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Western Airlines

Western Air Lines Inc. 1970 Annual Report

Notice to Stockholders

Under a new rule adopted by the Civil Aeronautics Board in July 1970, any person who owns as of December 31 of any year or acquires ownership, either beneficially or as a trustee, of more than five percent of any class of capital stock of an air carrier shall file with the CAB a report containing information required by Subpart B of Part 245.13 of the Board's Economic Regulations. This report must be filed with the Civil Aeronautics Board on or before April 1 of each year as to capital stock or capital owned as of December 31 of the preceding year and within 10 days of the acquisition, unless such person has otherwise filed with the CAB a report covering such acquisition or ownership. Any stockholder who believes that he may be required to file such a report may obtain further information by writing to the Director, Bureau of Operating Rights, Civil Aeronautics Board, Washington, D. C. 20428.

Highlights of 1970

Operating	1970	1969*	Change
Seat miles produced	9,839,299,000	8,509,441,000	+15.6%
Seat miles sold	5,159,081,000†	4,021,296,000	+28.3%
Passengers carried	6,187,527†	5,752,072	+7.6%
Passenger load factor — actual %	52.4	47.3	+5.1 pts.
— breakeven point %	52.7	53.1	−0.4 pts.
Financial			
Operating revenues	$298,109,620	$240,351,788	+24.0%
Operating income (loss)	$ 11,811,622	$ (12,400,902)	
Net earnings (loss)	$ 595,374	$ (12,198,860)	
Cash dividends paid	$ —	$ 2,451,634	
Common stock outstanding	5,394,266**	5,394,266 **	
Earnings (loss) per share	$ 0.11**	$ (2.26)**	
Cash dividends per share	$ —	$ 0.45 **	
Shareholders' equity	$ 79,904,835	$ 79,309,461	+0.8%
Shareholders' equity per share	$ 14.81**	$ 14.70 **	+0.8%
Cash and short-term securities	$ 64,601,543	$ 28,454,327	+127.0%
Working capital	$ 35,238,447	$ 20,447,092	+72.3%
Property and equipment at cost	$413,883,626	$429,107,512	−3.6%
Long-term debt	$174,184,358	$197,149,588	−11.7%
Number of employees at year end	8,830	9,225	−4.3%
Wages and salaries paid	$100,629,845	$ 87,495,153	+15.0%

*Operations were suspended from July 29 to August 16, 1969 because of a strike.

†Operations of a competing carrier were partially suspended from July 8 to December 14, 1970.

**Adjusted for the 10% stock dividend paid on March 5, 1971.

President's Letter

To Our Stockholders:

It is indeed gratifying to report in the following pages that Western, despite the adverse circumstances facing the airline industry, was able to report a modest profit for 1970.

This achievement could not have been accomplished without the efforts of thousands of loyal and resourceful employees, whose dedication is hereby acknowledged with sincere gratitude.

As indicated in last year's annual report, our 1970 goal was to improve the company's financial condition with concentrated effort on two fronts: control of costs and capital expenditures and stimulation of new revenues. These efforts had to be exerted in the face of continuing inflation on the one hand and a sagging economy that slowed the growth of air travel on the other.

We believe that under such circumstances, our performance for 1970 was quite remarkable, particularly when compared to the airline industry as a whole.

Through aggressive marketing programs, for example, Western was able to obtain a reasonable share of Hawaii travel, which in turn, permitted us to increase revenues on a systemwide basis by 24 percent.

For the first time since 1966, the increase in seat miles sold—28.3 percent—was greater than the increase in seat miles produced—15.6 percent—as total capacity on routes other than the company's new Hawaii segments was reduced below the level of strike-affected 1969.

With the introduction of increased legroom for the more than 90 percent of our passengers who travel in coach or economy, the significant improvement in our on-time performance and the extra effort of our employees, the image of Western Air Lines as an aggressive, efficient and considerate airline was significantly enhanced.

Nevertheless, Western was unable to show a profit on some of its key routes during 1970. These routes include Hawaii, which has excessive competition and an unrealistically low fare structure, and the California/Coastal operations which commenced to show a loss in 1968.

Inflation, particularly in the areas of wages, employee benefits and work rules, is continuing to drive up our costs at a frightening rate; although projections for the U.S. economy indicate some improvement in 1971, the degree of traffic growth remains uncertain; and in the coming months we expect to be faced with more intense competition from the wide-bodied jets.

On December 16, 1970, your board of directors voted to merge with American Airlines. The details of this proposal were submitted to you for your approval in our proxy statement of February 22, 1971.

While awaiting the outcome of the Civil Aeronautics Board proceedings associated with the merger proposal, your management will continue to operate Western as an aggressive company serving the interests of its stockholders, the traveling and shipping public and its employees.

The airline industry is plagued with many problems and continues to function without being able to achieve an adequate rate of return on its investment. The most urgent need facing the carriers—and the one to which Western is devoting its full energies in 1971—is to find solutions which will work toward profitable employment of capital provided by Western's investors and by lending institutions at a level that will produce financial stability and future growth.

Your continued support in this endeavor will be sincerely appreciated. We hope you will fly Western whenever possible and urge your friends and associates to do likewise.

J. J. Taylor

J. Judson Taylor
President and Chief Executive Officer

March 15, 1971

Review of the Year

Earnings

Earnings in 1970 were $595,374, or 11 cents a share, compared to a loss of $12,198,860, or $2.26 a share, for 1969. (Per-share results for both years are based on 5,394,266 shares of stock, the number of shares outstanding at the end of each year after giving effect to a 10 percent stock dividend declared on December 16, 1970, and paid March 5, 1971, to stockholders of record on January 15, 1971.)

Operating income totaled $11,811,622, compared to a loss from operations of $12,400,902 in strike-affected 1969. The application of other expenses—primarily interest—resulted in a loss of $1,654,626 before tax credits, compared to a before-tax loss of $27,273,860 in 1969.

After tax credits of $2,250,000 (see Note 1 of Notes to Financial Statements), net earnings for 1970 were $595,374.

Revenues

Total operating revenues for 1970 were $298,109,620 (after reduction of $2,711,000 for payments to a struck carrier under the airlines' Mutual Aid Agreement). This represents an increase of 24 percent over the $240,351,788 of the previous year. Western became a participant in the Mutual Aid pact effective August 3, 1970.

Almost half of the increase in revenues was derived from the company's Hawaii routes which were inaugurated in August and September of 1969. The bulk of the remaining net gain in revenues resulted from increased coach revenues, as revenues from first class service on Mainland routes declined below the 1969 level.

Of Western's revenue dollar, 92.2 percent was derived from passenger traffic (82.5 percent coach and 9.7 percent first class). Express, freight and excess baggage accounted for 4.7 percent; mail, 1.6 percent; charter and other sources, 1.5 percent.

