Western Airlines Nineteen Seventy-One Annual Report

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.
555 South Flower Street, Los Angeles, California 90071

Annual Meeting

Fourth Thursday in April

Western Air Lines, Inc. 1971 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 1971

Operating	1971	1970	Change
Seat miles produced	9,776,869,000	9,839,299,000	– 0.6%
Seat miles sold	5,251,989,000	5,159,081,000	+ 1.8
Passengers carried	6,206,000	6,187,000	+ 0.3
Passenger load factor—actual %	53.7	52.4	+ 1.3 pts.
—breakeven point %	52.2	52.7	– 0.5 pts.

Financial			
Operating revenues	$325,595,000	$298,109,000	+ 9.2%
Operating income	$ 16,306,000	$ 11,811,000	+38.1
Net earnings	$ 6,457,000	$ 595,000	
Common stock outstanding	5,395,000	5,394,000	
Net earnings per share	$ 1.20	$ 0.11	
Net earnings per share assuming conversion of the debentures	$ 1.15	$ 0.11	
Stock dividend paid	10%	—	
Shareholders' equity	$ 86,397,000	$ 79,905,000	+ 8.1
Shareholders' equity per share	$ 16.01	$ 14.81	+ 8.1
Cash, certificates of deposit, and short-term securities	$ 81,024,000	$ 64,600,000	+25.4
Working capital	$ 53,207,000	$ 35,238,000	+51.0
Property and equipment at cost	$413,612,000	$413,883,000	– 0.1
Long-term debt	$152,040,000	$174,184,000	–12.7
Number of employees at year end	9,039	8,830	+ 2.4
Wages and salaries paid	$111,584,000	$100,629,000	+10.9

Operations of a competing regional carrier were substantially suspended from December 15, 1971, and operations of a competing trunk carrier were substantially suspended from July 8 to December 14, 1970.

Affected data adjusted where appropriate throughout this Annual Report for the 10% stock dividend paid March 5, 1971.

President's Letter

To Our Stockholders:

As detailed in the following pages, 1971 was a year of improved performance for Western Air Lines. Despite a generally sluggish economy and continuing inflation, your company increased its earnings to $6,457,000, or $1.20 a share, from $595,000, or 11 cents a share, for the previous year.

The improvement in earnings was derived from both operating and nonoperating sources. Operating Income increased 38 percent, largely because of higher yields and improved load factors.

Earnings before taxes also were aided substantially by decreased interest expense on the one hand and increased interest income on the other.

Although your company did not increase seat mile production during the year because of the economic slowdown, we were able to increase seat miles sold by 1.8 percent despite the fact that one of our major competitors was on strike in the latter half of 1970.

There is mounting evidence that 1972 will see a renewal of the growth in air travel. Western's success during the year will depend to a considerable degree on the extent of that traffic growth and the success of the Administration's efforts to slow down the forces of inflation.

Throughout 1971 and early 1972, your company has worked vigorously to obtain approval of the merger with American Airlines. Despite opposition from various parties to the case, we continue to believe that the merger is in the public interest and that it should be approved. While awaiting the final decision of the Civil Aeronautics Board and the President, however, we are moving ahead with plans that are designed to continue the company's growth and enhance its financial strength.

Through aggressive marketing and excellent service, Western was successful in maintaining a surprisingly good share of the Mainland-Hawaii market, despite the fact that it is the only California-Hawaii carrier which does not operate the new wide-bodied jets on these routes. However, in order to meet increases in wide-bodied competition on these and Mainland routes, the company has taken two steps:

> prior to May 31, we will complete conversion of the interiors of our Boeing 707s that are used in Hawaii service to a new "wide-body look" that will improve the appearance and comfort of these aircraft;
>
> and, as protection for the company's future should our proposed merger with American not be approved, we have ordered for delivery in the spring of 1973 four McDonnell Douglas DC-10s. Details of these orders are contained in the "Aircraft" section of this report.

In the meantime, in order to provide additional capacity on some of its Mainland routes, the company is taking delivery of five additional long-bodied Boeing 727 trijets in 1972 — three in the spring and two in the fall. These will be the first additions to the Western fleet since 1969.

In an effort to increase load factors in the coming months, the company has adopted the serving of complimentary champagne on every flight as a symbol of the total quality of our service and of the "champagne attitude" we have toward our passengers. We believe that when combined with our first class legspace, excellent on-time performance and other high standards of service, the serving of champagne will identify Western as a carrier which provides an outstanding product.

As in the past, our primary goal for 1972 is to achieve improved earnings through judicious control of costs and aggressive marketing. Although Western's rate of return on investment increased to 6.16 percent from 5.22 percent in 1970, it still is far short of the 12 percent standard set by the Civil Aeronautics Board for trunk airlines in its 1971 Passenger Fare Investigation.

Our task was made more difficult early this year when, as part of its decision in the *Alaska Service Investigation,* the Civil Aeronautics Board suspended Western's authority at Juneau and Ketchikan. Routes serving these cities produced three percent of Western's revenues and approximately $1 million in earnings before taxes in 1971. Accordingly, the company is working vigorously in an appeals court proceeding to reverse this CAB decision.

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

J. Judson Taylor
President and Chief Executive Officer

March 15, 1972

Year in Review

Earnings

Net earnings for 1971 were $6,457,000, or $1.20 a share, compared to net earnings of $595,000, or 11 cents a share, for 1970. (If all of the holders of the company's 5¼% Convertible Subordinated Debentures had converted their debentures into common stock at the end of 1971, the earnings per share for the year would have been $1.15.)

Operating income totaled $16,306,000, equal to five percent of operating revenues, compared to $11,811,000, or four percent of operating revenues, in 1970.

Interest income, derived from the temporary investment of cash into certificates of deposit and short-term securities, increased 57.9 percent, from $2,021,000 to $3,190,000. Interest expense decreased 23.5 percent, from $14,586,000 to $11,162,000, as a result of the decrease in the prime commercial interest rate and scheduled reductions in the company's long-term debt. The increase in interest income, along with the reduction in interest expense, contributed a net increase of $4,593,000 to earnings before taxes, which totaled $8,497,000 for 1971, compared to a loss of $1,655,000 for 1970.

Total taxes for 1971 amounted to $3,150,000 and consisted of $2,600,000 for Taxes on Income and $550,000 in taxes related to the extraordinary gain from the involuntary conversion of an aircraft. (See Note 1 of Notes to the Financial Statement.)

Taxes on Income consisted of Current Federal and State Taxes, $1,125,000; Deferred Income Taxes (which resulted from timing differences between financial and tax reporting), $2,600,000; charge equivalent to investment credits, $1,200,000; and the amortization of deferred investment credits, which reduced taxes on income by $2,325,000.

Revenues

Operating revenues for 1971 were a record $325,595,000, up 9.2 percent from the previous year. Most of the improvement came from increases in passenger revenues, which in 1971 produced 90.9 percent of operating revenues.

