

**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 June 30, 2022

or

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

For the transition period from _____ to _____

Commission File No. **1-7259**



SOUTHWEST AIRLINES CO.

(Exact name of registrant as specified in its charter)

Texas

(State or other jurisdiction of
incorporation or organization)

P.O. Box 36611

Dallas, Texas

(Address of principal executive offices)

74-1563240

(IRS Employer
Identification No.)

75235-1611

(Zip Code)

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

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Trading Symbol	Name of each exchange on which registered
Common Stock (\$1.00 par value)	LUV	New York Stock Exchange

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 every Interactive Data File required to be submitted 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 such files). Yes No

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

Large accelerated filer	<input checked="" type="checkbox"/>	Accelerated filer	<input type="checkbox"/>
Non-accelerated filer	<input type="checkbox"/>	Smaller reporting company	<input type="checkbox"/>
		Emerging growth company	<input type="checkbox"/>

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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 July 28, 2022: 593,350,161

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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)

	<u>June 30, 2022</u>	<u>December 31, 2021</u>
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 13,234	\$ 12,480
Short-term investments	3,197	3,024
Accounts and other receivables	1,389	1,357
Inventories of parts and supplies, at cost	751	537
Prepaid expenses and other current assets	825	638
Total current assets	<u>19,396</u>	<u>18,036</u>
Property and equipment, at cost:		
Flight equipment	21,598	21,226
Ground property and equipment	6,563	6,342
Deposits on flight equipment purchase contracts	637	—
Assets constructed for others	12	6
	<u>28,810</u>	<u>27,574</u>
Less allowance for depreciation and amortization	<u>13,216</u>	<u>12,732</u>
	15,594	14,842
Goodwill	970	970
Operating lease right-of-use assets	1,495	1,590
Other assets	847	882
	<u>\$ 38,302</u>	<u>\$ 36,320</u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 1,908	\$ 1,282
Accrued liabilities	1,587	1,624
Current operating lease liabilities	242	239
Air traffic liability	6,312	5,566
Current maturities of long-term debt	1,662	453
Total current liabilities	<u>11,711</u>	<u>9,164</u>
Long-term debt less current maturities	8,877	10,274
Air traffic liability - noncurrent	2,206	2,159
Deferred income taxes	2,072	1,770
Noncurrent operating lease liabilities	1,220	1,315
Other noncurrent liabilities	1,096	1,224
Stockholders' equity:		
Common stock	888	888
Capital in excess of par value	3,966	4,224
Retained earnings	16,311	15,774
Accumulated other comprehensive income	805	388
Treasury stock, at cost	<u>(10,850)</u>	<u>(10,860)</u>
Total stockholders' equity	<u>11,120</u>	<u>10,414</u>
	<u>\$ 38,302</u>	<u>\$ 36,320</u>

See accompanying notes.

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

	Three months ended June 30,		Six months ended June 30,	
	2022	2021	2022	2021
OPERATING REVENUES:				
Passenger	\$ 6,119	\$ 3,569	\$ 10,254	\$ 5,282
Freight	47	50	89	92
Other	562	389	1,079	686
Total operating revenues	<u>6,728</u>	<u>4,008</u>	<u>11,422</u>	<u>6,060</u>
OPERATING EXPENSES, NET:				
Salaries, wages, and benefits	2,220	1,825	4,450	3,395
Payroll support and voluntary Employee programs, net	—	(740)	—	(2,187)
Fuel and oil	1,636	803	2,640	1,272
Maintenance materials and repairs	210	222	420	395
Landing fees and airport rentals	388	403	733	716
Depreciation and amortization	325	315	649	627
Other operating expenses	791	586	1,523	1,049
Total operating expenses, net	<u>5,570</u>	<u>3,414</u>	<u>10,415</u>	<u>5,267</u>
OPERATING INCOME	1,158	594	1,007	793
OTHER EXPENSES (INCOME):				
Interest expense	93	116	186	229
Capitalized interest	(11)	(8)	(20)	(19)
Interest income	(28)	(2)	(31)	(4)
Other (gains) losses, net	68	(14)	212	(61)
Total other expenses (income)	<u>122</u>	<u>92</u>	<u>347</u>	<u>145</u>
INCOME BEFORE INCOME TAXES	1,036	502	660	648
PROVISION FOR INCOME TAXES	276	154	178	185
NET INCOME	\$ 760	\$ 348	\$ 482	\$ 463
NET INCOME PER SHARE, BASIC	\$ 1.29	\$ 0.59	\$ 0.83	\$ 0.78
NET INCOME PER SHARE, DILUTED	\$ 1.20	\$ 0.57	\$ 0.77	\$ 0.76
COMPREHENSIVE INCOME	\$ 674	\$ 544	\$ 899	\$ 723
WEIGHTED AVERAGE SHARES OUTSTANDING				
Basic	593	591	593	591
Diluted	635	615	640	612

See accompanying notes.

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

	Common Stock	Capital in excess of par value	Retained earnings	Accumulated other comprehensive income	Treasury stock	Total
Balance at December 31, 2021	\$ 888	\$ 4,224	\$ 15,774	\$ 388	\$ (10,860)	\$ 10,414
Cumulative effect of adopting Accounting Standards Update No. 2020-06, Debt (See Note 3)	—	(300)	55	—	—	(245)
Issuance of common and treasury stock pursuant to Employee stock plans	—	—	—	—	7	7
Share-based compensation	—	16	—	—	—	16
Comprehensive income	—	—	(278)	503	—	225
Balance at March 31, 2022	\$ 888	\$ 3,940	\$ 15,551	\$ 891	\$ (10,853)	\$ 10,417
Issuance of common and treasury stock pursuant to Employee stock plans	—	10	—	—	3	13
Share-based compensation	—	16	—	—	—	16
Comprehensive income (loss)	—	—	760	(86)	—	674
Balance at June 30, 2022	\$ 888	\$ 3,966	\$ 16,311	\$ 805	\$ (10,850)	\$ 11,120

	Common Stock	Capital in excess of par value	Retained earnings	Accumulated other comprehensive income (loss)	Treasury stock	Total
Balance at December 31, 2020	\$ 888	\$ 4,191	\$ 14,777	\$ (105)	\$ (10,875)	\$ 8,876
Cumulative effect of adopting Accounting Standards Update No. 2016-01, Financial Instruments	—	—	19	(19)	—	—
Issuance of common and treasury stock pursuant to Employee stock plans	—	(8)	—	—	8	—
Share-based compensation	—	14	—	—	—	14
Stock warrants	—	23	—	—	—	23
Comprehensive income	—	—	116	64	—	180
Balance at March 31, 2021	\$ 888	\$ 4,220	\$ 14,912	\$ (60)	\$ (10,867)	\$ 9,093
Issuance of common and treasury stock pursuant to Employee stock plans	—	11	—	—	2	13
Share-based compensation	—	16	—	—	—	16
Stock warrants	—	22	—	—	—	22
Comprehensive income (loss)	—	—	348	196	—	544
Balance at June 30, 2021	\$ 888	\$ 4,269	\$ 15,260	\$ 136	\$ (10,865)	\$ 9,688

See accompanying notes.

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

	Three months ended		Six months ended	
	June 30,		June 30,	
	2022	2021	2022	2021
CASH FLOWS FROM OPERATING ACTIVITIES:				
Net income	\$ 760	\$ 348	\$ 482	\$ 463
Adjustments to reconcile net income to cash provided by operating activities:				
Depreciation and amortization	325	315	649	627
Impairment of long-lived assets	15	—	31	—
Unrealized mark-to-market adjustment on available for sale securities	4	—	7	—
Unrealized/realized (gain) loss on fuel derivative instruments	(20)	(17)	15	(23)
Deferred income taxes	272	(30)	174	(26)
Loss on partial extinguishment of convertible and unsecured notes	43	—	116	—
Changes in certain assets and liabilities:				
Accounts and other receivables	439	(563)	105	(797)
Other assets	(1)	16	(45)	5
Accounts payable and accrued liabilities	328	989	506	923
Air traffic liability	(92)	946	793	1,546
Other liabilities	(103)	(64)	(209)	(186)
Cash collateral received from (provided to) derivative counterparties	(101)	48	284	86
Other, net	37	17	69	32
Net cash provided by operating activities	1,906	2,005	2,977	2,650
CASH FLOWS FROM INVESTING ACTIVITIES:				
Capital expenditures	(987)	(95)	(1,497)	(190)
Assets constructed for others	(3)	—	(6)	—
Purchases of short-term investments	(1,545)	(1,651)	(2,470)	(2,975)
Proceeds from sales of short-term and other investments	980	1,277	2,280	2,495
Net cash used in investing activities	(1,555)	(469)	(1,693)	(670)
CASH FLOWS FROM FINANCING ACTIVITIES:				
Proceeds from Payroll Support Program loan and warrants	—	625	—	1,136
Proceeds from Employee stock plans	13	13	19	26
Payments of long-term debt and finance lease obligations	(53)	(43)	(146)	(109)
Payments for repurchases and conversions of convertible debt	(178)	—	(409)	—
Other, net	3	22	6	28
Net cash provided by (used in) financing activities	(215)	617	(530)	1,081
NET CHANGE IN CASH AND CASH EQUIVALENTS	136	2,153	754	3,061
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	13,098	11,971	12,480	11,063
CASH AND CASH EQUIVALENTS AT END OF PERIOD	\$ 13,234	\$ 14,124	\$ 13,234	\$ 14,124
CASH PAYMENTS FOR:				
Interest, net of amount capitalized	\$ 141	\$ 150	\$ 161	\$ 167
Income taxes	\$ 7	\$ 176	\$ 11	\$ 177
SUPPLEMENTAL DISCLOSURE OF NONCASH TRANSACTIONS:				
Adoption of Accounting Standards Update 2020-06, Debt (See Note 3)	\$ —	\$ —	\$ 245	\$ —
Right-of-use assets acquired under operating leases	\$ 3	\$ 12	\$ 27	\$ 230
Flight equipment acquired against supplier credit memo	\$ —	\$ 207	\$ —	\$ 512
Assets constructed for others	\$ —	\$ (341)	\$ —	\$ (309)

See accompanying notes.

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

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1. BASIS OF PRESENTATION

Southwest Airlines Co. (the "Company" or "Southwest") 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.

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 June 30, 2022 and 2021 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. However, beginning in early 2020, as a result of the COVID-19 pandemic, the Company's results have not always been in line with such historical trends. See Note 2 for further information. Air travel is also significantly impacted by general economic conditions, the amount of disposable income available to consumers and changes in consumer behavior, unemployment levels, corporate travel budgets, global pandemics such as COVID-19, extreme or severe weather and natural disasters, fears of terrorism or war, governmental actions, 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, and the periodic volatility of commodities used by the Company for hedging jet fuel, have created, and may continue to create, significant volatility in the Company's financial results. See Note 4 for further information on fuel and the Company's hedging program. Operating results for the three and six months ended June 30, 2022, are not necessarily indicative of the results that may be expected for future quarters or for the year ended December 31, 2022. For further information, refer to the Consolidated Financial Statements and footnotes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2021.

2. WORLDWIDE PANDEMIC

As a result of the rapid spread of the novel coronavirus, COVID-19, throughout the world, including into the United States, on March 11, 2020, the World Health Organization classified the virus as a pandemic. The speed with which the effects of the COVID-19 pandemic changed the U.S. economic landscape, outlook, and in particular the travel industry, was swift and unexpected. The Company experienced significant disruptions in travel and reduced bookings throughout the remainder of 2020 and for the entirety of 2021 as a result of the pandemic and subsequent variants of COVID-19. Following a significant negative impact to revenues and bookings in January and February 2022, which included increased trip cancellations and staffing challenges associated with the Omicron variant, the Company saw improvements in revenue trends in March 2022 and throughout second quarter 2022 as COVID-19 cases significantly trended downward and bookings for summer travel accelerated. The Company continues to monitor demand for air travel and proactively adjust its published flight schedules and capacity.

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

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

<u>(dollars in millions, shares in thousands)</u>	Grant	Promissory Note	Warrants	Total Payroll Support Proceeds	Warrants (shares)	Warrant strike price	Promissory Note Maturity Date
PSP1	\$ 2,337	\$ 976	\$ 40	\$ 3,354	2,676	\$36.47/share	April 19, 2030
PSP2	\$ 1,393	\$ 566	\$ 27	\$ 1,987	1,223	\$46.28/share	January 15, 2031
PSP3	\$ 1,310	\$ 526	\$ 18	\$ 1,852	899	\$58.51/share	April 23, 2031
Total	\$ 5,040	\$ 2,068	\$ 85	\$ 7,193	4,798		

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

Under each of the three Payroll Support programs, funds received were used solely to pay qualifying employee salaries, wages, and benefits. All grant portions of the Payroll Support programs received had been allocated and classified as a contra-expense line item in the Company's financial statements by the end of 2021, including approximately \$724 million and \$1.9 billion for the three and six months ended June 30, 2021, in the accompanying unaudited Condensed Consolidated Statement of Comprehensive Income.

On June 1, 2020, the Company announced Voluntary Separation Program 2020 ("Voluntary Separation Program"), a voluntary separation program that allowed eligible Employees the opportunity to voluntarily separate from the

Company in exchange for severance, medical/dental coverage for a specified period of time, and travel privileges based on years of service. A total of over 4,200 Employees elected to participate in Voluntary Separation Program.

In conjunction with Voluntary Separation Program, the Company also offered certain contract Employees the option to take voluntary Extended Emergency Time Off ("Extended ETO"), for periods between six and 18 months, with the exception of Pilots, who could elect to take Extended ETO for periods of up to five years, all subject to early recalls. Approximately 12,000 Employees participated in the Extended ETO program in 2020 and 2021 combined. The Company had no Employees remaining on Extended ETO past March 31, 2022.

The purpose of Voluntary Separation Program and Extended ETO was to maintain a reduced workforce to operate at reduced capacity relative to the Company's operations prior to the COVID-19 pandemic. In accordance with the accounting guidance in Accounting Standards Codification ("ASC") Topic 712 (Compensation — Nonretirement Postemployment Benefits), the Company accrued charges related to the special termination benefits described above upon Employees accepting Voluntary Separation Program or Extended ETO offers. The Company accrued expenses totaling \$1.4 billion for its Voluntary Separation Program and Extended ETO program in 2020, which are being reduced as program benefits are paid. For both the Voluntary Separation Program and Extended ETO programs combined, approximately \$60 million of the liability balances were relieved during the first six months of 2022 through payments to Employees, leaving a balance of \$269 million as of June 30, 2022. The liability associated with the Extended ETO program was fully relieved at March 31, 2022. During the first six months of 2021, the Company determined that it was no longer probable that the remaining portion of the Employees on Extended ETO would remain on such leave for their entire elected term. Therefore, a portion of the accruals previously recorded were reversed, resulting in a net \$130 million credit to expense during the first six months of 2021. Both the initial charge and the partial reversal were classified within Payroll support and voluntary Employee programs, net, in the accompanying unaudited Condensed Consolidated Statement of Comprehensive Income.

In response to flight schedule adjustments due to the effects of the COVID-19 pandemic, a number of aircraft were taken out of the Company's schedule beginning in late March 2020, and placed in short-term storage, as well as some in a longer term storage program. As of June 30, 2022, four Boeing 737-700 aircraft remained in storage, all of which were retired from the Company's fleet in July 2022.

3. NEW ACCOUNTING PRONOUNCEMENTS

On May 3, 2021, the FASB issued ASU 2021-04, Earnings Per Share (Topic 260), Debt—Modifications and Extinguishments (Subtopic 470-50), Compensation—Stock Compensation (Topic 718), and Derivatives and Hedging—Contracts in Entity's Own Equity (Subtopic 815-40): Issuer's Accounting for Certain Modifications or Exchanges of Freestanding Equity-Classified Written Call Options. This new standard provides clarification and reduces diversity in an issuer's accounting for modifications or exchanges of freestanding equity-classified written call options (such as warrants) that remain equity classified after modification or exchange. This standard is effective for fiscal years beginning after December 15, 2021, and the standard was adopted and applied prospectively by the Company as of January 1, 2022, but the adoption and application did not have a significant impact on the Company's financial statements and disclosures, including interim periods.

On January 7, 2021, the FASB issued ASU 2021-01, Reference Rate Reform (Topic 848). This new standard provides optional temporary guidance for entities transitioning away from London Interbank Offered Rate ("LIBOR") to new reference interest rates so that derivatives affected by the discounting transition are explicitly eligible for certain optional expedients and exceptions with Topic 848. These amendments do not apply to any contract modifications made after December 31, 2022, any new hedging relationships entered into after December 31, 2022, or to existing hedging relationships evaluated for effectiveness existing as of December 31, 2022, that apply certain optional practical expedients. This standard was effective immediately and may be applied (i) on a full retrospective basis as of any date from the beginning of an interim period that includes or is subsequent to March 12, 2020, or (ii) on a prospective basis to new modifications from any date within an interim period that includes or is subsequent to the date of the issuance of a final update, up to the date that financial statements are available to be

issued. The Company had no material LIBOR-related contract modifications during the six months ended June 30, 2022.

On August 5, 2020, the FASB issued ASU 2020-06, Debt—Debt with Conversion and Other Options (Subtopic 470-20) and Derivatives and Hedging—Contracts in Entity’s Own Equity (Subtopic 815-40): Accounting for Convertible Instruments and Contracts in an Entity’s Own Equity. This new standard reduced the number of accounting models for convertible debt instruments and convertible preferred stock, made targeted improvements to the disclosures for convertible instruments and earnings-per-share ("EPS") guidance, and amended the guidance for the derivatives scope exception for contracts in an entity’s own equity to reduce form-over-substance-based accounting conclusions. This standard is effective for fiscal years beginning after December 15, 2021, and the Company adopted this standard as of January 1, 2022, utilizing the modified retrospective method. Under the modified approach, the Company applied guidance to all financial instruments that were outstanding as of the beginning of the year of adoption with the cumulative effect recognized as an adjustment to the opening balance of retained earnings. Upon adoption, the Company reclassified the remaining equity component of \$300 million, from Additional paid-in capital to Long-term debt associated with its 1.25% Convertible Senior Notes due 2025 (the “Convertible Notes”), and no longer records amortization of the debt discount to Interest expense. The cumulative effect from prior period amortization of the debt discount that has been recorded to Interest expense, offset by reductions to Capital in excess of par value related to the requisition of the equity component through previous repurchases, resulted in a \$55 million adjustment to the opening balance of Retained earnings upon adoption. The new standard requires the use of the if-converted method to calculate diluted EPS, which is generally more dilutive, rather than the treasury stock method as was the Company's policy pre-adoption. For the three and six months ended June 30, 2022, the impacts of adopting this new standard were decreases to the Company's Net income in the amounts of \$21 million, or \$0.20 per diluted share, and \$57 million, or \$0.21 per diluted share, respectively, as a result of higher losses recognized on the Company’s extinguishment transactions following the elimination of the equity component of the Convertible Notes, partially offset by the elimination of the non-cash interest expense associated with the prior debt discount amortization. See Note 7.