The number of passengers carried increased 7.6 percent. However, because the average passenger trip on Western increased from 699 miles in 1969 to 834 miles in 1970, seat miles sold were up 28.3 percent.

Although the number of seat miles sold at discount fares increased 13.9 percent over 1969, the percentage sold at a discount decreased from 41.5 percent of all seat miles sold in 1969 to 36.8 percent in 1970.

Despite fare increases of 3.1 percent in February and 3.7 percent in October 1969 and more modest adjustments in 1970 (described in the Fare Changes section of this report), Western's average revenue per seat mile sold decreased from 5.51 cents in 1969 to 5.42 cents in 1970. The decline resulted primarily from the impact of the abnormally low fare structure on Hawaii routes which represented approximately 18 percent of all seat miles sold on Western's system during 1970.

Fare Changes

In 1970, the Civil Aeronautics Board instituted investigations into the structure and level of domestic and Mainland-Hawaii passenger fares, domestic freight rates and domestic mail rates and into the level of return on investment for U.S. carriers. Upon completion of those investigations, the CAB may prescribe changes in the structure and level of any or all such fares and rates.

Although the industry has not been permitted to make broad across-the-board increases pending the outcome of the fare investigations sometime later this year, CAB approval was granted for certain selective fare adjustments.

On July 1, a "rounding-up" of fares to even dollar amounts in conjunction with the introduction of a new federal travel tax resulted in a passenger fare increase expected to average 7/10 of one percent for Western.

On October 15, a 10 percent increase in Alaska fares was granted which is expected to produce an annual increase in Western's revenues equivalent to 8/10 of one percent.

On December 19, the CAB approved cancellation of commuter fares between California and Las Vegas resulting in an additional 8/10 of one percent increase in Western's annual revenues.

Effective January 11, 1971, the CAB authorized carriers to increase fares in certain short-haul markets, to eliminate excursion fares on most trips under 1,500 miles, to reduce certain fare discounts and to increase first class fares for trips under 1,200 miles, resulting in an increase in passenger fares expected to average 2.5 percent for Western.

On July 9, 1970, the United States Court of Appeals for the District of Columbia held that the CAB's order permitting the October 1969 fare increase and the tariffs filed by the air carriers pursuant to that order were unlawful, on the ground that the CAB had not complied with the applicable statutory procedures. The Court's decision did not require any reduction in existing fares, nor was any such reduction effected. On September 24, 1970, after proceedings intended to comply with the statutory requirements, the CAB issued an order permitting tariffs identical to those previously approved to become effective October 15, 1970. While the Court's decision does not require repayment of fares collected in the past, on February 25, 1971, the CAB instituted an investigation to determine whether such fares were unreasonable, and, if found to be unreasonable, to determine whether and to what extent relief, including restoration of overcharge or otherwise, may and should be granted.

The Court's decision has occasioned a number of actions, brought in various cities on behalf of air travelers in general, naming a number of domestic air carriers (including Western) as defendants. The plaintiffs in these actions request repayment of the amounts alleged to have been unlawfully collected (in one action allegedly $300,000,000) by all the defendant air carriers since the October 1969 fare increase. In addition, the plaintiffs in one or more of these actions seek treble damages, punitive damages and injunctive relief against the continuation by the defendants of air fares at present levels and ask that the defendants deposit with the courts in which the actions have been brought the amounts alleged to have been unlawfully collected and that they provide the means of identifying and paying the cost of notifying all persons allegedly damaged. In Western's opinion, the plaintiffs are not entitled to any recovery on their claims.

Expenses

Despite continuing inflation and a change in aircraft seating configuration to give Western's coach and economy passengers added legroom, the company was able to increase seat mile production 15.6 percent in 1970 at an increase in operating costs of 13.3 percent.

Total operating expenses for the year amounted to $286,297,998, compared to $252,752,690 for the previous year. High on the list of inflationary items were wages, salaries and employee benefits costs which increased 16.4 percent despite a lower level of employment throughout the year. Depreciation and amortization was up 5.1 percent to $36,579,626 and other expenses increased 13.1 percent.

Interest expense totaled $14,586,128, down 1.1 percent from the previous year.

The change in seating configuration, completed in June, reduced the number of seats on the company's aircraft in subsequent months by eight percent and for the year by six percent.

This configuration change caused an increase in the cost of a seat mile produced and in the breakeven load factor (as well as in the actual load factor). The impact of continuing inflation also tended to cause increases in the same cost indicators. Nevertheless, the company was able to reduce seat mile costs for the year to 2.91 cents from 2.97 cents in the previous year. Breakeven load factor was reduced to 52.7 percent from 53.1 percent in strike-affected 1969.

Finances

Although the consistent earnings pattern which is needed for sound strengthening and to provide a reasonable return on investment did not emerge during the year, Western ended 1970 in good financial condition.

Cash and short-term securities increased during the year from $28,454,327 at December 31, 1969, to $64,601,543 at the end

Brief Statement of Earnings

Western's revenues came from:	1970	1969*
Passengers		
Coach	$246,019,597	$192,659,374
Deluxe	28,773,126	27,870,293
	274,792,723	220,529,667
Express, freight and baggage	13,993,889	11,969,392
Mail	4,752,051	4,502,928
Charter	3,187,243	759,991
Other income	3,405,008	2,945,423
	300,130,914	240,707,401
Western's expenses were:		
Wages and salaries	100,629,845	87,495,153
Social security, group insurance and retirement plans	12,486,516	9,660,929
Property, fuel and other taxes	6,750,840	4,985,938
Aircraft fuels	37,357,120	32,857,173
Depreciation and amortization	36,579,626	34,820,805
Materials and repairs	20,424,846	21,442,561
Utilities and services	24,737,983	20,399,425
Service to passengers	14,511,559	11,926,473
Rentals of flying equipment	2,992,188	350,994
Rentals of ground facilities	5,301,331	5,029,186
Landing fees	5,211,471	4,360,150
Advertising and publicity	8,780,598	8,210,484
Insurance	4,174,531	5,148,098
Interest	14,586,128	14,747,559
Other costs	7,260,958	6,546,333
	301,785,540	267,981,261
Loss before taxes on income	(1,654,626)	(27,273,860)
Taxes on income (tax credits)	(2,250,000)	(15,075,000)
Net earnings (loss)	$ 595,374	$(12,198,860)

*Operations were suspended from July 29 to August 16, 1969 because of a strike.

