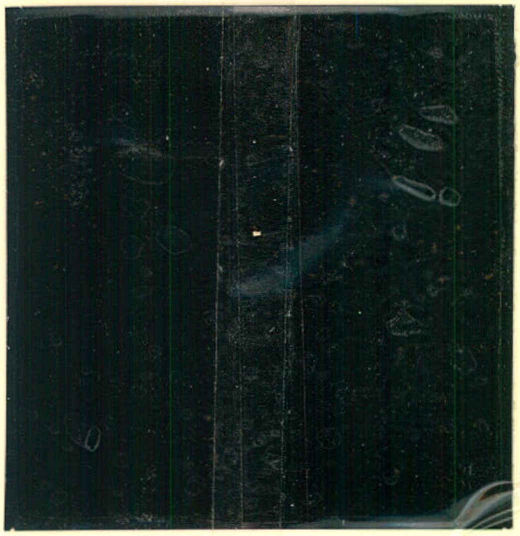
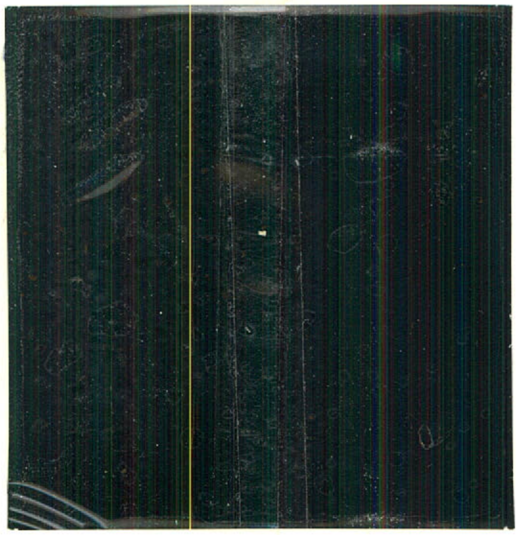
Western Airlines
Nineteen Seventy-Two
Annual Report





Notice to Stockholders

A rule adopted by the Civil Aeronautics Board ("CAB") in July 1970, as amended on December 29, 1972, imposes obligations on certain stockholders of air carriers. Any person who owns as of December 31 of any year or subsequently acquires, either beneficially or as a trustee, more than 5% of any class of capital stock of an air carrier must file with the CAB a report containing the information required by Part 245.12 of the CAB's Economic Regulations on or before April 1 as to the capital stock owned as of December 31 and/or a report containing the information required by Part 245.13 of the CAB's Economic Regulations within 10 days after acquisition as to the capital stock acquired after December 31. Any bank or broker which holds as trustee more than 5% of any class of capital stock of an air carrier on the last day of any quarter of a calendar year must file with the CAB within 30 days after the end of the quarter a report in accordance with the provisions of Part 245.14 of the CAB's Economic Regulations.

Any person required to report under either Part 245.12, Part 245.13 or Part 245.14 of the CAB's Economic Regulations who grants a security interest in more than 5% of any class of capital stock of an air carrier must within 30 days after granting such security interest file with the CAB a report containing the information required in Part 245.15. 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.

Western Air Lines, Inc. 1972 Annual Report

Highlights of 1972

Operating	1972	1971	Change
Available seat miles	10,300,178,000	9,776,869,000	+ 5.4%
Revenue passenger miles	5,995,925,000	5,251,989,000	+14.2
Passengers carried	6,931,000	6,206,000	+11.7
Passenger load factor—actual %	58.2	53.7	+ 4.5 pts.
—breakeven point %	54.4	52.2	+ 2.2 pts.

Financial	1972	1971	Change
Operating revenues	$365,663,000	$325,595,000	+12.3%
Operating income	$ 23,607,000	$ 16,306,000	+44.8
Net earnings	$ 11,216,000	$ 6,457,000	+73.7
Net earnings per share	$ 0.81	$ 0.46	
Net earnings per share assuming conversion of the debentures	$ 0.74	$ 0.45	
Cash dividends per share	$ 0.09	$ —	
Stock dividend paid (3% in April 1973)	—	10%	
Shares of common stock outstanding	13,926,000	13,894,000	+ 0.2
Shareholders' equity	$ 96,723,000	$ 86,397,000	+12.0
Shareholders' equity per share	$ 6.95	$ 6.22	
Cash, certificates of deposit, and short-term securities	$ 55,382,000	$ 81,024,000	−31.6
Working capital	$ 20,592,000	$ 53,207,000	−61.3
Unused bank credit	$ 65,000,000	—	
Property and equipment at cost	$452,333,000	$413,612,000	+ 9.4
Long-term debt	$130,487,000	$152,040,000	−14.2
Number of employees at year end	9,676	9,039	+ 7.0
Wages and salaries paid	$126,618,000	$111,584,000	+13.5

