent for the first nine months of 2015 compared with the first nine months of 2014 primarily due to lower jet fuel prices. Operating expenses per ASM, excluding fuel and special items (a non-GAAP financial measure), remained relatively flat year-over-year. See the previous Note Regarding Use of Non-GAAP Financial Measures.

Salaries, wages, and benefits expense for the first nine months of 2015 increased by \$681 million, or 16.8 percent, compared with the first nine months of 2014. Salaries, wages, and benefits expense per ASM for the first nine months of 2015 increased 9.5 percent, compared with the first nine months of 2014. On a dollar basis, approximately 55 percent of the increase was due to higher salaries as a result of increased training, additional headcount, contractual increases, and the ratification bonuses associated with certain contract labor groups. The remainder of the increase was due to higher profitsharing expense due to increased profits in the first nine months of 2015. On a per ASM basis, approximately 50 percent of the increase was due to higher profitsharing expense, and the remainder was due to higher salaries.

Fuel and oil expense for the first nine months of 2015 decreased by \$1.3 billion, or 31.7 percent, compared with the first nine months of 2014. On a per ASM basis, Fuel and oil expense for the first nine months of 2015 decreased 36.2 percent, compared with the first nine months of 2014. Excluding the impact of hedging, both the dollar and unit cost decreases were virtually all attributable to lower jet fuel prices. The Company's average economic jet fuel cost per gallon decreased 30.9 percent, on a year-over-year basis, from \$3.01 during the first nine months of 2014 to \$2.08 during the first nine months of 2015. The Company also slightly improved its fuel efficiency during the first nine months of 2015 compared with the same prior year period, when measured on the basis of ASMs generated per gallon of fuel. Fuel gallons consumed increased 4.6 percent, compared with the first nine months of 2014, while year-over-year capacity increased 6.9 percent as a result of fleet modernization and a 1.6 percent increase in Average length of passenger haul. As a result of the Company's fuel hedging program, the Company recognized net losses totaling \$184 million in Fuel and oil expense for the first nine months of 2015, compared with net gains totaling \$46 million for the first nine months of 2014. These totals include cash settlements realized from the settlement of fuel derivatives totaling \$326 million paid to counterparties for the first nine months of 2015, compared with \$72 million received from counterparties in the first nine months of 2014. Additionally, these totals exclude gains and/or losses recognized from hedge ineffectiveness and from derivatives that do not qualify for hedge accounting, which impacts

are recorded as a component of Other (gains) losses, net. See Note 3 to the unaudited Condensed Consolidated Financial Statements.

Maintenance materials and repairs expense for the first nine months of 2015 decreased by \$5 million, or 0.7 percent, compared with the first nine months of 2014. On a per ASM basis, Maintenance materials and repairs expense decreased 8.0 percent, compared with the first nine months of 2014. On both a dollar and per ASM basis, the decrease was primarily attributable to reduced engine and avionic repair expense as a result of the B717 aircraft transitioning out of the Company's fleet, partially offset by slightly higher engine and avionics expense associated with the replacement of the B717s with Boeing 737s.

Aircraft rentals expense for the first nine months of 2015 decreased by \$48 million, or 21.1 percent, compared with the first nine months of 2014. On a per ASM basis, Aircraft rentals expense decreased by 26.1 percent, compared with the first nine months of 2014. On both a dollar and per ASM basis, the decrease was primarily due to the transition of leased B717s out of the Company's fleet for conversion and delivery to Delta. The majority of these leased aircraft removed from service have been replaced by owned or capital leased Boeing 737 aircraft.

Landing fees and other rentals expense for the first nine months of 2015 increased by \$38 million, or 4.5 percent, compared with the first nine months of 2014. On a per ASM basis, Landing fees and other rentals expense decreased 2.3 percent, compared with the first nine months of 2014, as the dollar increases were more than offset by the 6.9 percent increase in capacity, as trips flown remained flat but the Company had a change in fleet mix to larger gauge aircraft. On a dollar basis, approximately 60 percent of the increase was due to heavier landing weights for 737-800 aircraft, which now make up a larger portion of the Company's fleet. The remainder of the increase was due to higher space rental rates at various airports.

Depreciation and amortization expense for the first nine months of 2015 increased by \$64 million, or 9.3 percent, compared with the first nine months of 2014. On a per ASM basis, Depreciation and amortization expense increased 1.4 percent, compared with the first nine months of 2014. On both a dollar and per ASM basis, the majority of the increase was due to the purchase and capital lease of new and used Boeing 737 aircraft over the last 12 months, the majority of which have replaced leased B717s removed from service.

The Company incurred \$32 million of Acquisition and integration expense for the first nine months of 2015, compared with \$78 million for the first nine months of 2014. The 2015 costs primarily consisted of Employee training and certain expenses associated with the grounding and conversion costs resulting from the transition of B717s to Delta. See Note 6 to the unaudited Condensed Consolidated Financial Statements for further information.