Brief Balance Sheet

Western owns:	1970	1969
Cash and short-term securities	$ 64,601,543	$ 28,454,327
Receivables due from others	21,732,984	19,408,382
Federal income taxes refundable	—	12,285,989
Maintenance and operating supplies	11,104,517	13,016,516
Buildings and improvements, net	13,364,022	14,007,513
Flight and other equipment, net	234,062,785	271,749,132
Prepaid expenses	4,575,804	2,986,496
Equipment not used in operations, net	2,417,018	2,062,898
Deferred charges and other	3,310,253	3,616,859
	355,168,926	367,588,112
Western owes:		
Payables due to vendors and others	37,861,900	34,582,902
Federal income taxes—deferred	17,495,000	17,919,000
Unamortized investment credits	13,584,000	16,060,000
Other deferred items	3,224,332	1,445,445
Tickets sold but not yet used	5,949,274	4,926,089
Notes payable—current and long term	197,149,585	213,345,215
	275,264,091	288,278,651
Excess of what is owned over what is owed, or shareholders' equity	$ 79,904,835	$ 79,309,461

of 1970. Cash not required in the daily operations of the company was invested in marketable securities. In 1970, these investments resulted in interest income amounting to $2,021,293. Working capital increased from $20,447,092 at the end of 1969 to $35,238,447 at December 31, 1970.

The ratio of current assets to current liabilities was $1.53-to-$1.00 at December 31, 1970, up from $1.37-to-$1.00 at the previous year end.

The Statement of Source and Application of Funds is constructed to show the major elements involved in the generation and utilization of cash and marketable securities. As indicated, operations generated a net contribution of $39,138,027. This amount included non-cash charges of $41,529,249 for depreciation, amortization and reserves against which was offset tax credits amounting to $2,050,000 (for further details see Note 1 of Notes to Financial Statements). Other funds were provided by a refund of $12,285,989 in federal income taxes resulting from tax losses as filed for 1969, by an $11,071,783 increase in current liabilities, and by $3,220,138 received on disposition of property.

Funds applied during the year amounted to $29,701,808. Scheduled payments under long-term debt agreements accounted for $22,965,227. In 1970, long-term debt was reduced from $197.1 million to $174.2 million (for further details see Note 2 of Notes to Financial Statements).

A significant difference between 1969 and 1970 lies in the area of capital expenditures. The company acquired no new aircraft in 1970 and additions to plant, equipment and inventories were kept to a minimum; as a result, expenditures in these categories declined from $46,196,539 in 1969 to $4,796,784 in 1970. Without the resumption of a reasonable earnings pattern, capital expenditures other than those required to maintain a high level of safety and service will remain highly restricted.

Stock Dividend

On December 16, 1970, Western's board of directors declared a stock dividend of 1/10 of a share of capital stock for each share outstanding. This dividend was paid on March 5, 1971, to stockholders of record as of January 15, 1971.

Annual Meeting

The 1971 regular meeting of shareholders will be held at the Beverly Hilton Hotel, Beverly Hills, California, on April 22. On or about March 22, stockholders will receive formal notice of the meeting and proxy material.

Shareholders, Stock and Debentures

Although per-share earnings in this report were computed after adjustment for the 10 percent stock dividend declared on December 16, 1970, there were 4,903,879 shares of Western common stock issued and outstanding at the end of 1970, the same as at the end of the previous year.

At year's end, 806,884 shares were reserved for conversion of the 5¼ percent convertible subordinated debentures sold in 1968. After giving effect to the 10 percent stock dividend, the number of shares reserved for conversion was increased to 887,572 and the conversion price was decreased from $36.75 per share to $33.41.

Holders of the debentures received interest at the rate of 5¼ percent per year on February 1 and August 1, 1970.

The company's stock was held by approximately 12,000 shareholders at year end.

At the 1970 annual meeting of shareholders in Beverly Hills in April, 78.9 percent of all shares were voted in person or by proxy.

Shareholders' equity at December 31, 1970, was $79,904,835, or $14.81 a share, compared to $79,309,461, or $14.70 a share, at December 31, 1969, after adjustment for the 10 percent stock dividend.

Aircraft

At the end of 1970, Western operated 72 aircraft—five Boeing 707-300C intercontinentals, 26 Boeing 720B's, three Boeing

720s, six Boeing 727-200s, 30 Boeing 737-200s, and two Lockheed Electra propjets.

Western has no additional aircraft of any type on order, having cancelled orders for three Boeing 747s, five Boeing 707s and four Boeing 727s in the summer of 1969 when satisfactory financing arrangements could not be made. The company is studying the 747s, DC-10s and 1011s.

Ten Electras were withdrawn from service during the year when the company discontinued an all-cargo service which was not profitable and temporarily transferred short-haul routes in Alaska to a local service carrier.

Five Electras were sold during 1970 and, after withdrawing one additional Electra from Alaska service, six others were sold in February 1971. One Electra is being retained to operate the company's Seattle/Tacoma-Kodiak service.

Early in 1970, Western initiated a program to modify the engines on its 737 and 727 aircraft that will substantially reduce the visible exhaust smoke from these aircraft. Target date for the conversion of the 98 engines involved was December 31, 1972. As of January 1971, 37 of these conversions had been completed and it appeared that Western will beat the 1972 target date by a substantial margin.

Marketing

Western carried a record 6,187,527 passengers in 1970, a 7.6 percent increase over the previous year. Passenger load factor for the year, favorably affected by the seating configuration change, was 52.4 percent, compared to 47.3 percent in 1969.

Aided by a 19.3 percent increase in average length of passenger haul, passenger revenues increased 24.6 percent, from $220,529,667 in 1969 to $274,792,723 in 1970.

Revenues from air cargo shipments (freight, express, excess baggage, air mail and regular first class mail) increased from $16,472,320 in 1969 to $18,745,940 in 1970.

Western's traffic and revenue gains during 1970 were achieved under adverse circumstances—a slowdown in the growth of air travel in the U. S. and increased competition.

Faced with the urgent need to return to profitable operations as soon as possible, the company aggressively launched new marketing programs which were carried out with determined enthusiasm by Western employees.

Highlighting the company's program for 1970 were:

. . . modification of aircraft interiors to provide every coach, economy and commuter passenger with the same legroom as in first class;

. . . establishment of a program to improve the company's on-time performance;

. . . greater concentration on group travel (particularly in Hawaii markets);

. . . increased flexibility of aircraft utilization that would permit the company to increase its charter business and schedule extra sections whenever demand was great enough;

. . . new in-flight service features appropriate to the passenger's destination and length of flight;

. . . creation of a new corporate "look of the Seventies" through the establishment of a new company symbol and coordinated design program;

. . . increased involvement of all company employees in product improvement through increased communication of goals, introduction of new service features and marketing programs to field personnel by a special task force of department heads, and establishment of a suggestion system to encourage employee suggestions for product improvements as well as cost control ideas.

Backing up these programs was a realignment of the sales division into a broader marketing division and creation of a new service division along lines that would permit maximum support to changes in the marketplace.

Public acceptance of the company's increased legroom was enthusiastic. Using the slogans "Western: First in Space," and "You've Got First-Class Legs," the company built its advertising and sales promotion programs around this system-wide feature which no other airline has been able to duplicate to date, although several have attempted to copy it in part.