4. FINANCIAL DERIVATIVE INSTRUMENTS

Fuel Contracts

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

The Company has used financial derivative instruments for both short-term and long-term timeframes, and 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.

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

As of June 30, 2022, the Company had fuel derivative instruments in place to provide coverage at varying price levels. The following table provides information about the Company's volume of fuel hedging on an economic basis:

Period (by year)	Maximum fuel hedged as of June 30, 2022 (gallons in millions) (a)	Derivative underlying commodity type as of June 30, 2022
Remainder of 2022	610	WTI crude oil, Brent crude oil, and Heating oil
2023	769	WTI crude oil and Brent crude oil
2024	358	WTI crude oil

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

Upon proper qualification, the Company accounts for its fuel derivative instruments as cash flow hedges. Qualification is re-evaluated quarterly, and all periodic changes in fair value of the derivatives designated as hedges are recorded in Accumulated other comprehensive income ("AOCI") until the underlying jet fuel is consumed. See Note 5.

If a derivative initially does not qualify or ceases to qualify for hedge accounting, any change in the fair value of the derivative instrument since the last reporting period would be recorded in 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. Factors that have and may continue to lead to the loss of hedge accounting include: significant fluctuation in energy prices, significant weather events affecting refinery capacity and the production of refined products, and the volatility of the different types of products the Company uses in hedging. Certain types of derivative instruments do not qualify for hedge accounting, including those that result in a net sold position (sold gallons exceeding purchased gallons). Increased volatility in certain commodity markets for an extended period of time, especially if such volatility were to worsen, could cause the Company to lose hedge accounting altogether for the commodities used in its fuel hedging program, which would create further volatility in the Company's GAAP financial results. However, even though derivatives may not qualify for hedge accounting, the Company continues to hold the instruments as management believes derivative instruments continue to afford the Company the opportunity to stabilize jet fuel costs. When the Company has sold derivative positions in order to effectively "close" or offset a derivative already held as part of its fuel derivative instrument portfolio, any subsequent changes in fair value of those positions are marked to market through earnings. Likewise, any changes in fair value of those positions that were offset by entering into the sold positions and were de-designated as hedges are concurrently marked to market through 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 that have been recorded to AOCI would be required to be immediately reclassified into earnings.

During 2021, as a result of the drop in demand for air travel compared with 2019 due to the pandemic, the Company was in an estimated "over-hedged" position and was required to de-designate a portion of its fuel hedges for hedge accounting purposes. However, the impact of such de-designations was not material to 2021 financial results.

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	Fair value at	Fair value at	Fair value at
		6/30/2022	12/31/2021	6/30/2022	12/31/2021
Derivatives designated as hedges (a)					
Fuel derivative contracts (gross)	Prepaid expenses and other current assets	\$ 797	\$ 409	\$ —	\$ —
Fuel derivative contracts (gross)	Other assets	372	287	—	—
Interest rate derivative contracts	Other assets	11	—	—	—
Interest rate derivative contracts	Other noncurrent liabilities	—	—	—	4
Total derivatives designated as hedges		<u>\$ 1,180</u>	<u>\$ 696</u>	<u>\$ —</u>	<u>\$ 4</u>
Derivatives not designated as hedges (a)					
Fuel derivative contracts (gross)	Prepaid expenses and other current assets	\$ 125	\$ —	\$ 167	\$ —
Total derivatives		<u>\$ 1,305</u>	<u>\$ 696</u>	<u>\$ 167</u>	<u>\$ 4</u>

(a) Represents the position of each trade before consideration of offsetting positions with each counterparty and does not include the impact of cash collateral deposits provided to or received from counterparties. See discussion of credit risk and collateral following in this Note 4.

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

(in millions)	Balance Sheet location	June 30, 2022	December 31, 2021
Cash collateral deposits held from counterparties for fuel contracts - current	Offset against Prepaid expenses and other current assets	\$ 297	\$ 80
Cash collateral deposits held from counterparties for fuel contracts - noncurrent	Offset against Other assets	162	95
Receivable from third parties for fuel contracts	Accounts and other receivables	125	8

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. If its fuel derivative instruments are in a net asset position with a counterparty, cash collateral amounts held are first netted against current outstanding derivative asset amounts associated with that counterparty until that balance is zero, and then any remainder is applied against the fair value of noncurrent outstanding derivative instruments. As of June 30, 2022, no cash collateral deposits were provided by or held by the Company based on its outstanding interest rate swap agreements.

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	June 30, 2022			December 31, 2021		
		(i)	(ii)	(iii) = (i) + (ii)	(i)	(ii)	(iii) = (i) + (ii)
		Gross amounts of recognized assets	Gross amounts offset in the Balance Sheet	Net amounts of assets presented in the Balance Sheet	Gross amounts of recognized assets	Gross amounts offset in the Balance Sheet	Net amounts of assets presented in the Balance Sheet
Fuel derivative contracts	Prepaid expenses and other current assets	\$ 922	\$ (464) (b)	\$ 458	\$ 409	\$ (80)	\$ 329
Fuel derivative contracts	Other assets	\$ 372	\$ (162)	\$ 210 (a)	\$ 287	\$ (95)	\$ 192 (a)
Interest rate derivative contracts	Other assets	\$ 11	\$ —	\$ 11 (a)	\$ —	\$ —	\$ — (a)

(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 9.

(b) Includes the current portion of cash collateral deposits held from counterparties and derivative liability associated with fuel contracts.

Offsetting of derivative liabilities
(in millions)

Description	Balance Sheet location	June 30, 2022			December 31, 2021		
		(i)	(ii)	(iii) = (i) + (ii)	(i)	(ii)	(iii) = (i) + (ii)
		Gross amounts of recognized liabilities	Gross amounts offset in the Balance Sheet	Net amounts of liabilities presented in the Balance Sheet	Gross amounts of recognized liabilities	Gross amounts offset in the Balance Sheet	Net amounts of liabilities presented in the Balance Sheet
Fuel derivative contracts	Prepaid expenses and other current assets	\$ 464	\$ (464) (b)	\$ —	\$ 80	\$ (80)	\$ —
Fuel derivative contracts	Other assets	\$ 162	\$ (162)	\$ — (a)	\$ 95	\$ (95)	\$ — (a)
Interest rate derivative contracts	Other noncurrent liabilities	\$ —	\$ —	\$ —	\$ 4	\$ —	\$ 4

(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 9.

(b) Includes the current portion of cash collateral deposits held from counterparties and derivative liability associated with fuel contracts.

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 six months ended June 30, 2022 and 2021:

Location and amount recognized in income on cash flow and fair value hedging relationships

(in millions)	Three months ended June 30, 2022		Three months ended June 30, 2021	
	Fuel and oil	Other operating expenses	Fuel and oil	Other operating expenses
Total	\$ (306)	\$ 2	\$ 12	\$ 1

(Gain) loss on cash flow hedging relationships:

Commodity contracts:

Amount of (gain) loss reclassified from AOCI into income	(306)	—	12	—
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Interest contracts:

Amount of loss reclassified from AOCI into income	—	2	—	1
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Location and amount recognized in income on cash flow and fair value hedging relationships

(in millions)	Six months ended June 30, 2022			Six months ended June 30, 2021		
	Fuel and oil	Other (gains)/ losses, net	Other operating expenses	Fuel and oil	Other (gains)/ losses, net	Other operating expenses
Total	\$ (508)	\$ —	\$ 3	\$ 28	\$ 6	\$ 2

(Gain) loss on cash flow hedging relationships

Commodity contracts:

Amount of (gain) loss reclassified from AOCI into income	(508)	—	—	28	6	—
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Interest contracts:

Amount of loss reclassified from AOCI into income	—	—	3	—	—	2
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Derivatives designated and qualified in cash flow hedging relationships

(in millions)	(Gain) loss recognized in AOCI on derivatives, net of tax	
	Three months ended June 30,	
	2022	2021
Fuel derivative contracts	\$ (140)	\$ (192)
Interest rate derivatives	(7)	6
Total	\$ (147)	\$ (186)

Derivatives designated and qualified in cash flow hedging relationships

(in millions)	(Gain) loss recognized in AOCI on derivatives, net of tax	
	Six months ended	
	June 30,	
	2022	2021
Fuel derivative contracts	\$ (792)	\$ (275)
Interest rate derivatives	(12)	(4)
Total	\$ (804)	\$ (279)

Derivatives not designated as hedges

(in millions)	(Gain) loss recognized in income on derivatives		Location of gain recognized in income on derivatives
	Three months ended		
	June 30,		
	2022	2021	
Fuel derivative contracts	\$ (20)	\$ (12)	Other (gains) losses, net

Derivatives not designated as hedges

(in millions)	(Gain) loss recognized in income on derivatives		Location of (gain) loss recognized in income on derivatives
	Six months ended		
	June 30,		
	2022	2021	
Fuel derivative contracts	\$ 15	\$ (16)	Other (gains) losses, net

The Company also recorded expense associated with premiums paid for fuel derivative contracts that settled/expired during the three and six months ended June 30, 2022 and 2021. Gains and/or losses associated with fuel derivatives that qualify for hedge accounting are ultimately recorded to Fuel and oil expense. Gains and/or losses associated with fuel derivatives that do not qualify for hedge accounting are recorded to Other (gains) and losses, net. The following tables present the impact of premiums paid for fuel derivative contracts and their location within the unaudited Condensed Consolidated Statement of Comprehensive Income during the period the contract settles:

(in millions)	Premium expense recognized in income on derivatives		Location of premium expense recognized in income on derivatives
	Three months ended		
	June 30,		
	2022	2021	
Fuel derivative contracts designated as hedges	\$ 26	\$ 14	Fuel and oil
Fuel derivative contracts not designated as hedges	—	10	Other (gains) losses, net

(in millions)	Premium expense recognized in income on derivatives		Location of premium expense recognized in income on derivatives
	Six months ended June 30,		
	2022	2021	
Fuel derivative contracts designated as hedges	\$ 53	\$ 29	Fuel and oil
Fuel derivative contracts not designated as hedges	—	21	Other (gains) losses, net

The fair values of the derivative instruments, depending on the type of instrument, were determined by the use of present value methods or option value models with assumptions about commodity prices based on those observed in underlying markets or provided by third parties. Included in the Company's cumulative unrealized gains from fuel hedges as of June 30, 2022, recorded in AOCI, were approximately \$545 million in net unrealized gains, net of taxes, which are expected to be realized in earnings during the twelve months subsequent to June 30, 2022.

Interest Rate Swaps

The Company is party to certain interest rate swap agreements that are accounted for as cash flow hedges, and has in the past held interest rate swap agreements that have qualified as fair value hedges, as defined in the applicable accounting guidance for derivative instruments and hedging. Several of the Company's interest rate swap agreements qualify for the "shortcut" or "critical terms match" methods of accounting for hedges, which dictate that the hedges were assumed to be perfectly effective at origination, and, thus, there was no ineffectiveness to be recorded in earnings.

For the Company's interest rate swap agreements that do not qualify for the "shortcut" or "critical terms match" methods of accounting, ineffectiveness is assessed at each reporting period. If hedge accounting is achieved, all periodic changes in fair value of the interest rate swaps are recorded in AOCI.

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 June 30, 2022, the Company had agreements with all of its active counterparties containing early termination rights and/or bilateral collateral provisions whereby security is required if market risk exposure exceeds a specified threshold amount based on the counterparty's credit rating. The Company also had agreements with counterparties in which cash deposits and letters of credit were required to be posted as collateral whenever the net fair value of derivatives associated with those counterparties exceeds specific thresholds. In certain cases, the Company has the ability to substitute among these different forms of collateral at its discretion.

The following table provides the fair values of fuel derivatives, amounts posted as collateral, and applicable collateral posting threshold amounts as of June 30, 2022, at which such postings are triggered:

Southwest Airlines Co.
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(in millions)	Counterparty (CP)							Other (a)	Total
	A	B	C	D	E	F	G		
Fair value of fuel derivatives	\$ 289	\$ 148	\$ 264	\$ 95	\$ 131	\$ 85	\$ 92	\$ 23	\$ 1,127
Cash collateral held from CP	356	7	37	—	40	19	—	—	459
Option to substitute LC for cash	N/A	N/A	(b)	(b)	(b)	N/A	(b)		
If credit rating is investment grade, fair value of fuel derivative level at which:									
Cash is provided to CP	>(100)	>(50)	>(75)	>(125)	>(40)	>(65)	>(100)		
Cash is received from CP	>0(c)	>150(c)	>250(c)	>125(c)	>100(c)	>70(c)	>100(c)		
If credit rating is non-investment grade, fair value of fuel derivative level at which:									
Cash is received from CP	(d)	(d)	(d)	(d)	(d)	(d)	(d)		

- (a) Individual counterparties with fair value of fuel derivatives < \$12 million.
(b) The Company has the option to substitute letters of credit for 100 percent of cash collateral requirement.
(c) Thresholds may vary based on changes in credit ratings within investment grade.
(d) Cash collateral is provided at 100 percent of fair value of fuel derivative contracts.

5. 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 six months ended June 30, 2022 and 2021 were as follows:

(in millions)	Three months ended June 30,	
	2022	2021
NET INCOME	\$ 760	\$ 348
Unrealized gain (loss) on fuel derivative instruments, net of deferred taxes of (\$29) and \$61	(95)	201
Unrealized gain (loss) on interest rate derivative instruments, net of deferred taxes of \$3 and (\$1)	9	(5)
Total other comprehensive income (loss)	\$ (86)	\$ 196
COMPREHENSIVE INCOME	\$ 674	\$ 544

(in millions)	Six months ended June 30,	
	2022	2021
NET INCOME	\$ 482	\$ 463
Unrealized gain on fuel derivative instruments, net of deferred taxes of \$122 and \$92	403	301
Unrealized gain on interest rate derivative instruments, net of deferred taxes of \$5 and \$1	14	6
Other, net of deferred taxes of \$— and (\$13)	—	(47)
Total other comprehensive income	\$ 417	\$ 260
COMPREHENSIVE INCOME	\$ 899	\$ 723

A rollforward of the amounts included in AOCI, net of taxes, is shown below for the three and six months ended June 30, 2022:

(in millions)	Fuel derivatives	Interest rate derivatives	Defined benefit plan items	Deferred tax	Accumulated other comprehensive income
Balance at March 31, 2022	\$ 1,141	\$ (50)	\$ 66	\$ (266)	\$ 891
Changes in fair value	182	10	—	(45)	147
Reclassification to earnings	(306)	2	—	71	(233)
Balance at June 30, 2022	<u>\$ 1,017</u>	<u>\$ (38)</u>	<u>\$ 66</u>	<u>\$ (240)</u>	<u>\$ 805</u>

(in millions)	Fuel derivatives	Interest rate derivatives	Defined benefit plan items	Deferred tax	Accumulated other comprehensive income
Balance at December 31, 2021	\$ 492	\$ (57)	\$ 66	\$ (113)	\$ 388
Changes in fair value	1,033	16	—	(245)	804
Reclassification to earnings	(508)	3	—	118	(387)
Balance at June 30, 2022	<u>\$ 1,017</u>	<u>\$ (38)</u>	<u>\$ 66</u>	<u>\$ (240)</u>	<u>\$ 805</u>

The following table illustrates the significant amounts reclassified out of each component of AOCI for the three and six months ended June 30, 2022:

Three months ended June 30, 2022

(in millions)	Amounts reclassified from AOCI	Affected line item in the unaudited Condensed Consolidated Statement of Comprehensive Income
Unrealized gain on fuel derivative instruments	\$ (306)	Fuel and oil expense
	(71)	Less: Tax expense
	<u>\$ (235)</u>	Net of tax
Unrealized loss on interest rate derivative instruments	\$ 2	Other operating expenses
	—	Less: Tax expense
	<u>\$ 2</u>	Net of tax
Total reclassifications for the period	<u><u>\$ (233)</u></u>	Net of tax

Six months ended June 30, 2022

(in millions)	Amounts reclassified from AOCI	Affected line item in the unaudited Condensed Consolidated Statement of Comprehensive Income
Unrealized gain on fuel derivative instruments	\$ (508)	Fuel and oil expense
	(119)	Less: Tax expense
	<u>\$ (389)</u>	Net of tax
Unrealized loss on interest rate derivative instruments	\$ 3	Other operating expenses
	1	Less: Tax expense
	<u>\$ 2</u>	Net of tax
Total reclassifications for the period	<u><u>\$ (387)</u></u>	Net of tax

6. REVENUE

Passenger Revenues

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

Revenue is categorized by revenue source as the Company believes it best depicts the nature, amount, timing, and uncertainty of revenue and cash flow. The following table provides the components of Passenger revenue recognized for the three and six months ended June 30, 2022 and 2021:

(in millions)	Three months ended June 30,		Six months ended June 30,	
	2022	2021	2022	2021
Passenger non-loyalty	\$ 5,118	\$ 2,875	\$ 8,482	\$ 4,230
Passenger loyalty - air transportation	821	549	1,445	826
Passenger ancillary sold separately	180	145	327	226
Total passenger revenues	\$ 6,119	\$ 3,569	\$ 10,254	\$ 5,282

As of June 30, 2022, and December 31, 2021, the components of Air traffic liability, including contract liabilities based on tickets sold and unused flight credits available to the Customer, both of which are net of recorded breakage, and loyalty points available for redemption, within the unaudited Condensed Consolidated Balance Sheet were as follows:

(in millions)	Balance as of	
	June 30, 2022	December 31, 2021
Air traffic liability - passenger travel and ancillary passenger services	\$ 3,634	\$ 2,936
Air traffic liability - loyalty program	4,884	4,789
Total Air traffic liability	\$ 8,518	\$ 7,725

The balance in Air traffic liability - passenger travel and ancillary passenger services also includes unused funds that are available for use by Customers and are not currently associated with a ticket, although they remain reusable, for a period of time, in the form of a flight credit that can be applied towards the purchase of future travel. These flight credits are typically created as a result of a prior ticket cancellation or exchange. Rollforwards of the Company's Air traffic liability - loyalty program for the three and six months ended June 30, 2022 and 2021 were as follows (in millions):

	Three months ended June 30,		Six months ended June 30,	
	2022	2021	2022	2021
Air traffic liability - loyalty program - beginning balance	\$ 4,884	\$ 4,623	\$ 4,789	\$ 4,447
Amounts deferred associated with points awarded	842	656	1,579	1,121
Revenue recognized from points redeemed - Passenger	(821)	(549)	(1,445)	(826)
Revenue recognized from points redeemed - Other	(21)	(11)	(39)	(23)
Air traffic liability - loyalty program - ending balance	\$ 4,884	\$ 4,719	\$ 4,884	\$ 4,719

Air traffic liability includes consideration received for ticket and loyalty related performance obligations which have not been satisfied as of a given date. Rollforwards of the amounts included in Air traffic liability as of June 30, 2022 and 2021 were as follows (in millions):

	Air traffic liability
Balance at December 31, 2021	\$ 7,725
Current period sales (passenger travel, ancillary services, flight loyalty, and partner loyalty)	11,086
Revenue from amounts included in contract liability opening balances	(3,029)
Revenue from current period sales	(7,264)
Balance at June 30, 2022	\$ 8,518

	Air traffic liability
Balance at December 31, 2020	\$ 7,133
Current period sales (passenger travel, ancillary services, flight loyalty, and partner loyalty)	6,851
Revenue from amounts included in contract liability opening balances	(1,600)
Revenue from current period sales	(3,705)
Balance at June 30, 2021	\$ 8,679

During 2020 and in parts of 2021, the Company experienced a significantly higher number of Customer-driven flight cancellations as a result of the COVID-19 pandemic. See Note 2 for further information. As a result, the amount of Customer flight credits held in Air traffic liability that are estimated to be redeemed for future travel as of June 30, 2022, remains much higher than historical levels. The amount of such Customer funds represents approximately 5 percent and 16 percent of the total Air traffic liability balance at June 30, 2022, and December 31, 2021, respectively, compared to approximately 2 percent of the Air traffic liability balance as of December 31, 2019. In order to provide additional flexibility to Customers who hold these funds, the Company significantly relaxed its previous policies with regards to the time period within which these funds can be redeemed, which is typically twelve months from the original date of purchase. For all Customer flight credits created or that would have otherwise expired between March 1 and September 7, 2020 associated with flight cancellations, the Company previously extended the expiration date to September 7, 2022. At June 30, 2022, \$1.1 billion of extended Customer flight credits with a September 7, 2022 expiration date remained in Air traffic liability, although the Company has estimated that a portion of those will not be redeemed. As a result, recognition of these flight credits as flown revenue, refunds, or breakage revenue has created more volatility over the life of these funds compared to periods in which these extended funds did not exist.

On July 28, 2022, the Company announced that all existing Customer flight credits as of that date, as well as any future flight credits issued, will no longer expire and will thus remain redeemable by Customers. This announcement is considered a contract modification under applicable accounting guidance and the Company will account for such change prospectively beginning in third quarter 2022. The Company's balance of existing Customer flight credits as of the modification date was approximately \$1.9 billion, including the extended funds that had been set to expire on September 7, 2022. As the Company continues to believe that a portion of Customer flight credits will not be redeemed, it expects to continue to estimate and record breakage associated with such amounts, although the amount of breakage realized on a prospective basis is expected to be lower and more stable than it has been during the pandemic. Flight credits result from canceling reservations and previously were valid for no longer than one year from the date of original purchase. Flight credits for non-refundable fares will be issued as long as the flight is cancelled more than 10 minutes prior to the scheduled departure.

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

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

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

The Company recognized revenue related to the marketing, advertising, and other travel-related benefits of the revenue associated with various loyalty partner agreements including, but not limited to, the Agreement with Chase, within Other operating revenues. For the three months ended June 30, 2022 and 2021, the Company recognized \$522 million and \$352 million, respectively. For the six months ended June 30, 2022 and 2021, the Company recognized \$1.0 billion and \$632 million, respectively.

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

7. 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). For the three and six months ended June 30, 2022, an immaterial number of shares related to the Company's restricted stock units and stock warrants were excluded from the denominator because inclusion of such shares would be antidilutive. For the three and six months ended June 30, 2021, an immaterial number of shares

related to the Company's restricted stock units were excluded from the denominator because inclusion of such shares would be antidilutive.

	Three months ended June 30,		Six months ended June 30,	
	2022	2021	2022	2021
NUMERATOR:				
Net income	\$ 760	\$ 348	\$ 482	\$ 463
Add: Interest expense	4 (a)	—	8 (a)	—
Net income attributable to common stockholders	764	348	490	463
DENOMINATOR:				
Weighted-average shares outstanding, basic	593	591	593	591
Dilutive effects of Convertible Notes	41 (a)	22 (b)	46 (a)	19 (b)
Dilutive effect of stock warrants	—	1	—	1
Dilutive effect of restricted stock units	1	1	1	1
Adjusted weighted-average shares outstanding, diluted	635	615	640	612
NET INCOME PER SHARE:				
Basic	\$ 1.29	\$ 0.59	\$ 0.83	\$ 0.78
Diluted	\$ 1.20	\$ 0.57	\$ 0.77	\$ 0.76

(a) As of January 1, 2022, the Company adopted ASU 2020-06 using the modified retrospective method. The standard requires the Company to apply the if-converted method for purposes of Net income per share. Using this method, the numerator is affected by adding back interest expense and the denominator is affected by including the effect of potential share settlement, if the effect is more dilutive, regardless of the type of settlement. For the three and six months ended June 30, 2022, all shares issuable on conversion were included in the denominator. See Notes 3 and 11 for further information regarding the new standard and the Convertible Notes.

(b) Prior to the adoption of ASU 2020-06, the Convertible Notes were accounted for using the treasury stock method for the purposes of Net income per share. For the three and six months ended June 30, 2021, the average market price of the Company's common stock exceeded the conversion price per share of \$38.48 and as such, the common shares underlying the Convertible Notes were included in the diluted calculation.

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 June 30, 2022, 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 time deposits), 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 time deposits that are classified as Level 2, due to the fact that the fair value for these instruments is determined utilizing observable inputs in non-active markets. Equity securities primarily consist of investments with readily determinable market values associated with the Company's excess benefit plan.

The Company's fuel and interest rate derivative instruments consist of over-the-counter contracts, which are not traded on a public exchange. Fuel derivative instruments currently consist solely of option contracts, whereas

interest rate derivatives consist solely of swap agreements. See Note 4 for further information on the Company's derivative instruments and hedging activities. The fair values of swap contracts are determined based on inputs that are readily available in public markets or can be derived from information available in publicly quoted markets. Therefore, the Company has categorized these swap contracts as Level 2. The Company's Treasury Department, which reports to the Chief Financial Officer, determines the value of option contracts utilizing an option pricing model based on inputs that are either readily available in public markets, can be derived from information available in publicly quoted markets, or are provided by financial institutions that trade these contracts. The option pricing model used by the Company is an industry standard model for valuing options and is a similar model used by the broker/dealer community (i.e., the Company's counterparties). The inputs to this option pricing model are the option strike price, underlying price, risk free rate of interest, time to expiration, and volatility. Because certain inputs used to determine the fair value of option contracts are unobservable (principally implied volatility), the Company has categorized these option contracts as Level 3. Volatility information is obtained from external sources, but is analyzed by the Company for reasonableness and compared to similar information received from other external sources. The fair value of option contracts considers both the intrinsic value and any remaining time value associated with those derivatives that have not yet settled. The Company also considers counterparty credit risk and its own credit risk in its determination of all estimated fair values. To validate the reasonableness of the Company's option pricing model, on a monthly basis, the Company compares its option valuations to third party valuations. If any significant differences were to be noted, they would be researched in order to determine the reason. However, historically, no significant differences have been noted. The Company has consistently applied these valuation techniques in all periods presented and believes it has obtained the most accurate information available for the types of derivative contracts it holds.

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

The following tables present the Company's assets and liabilities that are measured at fair value on a recurring basis at June 30, 2022, and December 31, 2021:

Description	June 30, 2022	Fair value measurements at reporting date using:		
		Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Assets		(in millions)		
Cash equivalents:				
Cash equivalents (a)	\$ 12,964	\$ 12,964	\$ —	\$ —
Commercial paper	270	—	270	—
Short-term investments:				
Treasury bills	2,432	2,432	—	—
Certificates of deposit	90	—	90	—
Time deposits	675	—	675	—
Fuel derivatives:				
Option contracts (b)	1,294	—	—	1,294
Interest rate derivatives (see Note 4)	11	—	11	—
Equity Securities	225	225	—	—
Total assets	\$ 17,961	\$ 15,621	\$ 1,046	\$ 1,294
Liabilities				
Fuel derivatives:				
Option contracts (b)	\$ (167)	\$ —	\$ —	\$ (167)

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

(b) In the unaudited Condensed Consolidated Balance Sheet amounts are presented as a net asset. See Note 4.

Description	December 31, 2021	Fair value measurements at reporting date using:		
		Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Assets		(in millions)		
Cash equivalents:				
Cash equivalents (a)	\$ 12,340	\$ 12,340	\$ —	\$ —
Commercial paper	90	—	90	—
Time deposits	50	—	50	—
Short-term investments:				
Treasury bills	2,399	2,399	—	—
Time deposits	625	—	625	—
Fuel derivatives:				
Option contracts (b)	696	—	—	696
Equity Securities	288	288	—	—
Total assets	\$ 16,488	\$ 15,027	\$ 765	\$ 696
Liabilities				
Interest rate derivatives (see Note 4)	\$ (4)	\$ —	\$ (4)	\$ —

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

(b) In the unaudited Condensed Consolidated Balance Sheet amounts are presented as an asset. See Note 4.

The Company did not have any material assets or liabilities measured at fair value on a nonrecurring basis during the six months ended June 30, 2022, or the year ended December 31, 2021. 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 six months ended June 30, 2022:

Fair value measurements using significant unobservable inputs (Level 3)

(in millions)	Fuel derivatives	
Balance at March 31, 2022	\$	1,273
Total gains for the period		
Included in earnings		20 (a)
Included in other comprehensive income		182
Sales		(16) (b)
Settlements		(332)
Balance at June 30, 2022	\$	<u>1,127</u>
The amount of total gains for the period included in earnings attributable to the change in unrealized gains or losses relating to assets still held at June 30, 2022	\$	<u>20 (a)</u>
The amount of total gains for the period included in other comprehensive income attributable to the change in unrealized gains or losses relating to assets still held at June 30, 2022	\$	<u>115</u>

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

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

Fair value measurements using significant unobservable inputs (Level 3)

(in millions)	Fuel derivatives	
Balance at December 31, 2021	\$	696
Total gains (losses) for the period		
Included in earnings		(15) (a)
Included in other comprehensive income		1,033
Sales		(26) (b)
Settlements		(561)
Balance at June 30, 2022	\$	<u>1,127</u>
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 June 30, 2022	\$	<u>(15) (a)</u>
The amount of total gains for the period included in other comprehensive income attributable to the change in unrealized gains or losses relating to assets still held at June 30, 2022	\$	<u>672</u>

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

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

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

The following table presents a range and weighted average of the unobservable inputs utilized in the fair value measurements of the Company's fuel derivatives classified as Level 3 at June 30, 2022:

Quantitative information about Level 3 fair value measurements

	Valuation technique	Unobservable input	Period (by year)	Range	Weighted Average (a)
Fuel derivatives	Option model	Implied volatility	Third quarter 2022	28-68%	48 %
			Fourth quarter 2022	44-65%	53 %
			2023	38-58%	50 %
			2024	34-48%	39 %

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

The carrying amounts and estimated fair values of the Company's short-term and long-term debt (including current maturities), as well as the applicable fair value hierarchy tier, at June 30, 2022, are presented in the table below. The fair values of the Company's publicly held long-term debt are determined based on inputs that are readily available in public markets or can be derived from information available in publicly quoted markets; therefore, the Company has categorized these agreements as Level 2. All privately held debt agreements are categorized as Level 3. The Company has determined the estimated fair value of this debt to be Level 3, as certain inputs used to determine the fair value of these agreements are unobservable. The Company utilizes indicative pricing from counterparties and a discounted cash flow method to estimate the fair value of the Level 3 items.

(in millions)	Carrying value	Estimated fair value	Fair value level hierarchy
2.75% Notes due November 2022	\$ 300	\$ 300	Level 2
Pass Through Certificates due August 2022 - 6.19%	33	33	Level 2
4.75% Notes due 2023	1,247	1,259	Level 2
1.25% Convertible Notes due 2025	1,795	2,121	Level 2
5.25% Notes due 2025	1,549	1,582	Level 2
3.00% Notes due 2026	300	281	Level 2
3.45% Notes due 2027	300	282	Level 2
5.125% Notes due 2027	1,944	1,963	Level 2
7.375% Debentures due 2027	115	126	Level 2
2.625% Notes due 2030	500	423	Level 2
1.000% PSP1 due 2030	976	900	Level 3
1.000% PSP2 due 2031	566	510	Level 3
1.000% PSP3 due 2031	526	470	Level 3

9. SUPPLEMENTAL FINANCIAL INFORMATION

(in millions)	June 30, 2022	December 31, 2021
Trade receivables	\$ 59	\$ 58
Credit card receivables	166	83
Business partners and other suppliers	541	432
Taxes receivable (a)	219	699
Fuel hedging and receivables	125	8
Other	279	77
Accounts and other receivables	<u>\$ 1,389</u>	<u>\$ 1,357</u>

(in millions)	June 30, 2022	December 31, 2021
Derivative contracts	\$ 221	\$ 192
Intangible assets, net	295	295
Other	331	395
Other assets	<u>\$ 847</u>	<u>\$ 882</u>

(in millions)	June 30, 2022	December 31, 2021
Accounts payable trade	\$ 395	\$ 156
Salaries payable	340	287
Taxes payable excluding income taxes	318	200
Aircraft maintenance payable	69	42
Fuel payable	260	170
Other payable	526	427
Accounts payable	<u>\$ 1,908</u>	<u>\$ 1,282</u>

(in millions)	June 30, 2022	December 31, 2021
Voluntary Separation Program	\$ 79	\$ 92
Profitsharing and savings plans	154	262
Vacation pay	463	451
Health	231	152
Workers compensation	155	141
Property and income taxes	58	65
Interest	96	46
Deferred supplier payments (b)	—	80
Other	351	335
Accrued liabilities	<u>\$ 1,587</u>	<u>\$ 1,624</u>

(in millions)	June 30, 2022	December 31, 2021
Voluntary Separation Program	\$ 190	\$ 233
Postretirement obligation	334	330
Other deferred compensation	302	369
Other	270	292
Other noncurrent liabilities	<u>\$ 1,096</u>	<u>\$ 1,224</u>

(a) This amount includes approximately \$472 million as of December 31, 2021 associated with a significant cash tax refund expected as a result of the CARES Act allowing entities to carry back 2020 losses to prior periods of up to five years, and claim refunds of federal taxes paid. The refund was received by the Company during second quarter 2022. These amounts as of June 30, 2022 and December 31, 2021 also include excise taxes remitted to taxing authorities for which the subsequent flights were canceled by Customers, resulting in amounts due back to the Company.

(b) Represents amounts owed at December 31, 2021 for aircraft deliveries received that will be relieved via future payments to supplier.

For further information on fuel derivative and interest rate derivative contracts, see Note 4.

Other Operating Expenses

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

10. COMMITMENTS AND CONTINGENCIES

Dallas Love Field

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

Although the City of Dallas received commitments from various sources that helped to fund portions of the LFMP project, including the Federal Aviation Administration ("FAA"), the Transportation Security Administration, and the City of Dallas' Aviation Fund, the majority of the funds used were from the issuance of bonds. The Company guaranteed principal and interest payments on bonds issued by the LFAMC (the "Series 2010" bonds and the "Series 2012" bonds). Given the Company's guarantee associated with the bonds issued to fund LFMP, the remaining debt service amount was considered a minimum lease payment under the adoption of ASC Topic 842, Leases, and therefore was recorded as a lease liability with a corresponding right-of-use asset within the Company's unaudited Condensed Consolidated Balance Sheet.

All of the outstanding Series 2010 bonds, in the principal amount of \$310 million, were redeemed by LFAMC on September 28, 2021 (Redemption Date). As the Series 2010 bonds have been fully repaid following the Redemption Date, the Company's guarantee associated with the Series 2010 bonds no longer exists.

As of June 30, 2022, \$79 million of principal remained outstanding associated with the Series 2012 bonds. The net present value of the future principal and interest payments associated with the Series 2012 bonds was \$88 million as of June 30, 2022, and was reflected as part of the Company's operating lease right-of-use assets and lease obligations in the unaudited Condensed Consolidated Balance Sheet.

Contractual Obligations and Contingent Liabilities and Commitments

During second quarter 2022, the Company entered into supplemental agreements with The Boeing Company ("Boeing") to replace the majority of its 2022 Boeing 737-7 ("-7") firm orders with Boeing 737-8 ("-8") firm orders, among other adjustments to its near-term contractual order book. The Company also exercised 20 -8 options for delivery in 2022, exercised four -7 options for delivery in 2023, exercised three -8 options for delivery in 2023, and accelerated and exercised 17 2023 -8 options for delivery in 2022.