Operations of a competing trunk carrier were substantially suspended from June 30 to October 2, 1972, and operations of a competing regional carrier were substantially suspended from December 15, 1971, to April 10, 1972

Affected data adjusted where appropriate throughout this Annual Report for the 3% stock dividend declared on January 22, 1973, payable on April 10, 1973, to shareholders of record on February 20, 1973, and for the 2½ for 1 stock split effected on September 13, 1972, and distributed on October 30, 1972.

President's Letter

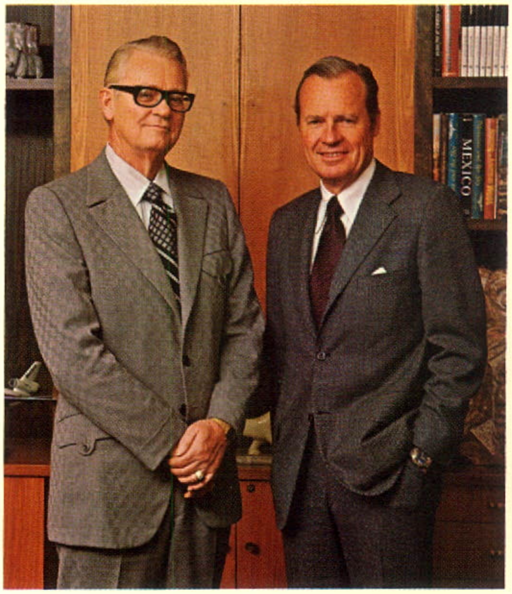
To Our Stockholders:

The year 1972 was one of the best in Western Air Lines' 46-year history. Despite the uncertainty of a pending merger that ultimately was denied, and the continuing problems that faced the airline industry, the performance of your company was excellent. Profits increased 74 percent; we resumed payment of dividends to stockholders, provided outstanding service to a record number of travelers and shippers, and finished the year in a strong financial position.

Much of the credit for the company's gratifying progress must go to its 9,600 employees, who, notwithstanding the difficulties, demonstrated great poise, professionalism and dedication. As a result of their support and the able leadership of J. Judson Taylor, who guided the company from heavy losses in 1969 to profitability in 1972, Western today is in an excellent position to continue its growth.

From late 1970 until the summer of 1972 your company pursued a merger application with American Airlines in the belief that the consolidation of these two companies would produce worthwhile benefits to our shareholders and to the public. At the same time, however, we recognized that the proposed merger would face opposition and that it might not be approved by the Civil Aeronautics Board and the President. Accordingly, we were determined to conduct our day-to-day operations as efficiently and profitably as possible and continue our planning in a manner that would permit Western to move ahead as a viable carrier should the merger be turned down. As our 1972 results detailed in this report indicate, we have been successful in attaining these objectives.

Western is today—and in the future will be more than ever—a performance-oriented company. In 1972, based on Civil Aeronautics Board standards, we had the best on-time record of any trunk airline. In providing coach and economy passengers — who represent 87 percent of our revenue — with first class legspace on every flight, we believe we did more to make the passenger comfortable in a meaningful way than any other airline. Our ratio of commendations-to-complaints improved significantly during the year. Western had fewer consumer complaints filed with the Civil Aeronautics Board than any other trunkline.



Fred Benninger
Chairman

Arthur F. Kelly
President

Of continuing concern for the future is the matter of traffic growth vs. cost increases. We believe traffic will continue to grow at a healthy rate. Most estimates for our industry indicate that revenue passenger miles should increase 10-11 percent in 1973. We believe these forecasts are reasonable. In order to benefit from this growth, however, we must insure that costs are carefully controlled. Every item of operating expense is being considered from a profit-planning standpoint.

In the summer of 1973, Western will introduce its first wide-bodied jets, four DC-10s. The aircraft will make the company's service more competitive on major routes where other carriers operate wide-bodied aircraft. When combined with a full-year's utilization of the five Boeing 727s that were received in 1972, they will permit us to increase our capacity by approximately 12 percent for the year.