The legroom feature, coupled with "Islander" in-flight service and aggressive promotion with tour operators, travel agencies and hotels, permitted Western to compete effectively on Hawaii routes.

Western's on-time efforts also were highly successful as the company—seventh in the industry ratings in January—moved up to No. 1 in June, August, September and October to rank second in the industry for the year through November.

In addition to working directly with tour operators and travel agents in developing Hawaii traffic, a high percentage of which is group travel, Western sought the cooperation of other airlines that do not serve the 50th state in a "Hawaii-Plus-(a Western connecting point)" concept to increase revenues from off-line sources. These were productive programs and are being continued.

Charter revenues increased from $759,991 in 1969 to $3,187,243 in 1970. The company also operated more than 700 extra sections for 50,000 passengers who otherwise could not have been accommodated on scheduled flights. In addition to its "Islander" service on Hawaii flights, in-flight innovations were introduced in a new "Fiesta" service on Mexico routes, a "Golden Californian" service on Twin Cities-California and Pacific Northwest-California routes. A new "Western's World" in-flight magazine was introduced for the enjoyment of passengers on all Western flights, with advertising space paying the majority of its cost.

Western's new corporate symbol, which is shown on the cover of this report, is the key element of the company's "new look." The new design format is being introduced to graphic material, equipment and facilities on a normal replacement basis in a controlled program to insure a coordinated and modern visual appearance to the company's many publics.

In 1968, Western introduced its computerized ACCU-RES reservations and flight information system. In 1970, the company became the first airline operating into Mexico to provide "on-line" communication to its central reservations computer; in January 1971, this same service was extended to Anchorage and, in March, will include Juneau and Ketchikan, thereby giving every city on Western's system direct access to all pertinent customer service information stored electronically in the computer.

Personnel and Management

As of December 31, Western had 8,830 employees, compared to 9,225 at the end of 1969.

In 1970, wages and salaries amounted to $100,629,845, 35.1 percent of operating expenses, compared to $87,495,153, or 34.6 percent of operating expenses, in the previous year. Company contributions to Social Security, group insurance and employee retirement plans amounted to an additional $12,486,516.

Approximately 85 percent of the company's employees are covered by agreements with unions. A contract was signed during the year with the company's stewardesses and negotiations with the pilots' union were begun. Agreement on the pilot contract was reached on February 26, 1971.

Other contracts covering employees will be open for amendment as follows: dispatchers, July 1, 1971; mechanics and related employees, November 1, 1971; stores employees, November 1, 1971; stewardesses, March 31, 1972; and clerical, office, fleet and passenger service employees, October 1, 1972.

At the board of directors' July meeting, Kirk Kerkorian was elected chairman of the board of directors to succeed Terrell C. Drinkwater, who had retired as chairman and resigned as a director effective May 31.

Mr. Drinkwater had served as the company's president from January 1947 until his election as chairman in 1969. In order that Western may continue to avail itself of his extensive experience and knowledge of air transportation, he has agreed that he will be available to serve as a consultant to the company.

Elected to the board to fill the vacancy created by Mr. Drinkwater's resignation was actor-producer Cary Grant.

At its first meeting of 1971, held on January 25, the board voted to increase the number of directors from 19 to 20 members and elected George Mason, vice president of Tracinda Investment Company, to fill the newly created vacancy.

Officer changes during 1970 were: Gerald P. O'Grady, vice president-corporate affairs and secretary from vice president-properties and facilities; and Philip E. Peirce, senior vice president-service from vice president-administration.

Arthur G. Woodley, who founded and was president of Pacific Northern Airlines until its merger into Western in 1967, retired as vice president-Alaska effective February 28, 1971, but will remain as a director.

Route Development

During 1970, the Civil Aeronautics Board completed action on a number of major route applications involving Western. As a result, the company received the following new authority:

Minneapolis/St. Paul to Portland and Seattle/Tacoma: First competitive service on these new routes was inaugurated by Western on September 15;

Phoenix to Portland and Seattle/Tacoma Nonstop Service: This award permitted the company to eliminate a mandatory stop at Los Angeles on flights between Arizona and the Pacific Northwest. The nonstop flights were inaugurated in January 1971;

San Diego to Denver Nonstop Service: This award lifted a restriction which required that Western flights stop at Phoenix enroute between San Diego and Denver. The nonstop service was inaugurated on June 8. The matter of competitive service on this route is still pending.

In the CAB's **Pacific Northwest-California Service Investigation,** Western was authorized to provide Seattle/Tacoma and Portland-to-San Diego nonstop service but has not yet inaugurated the service because of current market conditions. Although little new service was authorized between the Pacific Northwest and major airports at Los Angeles and San Francisco in this proceeding, new authority was granted to another carrier between the Pacific Northwest and Ontario/Long Beach/Burbank/Orange County, nonstop or via Oakland or San Jose.