While the Company is contractually scheduled to receive 114 MAX deliveries, including options, this year, a portion of its deliveries are expected to shift into 2023 due to Boeing's supply chain challenges and the current

status of the -7 certification. Based on recent discussions with Boeing regarding the pace of expected deliveries for the remainder of this year, the Company is currently estimating it will receive a total of 66 -8 aircraft deliveries and no -7 deliveries in 2022. The Company retains significant flexibility to manage its fleet size, including opportunities to accelerate fleet modernization efforts if growth opportunities do not materialize. Given the current supply chain and aircraft delivery delays, the Company will continue working with Boeing on the Company's contractual order book with focus on 2022 and 2023. Additional information regarding the Company's contractual order book is included in the following table as of June 30, 2022:

The Boeing Company				
	-7 Firm Orders	-8 Firm Orders	-7 or -8 Options	Total
2022	14	95	5	114 (c)
2023	86	—	4	90
2024	30	—	56	86
2025	30	—	56	86
2026	15	15	40	70
2027	15	15	6	36
2028	15	15	—	30
2029	20	30	—	50
2030	15	45	—	60
2031	—	10	—	10
	<u>240 (a)</u>	<u>225 (b)</u>	<u>167</u>	<u>632</u>

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

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

(c) Includes 12 -8 deliveries received through June 30, 2022, 23 expected -8 deliveries in third quarter 2022, and 31 expected -8 deliveries in fourth quarter 2022, for a total of 66 -8 deliveries in 2022. While the Company is contractually scheduled to receive 114 MAX deliveries, including options, this year, a portion of its deliveries are expected to shift into 2023 due to Boeing's supply chain challenges and the current status of the -7 certification. Furthermore, given the current ongoing status of the -7 certification and pace of expected deliveries for the remainder of this year, it is the Company's assumption that it will receive no -7 aircraft deliveries in 2022, and has the ability to convert -7s to -8s as noted in footnote (b).

Based on the Company's existing agreement with Boeing, capital commitments associated with its firm orders as of June 30, 2022, were: \$2.4 billion remaining in 2022, \$2.2 billion in 2023, \$910 million in 2024, \$845 million in 2025, \$984 million in 2026, \$1.0 billion in 2027, and \$6.3 billion thereafter.

In addition, subsequent to June 30, 2022, and through August 1, 2022, due to the current status of the -7 certification, the Company converted 48 2023 -7 firm orders to -8 firm orders in 2023. These conversions did not result in a significant change to the Company's commitments as of June 30, 2022.

Contingencies

The Company is from time to time subject to various legal proceedings and claims arising in the ordinary course of business and records a liability for such claims when it is probable that a loss will be incurred and the amount is reasonably estimable. In recent years, the airline industry has experienced an increase in litigation asserting the application of state and local employment laws, particularly in California. On June 30, 2022, the U.S. Supreme Court denied review of the Ninth Circuit's ruling in *Bernstein v. Virgin America, Inc.*, which held that federal law did not preempt the California state meal-and-rest-break regulations for flight attendants at issue. The Company is a defendant in multiple proceedings asserting wage and hour claims with respect to certain employees who work in, or are based in, California. The *Bernstein* decision may adversely affect the Company's defenses in some or all of those proceedings and may give rise to additional litigation in these or other areas previously believed to be preempted by federal law. The Company is currently not able to estimate a range of possible loss.

11. FINANCING ACTIVITIES

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

Holders may convert their Convertible Notes at their option at any time prior to the close of business on the business day immediately preceding February 1, 2025, in the event certain conditions are met, as stated in the offering documents. As of June 30, 2022, the conditions were not met that would allow holders to exercise their conversion option.

Upon conversion, the Company will pay or deliver, as the case may be, cash, shares of the Company's common stock or a combination of cash and shares of common stock, at the Company's election. The Company intends to settle conversions by paying cash up to the principal amount of the Convertible Notes, with any excess conversion value settled in cash or shares of common stock. The initial conversion rate is 25.9909 shares of common stock per \$1,000 principal amount of Convertible Notes (equivalent to an initial conversion price of approximately \$38.48 per share of common stock).

Upon issuance, the Company bifurcated the Convertible Notes for accounting purposes between a liability component and an equity component utilizing applicable guidance. The liability component was determined by estimating the fair value of a hypothetical issuance of an identical offering excluding the conversion feature of the Convertible Notes. The initial carrying amount of the equity component was calculated as the difference between the liability component and the face amount of the Convertible Notes.

The Company adopted ASU 2020-06, as of January 1, 2022, utilizing the modified retrospective method approach. See Note 3 for further information. Upon adoption, the Company reclassified the remaining equity component, of \$300 million, from Additional paid-in capital to Long-term debt associated with its Convertible Notes, and no longer records amortization of the debt discount to Interest expense. The following table details the equity and liability component recognized related to the Convertible Notes, prior to and following the adoption of ASU 2020-06:

(in millions)	June 30, 2022	December 31, 2021
Equity component:		
Carrying amount of Convertible Notes	\$ —	\$ 311
Carrying amount of issuance costs	—	(11)
Net carrying amount	<u>\$ —</u>	<u>\$ 300</u>
Liability component:		
Principal amount	\$ 1,795	\$ 2,097
Unamortized debt discount	—	(255)
Net carrying amount	<u>\$ 1,795</u>	<u>\$ 1,842</u>

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

(in millions)	Three months ended June 30,		Six months ended June 30,	
	2022	2021	2022	2021
Non-cash amortization of the debt discount	\$ —	\$ 19	\$ —	\$ 37
Non-cash amortization of debt issuance costs	3	2	7	4
Contractual coupon interest	6	7	12	15
Total interest expense	\$ 9	\$ 28	\$ 19	\$ 56

The unamortized debt issuance costs are being recognized as non-cash interest expense based on the 5-year term of the notes, through May 1, 2025, less amounts that were or will be required to be accelerated immediately upon conversion or repurchases. The Company had no changes to conversion terms, contingencies, or exercise prices during the six months ended June 30, 2022. The effective interest rate associated with the Convertible Notes was approximately 1.9 percent for the three and six months ended June 30, 2022.

During the three and six months ended June 30, 2022, the Company paid \$231 million and \$555 million, respectively, in debt and finance lease obligations, which included scheduled debt and lease payments, extinguishment of Convertible Notes, and the early prepayment of debt. The following tables present the impact of the partial extinguishment of the Company's Convertible Notes and early prepayment of debt within the unaudited Condensed Consolidated Statement of Comprehensive Income for the three and six months ended June 30, 2022:

Three months ended June 30, 2022

(in millions)	Cash payment	Principal repayment	Loss on extinguishment (a)	Non-cash amortization of debt discount and (issuance) costs
1.25% Convertible Notes due 2025	\$ 178	\$ 138	\$ 42	\$ (2)
5.125% Notes due 2027	\$ 27	\$ 26	\$ 1	\$ —
4.75% Notes due 2023	3	3	—	—
5.25% Notes due 2025	1	1	—	—
Total	\$ 209	\$ 168	\$ 43	\$ (2)

Six months ended June 30, 2022

(in millions)	Cash payment	Principal repayment	Loss on extinguishment (a)	Non-cash amortization of debt discount and (issuance) costs
1.25% Convertible Notes due 2025	\$ 409	\$ 302	\$ 112	\$ (5)
5.125% Notes due 2027	\$ 61	\$ 56	\$ 4	\$ 1
4.75% Notes due 2023	3	3	—	—
5.25% Notes due 2025	1	1	—	—
Total	\$ 474	\$ 362	\$ 116	\$ (4)

(a) Reflected in Other (gains) losses, net.

The Company has access to \$1.0 billion under its amended and restated revolving credit facility (the "Amended A&R Credit Agreement"). In July 2022, this facility was amended to extend the expiration date to August 2025, and to change the benchmark rate from the London Interbank Offered Rate to the Secured Overnight Financing Rate ("SOFR"). There were no amounts outstanding under the Amended A&R Credit Agreement as of June 30, 2022.

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

Relevant comparative operating statistics for the three and six months ended June 30, 2022, 2021, and 2019 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. For the three and six months ended June 30, 2022, the Company believes a comparison of its 2022 to 2019 (pre-pandemic) operating statistics is relevant and useful as the Company continues to recover from the pandemic. For the three and six months ended June 30, 2021, and 2022, most of these operating statistics were significantly impacted by the COVID-19 pandemic and decisions the Company made as a result of the pandemic. See Note 2 to the unaudited Condensed Consolidated Financial Statements for further information.

	Three months ended June 30,				
	2022	2021	2022 Change to 2021	2019	2022 Change to 2019
Revenue passengers carried (000s)	33,224	26,158	27.0 %	34,924	(4.9)%
Enplaned passengers (000s)	41,284	32,786	25.9 %	42,569	(3.0)%
Revenue passenger miles (RPMs) (in millions) ^(a)	32,523	27,689	17.5 %	34,528	(5.8)%
Available seat miles (ASMs) (in millions) ^(b)	37,322	33,414	11.7 %	39,985	(6.7)%
Load factor ^(c)	87.1 %	82.9 %	4.2 pts.	86.4 %	0.7 pts.
Average length of passenger haul (miles)	979	1,059	(7.6)%	989	(1.0)%
Average aircraft stage length (miles)	727	794	(8.4)%	750	(3.1)%
Trips flown	326,848	268,879	21.6 %	347,684	(6.0)%
Seats flown (000s) ^(d)	50,758	41,836	21.3 %	52,398	(3.1)%
Seats per trip ^(e)	155.3	155.6	(0.2)%	150.7	3.1 %
Average passenger fare	\$ 184.17	\$ 136.46	35.0 %	\$157.10	17.2 %
Passenger revenue yield per RPM (cents) ^(f)	18.81	12.89	45.9 %	15.89	18.4 %
Operating revenues per ASM (cents) ^(g)	18.03	11.99	50.4 %	14.78	22.0 %
Passenger revenue per ASM (cents) ^(h)	16.39	10.68	53.5 %	13.72	19.5 %
Operating expenses per ASM (cents) ⁽ⁱ⁾	14.92	10.22	46.0 %	12.36	20.7 %
Operating expenses per ASM, excluding fuel (cents)	10.54	7.81	35.0 %	9.52	10.7 %
Operating expenses per ASM, excluding fuel and profitsharing (cents)	10.32	7.56	36.5 %	9.09	13.5 %
Fuel costs per gallon, including fuel tax	\$ 3.36	\$ 1.88	78.7 %	\$ 2.13	57.7 %
Fuel costs per gallon, including fuel tax, economic	\$ 3.36	\$ 1.92	75.0 %	\$ 2.13	57.7 %
Fuel consumed, in gallons (millions)	486	426	14.1 %	532	(8.6)%
Active fulltime equivalent Employees ^(j)	62,333	54,448	14.5 %	59,793	4.2 %
Aircraft at end of period ^(k)	730	736	(0.8)%	753	(3.1)%

	Six months ended June 30,				
	2022	2021	2022 Change to 2021	2019	2022 Change to 2019
Revenue passengers carried (000s)	59,253	40,383	46.7 %	66,220	(10.5)%
Enplaned passengers (000s)	73,289	50,713	44.5 %	80,382	(8.8)%
Revenue passenger miles (RPMs) (in millions) ^(a)	59,006	42,565	38.6 %	65,232	(9.5)%
Available seat miles (ASMs) (in millions) ^(b)	71,706	56,561	26.8 %	77,871	(7.9)%
Load factor ^(c)	82.3 %	75.3 %	7.0 pts.	83.8 %	(1.5) pts.
Average length of passenger haul (miles)	996	1,054	(5.5)%	985	1.1 %
Average aircraft stage length (miles)	745	785	(5.1)%	751	(0.8)%
Trips flown	614,599	461,280	33.2 %	674,074	(8.8)%
Seats flown (000s) ^(d)	95,305	71,627	33.1 %	101,871	(6.4)%
Seats per trip ^(e)	155.1	155.3	(0.1)%	151.1	2.6 %
Average passenger fare	\$ 173.06	\$ 130.79	32.3 %	\$154.50	12.0 %
Passenger revenue yield per RPM (cents) ^(f)	17.38	12.41	40.0 %	15.68	10.8 %
Operating revenues per ASM (cents) ^(g)	15.93	10.71	48.7 %	14.20	12.2 %
Passenger revenue per ASM (cents) ^(h)	14.30	9.34	53.1 %	13.14	8.8 %
Operating expenses per ASM (cents) ⁽ⁱ⁾	14.52	9.31	56.0 %	12.31	18.0 %
Operating expenses per ASM, excluding fuel (cents)	10.84	7.06	53.5 %	9.55	13.5 %
Operating expenses per ASM, excluding fuel and profitsharing (cents)	10.68	6.87	55.5 %	9.21	16.0 %
Fuel costs per gallon, including fuel tax	\$ 2.86	\$ 1.78	60.7 %	\$ 2.09	36.8 %
Fuel costs per gallon, including fuel tax, economic	\$ 2.86	\$ 1.83	56.3 %	\$ 2.09	36.8 %
Fuel consumed, in gallons (millions)	923	712	29.6 %	1,026	(10.0)%
Active fulltime equivalent Employees ^(j)	62,333	54,448	14.5 %	59,793	4.2 %
Aircraft at end of period ^(k)	730	736	(0.8)%	753	(3.1)%

(a) 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.

(b) 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.

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

(d) 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.

(e) Seats per trip is calculated by dividing seats flown by trips flown.

(f) 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.

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

(h) 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.

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

(j) Included 1,446 Employees on Extended Emergency Time Off as of June 30, 2021. See Note 2 to the unaudited Condensed Consolidated Financial Statements for further information.

(k) Included four and 39 Boeing 737 Next Generation aircraft in storage as of June 30, 2022 and June 30, 2021, respectively. Included 34 Boeing 737 MAX ("MAX") aircraft in long term storage as of June 30, 2019.

Financial Overview

The Company's financial results in 2021 were impacted and in 2022 have continued to be impacted, by the effects of the COVID-19 pandemic, which began in early 2020, on both an accounting principles generally accepted in the United States ("GAAP") and Non-GAAP basis. Although demand for leisure travel surged in second quarter 2022 and second quarter 2022 Operating revenues exceeded second quarter 2019 Operating revenues, both capacity (or ASMs) and business travel remained below comparable 2019 levels primarily due to available staffing constraints, in particular Pilots. In addition, GAAP results for the three and six months ended June 30, 2021, included impacts associated with payroll funding support ("Payroll Support") programs with the United States Department of the Treasury ("Treasury"), as referenced in Note 2 to the unaudited Condensed Consolidated Financial Statements.

The Company recorded second quarter and year-to-date GAAP and non-GAAP results for 2022, 2021, and 2019 as noted in the following tables. The Company believes comparisons of current year financial results to 2019 continue to be relevant given the significant impacts resulting from the pandemic. 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.

(in millions, except per share amounts)	Three months ended June 30,				
	2022	2021	2022 Change to 2021	2019	2022 Change to 2019
GAAP					
Operating income	\$ 1,158	\$ 594	94.9 %	\$ 968	19.6 %
Net income	\$ 760	\$ 348	118.4 %	\$ 741	2.6 %
Net income per share, diluted	\$ 1.20	\$ 0.57	110.7 %	\$ 1.37	(12.3)%
Non-GAAP					
Operating income (loss)	\$ 1,173	\$ (162)	n.m.	\$ 968	21.2 %
Net income (loss)	\$ 825	\$ (206)	n.m.	\$ 741	11.3 %
Net income per share, diluted	\$ 1.30	\$ (0.35)	n.m.	\$ 1.37	(4.9)%

(in millions, except per share amounts)	Six months ended June 30,				
	2022	2021	2022 Change to 2021	2019	2022 Change to 2019
GAAP					
Operating income	\$ 1,007	\$ 793	27.0 %	\$ 1,473	(31.6)%
Net income	\$ 482	\$ 463	4.1 %	\$ 1,128	(57.3)%
Net income per share, diluted	\$ 0.77	\$ 0.76	0.7 %	\$ 2.06	(62.9)%
Non-GAAP					
Operating income (loss)	\$ 1,038	\$ (1,431)	n.m.	\$ 1,473	(29.5)%
Net income (loss)	\$ 633	\$ (1,221)	n.m.	\$ 1,128	(43.9)%
Net income per share, diluted	\$ 1.00	\$ (2.07)	n.m.	\$ 2.06	(51.4)%

The Company's financial results for the three and six months ended June 30, 2022, exceeded the comparative 2021 financial results despite \$724 million and \$1.9 billion in grant allocations of Payroll Support from Treasury during the three and six months ended June 30, 2021, respectively, utilized to fund a portion of salaries, wages, and benefits. See below and Note 2 to the unaudited Condensed Consolidated Financial Statements for further information. On a non-GAAP basis, the Company's Operating income (loss) and Net income (loss) improved significantly in the three and six months ended June 30, 2022, versus the same prior year period due to the

significant recovery in travel demand, which was aided by a reduction in COVID-19 cases and hospitalizations, an increase in vaccinations, and a decline in travel-related restrictions across the United States. 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. These impacts combined resulted in a 67.9 percent and 88.5 percent increase in Operating revenues for the three and six months ended June 30, 2022, respectively, versus the same prior year periods. Operating revenues for the three and six months ended June 30, 2022, exceeded the comparative 2019 pre-pandemic levels primarily due to higher yields, despite the slight decrease in capacity. Operating expenses for the three and six months ended June 30, 2022, exceeded the comparative pre-pandemic 2019 levels primarily due to higher salaries, wages, and benefits and fuel prices.

2022 Outlook

The following tables present current selected financial guidance for third quarter and full year 2022:

	3Q 2022 Estimation
Operating revenue compared with 2019 (a)	Up 8% to 12%
ASMs compared with 2019 (b)	~Flat
Economic fuel costs per gallon (c)(d)	\$3.25 to \$3.35
Fuel hedging premium expense per gallon	\$0.02
Fuel hedging cash settlement gains per gallon	\$0.46
ASMs per gallon (fuel efficiency)	76 to 78
CASM-X (e) compared with 2019 (f)	Up 12% to 15%
Scheduled debt repayments (millions)	~\$55
Interest expense (millions)	~\$90
Aircraft (g)	741

	2022 Estimation
ASMs compared with 2019 (b)	Down ~4%
Economic fuel costs per gallon (c)(d)	\$2.95 to \$3.05
Fuel hedging premium expense per gallon	\$0.04
Fuel hedging cash settlement gains per gallon	\$0.51
CASM-X (e) compared with 2019 (f)	Up 12% to 16%
Scheduled debt repayments (millions)	~\$820
Interest expense (millions)	~\$360
Aircraft (g)	765
Effective tax rate	24% to 26%
Capital spending (billions) (h)	~\$4.0

(a) The Company believes that operating revenues compared with 2019 is a relevant measure of performance due to the significant impacts in 2020 and 2021 from the pandemic.