Other operating expenses for the first nine months of 2015 decreased by \$4 million, or 0.2 percent, compared with the first nine months of 2014. On a per ASM basis, Other operating expenses decreased 5.4 percent, compared with the first nine months of 2014. On both a dollar and per ASM basis, the decrease was the result of a \$37 million litigation settlement received during first quarter 2015. Excluding the impact of the litigation settlement, Other operating expenses increased 2.5 percent. Approximately 60 percent of the increase, excluding the litigation settlement, was due to higher personnel expenses partially as a result of increased inclement weather events during 2015, and approximately 35 percent was related to higher advertising and promotions expenses.

#### Other

Other expenses (income) include interest expense, capitalized interest, interest income, and other gains and losses.

Other (gains) losses, net, primarily includes amounts recorded as a result of the Company's hedging activities. See Note 3 to the unaudited Condensed Consolidated Financial Statements for further information on the Company's hedging activities. The following table displays the components of Other (gains) losses, net, for the nine months ended September 30, 2015 and 2014:

| (in millions)  | Nine months ended September 30, |       |
|--|---------------------------------|-------|
|  | 2015                            | 2014  |
| Mark-to-market impact from fuel contracts settling in future periods | \$271                           | \$5   |
| Ineffectiveness from fuel hedges settling in future periods          | (16                             | ) (31 |
| Realized ineffectiveness and mark-to-market (gains) or losses        | 61                              | (5    |
| Premium cost of fuel contracts                                       | 81                              | 49    |
| Other  | (3                              | ) (2  |
|  | \$394                           | \$16  |

#### Income Taxes

The Company's effective tax rate was approximately 37.5 percent for the first nine months of 2015, compared with 37.6 percent for the first nine months of 2014.

#### Liquidity and Capital Resources

Net cash provided by operating activities was \$836 million for the three months ended September 30, 2015, compared with \$240 million provided by operating activities in the same prior year period. For the nine months ended September 30, 2015, net cash provided by operating activities was \$2.9 billion, compared with \$2.7 billion provided by operating activities in the nine months ended September 30, 2014. The operating cash flows for the nine months ended September 30, 2015, were largely impacted by the Company's net income (as adjusted for noncash items); a \$617 million increase in Air traffic liability as a result of bookings for future travel, sales of frequent flyer points to business partners, and the \$172 million Special revenue adjustment; and a \$424 million increase in Accounts payable and accrued liabilities. These cash inflows were partially offset by \$471 million in cash outflows related to the purchase of derivatives utilized to offset a portion of the Company's 2015 and 2016 fuel hedge positions prior to their settlement, as well as new fuel derivatives, which are classified as Other, net. Also, the Company provided an additional \$213 million in cash collateral to fuel derivative counterparties during the nine months ended September 30, 2015. See Note 3 to the unaudited Condensed Consolidated Financial Statements for further information. Net cash provided by operating activities is primarily used to finance capital expenditures, repay debt, fund stock repurchases, pay dividends, and provide working capital.

Net cash used in investing activities was \$259 million during the three months ended September 30, 2015, compared with \$44 million used in investing activities in the same prior year period. For the nine months ended September 30, 2015, net cash used in investing activities was \$967 million, compared with \$1.3 billion used in the same prior year period. Investing activities in both years included capital expenditures, payments associated with airport construction projects, denoted as Assets constructed for others, and changes in the balance of the Company's short-term and noncurrent investments. During the nine months ended September 30, 2015, capital expenditures were \$1.2 billion, consisting primarily of payments for new and previously owned aircraft delivered to the Company, as well as a payment made in connection with a long-term sublease agreement that transferred the usage of two gates at Dallas Love Field to the Company. This compared with \$1.3 billion in Capital expenditures during the same prior year period. During the nine months ended September 30, 2015, the Company's transactions in short-term and noncurrent investments resulted in a net cash inflow of \$349 million, compared with a net cash inflow of \$83 million during the same prior year period.

Net cash used in financing activities was \$609 million during the three months ended September 30, 2015, compared with \$246 million used in financing activities for the same prior year period. For the nine months ended September 30,



2015, net cash used in financing activities was \$1.5 billion, compared with \$962 million used in the same prior year period. During the nine months ended September 30, 2015, the Company repaid \$170 million in debt and capital lease obligations, repurchased \$1.2 billion of its outstanding common stock through share repurchase programs, and paid \$180 million in dividends to Shareholders. During the nine months ended September 30, 2014, the Company repaid \$167 million in debt and capital lease obligations, repurchased approximately \$755 million of its outstanding common stock through share repurchase programs, and paid \$138 million in dividends to Shareholders.

The Company is a “well-known seasoned issuer” and has an effective shelf registration statement registering an indeterminate amount of debt and equity securities for future sales. The Company currently intends to use the proceeds from any future securities sales off this shelf registration statement for general corporate purposes.