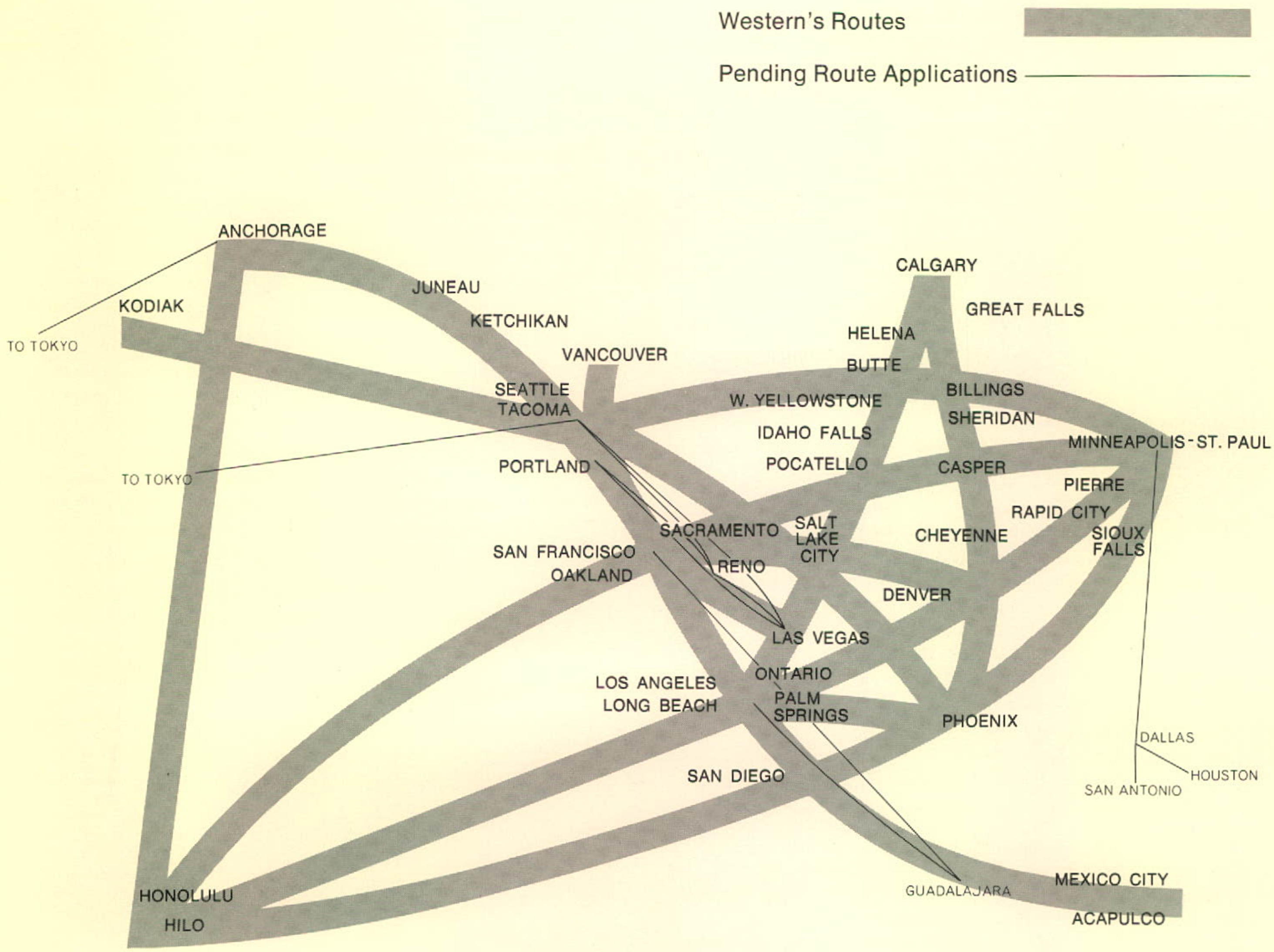
On September 1, Western temporarily transferred, pending the decision by the CAB on the route alignment proposals in the **Alaska Service Investigation,** its short-haul routes west of Anchorage to an Alaska-based local service carrier. An examiner's decision in the case, which was established to review intra-Alaska service and the route pattern from Portland and Seattle/Tacoma to key cities in Alaska (other than Anchorage), is expected shortly.

On January 29, 1971, the examiner in the **Las Vegas/Reno-Portland/Seattle Nonstop Service Investigation** recommended that Western be given nonstop authority between Las Vegas and Portland and Las Vegas and Seattle/Tacoma. The company will continue to seek Las Vegas-Reno and Reno-Portland/Seattle routes which also are at issue in the case. Final board action is expected later this year.

In other route cases Western's applications for urgently needed access to major traffic-generating points on the East Coast were denied. There are no proceedings before the Civil Aeronautics Board which would give Western the opportunity to serve these long-haul, high-density routes in the foreseeable future.

Pending before the CAB are the company's applications for routes to Tokyo from Seattle/Tacoma, nonstop and via Anchorage; to Guadalajara from California; and to Texas points from Minneapolis/St. Paul.

Western's Route System



10 Years of Growth

Financial	1970	1969[4]	1968
Revenues:[5]			
Passenger	$ 274,793	$220,530	205,753
Express, freight and excess baggage	13,994	11,969	9,331
Mail	4,752	4,503	4,128
Other	4,571	3,350	2,741
Total Revenues	298,110	240,352	221,953
Operating Expenses:[5]			
Depreciation and amortization	36,580	34,821	25,051
Payroll	100,630	87,495	71,885
Other	149,088	130,437	105,335
Total Operating Expenses	286,298	252,753	202,271
Operating Income[5] (Loss)	11,812	(12,401)	19,682
Interest[5]	(14,587)	(14,748)	(6,536)
Other Income and Expenses—Net[5]	1,120	(125)	15
Earnings (Loss) before Taxes on Income[5]	(1,655)	(27,274)	13,161
Taxes on Income (Tax Credits)[5]	(2,250)	(15,075)	4,725
Net Earnings (Loss) from Operations[5]	595	(12,199)	8,436
Gain on Major Dispositions of Property (Less Applicable Income Taxes)[5]	—	—	—
Net Earnings[5] (Loss)	$ 595	(12,199)	8,436
Shareholders			
Net earnings (loss) from operations per share[2]	$ 0.11	(2.26)	1.56
Gain on disposition of property per share[2]	—	—	—
Total	$ 0.11	(2.26)	1.56
Dividends paid per share:			
Cash[3]	$ —	0.45	0.91
Shares outstanding—actual[5]	4,904	4,904	4,902
—adjusted[2, 5]	5,394	5,394	5,392
Shareholders' equity—total[5]	$ 79,905	79,309	93,862
Shareholders' equity—a share[2]	14.81	14.70	17.41
Working capital[5]	35,238	20,447	25,764
Long-term debt[5]	174,184	197,150	183,718
Property and equipment—net[5]	247,427	285,757	284,787
Total assets[5]	355,169	367,588	349,039
Operations			
Route miles at end of year	26,891	24,523	14,156
Airplanes operated at end of year:			
Boeing 720-B	26	26	27
Boeing 720	3	3	3
Boeing 707-300C	5	5	5
Boeing 737	30	30	17
Boeing 727-200 — leased	6	6	—
Other aircraft	2	8	12
Airplane miles flown[5]	86,298	72,650	60,125
Ton miles produced[5]	1,266,124	1,077,657	891,001
Ton miles sold[4, 5]	584,554	448,420	418,856
Seat miles produced[5]	9,839,299	8,509,441	7,096,229
Seat miles sold[4, 5]	5,159,081	4,021,296	3,841,864
Express, freight and mail ton miles sold[5]	68,646	60,514	47,446
Passengers carried[4]	6,187,527	5,752,072	5,692,947
Express, freight and mail tons carried	73,140	66,107	58,129
Passenger load factor—actual %	52.4	47.3	54.1
—breakeven point %	52.7	53.1	50.7
Average length in miles per passenger trip	834	699	675
Operating expenses per seat mile produced	$ .0291	$ .0297	.0285
Average revenue per seat mile sold	$ .0542	$ .0551	.0537
Employees at end of year	8,830	9,225	8,919

[1]All financial data in this report give effect, retroactively throughout the periods prior to 1968, to the merger of Pacific Northern Airlines into Western on July 1, 1967, which was accounted for as a pooling of interests.

[2]Based on shares of the Company outstanding at the close of the respective periods, adjusted to give retroactive effect to the 10% stock dividend paid March 5, 1971, the May 1964 three-for-one split, and the equivalent outstanding shares of Pacific Northern Airlines, Inc., merged into the Company on July 1, 1967.