Our revenue per passenger mile in 1972 was essentially the same as in 1971 despite the September fare increase that amounted to approximately 1.8 percent for Western's system. The carry-over effect for 1973 will be approximately 1.2 percent. We are continuing our efforts to obtain fare increases for Mainland-Hawaii and certain intra-California routes.

The stringent new security measures ordered by the government that were introduced throughout our system in January 1973 will increase the company's costs. We are hopeful that the Civil Aeronautics Board will permit the airlines to recover these added costs by a surcharge to be paid by the passengers.

In order to meet our goals of improved performance and greater efficiency, we have increased our emphasis on corporate planning. We recently established a corporate planning department which we believe is unique in the airline industry. Not only is it responsible for developing both near-term and long-range forecasts, but it also includes flight scheduling, cost control and fleet planning. Consolidation of these important functions with economic research and analysis will permit the department to develop an annual profit plan and to adjust schedules and establish budgets to conform with the plan.

We are optimistic about the future of Western. We feel we have a strong management team, dedicated and resourceful employees and a route system that, although in need of expansion, will produce continuing traffic growth. We have been aggressive and innovative competitors and we intend to be even more so in the future.

Your continued support will help us in this endeavor. We hope you will fly and ship on Western whenever possible and encourage your friends, neighbors and associates to do likewise.

Kelly

Arthur F. Kelly
President and Chief Executive Officer

March 8, 1973

Year in Review

Earnings

Net earnings in 1972 were $11,216,000, a 74 percent increase over 1971 net earnings of $6,457,000.

(All per-share figures appearing throughout this report are adjusted for stock splits and stock dividends, including the three percent stock dividend declared January 22, 1973.)

Net earnings per share, based on the weighted average number of shares outstanding during the year were 81 cents a share, compared to 46 cents a share for 1971. For purposes of comparison to interim reporting made during 1972, the net earnings per share unadjusted for the stock dividend were 83 cents a share compared to 48 cents a share for 1971.

Fully diluted net earnings per share, assuming that all holders of the company's 5¼ percent Convertible Subordinated Debentures had converted their debentures into common stock, were 74 cents a share, compared to 45 cents a share for 1971.

Operating income totaled $23,607,000, equal to 6.5 percent of operating revenues, compared to $16,306,000, or 5.0 percent of operating revenues, for 1971.

Interest expense (before reduction for interest capitalized) decreased from $11,278,000 in 1971 to $10,240,000, reflecting both a decrease in long-term debt and lower effective interest rates on notes payable to a bank. Interest rates on such notes are fixed at one-quarter percent over the bank's prime commercial rate and vary with changes in the prime rate, which was on the average lower in 1972 than in 1971. In 1972 the prime rate fluctuated between 4¾ percent and six percent compared to between 5¼ percent and 6¾ percent in 1971.

Interest income decreased from $3,190,000 for 1971 to $2,832,000 for 1972. The decrease resulted from a decline in investments in certificates of deposit and short-term marketable securities as the company used cash to pay for aircraft acquired in 1972 and to make deposits on the DC-10 aircraft to be delivered in 1973.

Earnings before income taxes for 1972 totaled $17,516,000, more than double Western's pre-tax earnings for 1971.