Passenger revenues were up 7.6 percent, from $274,792,000 to $295,807,000. Contributing to the gain were a 6.5 percent increase in yield (revenue per seat mile sold) and a 1.8 percent increase in the number of seat miles sold.

Western's yield increased from 5.42 cents in 1970 to 5.77 cents in 1971 largely as a result of two factors: the fare increases on both domestic and Hawaii routes that became effective in May 1971 and an improved "mix" beween full fare travel and that which is sold at a discount. While full fare travel increased 11 percent during the year, discount travel decreased 15 percent and represented 31.4 percent of all seat miles sold by Western, compared to 37.5 percent for 1970.

Revenues from express, freight, excess baggage, mail, charters and other operating sources increased 27.8 percent to $29,788,000 from $23,317,000.

Fare Changes

In April 1971, the Civil Aeronautics Board issued its opinions in certain phases of the *Domestic Passenger Fare Investigation,* a proceeding that has been pending since January 1970.

The CAB authorized an interim increase in domestic fares of six percent which became effective May 7, 1971. Because it did not include Hawaii and Alaska fares and could not affect intra-California fares, which also are regulated by the State Public Utilities Commission, the CAB increase averaged only 4.5 percent when applied to Western's system.

In other phases of the *Investigation,* the board also determined that trunklines should be permitted to earn a 12 percent return on their investments and decided that the level of future fare increases should be based on the assumption that trunklines realize prescribed load factors.

In conjunction with its study of Mainland-Hawaii fares, the CAB also permitted Western and other carriers to implement an interim increase of approximately 10 percent on May 15.

Still pending in the highly complex *Fare Investigation* are a number of issues including:

a tentative decision by the CAB to prescribe fare differentials relating to the number of seats abreast and the maximum distance between rows of seats in the various classes of service;

a tentative decision by the CAB to allow an additional increase of three percent on domestic fares.

Expenses

Operating expenses increased 8.0 percent, from $286,298,000 in 1970 to $309,289,000 in 1971 despite the fact that seat mile production decreased 0.6 percent to 9.77 billion from 9.84 billion.

The increase in operating expenses without a corresponding increase in production is largely attributable to inflationary factors.

Wages and salaries, together with costs for related Social Security, group insurance and retirement plans, in 1971 represented 41.1 percent of all operating costs. These items of expense increased 12.3 percent despite the fact that the number of employees at year's end was up only 2.4 percent from the previous year.

Landing fees increased 30.9 percent and rentals of ground facilities were up 9.3 percent.

Depreciation and amortization, which accounts for 11.4 percent of operating expenses, decreased to $35,144,000 from $36,583,000, largely because of the loss of a 720B aircraft in the first quarter of the year.

The cost of producing a seat mile increased from 2.91 cents in 1970 to 3.16 cents in 1971, and the beneficial effects of the increased yield produced only a modest improvement in breakeven load factor, from 52.7 percent in 1970 to 52.2 percent in 1971.

Finances

Aided by improved earnings, Western's financial condition was strengthened in 1971.

Cash, certificates of deposit and short-term securities continued to increase during the year and totaled $81,024,000 at December 31, 1971, compared to $64,600,000 at the end of 1970.

Working capital at year's end was $53,207,000, an increase of $17,969,000 from the 1970 total of $35,238,000. The ratio of current assets to current liabilities was $1.81 to $1.00, up from $1.53 to $1.00 at the end of 1970.

The Statement of Changes in Financial Position shows the sources and applications of working capital.

Total working capital provided was $50,661,000 compared to $42,553,000 for 1970. As indicated, working capital from operations as adjusted amounted to $45,017,000 and consisted primarily of earnings amounting to $5,897,000 before extraordinary gain and adjustments for charges and credits that did not affect working capital, including depreciation, amortization and maintenance reserve provision amounting to $38,607,000. The proceeds from the involuntary conversion of an aircraft provided an additional $4,900,000.

Brief Statement of Earnings

(in thousands of dollars)

Western's revenues came from:	1971	1970	Change
Passengers			
Coach	$272,038	$246,019	+10.6%
Deluxe	23,769	28,773	−17.4
	295,807	274,792	+ 7.6
Express, freight, and baggage	15,075	13,993	+ 7.7
Mail	5,156	4,752	+ 8.5
Charter	4,284	3,187	+34.4
Interest income	3,190	2,021	+57.9
Other income	5,274	1,385*	
	328,786	300,130	+ 9.5

Western's expenses were for:	1971	1970	Change
Wages and salaries	111,584	100,629	+10.9
Social security, group insurance and retirement plans	15,491	12,486	+24.1
Aircraft fuel	38,663	37,357	+ 3.5
Depreciation and amortization	35,144	36,583	− 3.9
Utilities and services	26,667	24,737	+ 7.8
Materials and repairs	20,487	20,424	+ 0.3
Service to passengers	14,644	14,511	+ 0.9
Interest	11,162	14,586	−23.5
Advertising and publicity	10,191	8,780	+16.1
Property, fuel and other taxes	7,163	6,750	+ 6.1
Landing fees	6,824	5,211	+30.9
Insurance and related costs	5,869	4,174**	+40.6
Rentals of ground facilities	5,793	5,301	+ 9.3
Rentals of flying equipment	3,843	2,992	+28.4
Other costs	6,764	7,264	− 6.9
Taxes on income (tax credits)	2,600	(2,250)	
	322,889	299,535	+ 7.8
Earnings before extraordinary gain	5,897	595	
Extraordinary gain—net	560	—	
Net earnings	$ 6,457	$ 595	

*Reduced by $2,700,000 for Mutual Aid payments (such payments for 1971 were minimal).

**Expenses for 1970 are net of an insurance dividend.

Brief Balance Sheet

(in thousands of dollars)

Western owns:	1971	1970
Cash, certificates of deposit, and short-term securities	$ 81,024	$ 64,600
Receivables due from others	22,943	21,732
Maintenance and operating supplies	11,005	11,104
Buildings and improvements, net	12,955	13,364
Flight and other equipment, net	196,635	234,062
Deposits on purchase contracts	7,148	—
Prepaid expenses	4,150	4,579
Equipment not used in operations, net	2,214	2,417
Deferred charges and other	2,278	3,310
	340,352	355,168

Western owes:	1971	1970
Payables due to vendors and others	39,171	37,863
Federal income taxes—deferred	19,433	17,495
Unamortized investment credits	12,271	13,584
Tickets sold but not yet used	5,281	5,949
Other deferred items	4,296	3,223
Notes payable—current and long-term	173,503	197,149
	253,955	275,263
Excess of what is owned over what is owed, or shareholders' equity	$ 86,397	$ 79,905

Working capital applied during the year amounted to $32,692,000. Scheduled reductions of long-term debt accounted for $22,144,000 (for further details see Note 2 of Notes to the Financial Statement) and $7,148,000 was used as deposits toward the purchase of new aircraft. As in 1970, Western continued to keep its purchases of property and equipment at a minimum, totaling $3,400,000 in 1971, compared to $4,796,000 in the previous year.