1967	1966[4]	1965	1964	1963	1962	1961[4]
178,527	164,186	129,704	121,928	103,183	89,837	67,442
7,581	6,848	5,991	5,897	5,055	4,747	3,833
4,221	4,255	3,135	2,962	2,603	2,659	2,364
2,153	1,895	1,768	2,095	3,472	2,878	2,935
192,482	177,184	140,598	132,882	114,313	100,121	76,574
20,085	15,779	14,676	12,980	12,373	14,605	12,033
57,975	47,350	38,731	34,500	30,114	27,108	22,837
89,082	77,708	62,391	57,650	50,969	47,997	38,848
167,142	140,837	115,798	105,130	93,456	89,710	73,718
25,340	36,347	24,800	27,752	20,857	10,411	2,856
(3,011)	(3,239)	(2,553)	(2,491)	(2,916)	(2,725)	(1,930)
17	775	253	783	621	472	(140)
22,346	33,883	22,500	26,044	18,562	8,158	786
10,125	15,558	10,337	12,493	9,252	4,130	443
12,221	18,325	12,163	13,551	9,310	4,028	343
—	—	883	—	191	889	807
12,221	18,325	13,046	13,551	9,501	4,917	1,150
2.27	3.45	2.29	2.55	1.75	0.76	0.07
—	—	0.17	—	0.04	0.17	0.15
2.27	3.45	2.46	2.55	1.79	0.93	0.22
0.91	0.91	0.73	0.59	0.33	0.30	0.30
4,893	4,835	4,826	4,826	1,965	1,965	1,965
5,382	5,318	5,308	5,308	5,308	5,308	5,308
90,016	81,750	67,361	57,748	46,988	39,061	35,574
16.73	15.37	12.69	10.88	8.85	7.36	6.70
19,585	18,047	11,522	8,274	5,031	12,315	5,369
80,189	54,867	47,411	33,938	41,106	48,856	39,018
183,106	145,771	124,096	99,928	93,284	80,052	69,865
231,342	192,008	157,973	138,335	125,806	115,266	95,258
14,156	13,075	13,075	12,991	12,991	13,086	12,368
27	22	18	12	10	7	4
3	3	2	2	2	2	—
—	—	—	—	—	—	—
—	—	—	—	—	—	—
—	—	—	—	—	—	—
21	23	24	33	33	34	39
51,692	42,830	36,554	36,746	33,388	29,551	25,239
728,200	585,378	483,033	450,856	400,395	348,854	256,572
360,791	314,137	244,588	231,303	191,229	159,658	121,850
5,879,442	4,800,901	4,016,921	3,794,648	3,335,083	2,746,549	1,967,313
3,327,160	2,898,088	2,243,695	2,124,582	1,753,037	1,435,992	1,080,189
38,940	33,070	26,435	24,625	20,622	19,786	16,315
5,107,672	4,700,839	3,807,706	3,717,189	2,970,909	2,270,455	1,659,323
48,579	42,714	33,511	30,956	25,890	25,256	20,378
56.6	60.4	55.9	56.0	52.5	52.3	54.9
49.5	47.9	46.2	44.4	44.3	48.6	55.4
651	616	589	572	590	633	651
.0284	.0293	.0288	.0277	.0280	.0327	.0375
.0537	.0567	.0578	.0574	.0589	.0626	.0624
7,282	6,294	5,068	4,719	4,126	3,713	3,418

[3]Cash dividends per share for periods prior to January 1, 1967 are stated on the basis of the Company's shares (exclusive of equivalent Pacific Northern shares) outstanding at the date such dividends were declared as adjusted for the stock dividend and the stock split

[4]Operations of a competing carrier were partially suspended from July 8 to December 14, 1970. Western's operations were suspended from July 29 to August 16, 1969 and substantially curtailed from February 17 to June 1, 1961 because of strikes. Five other major carriers were struck from July 8 to August 19, 1966.

[5]000s omitted.

Balance Sheets

Western Air Lines Inc.

December 31, 1970 and December 31, 1969

ASSETS	**1970**	**1969**
Current Assets:		
Cash	$ 16,590,875	$ 23,472,571
Short-term securities (at amortized cost, including accrued interest, which approximates market)	48,010,668	4,981,756
Receivables (net of allowance for doubtful accounts of $350,000 in 1970 and $275,000 in 1969)	21,732,984	19,408,382
Federal income taxes refundable	—	12,285,989
Maintenance and operating supplies (at average cost)	11,104,517	13,016,516
Prepaid expenses	4,575,804	2,986,496
Total current assets	102,014,848	76,151,710
Property and Equipment at Cost:		
Flight equipment	354,507,609	370,020,328
Ground equipment	59,376,017	59,087,184
	413,883,626	429,107,512
Less allowance for depreciation and maintenance	166,456,819	143,350,867
	247,426,807	285,756,645
Deferred Charges and Other Assets:		
Boeing 737 and 727 preoperating costs, net	712,078	1,680,450
Flight equipment not used in operations, net	2,417,018	2,062,898
Other items	2,598,175	1,936,409
	5,727,271	5,679,757
	$355,168,926	$367,588,112

See accompanying notes to financial statements.

LIABILITIES	1970	1969
Current Liabilities:		
Accounts payable	$ 18,698,697	$ 18,227,504
Accrued salaries and wages	11,731,118	9,421,598
Accrued liabilities	7,432,085	6,933,800
Unused transportation	5,949,274	4,926,089
Current maturities of long-term debt (*Note 2*)	22,965,227	16,195,627
Total current liabilities	66,776,401	55,704,618
Long-Term Debt (*Note 2*)	174,184,358	197,149,588
Deferred Credits and Other Liabilities (*Note 1*):		
Deferred federal taxes on income	17,495,000	17,919,000
Unamortized investment credits	13,584,000	16,060,000
Other	3,224,332	1,445,445
	34,303,332	35,424,445
Shareholders' Equity (*Notes 2, 5 and 8*):		
Common stock—$1.00 par value per share Authorized 10,000,000 shares Issued 4,903,879 shares	4,903,879	4,903,879
Capital in excess of par value	19,235,433	19,235,433
Retained earnings	55,765,523	55,170,149
	79,904,835	79,309,461
	$355,168,926	$367,588,112

Statement of Operations and Retained Earnings

Western Air Lines Inc.