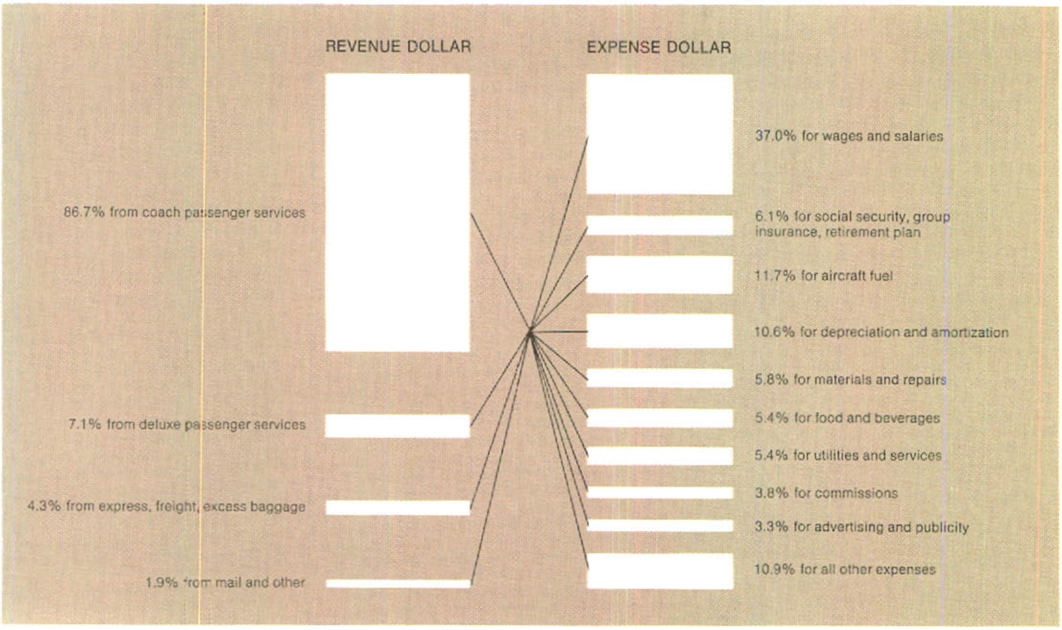
Taxes on income were $6,300,000. Before amortization of deferred investment credits of $2,300,000 for 1972 and $2,325,000 for 1971, the federal tax expense was $7,525,000 for 1972, compared with $3,950,000 for 1971. State income taxes increased from $975,000 to $1,075,000.

Revenues

Total operating revenues for 1972 were a record $365,663,000 (after reduction of $5,181,000 for payments to struck carriers under the airlines' Mutual Aid Agreement), a 12.3 percent increase over the $325,595,000 of the previous year.

Passenger revenues increased 15.9 percent, and represented 93.8 percent of total operating revenues. Revenues from coach traffic increased 16.5 percent and represented 92.4 percent of passenger revenues, or 86.7 percent of the company's revenue dollar; deluxe traffic increased 9.1 percent and contributed 7.1 percent of the revenue dollar. Express, freight and baggage increased 4.9 percent to $15,819,000 and represented 4.3 percent of operating revenues. Mail revenues decreased 3.0 percent and were 1.4 percent of the total. Charter revenues decreased from $4,284,000 to $2,100,000.

The average revenue per passenger mile for 1972 was 5.78 cents, almost identical to the previous year's 5.77 cents. The Civil Aeronautics Board in the fare level phase of the *Domestic Passenger Fare Investigation* approved a 2.7 percent fare increase on domestic routes effective in September. However, the increase did not apply on Hawaii, Alaska, Mexico or intra-California routes and, accordingly, represented an average increase of only 1.8 percent for Western's system. Offsetting this fare increase was an increase in discount travel, from 31.4 percent of all revenue passen-



ger miles in 1971 to 37.6 percent in 1972. This trend may be counteracted in part by the effect of the Civil Aeronautics Board's decision, which has yet to be implemented, holding that youth standby, youth reservation and family plan fares, some of the most popular discount fares, are unlawful.

Expenses

Inflation continued to play a major role in Western's expense picture in 1972 as operating expenses increased 10.6 percent on a 5.4 percent increase in available seat miles.

Operating expenses totaled $342,056,000, compared to $309,289,000 for 1971.

Personnel costs, which accounted for 43.1 percent of the expense dollar, increased 15.9 percent despite the fact that the increase in the number of employees was only seven percent. Of the $32,767,000 increase in operating expenses, $20,207,000—61.7 percent—was for wages and salaries, plus related costs for Social Security, group insurance and retirement plans.

Other major items of expense and comparisons with 1971 levels are detailed in the expenses section of the Brief Statement of Earnings.

The cost of producing a seat mile increased 5.1 percent, from 3.16 cents to 3.32 cents. Breakeven load factor increased from 52.2 percent to 54.4 percent.

Finances

The company continues in a strong financial position.