Dividends

On March 5, 1971, a 10 percent stock dividend was paid to shareholders of record as of January 15, 1971.

Annual Meeting

The 1972 regular meeting of shareholders will be held at the Beverly Hilton Hotel, Beverly Hills, California, on April 27. On or about March 24, formal notice of the meeting and proxy material will be mailed to each stockholder of record as of March 10, 1972.

Corporate Award

Western received for the second consecutive year an award from the Financial Analysts Federation for excellence in corporate reporting during 1970. Your company was one of only two U.S. airlines to win the honor which is given to companies who are judged superior in reporting financial information to stockholders and the financial community through press releases, quarterly reports to stockholders and interviews with financial analysts.

Shareholders, Stock and Debentures

At the close of 1971, there were 5,395,000 shares of Western common stock issued and outstanding, compared to 5,394,000 shares at the end of 1970 (after giving retroactive effect to the 10 percent stock dividend paid on March 5, 1971).

As a result of the 10 percent stock dividend, the number of shares of stock reserved for conversion of the 5¼ % Convertible Subordinated Debentures was increased from 807,000 shares at the end of 1970 to 888,000 shares at the end of 1971 and the conversion price was decreased from $36.75 to $33.41 a share. Holders of the debentures received interest payments on February 1 and August 1, 1971.

The company's stock was held by approximately 11,000 shareholders at year end.

At the 1971 annual meeting of shareholders in Beverly Hills in April, nearly 77 percent of all shares were represented in person or by proxy.

Shareholders' equity at December 31, 1971, was $86,397,000, or $16.01 a share, compared to $79,905,000, or $14.81 a share, at December 31, 1970, after giving effect to the 10 percent stock dividend.

Aircraft

At the end of 1971, Western operated 70 aircraft, compared to 72 at the end of the previous year. The reduction in the size of the company's fleet resulted from the withdrawal from service of a Lockheed Electra that had been used on Alaskan routes and from the loss of a Boeing 720B in a training accident.

In addition, six Lockheed Electras (three in passenger-freighter configuration which are leased to others and three in all-cargo configuration awaiting sale) were carried in "Flight Equipment Not Used in Operations" under Deferred Charges on the Balance Sheet.

Late in August, the company ordered three Boeing 727s (extended version) with the new "wide-body look" for delivery in May and June 1972 at a total purchase price of approximately $22.5 million. Also arranged, but recently dropped, were options to purchase three other such aircraft for delivery in 1973. Instead, the company has elected to purchase two more 727s for delivery in September and October this year at a cost of approximately $15 million.

In September 1971, Western agreed to purchase four McDonnell Douglas DC-10 aircraft for delivery in April, June (2) and July 1973 if the proposed merger with American shall not have been approved by that time. Total purchase price of these aircraft and related spares, exclusive of spare engines, is estimated at approximately $85 million. The four wide-bodied trijets had been on option to American Airlines which in August 1971 had agreed to purchase the aircraft contingent upon a successful consummation of the American-Western merger.

The purchase agreement provides that if the American-Western merger is not consummated by the time delivery is due, the four DC-10s will be acquired and operated by Western. Pending a decision on the merger, American will make the required progress payments of approximately $24 million on the aircraft, an obligation which will be assumed by Western if the merger has not been consummated by the time delivery is due.

The method of financing the 727 and DC-10 orders has not yet been determined.

In an effort to keep its five Boeing 707s competitive with wide-bodied aircraft being operated by other airlines, the company has ordered conversion kits that will give the 707 passenger compartments a "wide-body look." The kits, to be installed in the spring of 1972, include sculptured wall panels, sculptured ceilings with indirect lighting and overhead baggage compartments instead of hat racks.

In December 1971, Western became the first U.S. trunkline to complete conversion of the engines used on Boeing 727 and Boeing 737 aircraft to a configuration which virtually eliminates visible exhaust smoke. The program was begun in early 1970 and was completed a full year in advance of a deadline agreed to between the airline industry and the U.S. Department of Health, Education and Welfare. For its expeditious execution of the program, your company has been commended by the Federal Aviation Administration and the City of Inglewood (Calif.), which is located directly under the approach lanes to Los Angeles International Airport.

Western's Jet Fleet

	On Hand		On Order	
	Owned	Leased	1972	1973
DC-10	—	—	—	4
B-707-300C	5	—	—	—
B-720B	25	—	—	—
B-720	3	—	—	—
B-727-200	—	6	5	—
B-737-200	30	—	—	—

Marketing

Western carried a record 6,206,000 passengers in 1971, compared to 6,187,000 in 1970 when a strike against a major competitor inflated Western's traffic.

While Western's major competitors devoted much of their 1971 effort to introducing new wide-bodied aircraft, and lounges and special fares to stimulate the sale of their increased capacity, your company's marketing efforts were directed at providing increased reliability and personal service for its customers.

First-class legspace for all passengers on all flights, a program which was inaugurated in 1970, continued to serve as the major theme of the company's advertising and sales promotion activities.

Also stressed in sales, service and operations programs were continuing improvements in the key ingredients of excellent airline service — on-time performance; fast, accurate and complete reservations service; faster and more reliable baggage handling; a high standard of in-flight service; and improved communication with customers.

After disappointing on-time performances in January and February, Western was ranked by CAB figures as No. 1

in the trunkline industry in six of the next eight months (March, April, June, July, September and October) and was second in the industry for the year. On two occasions during the year, Western set what is believed to be an industry record: on-time departure of 99.5 percent of its originating flights for the entire day.

The company continued to augment the services of its ACCU-RES computerized reservations service by:

expanding the service to Alaska and Mexico;

adding immediate confirmation of rooms at Anchorage hotels to the service already available for hotel space in Hawaii and Mexico;

inaugurating an automatic ticketing system whereby the computer automatically prints flight coupons for all unticketed passengers on the day of their departure from major cities, thus saving many man-hours and permitting employees to spend more time assisting passengers with other aspects of their trip;

introducing a "fare-quote" system wherein the computer can instantly display for an agent's use fares for up to 12 legs of an itinerary on Western as well as 15 connecting airlines.

To make it possible for travelers in off-line areas to make toll-free telephone calls to Western reservations, the company introduced in May a nationwide Inward Wide Area Telephone Service (IN-WATS), using five "800 series" telephone numbers to cover the United States. Introduction of this system was another airline industry "first" for your company. The unique service proved immediately popular, and has introduced many new customers to the company by making it easier for travel agencies and interline offices to book space on Western.

Late in 1970, the company launched a program of placing Customer Service Directors on the highly competitive Los Angeles-Hawaii route to serve as management's representative with the customer, monitoring every aspect of his flight and determining the customer's reaction to Western's service. During 1971, this function was expanded to other key long-haul routes to ensure quality control.