For the years ended December 31, 1970 and December 31, 1969

	1970	1969*
Operating Revenues:		
Passenger	$274,792,723	$220,529,667
Express, freight and excess baggage	13,993,889	11,969,392
Mail	4,752,051	4,502,928
Other *(Note 7)*	4,570,957	3,349,801
	298,109,620	240,351,788
Operating Expenses:		
Flying operations	74,615,549	62,799,486
Maintenance	37,658,485	36,954,934
Passenger service	31,371,846	24,918,332
Aircraft and traffic servicing	52,693,576	47,384,866
Marketing and administrative	53,378,916	45,874,267
Depreciation and amortization *(Note 6)*	36,579,626	34,820,805
	286,297,998	252,752,690
Operating Income (Loss)	11,811,622	(12,400,902)
Other Income (Expenses):		
Interest expense	(14,586,128)	(14,747,559)
Interest income	2,021,293	355,613
Other expense — net	(901,413)	(481,012)
Earnings (Loss) before Taxes on Income	(1,654,626)	(27,273,860)
Taxes on Income (tax credits) *(Note 1)*	(2,250,000)	(15,075,000)
Net Earnings (Loss) $0.11 net earnings per share in 1970 and $2.26 net loss per share in 1969 based on shares outstanding at end of each year (adjusted for the 10% stock dividend paid March 5, 1971) *(Note 8)*	595,374	(12,198,860)
Retained Earnings at Beginning of Year	55,170,149	69,820,643
	55,765,523	57,621,783
Cash Dividends Paid	—	2,451,634
Retained Earnings at End of Year *(Note 2)*	$ 55,765,523	$ 55,170,149

*Operations were suspended from July 29 to August 16, 1969 because of a strike.
See accompanying notes to financial statements.

Statement of Source and Application of Funds

Western Air Lines Inc.

For the years ended December 31, 1970 and December 31, 1969

	1970	1969*
Source of Funds:		
Net earnings (loss)	$ 595,374	$(12,198,860)
Add back:		
Depreciation, amortization and maintenance reserve provision	41,529,249	37,692,055
Deferred income taxes	(850,000)	7,000,000
Charge (credit) related to investment credits	—	(6,350,000)
Amortization of investment credits	(2,050,000)	(2,150,000)
Gain on disposition of property	(86,596)	(25,550)
Total from operations	39,138,027	23,967,645
Proceeds from issuance of long-term debt	—	29,706,000
Refunds of equipment purchase deposits	133,087	4,625,993
Federal income taxes refunded	12,285,989	—
Proceeds from disposition of property	3,220,138	2,909,046
Increase in current liabilities	11,071,783	20,283,904
	65,849,024	81,492,588
Application of Funds:		
Purchase of airplanes, property and equipment	4,796,784	46,196,539
Increase in inventories, receivables and prepaid expenses	2,001,911	14,383,114
Long-term debt transferred to current liabilities	22,965,227	16,195,627
Cash dividends	—	2,451,634
Boeing 737 and 727 preoperating costs	—	1,483,430
Other (net)	(62,114)	198,337
	29,701,808	80,908,681
INCREASE IN CASH AND MARKETABLE SECURITIES	36,147,216	583,907
CASH AND MARKETABLE SECURITIES BALANCE AT:		
Beginning of period	28,454,327	27,870,420
End of period	$ 64,601,543	$ 28,454,327

*Operations were suspended from July 29 to August 16, 1969 because of a strike.
See accompanying notes to Financial Statements.

Notes to Financial Statements

Note 1. Taxes on Income.

The 1970 net income tax credit is summarized as follows:

Current income taxes	$ 650,000
Deferred income taxes (credits)	(850,000)
Amortization of investment credits	(2,050,000)
Net income tax credit	$(2,250,000)

Deferred income taxes arise from timing differences between financial and tax reporting. These differences are caused primarily by depreciation practices.

Investment credits generated and unapplied on tax returns amounted to $18,510,000 at December 31, 1970. Of this amount, $17,496,000 has been offset against the balance of deferred taxes on income and expire as follows: $897,000 in 1972, $2,069,000 in 1973, $2,870,000 in 1974, $9,030,000 in 1975, and $2,630,000 in 1976. The investment credits not offset against deferred taxes amounted to $1,014,000 and expire as follows: $984,000 in 1976 and $30,000 in 1977.

Of the $13,584,000 unamortized investment credit balance at December 31, 1970, $1,510,000 remains from investment credits utilized by reduction of taxes paid and $12,074,000 is related to investment credits not yet utilized for reduction of taxes paid.

Federal income tax returns have been examined by the U.S. Treasury Department through 1967. The federal income tax return for 1968 is being examined.

Note 2. Long-Term Debt (Unsecured).

On December 31, 1970, long-term debt was as follows:

Promissory note due December 31, 1975 with quarterly payments from March 31, 1970. The interest rate is ¼ % over the bank's prime commercial rate	$ 97,312,997
5¼ % promissory notes due September 1, 1981 with annual payments of $1,000,000 from September 1, 1970 which will increase to $4,000,000 a year starting in 1976	29,000,000
6⅝% promissory notes due September 1, 1984 with annual payments of $1,000,000 from September 1, 1970, which will increase to $2,000,000 a year starting in 1975, and further increase to $7,000,000 a year starting in 1982	39,000,000
5% to 6½ % promissory notes due 1971 and 1972	2,183,588
	167,496,585
Less current maturities	22,965,227
	144,531,358
5¼ % convertible subordinated debentures due February 1, 1993, with sinking fund payments of $1,500,000 a year starting in 1979	29,653,000
	$174,184,358

The following schedule shows the amount of long-term debt maturing in each of the five years subsequent to December 31, 1970:

1971	$22,965,227
1972	22,143,561
1973	21,462,600
1974	21,462,600
1975	22,462,600

Reserved for the conversion of debentures are 806,884 shares of common stock at $36.75 per share which is subject to adjustments in certain cases. After giving effect to the 10% stock dividend, the shares reserved for conversion are 887,572 and the conversion price is $33.41.

The related agreements with the bank and the insurance companies provide among other things (including restrictions on additional borrowings) conditions and requirements which operate to restrict retained earnings from which cash dividend distributions can be made. The indenture for the debentures also contains a requirement which operates to restrict retained earnings from which cash dividend distributions can be made. Since the second quarter of 1969 the indenture has operated to prevent any use of retained earnings for cash dividend distribution.

Note 3. Commitments and Contingent Liabilities.

The estimated minimum annual rentals under long-term leases of real property, with expiration dates ranging to 1998, were approximately $2,500,000 at December 31, 1970.

Annual rentals under a lease agreement covering six Boeing 727 aircraft aggregate $2,992,000 in 1970, $3,843,000 in 1971 and $4,130,000 in each year thereafter through 1984.

At December 31, 1970, various legal actions were pending against the City of Los Angeles and various actions and cross actions were pending against Western and other airlines, alleging excessive aircraft noise in the vicinity of Los Angeles International Airport. Western's counsel in these actions, which also represents most of the other airlines, is of the opinion that the airlines have substantial defenses to the imposition of any liability. An interlocutory judgment has been entered in one of these cases against the City of Los Angeles, awarding damages aggregating $740,000 to 620 property owners. The City has appealed.

Western is also a defendant, together with numerous other airlines, in a purported class action relating to charges for in-flight services.

Western believes these actions will not result in any material liability to the company.