The Company has access to a \$1 billion unsecured revolving credit facility, which expires in April 2018. Interest on the facility is based on the Company's credit ratings at the time of borrowing. At the Company's current ratings, the interest cost would be LIBOR plus a spread of 112.5 basis points. The facility contains a financial covenant, requiring a minimum coverage ratio of adjusted pre-tax income to fixed obligations, as defined. As of September 30, 2015, the Company was in compliance with this covenant and there were no amounts outstanding under the revolving credit facility.

On May 13, 2015, the Company's Board of Directors authorized the repurchase of up to \$1.5 billion of the Company's common stock in a new share repurchase program. Under this \$1.5 billion share repurchase program, the Company has launched the Third Quarter ASR Program for \$500 million, or 9.7 million shares (excluding the additional shares expected to be delivered to the Company upon settlement of the Third Quarter ASR Program). The purchase was recorded as a treasury share purchase for purposes of calculating earnings per share. As of September 30, 2015, the Company's cumulative repurchases under the May 2015 \$1.5 billion Board authorization have totaled \$800 million, or 17.8 million shares of common stock (excluding the additional shares expected to be delivered to the Company upon settlement of the Third Quarter ASR Program). See Part II, Item 2 for further information on the Company's share repurchase authorization.

Cumulative costs associated with the acquisition and integration of AirTran, as of September 30, 2015, totaled \$568 million (before profitsharing expense and taxes). Given the effective completion of the AirTran integration process, other than the continuing conversion and sublease of the Boeing 717 fleet throughout the remainder of 2015, the Company does not anticipate significant future integration expenditure requirements. See Note 6 to the unaudited Condensed Consolidated Financial Statements for further information. The Company believes that its current liquidity position, including unrestricted cash and short-term investments of \$3.1 billion as of September 30, 2015, anticipated future internally generated funds from operations, and its fully available, unsecured revolving credit facility of \$1 billion that expires in April 2018, will enable it to meet its future known obligations in the ordinary course of business. However, if a liquidity need were to arise, the Company believes it has access to financing arrangements because of its investment grade credit ratings, large value of unencumbered assets, and modest leverage, which should enable it to meet its ongoing capital, operating, and other liquidity requirements. The Company will continue to consider various borrowing or leasing options to maximize liquidity and supplement cash requirements, as necessary.

## Contractual Obligations and Contingent Liabilities and Commitments

The Company has contractual obligations and commitments primarily with regard to future purchases of aircraft, repayment of debt, and lease arrangements. As of September 30, 2015, the Company had firm deliveries and options for Boeing 737-700, 737-800, 737 MAX 7, and 737 MAX 8 aircraft as follows:

|       | The Boeing Company<br>737 NG |                        |         |                        | The Boeing Company<br>737 MAX |                      |         |     | Total | (3) |
|-------|------------------------------|------------------------|---------|------------------------|-------------------------------|----------------------|---------|-----|-------|-----|
|       | -700<br>Firm<br>Orders       | -800<br>Firm<br>Orders | Options | Additional<br>-700 A/C | -7<br>Firm<br>Orders          | -8<br>Firm<br>Orders | Options |     |       |     |
| 2015  | —                            | 19                     | —       | 24                     | —                             | —                    | —       | 43  |       |     |
| 2016  | —                            | 31                     | —       | 15                     | —                             | —                    | —       | 46  |       |     |
| 2017  | 15                           | —                      | 12      | 14                     | —                             | 14                   | —       | 55  |       |     |
| 2018  | 10                           | —                      | 12      | 4                      | —                             | 13                   | —       | 39  |       |     |
| 2019  | —                            | —                      | —       | —                      | 15                            | 10                   | —       | 25  |       |     |
| 2020  | —                            | —                      | —       | —                      | 14                            | 22                   | —       | 36  |       |     |
| 2021  | —                            | —                      | —       | —                      | 1                             | 33                   | 18      | 52  |       |     |
| 2022  | —                            | —                      | —       | —                      | —                             | 30                   | 19      | 49  |       |     |
| 2023  | —                            | —                      | —       | —                      | —                             | 24                   | 23      | 47  |       |     |
| 2024  | —                            | —                      | —       | —                      | —                             | 24                   | 23      | 47  |       |     |
| 2025  | —                            | —                      | —       | —                      | —                             | —                    | 36      | 36  |       |     |
| 2026  | —                            | —                      | —       | —                      | —                             | —                    | 36      | 36  |       |     |
| 2027  | —                            | —                      | —       | —                      | —                             | —                    | 36      | 36  |       |     |
| Total | 25                           | (1) 50                 | 24      | 57                     | 30                            | 170                  | (2) 191 | 547 |       |     |

(1) The Company has flexibility to substitute 737-800s in lieu of 737-700 firm orders.