In July, a customs facility was opened in the company's Los Angeles terminal building which provides Western's passengers who are arriving from Mexico City, Acapulco or Vancouver with faster and more convenient customs, immigration and public health processing.

In September, after studying cabin air circulation patterns, the company established smoking and no-smoking sections on all flights.

In October, the company launched a new marketing program, "YouthFlight," designed to attract more young travelers to Western. In November, Western formed a "Booster Club," composed of customers who have taken the time to write a complimentary letter or customer comment card to the company. Members are given special luggage tags which identify them as "boosters," an introductory visit to the company's Horizon Club, and special mailings to announce features of Western service and encourage their enthusiasm.

In November, the company introduced a new Travelcard to replace and update its Charge-A-Flight program, which had been introduced in 1954. In addition to providing broader use for travel on connecting carriers, Travelcard offers new and easier payment terms, and may be used for charging a variety of vacation package tours, as well as shipments via the company's new Speed Pak service that permits small packages to be shipped from airport ticket counters. It may also be used for cashing personal checks up to $25 at any Western ticket counter and for charging tickets that are sent to the customer's home or office by mail.

Group travel continues to be a major source of revenue, especially to vacation destinations. Throughout 1971, the company devoted intensive effort to the development of this source of business, particularly in the highly competitive

Hawaii markets where tour operators and travel agents book a large share of the traffic.

For 1972, Western has launched a unique marketing and passenger service feature—complimentary champagne to every passenger on every flight.

Designed to strengthen the company's competitive position at a time when other carriers are starting to copy Western's popular legspace theme and to counteract the lounges featured by carriers flying larger aircraft, the champagne campaign was found to be highly effective in pre-inauguration service tests and opinion surveys.

Western believes adding champagne to first class legspace and the existing excellent ground and in-flight services will serve as a symbol of the total quality and "champagne attitude" the company is seeking to extend to all of its customers.

Personnel and Management

As of December 31, Western had 9,039 employees, compared to 8,830 at the end of 1970.

Wages and salaries for 1971 amounted to $111,584,000, (36.1 percent of operating expenses) compared to $100,629,000 (or 35.1 percent of operating expenses) in the previous year. Company contributions to Social Security, group insurance and employee retirement plans amounted to an additional $15,491,000 for the year.

Approximately 85 percent of the company's employees are covered by agreements with labor unions. Contracts were signed with the pilots union and company dispatchers during 1971.

Western is currently negotiating contracts with the unions representing mechanics and related employees and stock clerks, whose agreements became open for amendment on November 1, 1971.

Other employees are covered by agreements which will become open for amendment on the following dates: stewardesses — March 31, 1972; clerical, office, fleet and passenger service employees — October 1, 1972; pilots — March 1, 1973; and dispatchers — June 30, 1973.

At the board of directors' meeting in April, Fred Benninger was elected chairman of the board of directors to succeed Kirk Kerkorian, who expressed a desire not to be re-elected after serving as chairman since July 1970. At the same time George Mason, who had been elected to the board in January 1971, resigned.

At the regular July meeting, the directors returned the size of the board to 21 members when it elected Louis B. Lundborg, retired chairman of the Bank of America, and William R. Boyd, executive, Metro-Goldwyn-Mayer. Mr. Lundborg's election is subject to CAB approval. An application for such approval has been filed with the CAB.

Merger Case

The final procedural step in the American-Western Merger Case — oral argument before the five CAB members — was completed in Washington, D.C., on February 17.

Supporting the merger were the Department of Transportation, which indicated that the American-Western merger conforms to its newly issued guidelines for mergers in the transportation industry, and many states and communities served by the two carriers.

On the other hand, the Antitrust Division of the Department of Justice, the CAB's Bureau of Operating Rights, labor unions which represent Western's employees and other airlines who would compete against the merged carrier either supported the examiner's recommendation against approval of the merger or urged that it not be approved without certain service restrictions or route deletions.

The Merger Agreement, which provides for an exchange of 1.3 shares of American stock for each share of Western stock outstanding on the date of consummation of the merger, was approved by stockholders of both companies on March 19, 1971. Western's shareholders cast 3,915,220 votes for the merger and 81,707 against. American's stockholder vote was 15,782,533 for and 226,373 against.

It is not possible to predict when the final decision in this case will be released; however, your management expects the decision to be rendered in a few months.

Alaska Service Case

On December 9, 1971, as part of its decision in the *Alaska Service Investigation,* the Civil Aeronautics Board ordered the following changes in Western's Alaska route authority:

suspended the company's authority to serve Ketchikan and Juneau for a seven-year period in favor of a subsidized carrier;

made permanent the temporary transfer of short-haul routes west of Anchorage which the company had arranged with another carrier in 1970;

made permanent the temporary suspension of Western's service to Yakutat and Cordova; and

made Western's Seattle-Kodiak authority seasonal, between April 15 and October 15.

The company is in accord with the decision as it relates to the short-haul routes west of Anchorage, service to Yakutat and Cordova and seasonal service to Kodiak, but has appealed to the federal courts for judicial review of that part of the Board's decision that would suspend Western's permanently certificated route serving Juneau and Ketchikan. In 1971, service to these two cities generated approximately three percent of Western's total revenues and produced approximately $1 million in earnings before taxes.

Although denying the company's request for a stay of the CAB order pending completion of judicial review, the U.S. Court of Appeals for the District of Columbia Circuit agreed to hear the case on an expedited basis.

In the meantime, however, Western was required to discontinue service on the Seattle-Ketchikan-Juneau-Anchorage "inside route" effective February 7, 1972. The company continues to operate Seattle-Anchorage nonstop service and twice-weekly flights between Anchorage and Honolulu. It also plans to operate three flights a week between Seattle and Kodiak under its seasonal authority after April 15.

Your company continues to believe that the CAB exceeded its statutory authority in suspending Western at Ketchikan and Juneau and will persist in its efforts to obtain a reversal of this decision.