For information regarding fare increases and related litigation see last two paragraphs under "Fare Changes".

Note 4. Retirement Plans.

The company has retirement plans covering all eligible employees. The cost of these plans charged to operating expense totaled $3,651,228 in 1969 and $4,660,611 in 1970. During 1970, reductions in annual pension costs due to a revision of an actuarial assumption were partially offset by increased annual costs due to improvements in pension benefits adopted during the year and the partial assumption by the company of a portion of contributions formerly paid by employees. The company's actuary is of the opinion that the assets under the plans exceed the accrued vested benefits of the plans.

Note 5. Stock Options.

At December 31, 1970, options were outstanding for the purchase of 109,500 shares of common stock by officers at an average price of $26.64 per share. An additional 76,700 shares were reserved for issuance of future options. (After giving effect to the 10% stock dividend declared December 16, 1970 and payable March 5, 1971, the number of shares subject to outstanding options is 120,450; the average option price is $24.22, and the additional shares reserved are 84,370.)

Note 6. Depreciation and Amortization.

Depreciation for book purposes is computed on the straight-line basis predicated on estimated useful lives, which for flight equipment are ten to fifteen years.

Note 7. Mutual Aid Agreement.

The company's participation in the Mutual Aid Agreement with several other carriers became effective August 3, 1970. From this date through December 31, 1970, $2,711,000 was provided for payments to a struck carrier. This amount was charged to "Other" operating revenues.

Note 8. Stock Dividend.

A 10% stock dividend was declared on December 16, 1970, and paid on March 5, 1971 to shareholders of record on January 15, 1971. The dividend will be recorded in 1971 by a transfer of $490,387 to common stock and $10,482,022 to capital in excess of par value. After giving effect to this dividend the shares outstanding are 5,394,266.

Note 9. Proposed Merger.

On December 16, 1970, the Board of Directors of Western approved an Agreement of Merger providing for the merger of Western into American Airlines, Inc. This agreement as subsequently amended and restated was approved by the Board of Directors as of January 14, 1971. The proposed merger is subject to certain conditions including the approval of shareholders of both companies, the lending institutions, certain regulatory authorities, and the President of the United States.

Accountants' Report

The Board of Directors
WESTERN AIR LINES, INC.:

We have examined the balance sheet of Western Air Lines, Inc. as of December 31, 1969 and 1970 and the related statements of operations and retained earnings and source and application of funds for the two years then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, such financial statements present fairly the financial position of Western Air Lines, Inc. at December 31, 1969 and 1970 and the results of its operations for the two years then ended, in conformity with generally accepted accounting principles applied on a consistent basis. Also, in our opinion, the statement of source and application of funds for the years ended December 31, 1969 and 1970 presents fairly the information shown therein.

Los Angeles, Calif.
March 5, 1971

Peat, Marwick, Mitchell & Co.

Board of Directors

James D. Aljian
Secretary-Treasurer, Tracinda Investment Company, Beverly Hills, California

Fred Benninger
President, International Leisure Corporation, Las Vegas, Nevada, and Vice Chairman of the Board, Western Air Lines, Inc.

Hugh W. Darling
Darling, Hall, Rae & Gute, Attorneys-at-Law, Los Angeles, California

Leo H. Dwerlkotte
Las Vegas, Nevada

James D. Garibaldi
Attorney at Law, Garibaldi & Lane, Los Angeles, California

Cary Grant
Universal City, California

Arthur F. Kelly
Senior Vice President - Marketing, Western Air Lines, Inc., Los Angeles, California

Peter M. Kennedy
Vice President, Dominick & Dominick, New York, New York

Kirk Kerkorian
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Linkletter Enterprises, Inc., Los Angeles, California

George Mason
Vice President, Tracinda Investment Company, Beverly Hills, California

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Chairman of the Board, Pauley Petroleum, Inc., Los Angeles, California

Walter M. Sharp
President, Community Bank, Huntington Park, California

Stanley R. Shatto
Executive Vice President - Transportation, Western Air Lines, Inc., Los Angeles, California

William Singleton
Vice President and Assistant to the President, Metro-Goldwyn-Mayer, Inc., Culver City, California

J. Judson Taylor
President, Western Air Lines, Inc., Los Angeles, California

Vernon O. Underwood
President, Young's Market Company, Inc., Los Angeles, California

Harry J. Volk
Chairman of the Board, Union Bank, Los Angeles, California

Arthur G. Woodley
Bellevue, Washington

Richard W. Wright
President, Mountain States Employers Council, Inc., Denver, Colorado

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Chairman of the Board, Homestake Mining Company, San Francisco, California

John M. Wallace
Walker Bank & Trust Company, Salt Lake City, Utah

Alexander Warden
Great Falls, Montana

Sidney F. Woodbury
President, Pine Street Company, Portland, Oregon

Corporate Officers

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Fred Benninger, Vice Chairman

J. Judson Taylor, President and Chief Executive Officer and Director
Stanley R. Shatto, Executive Vice President-Transportation and Director
Arthur F. Kelly, Senior Vice President - Marketing and Director
Philip E. Peirce, Senior Vice President - Service
Charles J. J. Cox, Vice President - Finance
Gerald P. O'Grady, Vice President - Corporate Affairs and Secretary
Robert O. Kinsey, Vice President and Assistant to the President

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Lawrence H. Lee, Vice President - Industrial Relations
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Joseph M. Fogarty, Assistant Vice President - Maintenance and Overhaul
H. S. Gray, Assistant Treasurer and Budget Director
David E. Holt, Assistant Vice President - Agency and Tour Sales
Roderick G. Leith, Assistant Treasurer and Controller
S. J. Rogers, Assistant Vice President - Product Pricing
Neil S. Stewart, Assistant Vice President - Market Development, Pacific Region
Dan A. Zaich, Assistant Vice President - Labor Relations

General Offices

Western Air Lines Building, 6060 Avion Drive
Los Angeles International Airport
Los Angeles, California 90009

Stock Registrars

Bank of America National Trust & Savings Assn.
111 West Seventh Street, Los Angeles, California 90014

The Chase Manhattan Bank
1 Chase Manhattan Plaza, New York, New York 10015

Stock Transfer Agents

Security Pacific National Bank
124 West Fourth Street, Los Angeles, California 90014

Chemical Bank
20 Pine Street, New York, New York 10015

Debenture Trustee

The Chase Manhattan Bank
1 Chase Manhattan Plaza, New York, New York 10015

Stock Listings

Listed and traded on
New York Stock Exchange
Pacific Coast Stock Exchange

General Counsel

Hugh W. Darling
Darling, Hall, Rae & Gute
523 West Sixth Street, Los Angeles, California 90014

Independent Accountants

Peat, Marwick, Mitchell & Co.
629 South Spring Street, Los Angeles, California 90014

Annual Meeting

Fourth Thursday in April