(2) The Company has flexibility to substitute MAX 7 in lieu of MAX 8 firm orders beginning in 2019.

(3) Includes 13 737-800s and 16 737-700s delivered as of September 30, 2015.

The Company's financial commitments associated with the firm orders and additional 737-700 aircraft in the above aircraft table are as follows: \$272 million remaining in 2015, \$1.2 billion in 2016, \$1.2 billion in 2017, \$1.0 billion in 2018, \$1.1 billion in 2019, and \$5.7 billion thereafter.

For aircraft commitments with Boeing, the Company is required to make cash deposits towards the purchase of aircraft. These deposits are classified as Deposits on flight equipment purchase contracts in the unaudited Condensed Consolidated Balance Sheet until the aircraft is delivered, at which time deposits previously made are deducted from the final purchase price of the aircraft and are reclassified as Flight equipment.

The following table details information on the aircraft in the Company's fleet as of September 30, 2015:

| Type    | Seats      | Average<br>Age (Yrs) | Number<br>of Aircraft | Number<br>Owned | Number<br>Leased |
|---------|------------|----------------------|-----------------------|-----------------|------------------|
| 737-300 | 137 or 143 | 22                   | 119                   | (a) 76          | 43               |
| 737-500 | 122        | 24                   | 12                    | 9               | 3                |
| 737-700 | 143        | 11                   | 463                   | 395             | 68               |
| 737-800 | 175        | 2                    | 98                    | 91              | 7                |
| TOTALS  |            | 12                   | 692                   | 571             | 121              |

(a) Of the total, 78 737-300 aircraft have 143 seats and 41 have 137 seats.



## Critical Accounting Policies and Estimates

During third quarter 2015 the Company executed an amended Agreement with Chase, through which the Company sells loyalty points and other items to Chase. The Company's Rapid Rewards program members ("Members") are able to accrue loyalty points based on purchases using the Chase co-branded Southwest Visa credit card. The Agreement materially modified the previously existing agreement between Chase and the Company. Consideration received as part of this Agreement is subject to Accounting Standards Update 2009-13, "Multiple-Deliverable Revenue Arrangements - a consensus of the FASB Emerging Issues Task Force" ("ASU 2009-13"). The impact of the accounting change to the Company's frequent flyer accounting policy is described below.

### Frequent flyer accounting

The Company utilizes estimates in the recognition of liabilities associated with its frequent flyer program. These estimates primarily include the liability associated with frequent flyer Member account balances that are expected to be redeemed for travel or other products at a future date as well as the allocation of consideration received for points sold to certain business partners between transportation and non-transportation components. Frequent flyer account balances include points earned through flights taken, points sold to Customers, or points earned through business partners participating in the frequent flyer program.

Under the Southwest Rapid Rewards frequent flyer program, Members earn points for every dollar spent. The amount of points earned under the program is based on the fare and fare class purchased, with higher fare products (e.g., Business Select) earning more points than lower fare products (e.g., Wanna Get Away). Each fare class is associated with a points earning multiplier, and points for flights are calculated by multiplying the fare for the flight by the fare class multiplier. Likewise, the amount of points required to be redeemed for a flight is based on the fare and fare class purchased. Under the program, (i) Members are able to redeem their points for every available seat, every day, on every flight, with no blackout dates; and (ii) points do not expire so long as the Rapid Rewards Member has points-earning activity during a 24-month time period. In addition, Southwest co-branded Chase Visa credit card holders are able to redeem their points for items other than travel on Southwest Airlines, such as international flights on other airlines, cruises, hotel stays, rental cars, gift cards, event tickets, and more. In addition to earning points for revenue flights and qualifying purchases with Rapid Rewards Partners, Rapid Rewards Members also have the ability to purchase points.

The Company utilizes the incremental cost method of accounting for points earned through flights taken in its frequent flyer program. A liability is recorded for the estimated incremental cost of providing free travel as points are being earned. The liability recorded represents the total number of points expected to be redeemed by Members, regardless of whether the Members may have enough to qualify for a full travel award. The incremental cost liability is primarily composed of direct Passenger costs such as fuel, food, and other operational costs, but does not include any contribution to fixed overhead costs or profit. At September 30, 2015, the incremental cost liability was approximately \$57 million.