(b) Available seat miles (ASMs, or capacity). The Company's flight schedule is currently published for sale through March 8, 2023. The Company currently expects fourth quarter 2022 capacity to be down in the range of 1 percent to 2 percent compared with fourth quarter 2019, and first quarter 2023 capacity to be up approximately 10 percent, compared with first quarter 2022.

(c) See Note Regarding Use of Non-GAAP Financial Measures for additional information on special items. In addition, information regarding special items and economic results is included in the accompanying table Reconciliation of Reported Amounts to Non-GAAP Items (also referred to as "excluding special items").

(d) Based on the Company's existing fuel derivative contracts and market prices as of July 21, 2022, third quarter, fourth quarter, and full year 2022 economic fuel costs per gallon are estimated to be in the range of \$3.25 to \$3.35, \$3.00 to \$3.10, and \$2.95 to \$3.05, respectively. Economic fuel cost projections do not reflect the potential impact of special items because the Company cannot reliably predict or estimate the hedge accounting impact associated with the volatility of the energy markets, the impact of COVID-19 cases on air travel demand, or the impact to its financial statements in future periods. Accordingly, the

Company believes a reconciliation of non-GAAP financial measures to the equivalent GAAP financial measures for projected results is not meaningful or available without unreasonable effort. See Note Regarding Use of Non-GAAP Financial Measures.

(e) Operating expenses per available seat mile, excluding fuel and oil expense, special items, and profitsharing.

(f) Projections do not reflect the potential impact of fuel and oil expense, special items, and profitsharing because the Company cannot reliably predict or estimate those items or expenses or their impact to its financial statements in future periods, especially considering the significant volatility of the fuel and oil expense line item. Accordingly, the Company believes a reconciliation of non-GAAP financial measures to the equivalent GAAP financial measures for these projected results is not meaningful or available without unreasonable effort.

(g) Aircraft on property, end of period. The Company ended second quarter 2022 with 730 Boeing 737 aircraft. During third quarter 2022, the Company expects to take delivery of 23 Boeing 737 MAX 8 (-8) aircraft and retire 12 Boeing 737-700 (-700) aircraft to end the quarter with 741 aircraft. During fourth quarter 2022, the Company expects to take delivery of 31 -8 aircraft and retire seven -700 aircraft to end the year with 765 aircraft. The delivery schedule for the Boeing 737 MAX 7 (-7) is dependent on the Federal Aviation Administration ("FAA") issuing required certifications and approvals to Boeing and the Company. The FAA will ultimately determine the timing of the -7 certification and entry into service, and the Company therefore offers no assurances that current estimations and timelines are correct. Furthermore, given the current ongoing status of the -7 certification and pace of expected deliveries for the remainder of this year, it is the Company's assumption that it will receive no -7 aircraft deliveries in 2022, and that the remaining 48 Boeing 737 MAX (MAX) aircraft reflected in its 2022 contractual order book will shift into 2023.

(h) Represents the Company's current expectation which assumes the exercise of its five remaining 2022 MAX aircraft delivery options, and a total of 66 -8 aircraft deliveries in 2022, compared with the Company's previous estimation which assumed the delivery of 114 MAX aircraft in 2022. The Company continues to estimate \$900 million in non-aircraft capital spending in 2022.

COVID-19 Pandemic Impacts

As detailed in Note 2 to the unaudited Condensed Consolidated Financial Statements, in connection with the major negative impact of COVID-19 on air carriers, the Company has received significant financial assistance from Treasury in the form of Payroll Support, and this assistance had a significant impact on the Company's reported GAAP financial results in 2021. Such impact ended in third quarter 2021, and the Company's 2022 results do not reflect the benefit of this Payroll Support, and its future periods are not expected to benefit from such Payroll Support. However, future cash flows will be impacted through the portion of Payroll Support that was in the form of loans that will have to be repaid to Treasury.

During second quarter 2020, the Company introduced Voluntary Separation Program 2020 ("Voluntary Separation Program") and the Extended Emergency Time Off ("Extended ETO") program which helped closer align staffing to reduced flight schedules and enabled the Company to avoid involuntary furloughs and layoffs associated with the impacts of the pandemic. Approximately 16,000 Employees elected to participate in one of these programs. All Employees that elected to participate in the Extended ETO program have since returned or been recalled to work, or have chosen to permanently separate from the Company, and no Employees were on Extended ETO past March 31, 2022. The Company realized approximately \$1.1 billion of full year 2021 cost savings from the Voluntary Separation Program and Extended ETO but expects no material cost savings from these programs in 2022 and beyond. See Note 2 to the unaudited Condensed Consolidated Financial Statements for further information.

The Company met its 2021 hiring goals and plans to add over 10,000 Employees, net of attrition, in 2022. The Company continues to strive to provide sufficient and optimized staffing to support its anticipated flight schedule plans for 2022 and beyond. For the three and six months ended June 30, 2022, the Company hired approximately 4,000 and 7,300 Employees, respectively, net of attrition, and returned to overall pre-pandemic staffing levels in May 2022. The Company has been making additional investments to attract and retain talent, including the decision in fourth quarter 2021 to further raise the Company's starting hourly pay rates from \$15 per hour to \$17 per hour for certain of its workgroups, subject, in each case, to acceptance of such change by the applicable union.

Company Overview

The Company has entered into supplemental agreements with The Boeing Company ("Boeing") to increase aircraft orders and accelerate certain options with the goal of improving potential growth opportunities, restoring its network closer to pre-pandemic levels, lowering operating costs, and further modernizing its fleet with less carbon-

intensive aircraft. See Note 10 to the unaudited Condensed Consolidated Financial Statements for further information. The Company continues to expect that more than half of the MAX aircraft in its firm order book will replace a significant amount of its 442 Boeing 737-700 ("-700") aircraft over the next 10 to 15 years to support the modernization of the Company's fleet, a key component of its environmental sustainability efforts.

For first half 2022, the Company was scheduled to receive 28 -8 aircraft, of which only 12 were received, all during second quarter 2022. The Company ended second quarter 2022 with 730 aircraft, which reflects four owned -700 retirements. In addition, the Company had four -700 aircraft in storage as of June 30, 2022, all of which were subsequently retired from the Company's fleet in July 2022. The Company is experiencing delays in aircraft deliveries from Boeing and now estimates 2022 deliveries to be 66 versus the previously expected 114. The Company is currently assuming 23 and 31 -8 aircraft deliveries in third quarter and fourth quarter 2022, respectively. The Company plans to retire 12 and seven -700 aircraft in third quarter and fourth quarter 2022, respectively. As a result, the Company expects to end third quarter with 741 aircraft and end 2022 with 765 aircraft, compared with its previous guidance of 814 aircraft. The Company now expects to retire 29 -700 aircraft in 2022, compared with its previous guidance of 28 -700 retirements this year.

The Company has published its flight schedule through March 8, 2023. During 2022, the Company is focusing on restoring its network, primarily in cities with a very strong Customer base, by adding city pair frequencies and connecting new service with existing points-of-strength to increase Customer depth.

On March 24, 2022, the Company announced a new fare product, Wanna Get Away Plus™, which became available to Customers in May 2022. Wanna Get Away Plus provides Customers with more flexibility, choice, and rewards for a modest buy-up from the Company's Wanna Get Away® fare product. In addition to all of the usual day of travel benefits and booking flexibility offered to Customers across all of the Company's fares, Wanna Get Away Plus provides additional benefits as compared with the Wanna Get Away fare product, including:

- Transferable flight credit(s), a new benefit that generally enables Customers to make a one-time transfer of eligible unused flight credit(s) to a new traveler for future use;
- More flexibility through same-day confirmed change/same-day standby; and
- More earning power in the Company's Rapid Rewards® loyalty program, with 8X points awarded on flights instead of the 6X points awarded on Wanna Get Away fares.

In July 2022, the Company announced that flight credits will no longer expire. The Company expects that this policy change, combined with its other attractive brand attributes, will contribute to an increase in Customer loyalty. Flight credits result from canceling reservations and previously were valid for no longer than one year from the date of original purchase. Flight credits for non-refundable fares will be issued as long as the reservation is cancelled more than 10 minutes prior to the scheduled departure. Flight credits or refunds for refundable fares will be issued regardless of cancellation time. Flight credits unexpired on, or created on or after July 28, 2022 do not expire and will show an expiration date (12/31/2040) until the Company's systems are updated. A flight credit with an expiration date on or before July 27, 2022, has expired in accordance with its existing expiration date.

On March 28, 2022, the Company reached a tentative collective-bargaining agreement with the International Association of Machinists and Aerospace Workers, AFL-CIO ("IAM"), which represents the Company's approximately 6,000 Customer Service Agents, Customer Representatives, and Source of Support Representatives. However, during May 2022, the IAM membership voted not to ratify the agreement. The Company will continue to engage in discussions on a new agreement with IAM.

On June 3, 2022, the Company reached a tentative collective-bargaining agreement with the Aircraft Mechanics Fraternal Association ("AMFA"), which represents the Company's nearly 170 Aircraft Appearance Technicians. However, the AMFA membership voted not to ratify the agreement. The Company will continue to engage in discussions on a new agreement with AMFA.

As part of its commitment to corporate sustainability, on April 22, 2022, the Company published its 2021 One Report describing the Company's sustainability strategies, which include the Company's fuel conservation and emissions mitigation initiatives and other efforts to minimize greenhouse gas emissions and address other environmental matters such as energy and water conservation, waste minimization, and recycling. The Company also published its first ever Diversity, Equity, and Inclusion ("DEI") Report on April 22, 2022. A companion piece to the One Report, the DEI Report takes a deeper dive into the Company's DEI goals, commitments, and initiatives and highlights the expected path forward. Information contained in the Southwest One Report and/or the DEI Report is not incorporated by reference into, and does not constitute a part of, this Form 10-Q. While the Company believes that the disclosures contained in the Southwest One Report, the DEI Report, and other voluntary disclosures regarding environmental, social, and governance ("ESG") matters are responsive to various areas of investor interest, the Company believes that these disclosures do not currently address matters that are material in the near term to the Company's operations, strategy, financial condition, or financial results, although this view may change in the future based on new information that could materially alter the estimates, assumptions, or timelines used to create these disclosures. Given the estimates, assumptions, and timelines used to create the Southwest One Report and other voluntary disclosures, the materiality of these disclosures is inherently difficult to assess in advance.

Material Changes in Results of Operations

Comparison of three months ended June 30, 2022 and June 30, 2021

Operating Revenues

Total operating revenues for second quarter 2022 increased by \$2.7 billion, or 67.9 percent, year-over-year, to a quarterly record of \$6.7 billion. Second quarter 2022 operating revenues per ASM (RASM) were 18.03 cents, an increase of 50.4 percent, compared with second quarter 2021. The dollar increase was primarily due to the significant improvement in travel demand in second quarter 2022 versus the impacts to demand and bookings from the COVID-19 pandemic in second quarter 2021. For second quarter 2022, the year-over-year RASM increase was primarily driven by a 45.9 percent improvement in yield and an increase in Load factor of 4.2 points. The Company's policy change to eliminate expiration dates on qualifying flight credits, in particular those that were set to expire on September 7, 2022, results in a shift in the timing of revenue recognition. As a result, the breakage benefit to second quarter 2022 Operating revenues associated with flight credits that were set to expire on September 7, 2022 will not recur in third quarter creating a one-time sequential operating revenue growth headwind from second quarter 2022 to third quarter 2022 in the range of \$250 million to \$300 million, or five points, compared with their respective 2019 levels. The Company does not anticipate a material impact from this policy change beyond third quarter 2022, and estimates that breakage as a percentage of revenue will normalize to pre-pandemic levels. The Company expects that this policy change, combined with its other attractive brand attributes, will contribute to an increase in Customer loyalty and new Customers. See Note 6 to the unaudited Condensed Consolidated Financial Statements for further information.

Passenger revenues for second quarter 2022 increased by \$2.6 billion, or 71.4 percent, year-over-year. On a unit basis, Passenger revenues increased 53.5 percent, year-over-year. The year-over-year increase in Passenger revenues on both a dollar and unit basis was primarily due to improvements in Passenger demand and bookings, the majority of which were for leisure oriented travel. The Company's revenue performance in second quarter 2022 was a quarterly record primarily due to a surge in leisure demand, especially in June, which resulted in strong passenger bookings, yields, and load factors. In addition, the Company's second quarter 2022 loyalty program revenue represented a quarterly record. June 2022 managed business revenues were down 19 percent, a sequential improvement compared with April and May 2022 managed business revenues, which were down 31 percent and 23 percent, respectively, all compared with their respective 2019 levels. While second quarter 2022 managed business revenues remained below 2019 levels, the Company was encouraged by the sequential improvement during the quarter, as well as managed business average fares that exceeded 2019 levels. Based on bookings thus far, the Company's third quarter 2022 managed business revenues are currently estimated to be down in the range of 17

percent to 21 percent, compared with third quarter 2019. June 2022 is estimated to represent a monthly peak for 2022 operating revenues based on first half 2022 results and current expectations for second half 2022.

Freight revenues for second quarter 2022 decreased by \$3 million, or 6.0 percent, compared with the second quarter 2021, primarily due to capacity challenges driven by an increase in Passenger demand resulting in reduced space for cargo shipments.

Other revenues for second quarter 2022 increased by \$173 million, or 44.5 percent, compared with second quarter 2021. On a dollar basis, approximately 59.5 percent of the increase was due to incremental revenue from the Company's new co-brand credit card agreement secured in December 2021. The remaining increase is primarily due to revenue from business partners, and improved retail spend on the Company's co-brand credit card with Chase Bank USA, N.A ("Chase").

Operating Expenses

Operating expenses for second quarter 2022 increased by \$2.2 billion, or 63.2 percent, compared with second quarter 2021, while capacity increased 11.7 percent over the same prior year period. Approximately 34 percent of the operating expense increase was due to \$724 million in Payroll Support allocated to offset a portion of salaries, wages, and benefits in second quarter 2021, compared with no support received in second quarter 2022. In addition, approximately 39 percent of the increase was due to higher Fuel and oil expense and 18 percent of the increase was due to higher Salaries, wages, and benefits. Historically, except for changes in the price of fuel, changes in Operating expenses for airlines have been largely driven by changes in capacity, or ASMs. The following table presents the Company's Operating expenses per ASM for the second quarter of 2022 and 2021, followed by explanations of these changes on a dollar basis. Unless otherwise specified, changes on a per ASM basis were driven by changes in capacity, which increased with the improvement of travel demand, causing the Company's fixed costs to be spread over significantly more ASMs.

(in cents, except for percentages)	Three months ended June 30,		Per ASM change	Percent change
	2022	2021		
Salaries, wages, and benefits	5.95 ¢	5.46 ¢	0.49 ¢	9.0 %
Payroll support and voluntary Employee programs, net	—	(2.22)	2.22	n.m.
Fuel and oil	4.38	2.41	1.97	81.7
Maintenance materials and repairs	0.56	0.66	(0.10)	(15.2)
Landing fees and airport rentals	1.04	1.21	(0.17)	(14.0)
Depreciation and amortization	0.87	0.94	(0.07)	(7.4)
Other operating expenses	2.12	1.76	0.36	20.5
Total	14.92 ¢	10.22 ¢	4.70 ¢	46.0 %

Operating expenses per ASM for second quarter 2022 increased by 46.0 percent, compared with second quarter 2021, primarily due to second quarter 2021 including Payroll Support from the Consolidated Appropriations Act, 2021, and American Rescue Plan Act of 2021. Operating expenses per ASM for second quarter 2022, excluding Fuel and oil expense, profitsharing, and special items (a non-GAAP financial measure), increased 5.1 percent, compared with second quarter 2021 primarily due to higher salaries and wages due to significantly more trips and step/pay rate increases for certain workgroups. 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.

Salaries, wages, and benefits expense for second quarter 2022 increased by \$395 million, or 21.6 percent, compared with second quarter 2021. On a per ASM basis, second quarter 2022 Salaries, wages, and benefits expense increased 9.0 percent, compared with second quarter 2021. On a dollar basis, the increase was primarily driven by higher salaries and wages due to significantly more trips and step/pay rate increases for certain workgroups.

Payroll support and voluntary Employee programs, net (a reduction to expense) had no amounts for second quarter 2022. Second quarter 2021 consisted primarily of \$724 million of Payroll Support proceeds allocated (credit to expense) and a \$15 million net reduction in the Extended ETO liability (reduction to expense) relating to certain Employees being recalled prior to their previously elected return dates.

See Note 2 to the unaudited Condensed Consolidated Financial Statements for further information.

Fuel and oil expense for second quarter 2022 increased by \$833 million, or 103.7 percent, compared with second quarter 2021. On a per ASM basis, second quarter 2022 Fuel and oil expense increased 81.7 percent. On a dollar basis, approximately 90 percent of the increase was attributable to an increase in jet fuel prices, and the remainder of the increase was due to an increase in fuel gallons consumed. The Company's second quarter 2022 average economic jet fuel price of \$3.36 per gallon is net of approximately \$332 million in gains from hedging activities. On a per ASM basis, the majority of the change was due to higher jet fuel prices. The following table provides more information on the Company's economic fuel cost per gallon, including the impact of fuel hedging premium expense and fuel derivative contract settlements:

	Three months ended June 30,	
	2022	2021
Economic fuel costs per gallon	\$ 3.36	\$ 1.92
Fuel hedging premium expense (in millions)	\$ 26	\$ 24
Fuel hedging premium expense per gallon	\$ 0.05	\$ 0.06
Fuel hedging cash settlement gain per gallon	\$ 0.68	\$ 0.02

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.