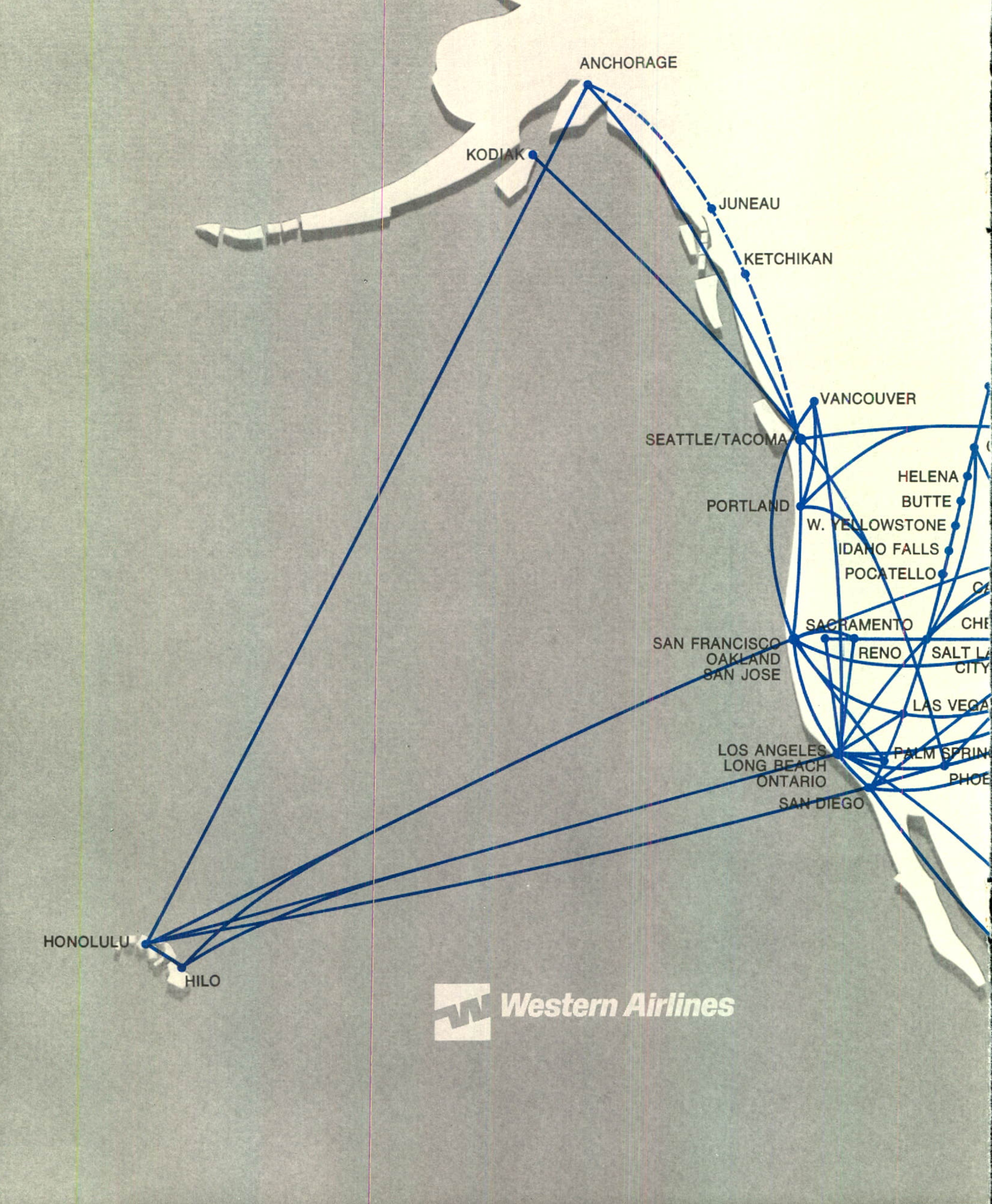
Other Route Cases

In the *Las Vegas/Reno-Portland/Seattle Nonstop Service Investigation,* all procedural steps have been completed and a final decision by the CAB is awaited. The examiner in the case recommended that Western be given nonstop authority between Las Vegas and Portland/Seattle. The company also is seeking Las Vegas-Reno and Reno-Portland/Seattle routes which also are at issue in the case.

In the *San Diego — Denver Nonstop Service Case,* in which Western was permitted to eliminate a mandatory Phoenix stop on flights between San Diego and Denver, the CAB ordered further hearings to update the record in order to determine whether to authorize another carrier to compete with Western in this market. In the meantime, Western continues to provide the nonstop service which was inaugurated in June 1970. An Examiner's Initial Decision in the reopened case is expected soon.

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.

Route System




CALGARY
GREAT FALLS
BILLINGS
SHERIDAN
MINNEAPOLIS
ST. PAUL
PIERRE
RAPID CITY
SIOUX FALLS
ASPER
EYENNE
AKE
DENVER
S
GS
ENIX
MEXICO CITY
ACAPULCO
Service Temporarily Suspended by Order of Civil Aeronautics Board

10 Years of Growth

Financial	1971/1970	1971	1970	1969[4]
Revenues:[7]				
Passenger	+ 7.6%	$ 295,807	274,792	220,530
Express, freight and excess baggage	+ 7.7	15,075	13,993	11,969
Mail	+ 8.5	5,156	4,752	4,503
Other	+109.0	9,557	4,572	3,350
Total Revenues	+ 9.2	325,595	298,109	240,352
Operating Expenses:[7]				
Depreciation and amortization	− 3.9	35,144	36,583	34,821
Payroll	+ 10.9	111,584	100,629	87,495
Other	+ 9.0	162,561	149,086	130,437
Total Operating Expenses	+ 8.0	309,289	286,298	252,753
Operating Income (Loss)[7]	+ 38.1	16,306	11,811	(12,401)
Interest expense[7]	− 23.5	(11,162)	(14,586)	(14,748)
Other Income and Expenses—Net[7]	+199.4	3,353	1,120	(125)
Earnings (loss) before extraordinary gains and taxes on income[5,7]		8,497	(1,655)	(27,274)
Taxes on Income (Tax Credits)[7]		2,600	(2,250)	(15,075)
Earnings (loss) before extraordinary gains[5,7]		5,897	595	(12,199)
Extraordinary gains (less applicable income taxes)[5,7]		560	—	—
Net Earnings (Loss)[7]		$ 6,457	595	(12,199)
Primary earnings (loss) per share before extraordinary items[2,5]		$ 1.10	0.11	(2.26)
Primary net earnings per share[2]		$ 1.20	0.11	(2.26)
Fully diluted earnings (loss) per share before extraordinary items[5]		$ 1.06	0.11	(2.26)
Fully diluted net earnings (loss) per share		$ 1.15	0.11	(2.26)
Return on investment %[6]		6.16	5.22	0.71
Cash dividends paid per share[3]		—	—	0.45
Stock dividends paid per share		10%	—	—
Shares outstanding—actual[7]		5,395	4,904	4,904
—adjusted[2,7]		5,395	5,394	5,394
Shareholders' equity—total[7]	+ 8.1	$ 86,397	79,905	79,310
Shareholders' equity—a share[2]	+ 8.1	16.01	14.81	14.70
Working capital[7]	+ 51.0	53,207	35,238	20,447
Long-term debt[7]	− 12.7	152,040	174,184	197,150
Property and equipment—net[7]	− 12.4	216,738	247,426	285,757
Total assets[7]	− 4.2	340,352	355,168	367,588
Operations				
Airplanes operated at end of year:				
Boeing 720-B		25	26	26
Boeing 720		3	3	3
Boeing 707-300C		5	5	5
Boeing 737		30	30	30
Boeing 727-200—leased		6	6	6
Propeller		1	2	8
Airplane miles flown[7]	+ 0.1	86,425	86,298	72,650
Ton miles produced[7]	—	1,266,130	1,266,124	1,077,657
Ton miles sold[4,7]	+ 2.4	598,448	584,554	448,420
Seat miles produced[7]	− 0.6	9,776,869	9,839,299	8,509,441
Seat miles sold[4,7]	+ 1.8	5,251,989	5,159,081	4,021,296
Express, freight and mail ton miles sold[7]	+ 6.7	73,249	68,646	60,514
Passengers carried[4]	+ 0.3	6,206,440	6,187,527	5,752,072
Express, freight and mail tons carried	+ 6.2	77,731	73,140	66,107
Passenger load factor—actual	+ 1.3 pts.	% 53.7	52.4	47.3
—breakeven point	− 0.5 pts.	% 52.2	52.7	53.1
Average length in miles per passenger trip	+ 1.4%	846	834	699
Operating expenses per seat mile produced	+ 8.6	$ .0316	.0291	.0297
Average revenue per seat mile sold	+ 6.5	$ .0577	.0542	.0551
Employees at end of year	+ 2.4	9,039	8,830	9,225

[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.