The Company also sells frequent flyer points and related services to business partners participating in the frequent flyer program. The majority of the points sold to business partners are through the Southwest co-branded Chase Visa credit card. Historically, funds received from the sale of points associated with these agreements were accounted for under the residual method. Under the residual method, the Company estimated the percent of the amount received from frequent flyer points sold associated with Southwest's co-branded Chase Visa credit card that related to free travel. The estimated amounts associated with free travel are deferred and recognized as Passenger revenue when the ultimate free travel awards are flown. The modified Agreement has the following multiple elements: travel points to be awarded; use of the Southwest Airlines' brand and access to Rapid Reward Member lists; advertising elements and the Company's resource team. Under ASU 2009-13 these deliverables are accounted for separately and allocation of

consideration from the Agreement is determined based on the relative selling price of each deliverable. Prior to the July 1, 2015 adoption of ASU 2009-13, the Company determined the selling price of air transportation and allocated any remaining consideration under the contract on a residual basis. The application of ASU 2009-13 to the Agreement decreases the relative value of the air transportation deliverables that the Company records as deferred revenue (and ultimately Passenger revenues when redeemed awards are flown) and increases the relative value of the marketing-

related deliverables recorded in Other revenues at the time these marketing-related deliverables are provided. This is principally due to the previous application of the residual method, which effectively applied the entire discount associated with the agreement to the marketing deliverables.

Significant management judgment was used to estimate the selling price of each of the deliverables. The objective was to determine the price at which the Company would transact a sale if the product or service was sold on a stand-alone basis. The Company determined the best estimate of selling price by considering multiple inputs and methods including, but not limited to, the estimated selling price of comparable travel, discounted cash flows, brand value, published selling prices, number of points awarded, and the number of points redeemed. 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 multiple deliverables. The Company records passenger revenue related to air transportation and certificates for discounted companion travel when the transportation is delivered. The other elements are recognized as Other - net revenue when earned.

The Company followed the transition approach of ASU 2009-13, which required that the Company's existing deferred revenue balance, classified within Air traffic liability, be adjusted to reflect the value, on a relative selling price basis, of any undelivered element remaining at the date of contract modification. The relative selling price of the undelivered element (air transportation) is lower than the rate at which it had been deferred under the previous contract and the Company recorded a one-time, non-cash adjustment to decrease frequent flyer deferred revenue and increase revenue through the recording of a Special revenue adjustment of \$172 million. Furthermore, third quarter 2015 Operating revenues increased \$131 million as a result of the amended Agreement with Chase and the resulting change in accounting methodology. See Note 2 to the unaudited Condensed Consolidated Financial Statements for further information.

Under its current program, Southwest estimates the portion of frequent flyer points that will not be redeemed. In estimating spoilage, the Company takes into account the Member's past behavior, as well as several factors related to the Member's account that are expected to be indicative of the likelihood of future point redemption. These factors include, but are not limited to, tenure with program, points accrued in the program, and whether or not the customer has a co-branded credit card. During fourth quarter 2014, the Company obtained sufficient historical behavioral data to develop a predictive statistical model to analyze the amount of spoilage expected for points sold to business partners, which indicated an increase in the expected spoilage rate. This change in estimate, which is recorded on a prospective basis, as of October 1, 2014, resulted in an increase in Passenger revenue of approximately \$30 million for the three months ended September 30, 2015. For the nine months ended September 30, 2015, this change in estimate resulted in an increase in Passenger revenue of \$115 million. The Company has again updated its analysis of projected spoilage and will implement a new rate on a prospective basis beginning in fourth quarter 2015. As the new rate is not materially different from the estimated rate used during the first three quarters of 2015, the Company does not expect the impact to recognized Passenger revenues to be significant. The precise impact will not be determinable until the actual number of point redemptions for the period is known. For the nine months ended September 30, 2015, based on actual redemptions of points sold to business partners, a hypothetical one percentage point change in the estimated spoilage rate would have resulted in a change to Passenger revenue of approximately \$22 million (an increase in spoilage would have resulted in an increase in revenue and a decrease in spoilage would have resulted in a decrease in revenue). Given that Member behavior will continue to develop as the program matures, the Company expects that current estimates may change in future periods. However, the Company believes its current estimates are reasonable given current facts and circumstances.

#### Cautionary Statement Regarding Forward-Looking Statements

This Form 10-Q contains "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. Forward-looking statements are based on, and include

statements about, the Company's estimates, expectations, beliefs, intentions, and strategies for the future, and the assumptions underlying these forward-looking statements. Specific forward-looking statements can be identified by the fact that they do not relate strictly to historical or current facts and include, without limitation, statements related to the following:

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- the Company's network plans and expectations, including its network and schedule optimization plans;
- the Company's fleet and capacity plans;
- the Company's financial outlook and projected results of operations, including specific factors expected to impact the Company's results of operations;
- the Company's plans and expectations with respect to managing risk associated with changing jet fuel prices;
- the Company's expectations with respect to liquidity and capital expenditures, including anticipated needs for, and sources of, funds;
- the Company's assessment of market risks; and
- the Company's plans and expectations related to legal proceedings.