The Company's second quarter 2022 available seat miles per gallon ("fuel efficiency") decreased 2.3 percent, year-over-year, and increased 2.1 percent when compared with second quarter 2019. The year-over-year decrease was primarily driven by the Company's increased Load factor and operating more of its least fuel-efficient -700 aircraft versus the prior year. The increase when compared with second quarter 2019 was due to operating more MAX aircraft, the Company's most fuel-efficient aircraft, as a percentage of its fleet. The MAX remains critical to the Company's efforts to modernize its fleet, reduce carbon emissions intensity, and achieve its near-term environmental sustainability goals. The Company expects third quarter 2022 fuel efficiency to be in the range of 76 to 78 ASMs per gallon, on a nominal basis.

The Company's multi-year fuel hedging program continues to provide insurance against spikes in energy prices and significantly offset the market price increase in jet fuel in second quarter 2022. The Company's current fuel derivative contracts contain a combination of instruments based in West Texas Intermediate ("WTI"), Brent crude oil, and refined products, such as heating oil. The economic fuel price per gallon sensitivities provided in the table below assume the relationship between Brent crude oil and refined products based on market prices as of July 21, 2022.

**Estimated economic fuel price per gallon,
including taxes and fuel hedging premiums**

Average Brent Crude Oil price per barrel	3Q 2022 (b)	4Q 2022 (b)
\$80	\$2.85 - \$2.95	\$2.75 - \$2.85
\$90	\$3.05 - \$3.15	\$2.95 - \$3.05
Current Market (a)	\$3.25 - \$3.35	\$3.00 - \$3.10
\$110	\$3.45 - \$3.55	\$3.35 - \$3.45
\$120	\$3.70 - \$3.80	\$3.60 - \$3.70
\$130	\$4.00 - \$4.10	\$3.85 - \$3.95
Fair market value of fuel derivative instruments	\$235 million	\$195 million
Estimated premium costs	\$13 million	\$13 million

(a) Brent crude oil average market prices as of July 21, 2022, were \$100 and \$94 per barrel for third quarter 2022 and fourth quarter 2022, respectively.

(b) Based on the Company's existing fuel derivative contracts and market prices as of July 21, 2022, third quarter, fourth quarter, and full year 2022 economic fuel costs per gallon are estimated to be in the range of \$3.25 to \$3.35, \$3.00 to \$3.10, and \$2.95 to \$3.05, respectively. Economic fuel cost projections do not reflect the potential impact of special items because the Company cannot reliably predict or estimate the hedge accounting impact associated with the volatility of the energy markets, the impact of COVID-19 cases on air travel demand, or the impact to its financial statements in future periods. Accordingly, the Company believes a reconciliation of non-GAAP financial measures to the equivalent GAAP financial measures for projected results is not meaningful or available without unreasonable effort. See Note Regarding Use of Non-GAAP Financial Measures.

In addition, the Company is providing its maximum percentage of estimated fuel consumption covered by fuel derivative contracts in the following table:

Period	Maximum fuel hedged percentage (c)
2022	63% (a)
2023	39% (b)
2024	17% (b)

(a) Based on the Company's available seat mile plans for full year 2022. The Company is currently 59 percent hedged for third quarter 2022 and 62 percent hedged for fourth quarter 2022.

(b) Due to uncertainty regarding available seat mile plans in future years, the Company believes that providing the maximum percent of fuel consumption covered by derivative contracts in 2023 and 2024 relative to 2019 fuel gallons consumed is a more relevant measure for future coverage.

(c) The Company's maximum fuel hedged percentage is calculated using the maximum number of gallons that are covered by derivative contracts divided by the Company's estimate of total fuel gallons to be consumed for each respective period. The Company's maximum number of gallons that are covered by derivative contracts may be at different strike prices and at strike prices materially higher than the current market prices. The volume of gallons covered by derivative contracts that ultimately get exercised in any given period may vary significantly from the volumes used to calculate the Company's maximum fuel hedged percentages, as market prices and the Company's fuel consumption fluctuate.

As a result of applying hedge accounting in prior periods, the Company has amounts in Accumulated other comprehensive income ("AOCI") that 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 4 to the unaudited Condensed Consolidated Financial Statements for further information), as well as the deferred amounts in AOCI at June 30, 2022, and the expected future periods in which these items are expected to settle and/or be recognized in earnings (in millions):

Year	Fair value of fuel derivative contracts at June 30, 2022	Amount of gains deferred in AOCI at June 30, 2022 (net of tax)
Remainder of 2022	\$ 495	\$ 373
2023	497	328
2024	135	79
Total	\$ 1,127	\$ 780

Maintenance materials and repairs expense for second quarter 2022 decreased by \$12 million, or 5.4 percent, compared with second quarter 2021. On a per ASM basis, Maintenance materials and repairs expense decreased 15.2 percent, compared with second quarter 2021. On a dollar basis, the decrease was primarily due to a decrease in engines and components expense driven by the "power-by-the-hour" contract for the -700 engines expiring at the end of 2021, in which expense was incurred based primarily upon engine hours flown. At January 1, 2022, a time and materials contract commenced, pursuant to which -700 engine expense is based on actual repairs. This decrease was partially offset by the timing of regular airframe maintenance checks as some costs had previously been deferred while a portion of the fleet was placed into temporary storage during the COVID-19 pandemic. There were multiple other smaller increases on a dollar basis, primarily related to an increase in various repairs as a result of deferring costs and reduced operations in second quarter 2021 due to the COVID-19 pandemic.

Landing fees and airport rentals expense for second quarter 2022 decreased by \$15 million, or 3.7 percent, compared with second quarter 2021. On a per ASM basis, Landing fees and airport rentals expense decreased 14.0 percent, compared with second quarter 2021. Despite the year-over-year increase in trips flown, on both a dollar and per ASM basis, Landing fees and airport rentals expense decreased slightly due to higher settlements and credits from various airports received in second quarter 2022.

Depreciation and amortization expense for second quarter 2022 increased by \$10 million, or 3.2 percent, compared with second quarter 2021. On a per ASM basis, Depreciation and amortization expense decreased by 7.4 percent, compared with second quarter 2021. On a dollar basis, the increase was primarily due to higher depreciation expense associated with owned aircraft and engines, including certain -700 aircraft planned for accelerated retirement dates in 2022.

Other operating expenses for second quarter 2022 increased by \$205 million, or 35.0 percent, compared with second quarter 2021. Included within this line item was aircraft rentals expense in the amounts of \$49 million and \$52 million for the three-month periods ended June 30, 2022 and 2021, respectively. On a per ASM basis, Other operating expenses increased 20.5 percent, compared with second quarter 2021. On a dollar basis, approximately 35 percent of the increase was due to higher revenue related expenses (including credit card processing charges) and approximately 20 percent of the increase was due to higher personnel expenses. The majority of the remainder was due to various flight-driven expenses.

The Company expects cost inflation in third quarter 2022, in particular with higher rates for labor, benefits, and airports. The Company also expects cost headwinds from operating at suboptimal productivity levels as headcount is expected to increase in third quarter 2022 while capacity levels are expected to remain relatively in line with third quarter 2019. The Company has increased short-haul trips in second half 2022 in an effort to restore its route network and support the reliability of its operational performance, which results in a decrease to average stage

length, and adds further unit cost headwinds. As a result of its successful hiring efforts and much improved operational reliability, the Company plans to begin moderating hiring where opportunities exist and intensify its focus on returning to historical efficiency levels.

Other

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

Interest expense for second quarter 2022 decreased by \$23 million, or 19.8 percent, compared with second quarter 2021, primarily due to elimination of the debt discount as a result of the Company's adoption of ASU 2020-06. See Note 3 to the unaudited Condensed Consolidated Financial Statements for further information.

Capitalized interest for second quarter 2022 increased by \$3 million, or 37.5 percent, compared with second quarter 2021, primarily due to an increase in average progress payment balances for scheduled future aircraft deliveries.

Interest income for second quarter 2022 increased by \$26 million, compared with second quarter 2021, primarily due to higher interest rates.

The following table displays the components of Other (gains) losses, net, for the three months ended June 30, 2022 and 2021:

(in millions)	Three months ended June 30,	
	2022	2021
Mark-to-market impact from fuel contracts settling in current and future periods	\$ (20)	\$ (11)
Premium cost of fuel contracts not designated as hedges	—	10
Unrealized mark-to-market adjustment on available for sale securities	4	—
Mark-to-market impact on deferred compensation plan investments	39	(17)
Loss on partial extinguishment of convertible and unsecured notes	43	—
Other	2	4
	\$ 68	\$ (14)

Income Taxes

The Company's effective tax rate was approximately 26.6 percent in second quarter 2022, compared with 30.7 percent in second quarter 2021. The higher tax rate for second quarter 2021 was primarily due to higher state taxes. The year-over-year decrease was partially offset by the losses on the Company's convertible debt repurchases, which are largely disallowed as a deduction for tax purposes. The Company currently estimates its annual 2022 effective tax rate to be approximately 24 percent to 26 percent.

Comparison of six months ended June 30, 2022 and June 30, 2021

Operating Revenues

Passenger revenues for the six months ended June 30, 2022, increased by \$5.0 billion, or 94.1 percent, compared with the first six months of 2021. On a unit basis, Passenger revenues increased 53.1 percent, year-over-year. The increase in Passenger revenues on both a dollar and unit basis were primarily due to easing of negative impacts associated with the COVID-19 pandemic, which resulted in improvements in Passenger demand and bookings, the majority of which were for leisure oriented travel, in the first six months of 2022, compared with the severe impacts to demand and bookings from the COVID-19 pandemic for the majority of the first six months of 2021.

Freight revenues for the six months ended June 30, 2022, decreased by \$3 million, or 3.3 percent, compared with the six months ended June 30, 2021, primarily due to capacity challenges driven by an increase in Passenger demand resulting in reduced space for cargo shipments.

Other revenues for the six months ended June 30, 2022, increased by \$393 million, or 57.3 percent, year-over-year. On a dollar basis, approximately half of the increase was associated with additional revenues generated from the Company's new co-brand credit card agreement secured in December 2021. The remaining increase in Other revenues is primarily due to income from business partners, including Chase, as the rebound in travel demand also resulted in higher spend on the Company's co-brand credit card, as well as additional revenues earned through the Company's rental car and hotel partners.

Operating Expenses

Operating expenses for the six months ended June 30, 2022, increased by \$5.1 billion, or 97.7 percent, compared with the first six months of 2021, while capacity increased 26.8 percent over the same prior year period. Approximately 37 percent of the operating expense increase was due to \$1.9 billion in Payroll Support allocated to offset a portion of salaries, wages, and benefits in the first six months of 2021, compared with no support received in the first six months of 2022. In addition, approximately 25 percent of the increase was due to higher Fuel and oil expense and approximately 20 percent of the increase was due to higher Salaries, wages, and benefits. Historically, except for changes in the price of fuel, changes in Operating expenses for airlines have been largely driven by changes in capacity, or ASMs. The following table presents the Company's Operating expenses per ASM for the first six months of 2022 and 2021, followed by explanations of these changes on a dollar basis. Unless otherwise specified, changes on a per ASM basis were driven by changes in capacity, which increased with the improvement of travel demand, causing the Company's fixed costs to be spread over significantly more ASMs.

(in cents, except for percentages)	Six months ended June 30,		Per ASM change	Percent change
	2022	2021		
Salaries, wages, and benefits	6.20 ¢	6.00 ¢	0.20 ¢	3.3 %
Payroll support and voluntary Employee programs, net	—	(3.87)	3.87	n.m.
Fuel and oil	3.68	2.25	1.43	63.6
Maintenance materials and repairs	0.59	0.70	(0.11)	(15.7)
Landing fees and airport rentals	1.02	1.27	(0.25)	(19.7)
Depreciation and amortization	0.90	1.11	(0.21)	(18.9)
Other operating expenses	2.13	1.85	0.28	15.1
Total	14.52 ¢	9.31 ¢	5.21 ¢	56.0 %

Operating expenses per ASM for the first six months of 2022 increased by 56.0 percent, compared with the first six months of 2021. The majority of the year-over-year unit cost increase was driven by the first six months of 2021 including Payroll Support from the Consolidated Appropriations Act, 2021, and the American Rescue Plan Act of 2021. Operating expenses per ASM for the first six months of 2022, excluding Fuel and oil expense, profitsharing, and special items (a non-GAAP financial measure), decreased 1.0 percent, year-over-year. 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.

Salaries, wages, and benefits expense for the first six months of 2022 increased by \$1.1 billion, or 31.1 percent, compared with the first six months of 2021. On a per ASM basis, Salaries, wages, and benefits expense for the first six months of 2022 increased 3.3 percent, compared with the first six months of 2021. On a dollar basis, the increase was primarily driven by higher salaries and wages due to significantly more trips and step/pay rate increases for certain workgroups, and \$127 million of additional salaries, wages, and benefits expense as a result of incentive pay offered to the Company's Operations Employees through early February 2022 in an effort to address available staffing challenges related to the Omicron variant.

Payroll support and voluntary Employee programs, net (a reduction to expense) had no amounts for the first six months of 2022. The first six months of 2021 consisted of the following items:

- \$1.9 billion of Payroll Support proceeds allocated (credit to expense);
- A \$130 million net reduction in the Extended ETO liability (reduction to expense) relating to certain Employees being recalled prior to their previously elected return dates; and
- \$117 million credit to expense associated with the Employee Retention Tax Credit for continuing to pay Employees' salaries during the time they were not working, as allowed under the CARES Act, and subsequent legislation.

See Note 2 to the unaudited Condensed Consolidated Financial Statements for further information.

Fuel and oil expense for the first six months of 2022 increased by \$1.4 billion, or 107.5 percent, compared with the first six months of 2021. On a per ASM basis, Fuel and oil expense for the first six months of 2022 increased 63.6 percent. On a dollar basis, approximately 75 percent of the increase was attributable to an increase in jet fuel prices per gallon, and the remainder of the increase was due to an increase in fuel gallons consumed. On a per ASM basis, the increase was primarily due to higher jet fuel prices. The following table provides more information on the Company's economic fuel cost per gallon, including the impact of fuel hedging premium expense and fuel derivative contracts:

	Six months ended June 30,	
	2022	2021
Economic fuel costs per gallon	\$ 2.86	\$ 1.83
Fuel hedging premium expense (in millions)	\$ 53	\$ 50
Fuel hedging premium expense per gallon	\$ 0.06	\$ 0.07
Fuel hedging cash settlement gains per gallon	\$ 0.61	\$ 0.01

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.

Maintenance materials and repairs expense for the first six months of 2022 increased by \$25 million, or 6.3 percent, compared with the first six months of 2021. On a per ASM basis, Maintenance materials and repairs expense decreased 15.7 percent, compared with the first six months of 2021. On a dollar basis, the increase was primarily due to the timing of regular airframe maintenance checks as some costs had previously been deferred while a portion of the fleet was placed into temporary storage during the COVID-19 pandemic. There were multiple other increases on a dollar basis, primarily related to an increase in various repairs as a result of deferring costs and reduced operations in the first six months of 2021 due to the COVID-19 pandemic. These increases were partially offset by a decrease in engines and components expense due to the "power-by-the-hour" contract for the Company's -700 engines expiring at the end of 2021.

Landing fees and airport rentals expense for the first six months of 2022 increased by \$17 million, or 2.4 percent, compared with the first six months of 2021. On a per ASM basis, Landing fees and airport rentals expense decreased 19.7 percent, compared with the first six months of 2021. On a dollar basis, the increase was primarily due to an increase in landing fees from the increased number of trips flown, partially offset by higher settlements and credits from various airports received in 2022.

Depreciation and amortization expense for the first six months of 2022 increased by \$22 million, or 3.5 percent, compared with the first six months of 2021. On a per ASM basis, Depreciation and amortization expense decreased 18.9 percent, compared with the first six months of 2021. On a dollar basis, the increase was primarily due to higher depreciation expense associated with owned aircraft and engines, including certain -700 aircraft planned for accelerated retirement dates in 2022.

Other operating expenses for the first six months of 2022 increased by \$474 million, or 45.2 percent, compared with the first six months of 2021. Included within this line item was aircraft rentals expense in the amount of \$98 million and \$103 million for the six month periods ended June 30, 2022 and 2021, respectively. On a per ASM basis, Other operating expenses increased 15.1 percent, compared with the first six months of 2021. On a dollar basis, approximately 25 percent of the increase was due to higher revenue related expenses (including credit card processing charges) and approximately 20 percent of the increase was due to higher personnel expenses. The majority of the remaining increase was due to various flight-driven expenses.

Other

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

Interest expense for the first six months of 2022 decreased by \$43 million, or 18.8 percent, compared with the first six months of 2021, primarily due to elimination of the debt discount due to the adoption of ASU 2020-06. See Note 3 to the unaudited Condensed Consolidated Financial Statements for further information.

Capitalized interest for the first six months of 2022 increased by \$1 million, or 5.3 percent, compared with the first six months of 2021, primarily due to an increase in average progress payment balances for scheduled future aircraft deliveries.

Interest income for the first six months of 2022 increased by \$27 million, compared with the first six months of 2021, due to higher interest rates.

The following table displays the components of Other (gains) losses, net, for the six months ended June 30, 2022 and 2021:

(in millions)	Six months ended June 30,	
	2022	2021
Mark-to-market impact from fuel contracts settling in current and future periods	\$ 15	\$ (9)
Premium cost of fuel contracts not designated as hedges	—	21
Unrealized mark-to-market adjustment on available for sale securities	7	—
Mark-to-market impact on deferred compensation plan investment	72	(18)
Correction on investment gains related to prior periods	—	(60)
Loss on partial extinguishment of convertible and unsecured notes	116	—
Other	2	5
	\$ 212	\$ (61)

Income Taxes

The Company's effective tax rate was approximately 26.9 percent for the first six months of 2022, compared with 28.4 percent for the first six months of 2021. The higher tax rate for the first six months of 2021 was primarily due to higher state taxes. The year-over-year decrease was partially offset by the losses on the Company's convertible debt repurchases, which are largely disallowed as a deduction for tax purposes.