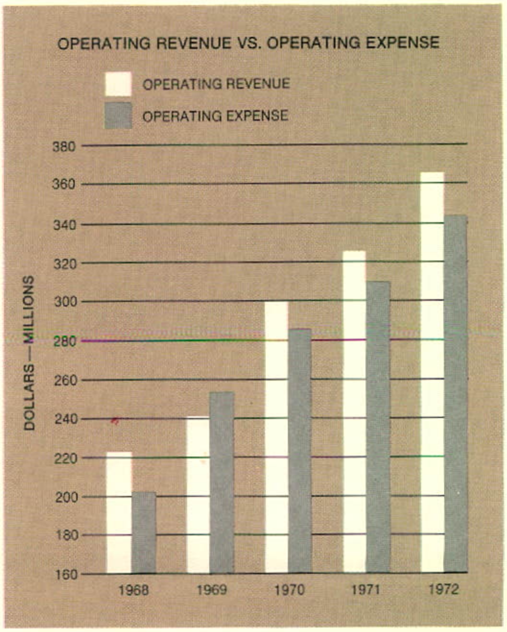
The Statement of Changes in Financial Position shows total working capital from all sources provided $49,261,000 in 1972, compared with $50,661,000 for 1971.

Working capital generated by operations totaled $47,206,000, compared to $45,017,000 in 1971. Earnings before extraordinary gains increased $5,319,000. However, the add back for depreciation, amortization and accrued aircraft overhauls was $3,353,000 less because of a decrease in accrued overhaul costs.

Application of working capital totaled $81,876,000, with $36,403,000 invested in five Boeing 727 aircraft and other property and equipment and $22,793,000 advanced to manufacturers of four DC-10 aircraft and five spare engines which will be delivered in 1973. Additionally, $21,463,000 was used for scheduled repayment of long-term debt and $1,217,000 for the payment of cash dividends.

As a result, working capital decreased by $32,615,000, from $53,207,000 to $20,592,000. This decrease is primarily reflected in an increase of $12,423,000 in current liabilities and a decrease of $25,642,000 in cash, certificates of deposit, and short-term securities which totaled $55,382,000 at the close of 1972.

The company did not find it necessary to use any part of the $65 million line of credit which was arranged in 1972 (for details, see



Brief Statement of Earnings
(in thousands of dollars)

Western's revenues came from:	1972	1971	Change
Passengers			
Coach	$316,908	$272,038	+16.5%
Deluxe	25,943	23,769	+ 9.1
	342,851	295,807	+15.9
Express, freight, and baggage	15,819	15,075	+ 4.9
Mail	5,000	5,156	− 3.0
Charter	2,100	4,284	−51.0
Interest income	2,832	3,190	−11.2
Other income	5,075	5,274	− 3.8
Provisions for mutual aid payments	(5,181)	—	
	368,496	328,786	+12.1

Western's expenses were for:	1972	1971	Change
Wages and salaries	126,618	111,584	+13.5
Social security, group insurance and retirement plans	20,664	15,491	+33.4
Aircraft fuel	40,137	38,663	+ 3.8
Depreciation and amortization	36,224*	35,144	+ 3.1
Materials and repairs	19,808	20,487	− 3.3
Food and beverages	18,584	14,644	+26.9
Utilities and services	18,343	16,600	+10.5
Commissions	12,949	10,067	+28.6
Advertising and publicity	11,156	10,191	+ 9.5
Interest, net of amounts capitalized	8,787	11,162	−21.3
Landing fees	7,519	6,824	+10.2
Property, fuel and other taxes	6,759	7,163	− 5.6
Rentals of ground facilities	6,275	5,793	+ 8.3
Insurance and related costs	5,285	5,869	−10.0
Rentals of flying equipment	4,135	3,843	+ 7.6
Other costs	7,737	6,764	+14.4
Taxes on income	8,600	4,925	+74.6
Amortization of investment tax credits	(2,300)	(2,325)	− 1.1
	357,280	322,889	+10.7
Earnings before extraordinary gain	11,216	5,897	+90.2
Extraordinary gain—net	—	560	
Net earnings	$ 11,216	$ 6,457	+73.7

*Includes writedown of Boeing 720 nonfan aircraft amounting to $1,000 ($500, or $0.04 a share, after taxes).