While management believes these forward-looking statements are reasonable as and when made, forward-looking statements are not guarantees of future performance and involve risks and uncertainties that are difficult to predict. Therefore, actual results may differ materially from what is expressed in or indicated by the Company's forward-looking statements or from historical experience or the Company's present expectations. Factors that could cause these differences include, among others:

- the Company's dependence on third parties, in particular with respect to its fleet and capacity plans;
- the impact of governmental regulations and other governmental actions related to the Company's operations;
- the Company's ability to timely and effectively implement, transition, and maintain the necessary information technology systems and infrastructure to support its operations and initiatives;
- changes in demand for the Company's services and the impact of economic conditions, fuel prices, and actions of competitors (including, without limitation, pricing, scheduling, and capacity decisions and consolidation and alliance activities) and other factors beyond the Company's control on the Company's business decisions, plans, and strategies;
- other changes in consumer behavior, including with respect to the Company's co-branded credit card;
- changes in the price of aircraft fuel, the impact of hedge accounting, and any changes to the Company's fuel hedging strategies and positions; and
- other factors as set forth in the Company's filings with the Securities and Exchange Commission, including the detailed factors discussed under the heading "Risk Factors" in the Company's Annual Report on Form 10-K for the year ended December 31, 2014.

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

### Item 3. Quantitative and Qualitative Disclosures About Market Risk

As discussed in Note 3 to the unaudited Condensed Consolidated Financial Statements, the Company endeavors to acquire jet fuel at the lowest possible price and to reduce volatility in operating expenses through its fuel hedging program with the use of financial derivative instruments. At September 30, 2015, the estimated fair value of outstanding contracts, excluding the impact of cash collateral provided to or held by counterparties, was a net liability of \$1.2 billion.

The Company's credit exposure related to fuel derivative instruments is represented by the fair value of contracts that are an asset to the Company. At such times, these outstanding instruments expose the Company to credit loss in the event of nonperformance by the counterparties to the agreements. As of September 30, 2015, the Company had no counterparties with which the derivatives held were a net asset, and nine counterparties with which the derivatives held were a net liability, totaling \$1.2 billion. 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. However, if one or more



of these counterparties were in a liability position to the Company and were unable to meet their obligations, any open derivative contracts with the counterparty could be subject to early termination, which could result in substantial losses for the Company. At September 30, 2015, the Company had agreements with all of its active counterparties containing

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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, letters of credit, and/or pledged aircraft are required to be posted as collateral whenever the net fair value of derivatives associated with those counterparties exceeds specific thresholds.

At September 30, 2015, \$478 million in cash collateral deposits and \$300 million in aircraft collateral were provided by the Company to counterparties based on its outstanding fuel derivative instrument portfolio. Due to the terms of the Company's current fuel hedging agreements with counterparties and the types of derivatives held, in the Company's judgment, it does not have significant additional cash collateral exposure. Given its investment grade credit rating, the Company can meet any additional significant collateral calls by posting aircraft and/or letters of credit. As an example, if market prices for the commodities used in the Company's fuel hedging activities were to decrease by 25 percent from market prices as of September 30, 2015, given the Company's current fuel derivative portfolio, its aircraft collateral facilities, and its investment grade credit rating, it would likely post an additional \$474 million in collateral which could be met by posting aircraft and/or letters of credit with its current counterparties. The Company has the option of providing cash, letters of credit, and/or pledging aircraft as collateral. At September 30, 2015, the Company had \$900 million of aircraft available to be posted as collateral. In addition, the Company would expect to also benefit from lower market prices paid for fuel used in its operations. See Note 3 to the unaudited Condensed Consolidated Financial Statements.

The Company is also subject to the risk that the fuel derivatives it uses to hedge against fuel price volatility do not provide adequate protection. A portion of the fuel derivatives in the Company's hedge portfolio are based on the market price of West Texas intermediate crude oil ("WTI"). In recent years, jet fuel prices have been more closely correlated with changes in the price of Brent crude oil ("Brent"). The Company has attempted to mitigate some of this risk by entering into more fuel hedges based on Brent crude. Although the Company has some fuel derivatives based on the price of Brent, to the extent the Company holds WTI-based derivatives, changes in the fair value of these positions will continue to create income statement volatility and may not provide complete protection against jet fuel price volatility. In addition, to add further protection, the Company may periodically enter into jet fuel derivatives for short-term timeframes. Jet fuel is not widely traded on an organized futures exchange and, therefore, there are limited opportunities to hedge directly in jet fuel for time horizons longer than approximately 24 months into the future.

See Item 7A "Quantitative and Qualitative Disclosures About Market Risk" in the Company's Annual Report on Form 10-K for the year ended December 31, 2014, for further information about market risk, and Note 3 to the unaudited Condensed Consolidated Financial Statements in this Form 10-Q for further information about the Company's fuel derivative instruments.

Item 4. Controls and Procedures

Disclosure Controls and Procedures

The Company maintains disclosure controls and procedures (as defined in Rule 13a-15(e) of the Securities Exchange Act of 1934 (the "Exchange Act")) designed to provide reasonable assurance that the information required to be disclosed by the Company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in the Securities and Exchange Commission's rules and forms. These include controls and procedures designed to ensure that this information is accumulated and communicated to the Company's management, including its Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure. Management, with the participation of the Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of the Company's disclosure controls and procedures as of September 30, 2015. Based on this evaluation, the Company's Chief Executive Officer and Chief Financial Officer have concluded that the Company's disclosure controls and procedures were effective as of September 30, 2015, at the reasonable assurance level.