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

	Three months ended June 30,		Percent Change	Six months ended June 30,		Percent Change
	2022	2021		2022	2021	
Fuel and oil expense, unhedged	\$ 1,942	\$ 802		\$ 3,148	\$ 1,266	
Add: Premium cost of fuel contracts designated as hedges	26	14		53	29	
Deduct: Fuel hedge gains included in Fuel and oil expense, net	(332)	(13)		(561)	(23)	
Fuel and oil expense, as reported	\$ 1,636	\$ 803		\$ 2,640	\$ 1,272	
Add: Fuel hedge contracts settling in the current period, but for which losses were reclassified from AOCI (a)	—	5		—	14	
Add: Premium cost of fuel contracts not designated as hedges	—	10		—	21	
Fuel and oil expense, excluding special items (economic)	<u>\$ 1,636</u>	<u>\$ 818</u>	100.0	<u>\$ 2,640</u>	<u>\$ 1,307</u>	102.0
Total operating expenses, net, as reported	\$ 5,570	\$ 3,414		\$ 10,415	\$ 5,267	
Add: Payroll support and voluntary Employee programs, net	—	740		—	2,187	
Add: Fuel hedge contracts settling in the current period, but for which losses were reclassified from AOCI (a)	—	5		—	14	
Add: Interest rate swap agreements terminated in a prior period, but for which losses were reclassified from AOCI (a)	—	1		—	2	
Add: Premium cost of fuel contracts not designated as hedges	—	10		—	21	
Deduct: Impairment of long-lived assets	(15)	\$ —		\$ (31)	\$ —	
Total operating expenses, excluding special items	\$ 5,555	\$ 4,170	33.2	\$ 10,384	\$ 7,491	38.6
Deduct: Fuel and oil expense, excluding special items (economic)	(1,636)	(818)		(2,640)	(1,307)	
Operating expenses, excluding Fuel and oil expense and special items	\$ 3,919	\$ 3,352	16.9	\$ 7,744	\$ 6,184	25.2
Deduct: Profitsharing expense	(81)	(85)		(118)	(109)	
Operating expenses, excluding Fuel and oil expense, special items, and profitsharing	<u>\$ 3,838</u>	<u>\$ 3,267</u>	17.5	<u>\$ 7,626</u>	<u>\$ 6,075</u>	25.5
Operating income, as reported	\$ 1,158	\$ 594		\$ 1,007	\$ 793	
Deduct: Payroll support and voluntary Employee programs, net	—	(740)		—	(2,187)	
Deduct: Fuel hedge contracts settling in the current period, but for which losses were reclassified from AOCI (a)	—	(5)		—	(14)	
Deduct: Interest rate swap agreements terminated in a prior period, but for which losses were reclassified from AOCI (a)	—	(1)		—	(2)	
Deduct: Premium cost of fuel contracts not designated as hedges	—	(10)		—	(21)	
Add: Impairment of long-lived assets	15	—		31	\$ —	
Operating income (loss), excluding special items	<u>\$ 1,173</u>	<u>\$ (162)</u>	n.m.	<u>\$ 1,038</u>	<u>\$ (1,431)</u>	n.m.

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	<u>Three months ended June 30,</u>		<u>Percent</u>	<u>Six months ended June 30,</u>		<u>Percent</u>
	<u>2022</u>	<u>2021</u>		<u>Change</u>	<u>2022</u>	
Other (gains) losses, net, as reported	\$ 68	\$ (14)		\$ 212	\$ (61)	
Add (Deduct): Mark-to-market impact from fuel contracts settling in current and future periods (a)	20	11		(15)	9	
Deduct: Premium cost of fuel contracts not designated as hedges	—	(10)		—	(21)	
Deduct: Unrealized mark-to-market adjustment on available for sale securities	(4)	—		(7)	—	
Deduct: Loss on partial extinguishment of convertible and unsecured notes	(43)	—		(116)	—	
Other (gains) losses, net, excluding special items	<u>\$ 41</u>	<u>\$ (13)</u>	n.m.	<u>\$ 74</u>	<u>\$ (73)</u>	n.m.
Income before income taxes, as reported	\$ 1,036	\$ 502		\$ 660	\$ 648	
Deduct: Payroll support and voluntary Employee programs, net	—	(740)		—	(2,187)	
Deduct: Fuel hedge contracts settling in the current period, but for which losses were reclassified from AOCI (a)	—	(5)		—	(14)	
Deduct: Interest rate swap agreements terminated in a prior period, but for which losses were reclassified from AOCI (a)	—	(1)		—	(2)	
Add (Deduct): Mark-to-market impact from fuel contracts settling in current and future periods (a)	(20)	(11)		15	(9)	
Add: Impairment of long-lived assets	15	—		31	—	
Add: Unrealized mark-to-market adjustment on available for sale securities	4	—		7	—	
Add: Loss on partial extinguishment of convertible and unsecured notes	43	—		116	—	
Income (loss) before income taxes, excluding special items	<u>\$ 1,078</u>	<u>\$ (255)</u>	n.m.	<u>\$ 829</u>	<u>\$ (1,564)</u>	n.m.
Provision for income taxes, as reported	\$ 276	\$ 154		\$ 178	\$ 185	
Add (Deduct): Net income (loss) tax impact of fuel and special items (b)	(23)	(203)		18	(528)	
Provision (benefit) for income taxes, net, excluding special items	<u>\$ 253</u>	<u>\$ (49)</u>	n.m.	<u>\$ 196</u>	<u>\$ (343)</u>	n.m.

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	Three months ended June 30,		Percent Change	Six months ended June 30,		Percent Change
	2022	2021		2022	2021	
Net income, as reported	\$ 760	\$ 348		\$ 482	\$ 463	
Deduct: Payroll support and voluntary Employee programs, net	—	(740)		—	(2,187)	
Deduct: Fuel hedge contracts settling in the current period, but for which losses were reclassified from AOCI (a)	—	(5)		—	(14)	
Deduct: Interest rate swap agreements terminated in a prior period, but for which losses were reclassified from AOCI (a)	—	(1)		—	(2)	
Add (Deduct): Mark-to-market impact from fuel contracts settling in current and future periods (a)	(20)	(11)		15	(9)	
Add: Loss on partial extinguishment of convertible and unsecured notes	43	—		116	—	
Add: Impairment of long-lived assets	15	—		31	—	
Add: Unrealized mark-to-market adjustment on available for sale securities	4	—		7	—	
Add (Deduct): Net income (loss) tax impact of special items (b)	23	203		(18)	528	
Net income (loss), excluding special items	<u>\$ 825</u>	<u>\$ (206)</u>	n.m.	<u>\$ 633</u>	<u>\$ (1,221)</u>	n.m.
Net income per share, diluted, as reported	\$ 1.20	\$ 0.57		\$ 0.77	\$ 0.76	
Add (Deduct): Impact of special items	0.08	(1.21)		0.24	(3.59)	
Add (Deduct): Net impact of net income (loss) above from fuel contracts divided by dilutive shares	(0.03)	(0.03)		0.02	(0.04)	
Add (Deduct): Net income (loss) tax impact of special items (b)	0.05	0.33		(0.03)	0.87	
Deduct: GAAP to Non-GAAP diluted weighted average shares difference (c)	—	(0.01)		—	(0.07)	
Net income (loss) per share, diluted, excluding special items	<u>\$ 1.30</u>	<u>\$ (0.35)</u>	n.m.	<u>\$ 1.00</u>	<u>\$ (2.07)</u>	n.m.
Operating expenses per ASM (cents)	14.92 ¢	10.22 ¢		14.52 ¢	9.31 ¢	
Add (Deduct): Impact of special items	(0.04)	2.22		(0.05)	3.87	
Deduct: Fuel and oil expense divided by ASMs	(4.38)	(2.41)		(3.68)	(2.25)	
Deduct: Profitsharing expense divided by ASMs	(0.22)	(0.25)		(0.16)	(0.19)	
Operating expenses per ASM, excluding Fuel and oil expense, profitsharing, and special items (cents)	<u>10.28¢</u>	<u>9.78¢</u>	5.1	<u>10.63 ¢</u>	<u>10.74 ¢</u>	(1.0)

(a) See Note 4 to the unaudited Condensed Consolidated Financial Statements for further information.

(b) Tax amounts for each individual special item are calculated at the Company's effective rate for the applicable period and totaled in this line item.

(c) Adjustment related to GAAP and Non-GAAP diluted weighted average shares difference, due to the Company being in a Net income position on a GAAP basis versus a Net loss position on a Non-GAAP basis for the three and six months ended June 30, 2021. See Note 7 to the unaudited Condensed Consolidated Financial Statements for further information.

Note Regarding Use of Non-GAAP Financial Measures

The Company's unaudited Condensed Consolidated Financial Statements are prepared in accordance with GAAP. These GAAP financial statements may include (i) unrealized noncash 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 and benefits the Company believes are unusual and/or infrequent in nature and thus may make comparisons to its prior or future performance difficult.

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 (also referred to as "excluding special items"), 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 additional insight to investors as supplemental information to its GAAP results. The non-GAAP measures provided that relate to the Company's performance on an economic fuel cost basis include Fuel and oil expense, non-GAAP; Total operating expenses, non-GAAP; Operating expenses, non-GAAP excluding Fuel and oil expense; Operating expenses, non-GAAP excluding Fuel and oil expense and profitsharing; Operating income (loss), non-GAAP; Other (gains) losses, net, non-GAAP; Income (loss) before income taxes, non-GAAP; Provision (benefit) for income taxes, net, non-GAAP; Net income (loss), non-GAAP; Net income (loss) per share, diluted, non-GAAP; and Operating expenses per ASM, non-GAAP, excluding Fuel and oil expense and profitsharing (cents). The Company's economic Fuel and oil expense 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 has historically been utilized by the Company, as well as some of the other airlines that utilize fuel hedging, as it 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 that are designated as hedges are reflected as a component of Fuel and oil expense, for both GAAP and non-GAAP (including economic) purposes in the period of contract settlement. The Company believes these economic results provide further insight into the impact of the Company's fuel hedges on its operating performance and liquidity since they exclude any unrealized, noncash 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 and analysts, 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, 2021 and Note 4 to the unaudited Condensed Consolidated Financial Statements.

The Company's GAAP results in the applicable periods may include other charges or benefits that are also deemed "special items," that the Company believes make its results difficult to compare to prior periods, anticipated future periods, or industry trends. Financial measures identified as non-GAAP (or as excluding special items) have been adjusted to exclude special items. For the periods presented, in addition to the items discussed above, special items include:

1. Proceeds related to the Payroll Support programs, which were used to pay a portion of Employee salaries, wages, and benefits;
2. Charges and adjustments to previously accrued amounts related to the Company's extended leave programs;
3. Adjustments for prior period losses reclassified from AOCI associated with forward-starting interest rate swap agreements that were terminated in prior periods related to 12 -8 aircraft leases;

4. Noncash impairment charges, primarily associated with adjustments to the salvage values for previously retired airframes;
5. Unrealized mark-to-market adjustment associated with certain available for sale securities; and
6. Losses associated with the partial extinguishment of the Company's Convertible Notes and early prepayment of debt.

Because management believes special items can distort the trends associated with the Company's ongoing performance as an airline, the Company believes that evaluation of its financial performance can be enhanced by a supplemental presentation of results that exclude the impact of special items in order to enhance consistency and comparativeness with results in prior periods that do not include such items and as a basis for evaluating operating results in future periods. The following measures are often provided, excluding special items, and utilized by the Company's management, analysts, and investors to enhance comparability of year-over-year results, as well as to industry trends: Fuel and oil expense, non-GAAP; Total operating expenses, non-GAAP; Operating expenses, non-GAAP excluding Fuel and oil expense; Operating expenses, non-GAAP excluding Fuel and oil expense and profitsharing; Operating income (loss), non-GAAP; Other (gains) losses, net, non-GAAP; Income (loss) before income taxes, non-GAAP; Provision (benefit) for income taxes, net, non-GAAP; Net income (loss), non-GAAP; Net income (loss) per share, diluted, non-GAAP; and Operating expenses per ASM, non-GAAP, excluding Fuel and oil expense and profitsharing (cents).

Liquidity and Capital Resources

The enormous impact of the COVID-19 pandemic on the U.S. travel industry created an urgent liquidity crisis for the entire airline industry, including the Company. However, due to the Company's pre-pandemic low balance sheet leverage, large base of unencumbered assets, and investment-grade credit ratings, the Company was able to quickly access additional liquidity during 2020, as Customer cancellations and ticket refunds spiked and sales and revenues dropped while the Company continued to experience significant fixed operating expenses. See Note 2 to the unaudited Condensed Consolidated Financial Statements for further information regarding the impact of the COVID-19 pandemic and assistance obtained under Payroll Support programs.

Net cash provided by operating activities was \$1.9 billion for the three months ended June 30, 2022, compared with \$2.0 billion provided by operating activities in the same prior year period. Net cash provided by operating activities was \$3.0 billion for the six months ended June 30, 2022, compared with \$2.7 billion provided by operating activities in the same prior year period. Operating cash inflows are historically primarily derived from providing air transportation to Customers. The vast majority of tickets are purchased prior to the day on which travel is provided and, in some cases, several months before the anticipated travel date. Operating cash outflows are related to the recurring expenses of airline operations. The operating cash flows for the six months ended June 30, 2022, were largely impacted by the Company's net income (as adjusted for noncash items), a \$793 million increase in Air traffic liability driven by higher ticket sales related to an increase in travel demand, a \$284 million increase in cash collateral received from derivative counterparties due to an increase in the fuel hedge portfolio, driven by increases in the forward curve market prices for energy commodities year-to-date, and a \$472 million cash tax refund from the Internal Revenue Service associated with the 2020 tax year. Operating cash flows for the six months ended June 30, 2021, included \$2.7 billion in Payroll Support program grant proceeds, of which \$1.9 billion was used to offset eligible costs through June 30, 2021, and was thus included in operating activities, as well as \$45 million allocated to the value of warrants issued and thus included in financing activities. The operating cash flows for the six months ended June 30, 2021, were also driven by an increase in Air traffic liability of \$1.5 billion as a result of increased ticket sales from the increase in leisure travel demand. Net cash provided by operating activities is primarily used to finance capital expenditures, repay debt, and provide working capital. Historically, the Company also used Net cash provided by operating activities to fund stock repurchases and pay dividends; however these shareholder return activities have been suspended due to restrictions associated with the payroll assistance under the Payroll Support programs and the Company's amended and restated revolving credit facility. See Note 2 to the unaudited Condensed Consolidated Financial Statements for further information.

Net cash used in investing activities totaled \$1.6 billion during the three months ended June 30, 2022, compared with \$469 million used in investing activities in the same prior year period. Net cash used in investing activities was \$1.7 billion during the six months ended June 30, 2022, compared with \$670 million used in investing activities in the same prior year period. Investing activities in both years included Capital expenditures and changes in the balance of the Company's short-term and noncurrent investments. During the six months ended June 30, 2022, Capital expenditures were \$1.5 billion, compared with \$190 million in the same prior year period. Capital expenditures increased, year-over-year, largely due to an increase in progress and delivery payments made for current period and future aircraft deliveries during the six months ended June 30, 2022, compared to the same prior year period, when progress payments were not made due to delivery credits provided by Boeing to the Company resulting from the settlement of 2020 estimated damages relating to the FAA grounding of the MAX aircraft.

The Company now estimates its 2022 capital spending to be approximately \$4.0 billion, which assumes the exercise of its five remaining 2022 aircraft options, and a total of 66 -8 aircraft deliveries in 2022, compared with its previous 2022 capital spending guidance of approximately \$5.0 billion which assumed the delivery of 114 MAX aircraft in 2022. See Note 10 to the unaudited Condensed Consolidated Financial Statements for further information. The Company's 2022 capital spending guidance continues to include approximately \$900 million in non-aircraft capital spending.

Net cash used in financing activities was \$215 million during the three months ended June 30, 2022, compared with \$617 million provided by financing activities for the same prior year period. Net cash used in financing activities

was \$530 million during the six months ended June 30, 2022, compared with \$1.1 billion provided by financing activities for the same year period. The Company repaid \$555 million in debt and finance lease obligations, including the extinguishment of \$302 million in principal of its Convertible Notes for a cash payment of \$409 million during the six months ended June 30, 2022, and is scheduled to repay approximately \$55 million in debt and finance lease obligations during third quarter 2022. The Company may engage in debt repurchases from time to time and future repurchases are not included in the scheduled to repay third quarter 2022 amount. During the six months ended June 30, 2021, the Company borrowed \$1.1 billion of loan proceeds under Payroll Support programs. See Note 2 to the unaudited Condensed Consolidated Financial Statements for further information. The Company also repaid \$109 million in debt and finance lease obligations during the six months ended June 30, 2021.

The Company is a "well-known seasoned issuer" and currently 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 \$1.0 billion under its amended and restated revolving credit facility (the "Amended A&R Credit Agreement"). In July 2022, this facility was amended to extend the expiration date to August 2025, and to change the benchmark rate from the London Interbank Offered Rate to the Secured Overnight Financing Rate ("SOFR"). The Amended A&R Credit Agreement has an accordion feature that would allow the Company, subject to, among other things, the procurement of incremental commitments, to increase the size of the facility to \$1.5 billion. 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 SOFR plus a credit spread adjustment of 10 basis points plus 200 basis points. The facility contains a financial covenant to maintain total liquidity, as defined in the Amended A&R Credit Agreement, of \$1.5 billion at all times under the Amended A&R Credit Agreement; the Company was compliant with this requirement as of June 30, 2022. There were no amounts outstanding under the Amended A&R Credit Agreement as of June 30, 2022.

Although not the case at June 30, 2022 due to the Company's significant financing activities throughout the early stages of the pandemic, the Company has historically carried a working capital deficit, in which its current liabilities exceed its current assets. This is common within the airline industry and is primarily due to the nature of the Air traffic liability account, which is related to advance ticket sales, unused funds available to Customers, and loyalty deferred revenue, which are performance obligations for future Customer flights, do not require future settlement in cash, and are mostly nonrefundable. See Note 6 to the unaudited Condensed Consolidated Financial Statements for further information.

The Company believes it has various options available to meet its capital and operating commitments, including unrestricted cash and short-term investments of \$16.4 billion as of June 30, 2022, and anticipated future internally generated funds from operations. However, the COVID-19 pandemic continues to evolve and could have a material adverse impact on the Company's ability to meet its capital and operating commitments. See Note 2 to the unaudited Condensed Consolidated Financial Statements for further information on the impacts of the COVID-19.