[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.

1968	1967	1966[4]	1965	1964	1963	1962
205,753	178,527	164,186	129,704	121,928	103,183	89,837
9,331	7,581	6,848	5,991	5,897	5,055	4,747
4,128	4,221	4,255	3,135	2,962	2,603	2,659
2,741	2,153	1,895	1,768	2,095	3,472	2,878
221,953	192,482	177,184	140,598	132,882	114,313	100,121
25,051	20,085	15,779	14,676	12,980	12,373	14,605
71,885	57,975	47,350	38,731	34,500	30,114	27,108
105,335	89,082	77,708	62,391	57,650	50,969	47,997
202,271	167,142	140,837	115,798	105,130	93,456	89,710
19,682	25,340	36,347	24,800	27,752	20,857	10,411
(6,536)	(3,011)	(3,239)	(2,553)	(2,491)	(2,916)	(2,725)
15	17	775	253	783	621	472
13,161	22,346	33,883	22,500	26,044	18,562	8,158
4,725	10,125	15,558	10,337	12,493	9,252	4,130
8,436	12,221	18,325	12,163	13,551	9,310	4,028
—	—	—	883	—	191	889
8,436	12,221	18,325	13,046	13,551	9,501	4,917
1.56	2.27	3.45	2.29	2.55	1.75	0.76
1.56	2.27	3.45	2.46	2.55	1.79	0.93
1.49						
1.49						
6.54	10.28	16.28	15.37	18.72	14.49	9.40
0.91	0.91	0.91	0.73	0.59	0.33	0.30
—	—	—	—	—	—	—
4,902	4,893	4,835	4,826	4,826	1,965	1,965
5,392	5,382	5,318	5,308	5,308	5,308	5,308
93,862	90,016	81,750	67,361	57,748	46,988	39,061
17.41	16.73	15.37	12.69	10.88	8.85	7.36
25,764	19,585	18,047	11,522	8,274	5,031	12,315
183,718	80,189	54,867	47,411	33,938	41,106	48,856
284,787	183,106	145,771	124,096	99,928	93,284	80,052
349,039	231,342	192,008	157,973	138,335	125,806	115,266
27	27	22	18	12	10	7
3	3	3	2	2	2	2
5	—	—	—	—	—	—
17	—	—	—	—	—	—
—	—	—	—	—	—	—
12	21	23	24	33	33	34
60,125	51,692	42,830	36,554	36,746	33,388	29,551
891,001	728,200	585,378	483,033	450,856	400,395	348,854
418,856	360,791	314,137	244,588	231,303	191,229	159,658
7,096,229	5,879,442	4,800,901	4,016,921	3,794,648	3,335,083	2,746,549
3,841,864	3,327,160	2,898,088	2,243,695	2,124,582	1,753,037	1,435,992
47,446	38,940	33,070	26,435	24,625	20,622	19,786
5,692,947	5,107,672	4,700,839	3,807,706	3,717,189	2,970,909	2,270,455
58,129	48,579	42,714	33,511	30,956	25,890	25,256
54.1	56.6	60.4	55.9	56.0	52.5	52.3
50.7	49.5	47.9	46.2	44.4	44.3	48.6
675	651	616	589	572	590	633
.0285	.0284	.0293	.0288	.0277	.0280	.0327
.0537	.0537	.0567	.0578	.0574	.0589	.0626
8,919	7,282	6,294	5,068	4,719	4,126	3,713

[4]Operations of a competing regional carrier were substantially suspended from December 15, 1971. Operations of a competing trunk carrier were substantially suspended from July 8 to December 14, 1970. Western's operations were suspended from July 29 to August 16, 1969 because of a strike. Five other major carriers were struck from July 8 to August 19, 1966.

[5]Extraordinary gains are from the involuntary conversion of and major sales of aircraft.

[6]The methodology used to compute the rate of return is essentially that used by the CAB.

[7]000s omitted.

Balance Sheet

Western Air Lines, Inc.

December 31, 1971 and 1970
(in thousands of dollars)

ASSETS	1971	1970	Change
Current Assets:			
Cash	$ 13,446	$ 16,590	−19.0%
Certificates of deposit	30,056	20,640	+45.6
Short-term securities (at amortized cost, including accrued interest, which approximates market)	37,522	27,370	+37.1
	81,024	64,600	+25.4
Receivables (net of allowance for doubtful accounts of $475 in 1971 and $350 in 1970)	22,943	21,732	+ 5.6
Maintenance and operating supplies (at average cost)	11,005	11,104	− 0.9
Prepaid expenses	4,150	4,579	− 9.4
Total current assets	119,122	102,015	+16.8
Properties and Equipment at Cost:			
Flight equipment	345,539	354,507	− 2.5
Ground equipment	60,925	59,376	+ 2.6
Deposits on purchase contracts *(Note 3)*	7,148	—	
	413,612	413,883	− 0.1
Less allowance for depreciation and amortization *(Note 6)* and maintenance	196,874	166,457	+18.3
	216,738	247,426	−12.4
Deferred Charges and Other Assets:			
Flight equipment not used in operations, net	2,214	2,417	− 8.4
Other items	2,278	3,310	−31.2
	4,492	5,727	−21.6
	$340,352	$355,168	− 4.2

See accompanying Notes to Financial Statements.