Changes in Internal Control over Financial Reporting

There were no changes in the Company's internal control over financial reporting (as defined in Rule 13a-15(f) under the Exchange Act) during the fiscal quarter ended September 30, 2015, that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

## PART II. OTHER INFORMATION

## Item 1. Legal Proceedings

A complaint alleging violations of federal antitrust laws and seeking certification as a class action was filed against Delta Air Lines, Inc. and AirTran in the United States District Court for the Northern District of Georgia in Atlanta on May 22, 2009. The complaint alleged, among other things, that AirTran attempted to monopolize air travel in violation of Section 2 of the Sherman Act, and conspired with Delta in imposing \$15-per-bag fees for the first item of checked luggage in violation of Section 1 of the Sherman Act. The initial complaint sought treble damages on behalf of a putative class of persons or entities in the United States who directly paid Delta and/or AirTran such fees on domestic flights beginning December 5, 2008. After the filing of the May 2009 complaint, various other nearly identical complaints also seeking certification as class actions were filed in federal district courts in Atlanta, Georgia; Orlando, Florida; and Las Vegas, Nevada. All of the cases were consolidated before a single federal district court judge in Atlanta. A Consolidated Amended Complaint was filed in the consolidated action on February 1, 2010, which broadened the allegations to add claims that Delta and AirTran conspired to reduce capacity on competitive routes and to raise prices in violation of Section 1 of the Sherman Act. In addition to treble damages for the amount of first baggage fees paid to AirTran and to Delta, the Consolidated Amended Complaint seeks injunctive relief against a broad range of alleged anticompetitive activities, as well as attorneys' fees. On August 2, 2010, the Court dismissed plaintiffs' claims that AirTran and Delta had violated Section 2 of the Sherman Act; the Court let stand the claims of a conspiracy with respect to the imposition of a first bag fee and the airlines' capacity and pricing decisions. On June 30, 2010, the plaintiffs filed a motion to certify a class, which AirTran and Delta have opposed. The parties have submitted briefs on class certification, and AirTran filed a motion to exclude the class certification reports of plaintiffs' expert. The Court has not yet ruled on the class certification motion or the related motion to exclude plaintiffs' expert. The parties engaged in extensive discovery, which was extended due to discovery disputes between plaintiffs and Delta, but discovery has now closed. On June 18, 2012, the parties filed a Stipulation and Order that plaintiffs have abandoned their claim that AirTran and Delta conspired to reduce capacity. On August 31, 2012, AirTran and Delta moved for summary judgment on all of plaintiffs' remaining claims, but discovery disputes between plaintiffs and Delta delayed further briefing on summary judgment. On December 2, 2013, plaintiffs moved for discovery sanctions against Delta, which the Court resolved by Order dated August 3, 2015. On August 5, 2015, the Court entered an order granting class certification, which was vacated on August 17, 2015, to permit further briefing on class certification and AirTran's motion to exclude plaintiffs' expert. On August 24, 2015, the Court entered a scheduling order to complete the briefing on defendants' motions for summary judgment, the motion for class certification, and motions to exclude experts by January 2016. AirTran denies all allegations of wrongdoing, including those in the Consolidated Amended Complaint, and intends to defend vigorously any and all such allegations.

On June 30, 2015, the U.S. Department of Justice ("DOJ") issued a Civil Investigative Demand ("CID") to the Company. The CID seeks information and documents about the Company's capacity from January 2010 to the present including public statements and communications with third parties about capacity. In June 2015, the Company also received a letter from the Connecticut Attorney General requesting information about capacity; and on August 21, 2015, the Attorney General of the State of Ohio issued an investigative demand seeking information and documents about the Company's capacity from December 2013 to the present. The Company is cooperating fully with the DOJ CID and these two state inquiries.

On July 1, 2015, a complaint was filed in the United States District Court for the Southern District of New York on behalf of putative classes of consumers alleging collusion among the Company, American Airlines, Delta Air Lines, and United Airlines to limit capacity and maintain higher fares in violation of Section 1 of the Sherman Act. Since then, a number of similar class action complaints have been filed in the United States District Courts for the Central District of California, the Northern District of California, the District of Columbia, the Middle District of Florida, the Southern District of Florida, the Northern District of Georgia, the Northern District of Illinois, the Southern District of Indiana, the Eastern District of Louisiana, the District of Minnesota, the Eastern District of New York, the Southern

District of New York, the Middle District of North Carolina, the District of Oklahoma, the Eastern District of Pennsylvania, the Northern District of Texas, the District of Vermont, and the Eastern District of Wisconsin. The complaints seek treble damages for periods that vary among the complaints, costs, attorneys' fees, and injunctive relief. The time for the Company to respond to the complaints varies by case and has not yet expired. Requests to transfer the pre-trial proceedings of these cases into to a single federal court were filed with the Judicial Panel on Multi-District Litigation ("MDL Panel"), and on October 13, 2015, the MDL Panel centralized the cases to the Federal District Court in the District of Columbia. The Company intends to vigorously defend these civil cases.