Brief Balance Sheet
(in thousands of dollars)

Western owns:	1972	1971	Change
Cash, certificates of deposit, and short-term securities	$ 55,382	$ 81,024	− 31.6%
Receivables due from others	28,760	22,943	+ 25.4
Flight equipment expendable parts	10,456	9,733	+ 7.4
Buildings and improvements, net	12,290	12,955	− 5.1
Flight and other equipment, net	201,967	196,635	+ 2.7
Deposits on purchase contracts	24,772	7,148	+246.6
Prepaid expenses	4,332	5,422	− 20.1
Equipment not used in operations, net	2,952	2,214	+ 33.3
Deferred charges and other	1,620	2,278	− 28.9
	342,531	340,352	− 0.6

Western owes:	1972	1971	Change
Payables due to vendors and others	50,032	39,171	+ 27.7
Federal income taxes—deferred	19,033	19,433	− 2.1
Unamortized investment credits	12,596	12,271	+ 2.6
Tickets sold but not yet used	6,843	5,281	+ 29.6
Other deferred items	5,354	4,296	+ 24.6
Notes payable—current and long-term	151,950	173,503	− 12.4
	245,808	253,955	− 3.2
Excess of what is owned over what is owed, or shareholders' equity	$ 96,723	$ 86,397	+ 12.0

Note 3 of the Notes to Financial Statements).

Long-term debt, exclusive of current maturities amounting to $21,463,000 reflected under current liabilities, totaled $130,487,000 and consisted of $38,925,000 of installment notes to a bank, $62 million of installment notes to insurance companies, and the 5¼ percent Convertible Subordinated Debentures amounting to $29,562,000. Although the bank loan agreement does not require Western to maintain compensating balances, it is Western's practice to maintain deposits approximating 15 percent of borrowings under its loan agreement with each of the participating banks.

Annual Meeting

The 1973 meeting of shareholders will be held at the Beverly Hilton Hotel, Beverly Hills, California, on April 26. On or about March 26, formal notice of the meeting and proxy material will be mailed to each stockholder.

Corporate Award

Western received for the third consecutive year an award from the Financial Analysts Federation for excellence in corporate reporting during 1971. The company was one of only four 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, reports to stockholders and interviews with financial analysts.

Dividends

At a special meeting held in August, your board of directors voted to resume payment of dividends by declaring a cash dividend of 10 cents a share on pre-split shares (four cents on split shares) which was paid on September 12. An additional cash dividend of five cents a share on the split shares was paid on November 28.

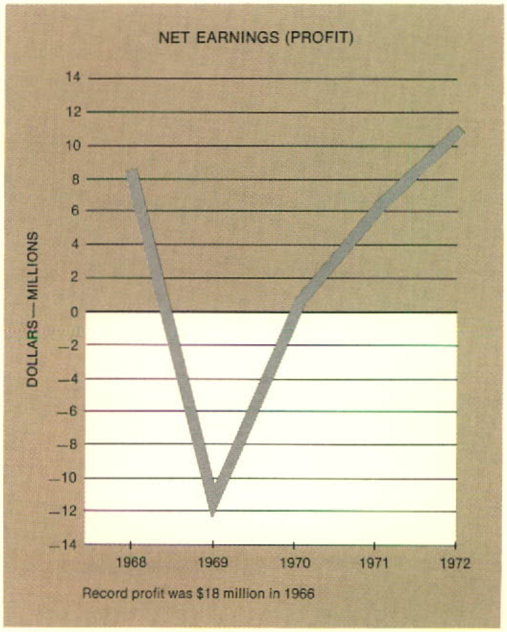
In September 1972, Western's board of directors expressed by resolution its intention to declare regular quarterly dividends, consistent with sound business principles, either in cash, stock or a combination of cash and stock, equivalent on the average to 50 percent of earnings.

At its first regular quarterly meeting of 1973, the board of directors voted a stock dividend of three percent. The value of the stock dividend on the day it was declared plus the two cash dividends paid in 1972, amounts to somewhat more than 50 percent of 1972 earnings.

At the same meeting, the board also voted a cash dividend of five cents a share. Both dividends are payable on April 10 to shareholders of record on February 20.

Shareholders, Stock and Debentures

On September 6, 1972, at a special meeting of shareholders, a proposal by the board of directors to increase authorized stock from 10 million shares to 25 million shares and to split outstanding shares 2½-for-one was overwhelmingly approved. The split increased the

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"Determine that the thing can and shall be done, and then we shall find the way"

—Abraham Lincoln

Senior members of Western's management team are UPPER LEFT — Executive Vice President Dominic P. Renda (center) with members of corporate planning department. LOWER LEFT—Charles J. J. Cox (left), senior vice president-finance, with Eugene D. Olson, vice president-data processing and systems. UPPER RIGHT—Arthur F. Gardner, senior vice president-operations, conducts on-time meeting which is attended daily by key members of executive staff to analyze previous day's operation. LOWER RIGHT—Senior Vice President-Marketing Philip E. Peirce (second from left) discusses return of "Very Important Bird" television commercials with members of advertising department.

number of Western shares outstanding from 5,404,000 to 13,511,000.