LIABILITIES	1971	1970	Change
Current Liabilities:			
Accounts payable	$ 16,606	$ 18,699	−11.2%
Accrued salaries and wages	13,374	11,731	+14.0
Accrued liabilities	9,191	7,433	+23.7
Unused transportation	5,281	5,949	−11.2
Current maturities of long-term debt *(Note 2)*	21,463	22,965	− 6.5
Total current liabilities	65,915	66,777	− 1.3
Long-Term Debt *(Note 2)*	152,040	174,184	−12.7
Deferred Credits and Other Liabilities *(Note 1):*			
Deferred federal taxes on income	19,433	17,495	+11.1
Unamortized investment credits	12,271	13,584	− 9.7
Other	4,296	3,223	+33.3
	36,000	34,302	+ 4.9
Shareholders' Equity *(Notes 2, 5 and 8):*			
Common stock—$1.00 par value per share Authorized 10,000,000 shares Issued 5,395,000 and 4,904,000 shares	5,395	4,904	+10.0
Capital in excess of par value	29,750	19,235	+54.7
Retained earnings	51,252	55,766	− 8.1
	86,397	79,905	+ 8.1
Commitments and Contingent Liabilities *(Note 3).*			
	$340,352	$355,168	− 4.2

Statement of Earnings

For the years ended December 31, 1971 and 1970
(in thousands of dollars)

	1971	1970	Change
Operating Revenues:			
Passenger	$295,807	$274,792	+ 7.6%
Express, freight and excess baggage	15,075	13,993	+ 7.7
Mail	5,156	4,752	+ 8.5
Other *(Note 7)*	9,557	4,572	+109.0
	325,595	298,109	+ 9.2
Operating Expenses:			
Flying operations	82,958	74,615	+ 11.2
Maintenance	39,422	37,658	+ 4.7
Passenger service	34,652	31,371	+ 10.5
Aircraft and traffic servicing	58,173	52,693	+ 10.4
Marketing and administrative	58,940	53,378	+ 10.4
Depreciation and amortization *(Note 6)*	35,144	36,583	− 3.9
	309,289	286,298	+ 8.0
Operating income	16,306	11,811	+ 38.1
Other Income (Expense):			
Interest expense	(11,162)	(14,586)	− 23.5
Interest income	3,190	2,021	+ 57.9
Other — net	163	(901)	
Earnings (loss) before taxes on income and extraordinary gain*	8,497	(1,655)	
Taxes on income (tax credits) *(Note 1)*	2,600	(2,250)	
Earnings before extraordinary gain*	5,897	595	
Extraordinary gain* net of federal income taxes *(Note 1)*	560	—	
Net earnings	$ 6,457	$ 595	
Per share data (based on shares outstanding at the end of each year with 1970 data adjusted for the 10% stock dividend paid in March 1971):			
Primary:			
Earnings before extraordinary gain*	$ 1.10	$ 0.11	
Net earnings	1.20	0.11	
Fully diluted (assuming conversion of the debentures):			
Earnings before extraordinary gain*	1.06	0.11	
Net earnings	1.15	0.11	

*The extraordinary gain resulted from the involuntary conversion of an aircraft.

See accompanying Notes to Financial Statements.

Statement of Changes in Financial Position

For the years ended December 31, 1971 and 1970
(in thousands of dollars)

		1971	1970
Sources of Working Capital:			
Earnings before extraordinary gain		$ 5,897	$ 595
Add back expenses which did not affect working capital:			
Taxes *(Note 1)*			
Deferred income taxes		2,600	(850)
Charge equivalent to investment credits		1,200	—
Amortization of investment credits		(2,325)	(2,050)
Other			
Depreciation and amortization *(Note 6)* and maintenance reserve provision		38,607	41,529
Other non-cash items		438	446
Total from operations before extraordinary gain		46,417	39,670
Extraordinary gain		560	—
Deduct income which did not affect working capital:			
Gain before taxes	$1,110		
Related deferred income taxes — credit *(Note 1)*	850	(1,960)	—
Reduction related to current taxes *(Note 1)* on the involuntary conversion of an aircraft		(1,400)*	—
Total from operations as adjusted		45,017	39,670
Proceeds from disposition of property:			
Involuntary conversion of an aircraft		4,900*	—
Other		526	3,220
Exercise of stock options		35	—
Other		183	(337)
Total working capital provided		50,661	42,553
Applications of Working Capital:			
Purchases of property and equipment		3,400	4,796
Deposits on purchase contracts		7,148	—
Payments of long-term debt and transfers to current liabilities		22,144	22,966
Total working capital applied		32,692	27,762
Increase in Working Capital		$17,969	$14,791
Summary of Changes in Working Capital:			
Increases (decreases) in current assets:			
Cash, certificates of deposit, and short-term securities		$16,423	$36,147
Federal income taxes refundable		—	(12,286)
Inventories, receivables, and prepaid expenses		684	2,001
Decreases (increases) in current liabilities		862	(11,071)
		$17,969	$14,791

*These proceeds from the involuntary conversion of an aircraft were $3,500 after current taxes of $1,400.

See accompanying Notes to Financial Statements.

Statement of Shareholders' Equity

For the two years ended December 31, 1971
(in thousands of dollars)

	Common Stock	Capital in Excess of Par Value	Retained Earnings	Shareholders' Equity
Amount at December 31, 1969	$4,904	$19,235	$55,171	$79,310
Net earnings	—	—	595	595
Amount at December 31, 1970	4,904	19,235	55,766	79,905
10% stock dividend paid in March	490	10,481	(10,971)	—
Exercise of stock options	1	34	—	35
Net earnings	—	—	6,457	6,457
Amount at December 31, 1971 *(Notes 2, 5, and 8)*	$5,395	$29,750	$51,252	$86,397

See accompanying Notes to Financial Statements.

Notes to Financial Statements

Note 1. Taxes on Income.

The 1971 net income tax and the 1970 net income tax credit are summarized as follows (in thousands):

	1971	1970
Exclusive of taxes related to extraordinary gain:		
Current income taxes—		
Federal	$ 150	$ 225
State	975	425
Deferred income taxes	2,600	(850)
Charge equivalent to investment credits	1,200	—
Amortization of deferred investment credits	(2,325)	(2,050)
	2,600	(2,250)
Related to extraordinary gain:		
Current income taxes	1,400	—
Deferred income taxes (credit)	(850)	—
	550	—
	$3,150	$ (2,250)

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 $17,308,000 at December 31, 1971, and have been offset on the balance sheet against deferred federal taxes on income. Such unapplied investment credits will expire as follows: $1,735,000 in 1976, $2,740,000 in 1977, $9,204,000 in 1978, $3,612,000 in 1979 and $17,000 in 1980.

Of the $12,271,000 unamortized investment credit balance at December 31, 1971, $1,340,000 remains from investment credits utilized to reduce taxes otherwise payable and $10,931,000 is related to investment credits not yet utilized for such purposes.

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).