The Company is from time to time subject to various legal proceedings and claims arising in the ordinary course of business, including, but not limited to, examinations by the Internal Revenue Service.

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

#### Item 1A. Risk Factors

There have been no material changes to the factors disclosed in Item 1A. Risk Factors in the Company's Annual Report on Form 10-K for the year ended December 31, 2014.

#### Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

##### Issuer Purchases of Equity Securities (1)

| Period                                       | (a)<br>Total number of shares purchased | (b)<br>Average price paid per share | (c)<br>Total number of shares purchased as part of publicly announced plans or programs | (d)<br>Maximum dollar value of shares that may yet be purchased under the plans or programs |
|--|---|-------------------------------------|---|---|
| July 1, 2015 through July 31, 2015           | —                                       | \$— (2)                             | —   | \$700,000,000 (2)   |
| August 1, 2015 through August 31, 2015       | 9,679,195                               | \$— (2)                             | 9,679,195   | \$700,000,000   |
| September 1, 2015 through September 30, 2015 | —                                       | \$—                                 | —   | \$700,000,000   |
| Total  | 9,679,195                               |                                     | 9,679,195   |   |

(1) In May 2015, the Company's Board of Directors authorized the repurchase of up to \$1.5 billion of the Company's common stock. Repurchases are made in accordance with applicable securities laws in open market, private, or accelerated repurchase transactions from time to time, depending on market conditions, and may be discontinued at any time.

(2) Under the Third Quarter ASR Program, the Company paid \$500 million in July 2015 and received an initial delivery of 9,679,195 shares on August 21, 2015, representing an estimated 75 percent of the shares to be purchased by the Company under the Third Quarter ASR Program based on a volume-weighted average price of \$38.7429 per share of the Company's common stock on the New York Stock Exchange during a calculation period between August 3, 2015 and August 20, 2015. The specific number of shares that the Company ultimately will repurchase under the Third Quarter ASR Program will be determined based generally on a discount to the volume-weighted average price per share of the Company's common stock during a calculation period to be completed in fourth quarter 2015. At settlement, under certain circumstances, the third party financial institution may be required to deliver additional shares of common stock to the Company, or under certain circumstances, the Company may be required to deliver shares of its common stock or may elect to make a cash payment to the third

party financial institution.

Item 3. Defaults Upon Senior Securities

None

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Item 4. Mine Safety Disclosures

Not applicable

Item 5. Other Information

None

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Item 6. Exhibits

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|---------|---|
| 3.1     | Restated Certificate of Formation of the Company, effective May 18, 2012 (incorporated by reference to Exhibit 3.1 to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 2012 (File No. 1-7259)). |
| 3.2     | Amended and Restated Bylaws of the Company, effective November 19, 2009 (incorporated by reference to Exhibit 3.1 to the Company's Current Report on Form 8-K filed November 20, 2009 (File No. 1-7259)).                 |
| 10.1    | Supplemental Letter Agreement No. 1810-LA-1501773 to Purchase Agreement No. 1810, dated January 19, 1994, between The Boeing Company and the Company.   |
| 31.1    | Rule 13a-14(a) Certification of Chief Executive Officer.  |
| 31.2    | Rule 13a-14(a) Certification of Chief Financial Officer.  |
| 32.1    | Section 1350 Certifications of Chief Executive Officer and Chief Financial Officer. (1)   |
| 101.INS | XBRL Instance Document.   |
| 101.SCH | XBRL Taxonomy Extension Schema Document.  |
| 101.CAL | XBRL Taxonomy Extension Calculation Linkbase Document.  |
| 101.DEF | XBRL Taxonomy Extension Definition Linkbase Document.   |
| 101.LAB | XBRL Taxonomy Extension Labels Linkbase Document.   |
| 101.PRE | XBRL Taxonomy Extension Presentation Linkbase Document.   |

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(1) Furnished, not filed.



SIGNATURES

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

SOUTHWEST AIRLINES CO.

October 29, 2015

By /s/ Tammy Romo

Tammy Romo  
Executive Vice President & Chief Financial Officer  
(On behalf of the Registrant and in  
her capacity as Principal Financial  
and Accounting Officer)

EXHIBIT INDEX

|         |   |
|---------|---|
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| 101.INS | XBRL Instance Document.   |
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| 101.PRE | XBRL Taxonomy Extension Presentation Linkbase Document.   |

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(1) Furnished, not filed.