As of June 30, 2022, the Company's total firm and option order book was 632 aircraft. See Note 10 to the unaudited Condensed Consolidated Financial Statements for further information.

The following table details information on the aircraft in the Company's fleet as of June 30, 2022:

Type	Seats	Average Age (Yrs)	Number of Aircraft	Number Owned	Number Leased
737-700	143	18	442 (a)	360	82
737-800	175	7	207	190	17
737-8	175	2	81	52	29
Totals		13	730	602	128

(a) Included four Boeing 737 Next Generation aircraft in storage as of June 30, 2022.

Critical Accounting Policies and Estimates

For information regarding the Company's Critical Accounting Policies and Estimates, see the "Critical Accounting Policies and Estimates" section of "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations" in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2021.

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:

- the Company's financial guidance for third quarter and full year 2022 and factors that could impact the Company's financial results;
- the Company's capacity guidance;
- the Company's estimated fuel costs, hedging gains, and fuel efficiency and the assumptions underlying the Company's fuel-related expectations and estimates, including expectations related to the Company's fuel derivative contracts;
- the Company's plans for the repayment of debt;
- the Company's fleet plans, including underlying expectations and dependencies;
- the Company's fleet and network-related goals, including without limitation with respect to growth opportunities, better optimized staffing, restoration of the Company's network, reduction of operating costs, and further fleet modernization with less carbon-intensive aircraft;
- the Company's cash flow expectations and capital spending guidance, in particular with respect to aircraft capital expenditures and underlying aircraft delivery expectations;
- the Company's hiring plans and expectations;
- the Company's expectations related to its policy change with respect to the expiration of flight credits;
- the Company's expectations with respect to its ability to meet its ongoing capital and operating commitments, including underlying assumptions and factors that could impact this ability;
- the Company's assessment of market risks; and
- the Company's plans and expectations related to legal and regulatory 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 Boeing and the FAA with respect to the Company's fleet, fuel, and other operational strategies and goals;
- the impact of labor and hiring matters on the Company's business decisions, plans, and strategies;
- the impact of fuel price changes, fuel price volatility, volatility of commodities used by the Company for hedging jet fuel, and any changes to the Company's fuel hedging strategies and positions on the Company's business plans and results of operations;
- any further negative developments related to the COVID-19 pandemic, including, for example, with respect to (i) the duration, spread, severity, or any recurrence of the COVID-19 pandemic or any new variant strains of the underlying virus; (ii) the effectiveness, availability, and usage of COVID-19 vaccines; (iii) the impact of government mandates, directives, orders, regulations, and other governmental actions related to COVID-19 on the Company's business plans and its ability to retain key Employees; (iv) the extent of the impact of COVID-19 on overall demand for air travel and the Company's related business plans and decisions; and (v) the impact of the COVID-19 pandemic on the Company's access to capital;
- the impact of governmental actions and governmental regulations on the Company's plans, strategies, financial results, and operations;

- the impact of fears or actual outbreaks of other diseases, extreme or severe weather and natural disasters, actions of competitors (including, without limitation, pricing, scheduling, capacity, and network decisions, and consolidation and alliance activities), consumer perception, economic conditions, fears of terrorism or war, socio-demographic trends, and other factors beyond the Company's control on consumer behavior and the Company's results of operations and business decisions, plans, strategies, and results;
- the impact of fears or actual acts of terrorism or war, political instability, cyber-attacks, and other factors beyond the Company's control on the Company's plans, financial results, operations, and ability to adequately insure against risks;
- 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;
- the Company's dependence on third parties, in particular with respect to its fuel supply, and the impact on the Company's operations and results of operations of any third party delays or non-performance; 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, 2021 and in this Quarterly Report on Form 10-Q for the quarter ended June 30, 2022.

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

Hedging

As discussed in Note 4 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 June 30, 2022, the estimated fair value of outstanding contracts was a net asset of \$1.1 billion.

The Company's credit exposure related to fuel derivative instruments is represented by the fair value of contracts that are in an asset position 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 June 30, 2022, the Company had nine counterparties for which the derivatives held were a net asset. 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 net 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 June 30, 2022, the Company had agreements with all of its active counterparties containing early termination rights and/or bilateral collateral provisions whereby security is required if market risk exposure exceeds a specified threshold amount based on the counterparty's credit rating. The Company also had agreements with counterparties in which cash deposits and/or letters of credit are required to be posted as collateral whenever the net fair value of derivatives associated with those counterparties exceeds specific thresholds. Refer to the counterparty credit risk and collateral table provided in Note 4 to the unaudited Condensed Consolidated Financial Statements for the fair values of fuel derivatives, amounts held as collateral, and applicable collateral posting threshold amounts as of June 30, 2022, at which such postings are triggered.

At June 30, 2022, \$459 million in cash collateral deposits were held by the Company from counterparties based on the Company's outstanding fuel derivative instrument portfolio. Due to the types of derivatives held as of June 30, 2022, the Company does not have cash collateral exposure. See Note 4 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. The Company has found that financial derivative instruments in commodities, such as 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. 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.

Financial Market Risk

The Company currently has agreements with organizations that process credit card transactions arising from purchases of air travel tickets by its Customers utilizing American Express, Discover, and MasterCard/VISA. Credit card processors have financial risk associated with tickets purchased for travel because the processor generally forwards the cash related to the purchase to the Company soon after the purchase is completed, but the air travel generally occurs after that time; therefore, the processor will have liability if the Company does not ultimately provide the air travel. Under these processing agreements, and based on specified conditions, increasing amounts of cash reserves could be required to be posted with the counterparty. There was no cash reserved for this purpose as of June 30, 2022.

A majority of the Company's sales transactions are processed by Chase Paymentech. Should chargebacks processed by Chase Paymentech reach a certain level, proceeds from advance ticket sales could be held back and used to

establish a reserve account to cover such chargebacks and any other disputed charges that might occur. Additionally, cash reserves are required to be established if the Company's credit rating falls to specified levels below investment grade. Cash reserve requirements are based on the Company's public debt rating and a corresponding percentage of the Company's Air traffic liability. As of June 30, 2022, no holdbacks were in place.

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, 2021, for further information about market risk, and Note 4 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 June 30, 2022. 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 June 30, 2022, 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) of the Exchange Act) during the quarter ended June 30, 2022, 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

On June 30, 2015, the U.S. Department of Justice ("DOJ") issued a Civil Investigative Demand ("CID") to the Company. The CID sought information and documents about the Company's capacity from January 2010 to the date of the CID, 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. The Company is cooperating fully with the DOJ CID and the state inquiry.

Further, 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 were 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 District of New Jersey, 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. On October 13, 2015, the Judicial Panel on Multi-District Litigation centralized the cases to the United States District Court in the District of Columbia. On March 25, 2016, the plaintiffs filed a Consolidated Amended Complaint in the consolidated cases alleging that the defendants conspired to restrict capacity from 2009 to present. The plaintiffs seek to bring their claims on behalf of a class of persons who purchased tickets for domestic airline travel on the defendants' airlines from July 1, 2011 to present. They seek treble damages, injunctive relief, and attorneys' fees and expenses. On May 11, 2016, the defendants moved to dismiss the Consolidated Amended Complaint, which the Court denied on October 28, 2016. On December 20, 2017, the Company reached an agreement to settle these cases with a proposed class of all persons who purchased domestic airline transportation services from July 1, 2011, to the date of the settlement. The Company agreed to pay \$15 million and to provide certain cooperation with the plaintiffs as set forth in the settlement agreement. After notice was provided to the proposed settlement class and the Court held a fairness hearing the Court issued an order granting final approval of the settlement on May 9, 2019. On June 10, 2019, certain objectors filed notices of appeal to the United States Court of Appeals for the District of Columbia Circuit, which the Court dismissed on July 9, 2021, for lack of jurisdiction because the district court's order approving the settlements was not a final appealable order. The case is continuing as to the remaining defendants. The Company denies all allegations of wrongdoing.

On July 11, 2019, a complaint alleging violations of federal and state laws and seeking certification as a class action was filed against Boeing and the Company in the United States District Court for the Eastern District of Texas in Sherman ("Sherman Complaint"). The complaint alleges that Boeing and the Company colluded to conceal defects with the Boeing 737 MAX ("MAX") aircraft in violation of the Racketeer Influenced and Corrupt Organization Act ("RICO") and also asserts related state law claims based upon the same alleged facts. The complaint seeks damages on behalf of putative classes of customers who purchased tickets for air travel from either the Company or American Airlines between August 29, 2017, and March 13, 2019. The complaint generally seeks money damages, equitable monetary relief, injunctive relief, declaratory relief, and attorneys' fees and other costs. On September 13, 2019, the Company filed a motion to dismiss the complaint and to strike certain class allegations. Boeing also moved to dismiss. On February 14, 2020, the trial court issued a ruling that granted in part and denied in part the motions to dismiss the complaint. The trial court order, among other things: (i) dismissed without prejudice various state law claims that the plaintiffs abandoned in response to the motions, (ii) dismissed with prejudice the remaining state law claims, including fraud by concealment, fraud by misrepresentation, and negligent misrepresentation on the grounds that federal law preempts those claims, and (iii) found that plaintiffs lack Article III standing to pursue one of the plaintiffs' theories of RICO injury. The order denied the motion to dismiss with respect to two RICO claims premised upon a second theory of RICO injury and denied the motion to strike the class allegations at the pleadings stage. On September 3, 2021, the trial court issued an order under Rule 23(a) and 23(b)(3) certifying four classes of persons associated with ticket purchases for flights during the period of August 29, 2017, through March 13, 2019, comprised of (i) those who purchased tickets (without being reimbursed) for flights on Southwest Airlines during the class period, except for those whose flights were solely on routes where, at the time of the ticket

purchase(s), a MAX plane was not scheduled for use (or actually used) and had not previously been used, (ii) those who reimbursed a Southwest Airlines ticket purchaser and thus bore the economic burden for a Southwest Airlines ticket for a flight meeting the preceding criteria set forth in (i) above, (iii) those who purchased tickets (without being reimbursed) for flights on American Airlines during the class period, except for those whose flights were solely on routes where, at the time of ticket purchase(s), a MAX plane was not scheduled for use (or actually used) and had not previously been used, and (iv) those who reimbursed an American Airlines ticket purchaser and thus bore the economic burden for an American Airlines ticket for a flight meeting the preceding criteria set forth in (iii) above. On September 17, 2021, the Company filed a petition for permission immediately to appeal the class certification ruling to the Fifth Circuit Court of Appeals. Boeing also filed such a petition. Plaintiffs filed their oppositions to the petitions on September 27, 2021. On September 30, 2021, the Fifth Circuit Court of Appeals granted the Company (and Boeing) permission to appeal the class certification ruling. On December 22, 2021, in response to a motion to stay the trial court proceedings filed by the Company and Boeing, the Fifth Circuit stayed all proceedings, including the pursuit of any discovery, in the trial court pending disposition of the class certification appeal by the Fifth Circuit. Following full briefing on the merits of the appeal, a three-judge panel of the Fifth Circuit heard oral argument of the appeal on July 5, 2022, and the Company is awaiting a decision from the Fifth Circuit. The Company denies all allegations of wrongdoing, believes the plaintiffs' positions are without merit, and intends to continue vigorously defending itself in all respects.

On February 19, 2020, a complaint alleging violations of federal securities laws and seeking certification as a class action was filed against the Company and certain of its officers in the United States District Court for the Northern District of Texas in Dallas. A lead plaintiff has been appointed in the case, and an amended complaint was filed on July 2, 2020. The amended complaint seeks damages on behalf of a putative class of persons who purchased the Company's common stock between February 7, 2017, and January 29, 2020. The amended complaint asserts claims under Sections 10(b) and 20 of the Securities Exchange Act and alleges that the Company made material misstatements to investors regarding the Company's safety and maintenance practices and its compliance with federal regulations and requirements. The amended complaint generally seeks money damages, pre-judgment and post-judgment interest, and attorneys' fees and other costs. On August 17, 2020, the Company and the individual defendants filed a motion to dismiss. On October 1, 2020, the lead plaintiff filed a response in opposition to the motion to dismiss. The Company filed a reply on or about October 21, 2020, such that the motion is now fully briefed, although the parties have each supplemented their prior briefing with regard to more recent case holdings in other matters. The Company denies all allegations of wrongdoing, including those in the amended complaint. The Company believes the plaintiffs' positions are without merit and intends to vigorously defend itself.

On June 22, 2020, a derivative action for breach of fiduciary duty was filed in the United States District Court for the Northern District of Texas naming the members of the Company's Board of Directors as defendants and the Company as a nominal defendant (the "Derivative Action"). The plaintiff alleges unspecified damage to Company's reputation, goodwill, and standing in the community, as well as damage from exposure to civil and regulatory liability and defense costs. According to the lawsuit, these damages arise from the Company's alleged failure to comply with safety and record maintenance regulations and false statements in public filings regarding the Company's safety practices. The plaintiff alleges the Board, in the absence of good faith, exhibited reckless disregard for its duties of oversight. On October 7, 2020, the Court entered an order staying and administratively closing the Derivative Action. The plaintiff in the Derivative Action shall have the right to reopen the action following the resolution of the Company's motion to dismiss in the ongoing litigation brought under the federal securities laws or upon the occurrence of certain other conditions. The Board and Company deny all allegations of wrongdoing made in the Derivative Action.

On August 26, 2021, a complaint alleging breach of contract and seeking certification as a class action was filed against the Company in the United States District Court for the Western District of Texas in Waco. The complaint alleges that the Company breached its Contract of Carriage and other alleged agreements in connection with its use of the allegedly defective MAX aircraft manufactured by The Boeing Company. The complaint seeks damages on behalf of putative classes of customers who provided valuable consideration, whether in money or other form (e.g., voucher, miles/points, etc.), in exchange for a ticket for air transportation with the Company, which transportation took place between August 29, 2017, and March 13, 2019. The complaint generally seeks money damages, declaratory relief, and attorneys' fees and other costs. On October 27, 2021, the Company filed a multi-faceted motion challenging the Complaint based upon lack of subject matter jurisdiction, the existence of the prior-filed

Sherman Complaint on appeal in the Fifth Circuit, improper venue, and failure to state a claim, and seeking to have the complaint's class contentions stricken. That motion was fully briefed by both parties and was argued to a United States Magistrate Judge on June 27, 2022. On July 5, 2022, the Magistrate Judge granted the motion in part and ordered the case stayed until the issuance of the Fifth Circuit's opinion in the Sherman Complaint. The Company denies all allegations of wrongdoing, believes the plaintiffs' positions are without merit, and intends to vigorously defend itself in all respects.

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

Except for the additional risk factor set forth below, 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, 2021.

Conflicting federal, state, and local laws and regulations may impose additional requirements and restrictions on the Company's operations, which could increase the Company's operating costs, result in service disruptions, and increase litigation risk.

Airlines are subject to extensive regulatory and legal requirements at the federal, state, and local levels that require substantial compliance costs and that may be inconsistent with each other. These laws could affect the Company's relationship with its workforce and cause its expenses to increase without an ability to pass through these costs. In recent years, the airline industry has experienced an increase in litigation asserting the application of state and local employment laws, particularly in California. On June 30, 2022, the U.S. Supreme Court denied review of the Ninth Circuit's ruling in *Bernstein v. Virgin America, Inc.*, which held that federal law did not preempt the California state meal-and-rest-break regulations for flight attendants at issue. The Company is a defendant in multiple proceedings asserting wage and hour claims with respect to certain employees who work in, or are based in, California. The *Bernstein* decision may adversely affect the Company's defenses in some or all of those proceedings and may give rise to additional litigation in these or other areas previously believed to be preempted by federal law. Application of state and local laws to the Company's operations may conflict with federal laws—or with the laws of other states and local governments—and may subject the Company to additional requirements and restrictions. Moreover, application of these state and local laws may result in operational disruption, increased litigation risk, and negative effects on the Company's collective bargaining agreements. Adverse litigation results in any of these cases could adversely impact the Company's operational flexibility and result in the imposition of damages and fines, which could potentially be significant.

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

(c) On May 15, 2019, the Company's Board of Directors authorized the repurchase of up to \$2.0 billion of the Company's common stock. Subject to certain conditions, including restrictions on the Company pursuant to the Payroll Support programs through September 30, 2022, repurchases may be made in accordance with applicable securities laws in open market or private, including accelerated, repurchase transactions from time to time, depending on market conditions. The Company has announced it has suspended further share repurchase activity until further notice. The Company has approximately \$899 million remaining under its current share repurchase authorization.

Item 3. Defaults Upon Senior Securities

None

Item 4. Mine Safety Disclosures

Not applicable

Item 5. Other Information

None

Item 6. Exhibits

- 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 [Second Amended and Restated Bylaws of the Company, effective November 17, 2016 \(incorporated by reference to Exhibit 3.1 to the Company's Current Report on Form 8-K filed November 21, 2016 \(File No. 1-7259\)\).](#)
- 10.1 [Supplemental Agreement No. 16 to Purchase Agreement No. 3729, dated December 13, 2011, between The Boeing Company and the Company. \(1\)](#)
- 10.2 [Supplemental Agreement No. 17 to Purchase Agreement No. 3729, dated December 13, 2011, between The Boeing Company and the Company. \(1\)](#)
- 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. \(2\)](#)
- 101.INS XBRL Instance Document - The instance document does not appear in the Interactive Data File because its XBRL tags are embedded within the Inline XBRL document.
- 101.SCH Inline XBRL Taxonomy Extension Schema Document.
- 101.CAL Inline XBRL Taxonomy Extension Calculation Linkbase Document.
- 101.DEF Inline XBRL Taxonomy Extension Definition Linkbase Document.
- 101.LAB Inline XBRL Taxonomy Extension Label Linkbase Document.
- 101.PRE Inline XBRL Taxonomy Extension Presentation Linkbase Document.
- 104 Cover Page Interactive Data File (formatted as Inline XBRL and contained in Exhibit 101).

(1) Certain confidential information contained in this agreement has been omitted because it is both not material and is of the type that the registrant treats as private or confidential.

(2) 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.

August 1, 2022

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)