For the years ended December 31, 1971 and 1970, long-term debt was as follows (in thousands):

	1971	1970
Senior Debt		
Promissory note due December 31, 1975 with quarterly payments of $4,865. The interest rate is ¼ % over the bank's prime commercial rate	$ 77,850	$ 97,312
5¼ % promissory notes due September 1, 1981 with annual payments of $1,000 from September 1, 1970 which will increase to $4,000 a year starting in 1976	28,000	29,000
6⅝ % promissory notes due September 1, 1984 with annual payments of $1,000 from September 1, 1970 which will increase to $2,000 a year starting in 1975 and further increase to $7,000 a year starting in 1982	38,000	39,000

	1971	1970
5% to 6½% promissory notes	—	2,184
	143,850	167,496
Less current maturities . . .	21,463	22,965
	122,387	144,531
Subordinated Debt		
5¼% convertible subordinated debentures due February 1, 1993, with sinking fund payments of $1,500 a year starting in 1979	29,653	29,653
	$152,040	$174,184

The following schedule shows the amount of long-term debt maturing in each of the five following calendar years:

1972	$21,463,000
1973	21,463,000
1974	21,463,000
1975	22,463,000
1976	6,000,000

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 provides, among other things, a requirement restricting cash dividends to $5,000,000 plus net earnings and proceeds from stock as added to shareholders' equity subsequent to December 31, 1967. This requirement is presently more restrictive than those in the loan agreements and at December 31, 1971 operated to restrict retained earnings from cash dividend distribution in the amount of $49,889,000, leaving $1,363,000 not so restricted.

Reserved for the conversion of the debentures are 888,000 shares of common stock at a conversion price of $33.41 per share (subject to adjustments in certain cases).

Note 3. Commitments and Contingent Liabilities.

The estimated minimum annual rentals under long-term leases of ground facilities, with expiration dates ranging to the year 2000, were approximately $3,200,000 at December 31, 1971 and $3,000,000 at December 31, 1970.

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

Western has on order three Boeing 727 aircraft for delivery in the spring of 1972 at a cost of approximately $22,500,000, of which approximately $6,400,000 has been paid in advance deposits. Also, American Airlines, Inc. exercised options for four McDonnell Douglas DC-10 aircraft for delivery in April, June (two) and July 1973, subject to consummation of the proposed merger with Western. Western agreed to purchase these aircraft from the manufacturer if the merger is not consummated (see Note 8). The total purchase price of these aircraft and related spares, exclusive of spare engines, is estimated to approximate $85,000,000. American will make the required advance payments, subject to Western's assumption of this obligation if the proposed merger is not consummated. The required advance payments will aggregate approximately $24,000,000.

Also, at December 31, 1971, the outstanding commitments for aircraft interior modification kits and spare parts amounted to approximately $2,750,000 and for ground facilities and equipment amounted to approximately $750,000.

Early in 1972, Western agreed to purchase two additional Boeing 727 aircraft from the manufacturer, at a cost of approximately $15,000,000, with delivery scheduled for the fall of 1972.

The company has not decided how much of the funds on hand together with the funds that will be generated internally before the deliveries of the aforementioned five 727 and four DC-10 aircraft will be used to meet the related commitments. Also, the source of the additional financing that will be needed has not been arranged.

At December 31, 1971, 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 $660,000 to 520 property owners. The City has announced its intention to appeal.

Western is a defendant, together with numerous other airlines, in a purported class action relating to charges for inflight services. Western believes that these actions will not result in any material liability to the company.

Western is also a defendant along with other domestic airlines in numerous actions seeking repayment and damages involving the collection of allegedly illegal fares (which in one action is alleged to amount to $300,000,000). In the opinions of Western and of the counsel representing the carriers, the carriers involved are not liable for the repayment of any or all of the fares in question.

In December 1971, the CAB suspended the company's authority to serve the cities of Ketchikan and Juneau for a period of seven years. Western estimates that during 1971 service to these cities generated approximately three percent of Western's total revenues and produced approximately $500,000 in net earnings. The company has appealed this decision to the federal courts.

Note 4. Retirement Plans.

The company has retirement plans covering all eligible employees. The cost of these plans charged to operating expense totaled $6,504,000 in 1971 and $4,660,000 in 1970. The company's actuary is of the opinion that the assets under each plan exceed the related liabilities for the accrued vested benefits.

Note 5. Stock Options.

The qualified stock option plan for officers is summarized as follows:

	1971		1970	
	Shares	Average per share	Shares	Average per share
Granted	6,500	$31.41	2,500	$15.68
Exercised	1,480	$23.62	—	—
Exercisable at end of year	48,660	$24.26	28,490	$23.95
Outstanding at end of year	124,040	$24.62	120,450	$24.22

An additional 79,300 shares were reserved at December 31, 1971 for the issuance of additional options.

Note 6. Depreciation and Amortization.

Depreciation for book purposes is computed on the straight-line basis predicated on estimated useful lives, which are as follows: for the five Boeing 707-300C aircraft acquired in 1968, twelve years to a residual value of 15%; for the thirty Boeing 737-200 aircraft acquired in 1968 and 1969, twelve years to a residual value of 15%; for the seventeen Boeing 720B and the three Boeing 720 aircraft acquired during 1961 to 1965, a common retirement date of December 31, 1975 to a residual value of $100,000 per aircraft; for the eight Boeing 720B aircraft acquired in 1966 and 1967, ten years to a residual value of $100,000 per aircraft.

Note 7. Mutual Aid Agreement.

Provisions for payments to the struck carriers participating in the Mutual Aid Agreement, which Western joined effective August 1970 were minimal in 1971, but were $2,700,000 for the year 1970 and charged to "Other" operating revenues. Operations of a competing regional carrier were substantially suspended from December 15, 1971, and operations of a competing trunk carrier were substantially suspended from July 8 to December 14, 1970.

Note 8. Proposed Merger.

During March 1971 the shareholders of Western and American Airlines, Inc. approved an Agreement of Merger, dated January 14, 1971, providing for the merger of Western into American. During December 1971 a hearing examiner for the Civil Aeronautics Board recommended disapproval of the merger. Exceptions to this recommendation have been taken by Western and American and the matter has been submitted to the CAB for a final decision and subsequent approval by the President of the United States. The holders of Western's long-term notes have expressed their intentions to conform, upon consummation of the merger, the terms and conditions of the Western credit agreements to the terms and conditions that exist in American credit agreements. This Agreement of Merger calls for the exchange of 1.3 shares of American's common stock for each share of Western's common stock. The exchange ratio is subject to adjustment in certain cases.

Accountants' Report

PEAT, MARWICK, MITCHELL & CO.
CERTIFIED PUBLIC ACCOUNTANTS
555 SOUTH FLOWER STREET
LOS ANGELES, CALIFORNIA 90071

The Board of Directors
Western Air Lines, Inc.:

We have examined the balance sheet of Western Air Lines, Inc. as of December 31, 1971 and 1970 and the related statements of earnings, shareholders' equity, and changes in financial position for the respective 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, the aforementioned financial statements present fairly the financial position of Western Air Lines, Inc. at December 31, 1971 and 1970, and the results of its operations and changes in its financial position and shareholders' equity for the respective years then ended in conformity with generally accepted accounting principles applied on a consistent basis.

Los Angeles, California
February 18, 1972

Peat, Marwick, Mitchell & Co.

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*Mr. Lundborg's election was subject to approval by the Civil Aeronautics Board. An application for such approval has been filed but approval has not been obtained.

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