Adjusted for the three percent stock dividend, there were 13,926,000 shares outstanding at the end of 1972 and 2,279,000 shares were reserved for conversion of the 5¼ percent Convertible Subordinated Debentures. The conversion price is $12.97 per share. Holders of the debentures receive interest payments on February 1 and August 1.

The company's stock was held by approximately 10,500 shareholders at year end.

At the 1972 annual meeting of shareholders in Beverly Hills in April, nearly 79 percent of all shares were represented in person or by proxy.

Shareholders' equity at December 31, 1972, was $96,723,000, or $6.95 a share, compared to $86,397,000, or $6.22 a share, at December 31, 1971.

Equipment and Facilities

At the end of 1972, Western operated 71 jet aircraft, compared to 69 at the end of 1971.

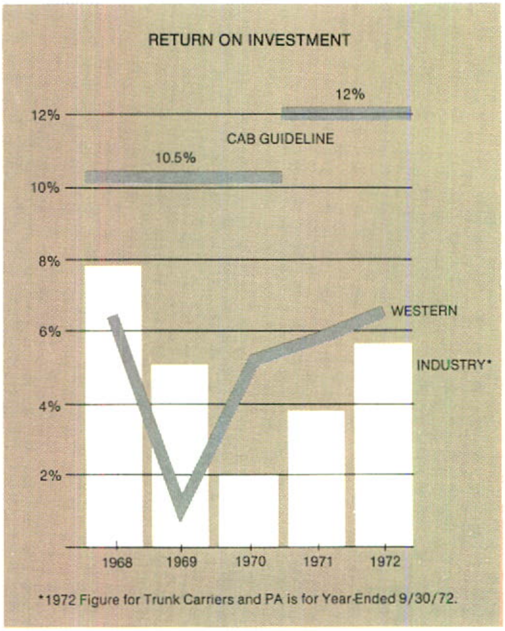
During the year, five Boeing 727-200s (extended version) were added to the fleet. In September 1972, three Boeing 720s which do not have the fanjet engines were removed from scheduled service and were transferred to "Flight equipment for sale" under Deferred Charges and Other Assets on the Balance Sheet. Three Lockheed Electras, which are leased to others, are carried in the same account.

In early 1972, Western converted its five Boeing 707s to the "wide-body look" by installing sculptured wall panels, sculptured ceilings with indirect lighting and overhead baggage compartments instead of hat racks to make them more competitive with the wide-body jets. The five Boeing 727s which Western acquired in 1972 are all equipped with these modern interiors. The company plans to convert its six leased 727s to the same interior late this year.

With the termination of the merger agreement with American, Western assumed responsibility for the purchase of the four DC-10s that had been ordered by American contingent upon successful consummation of the proposed merger. The purchase agreement between Western and the manufacturer provided that if the merger were not approved, the four DC-10s would be acquired by Western and that Western would pay the progress payments on the aircraft which would have been due at an earlier date had Western ordered the aircraft originally. Payments of $16.9 million, including interest payments of $700,000, were made in August and an additional $6.6 million was paid during the balance of the year.

One of the DC-10 aircraft will be delivered in April, two in June and one in July. All four aircraft will go into service by August 1 on long-haul, high-density routes where the company is now competing with wide-body jets or expects to in the near future.

In connection with the operation of DC-10



"A fair exterior is a silent recommendation"

—Publilius Syrus

As each of Western's facilities needs refurbishing, it is redecorated in the company's modern, bright and efficient "new look," typified by this ticket counter at Los Angeles International Airport.

aircraft, Western expects to expend substantial sums for airport terminal building improvements, a hangar addition and other related facilities that will be required to efficiently operate and service these new-generation aircraft. Included will be a single "high bay" hangar and an employee parking structure at the company's Los Angeles International Airport headquarters at an estimated cost of nearly $10 million, a $6 million expansion of passenger terminal facilities to provide four DC-10 gates at Los Angeles International Airport and major modifications of terminal facilities to accommodate the DC-10s at San Francisco, Minneapolis-St. Paul, Denver and Seattle-Tacoma.

Western's Jet Fleet

	Owned	Leased
DC-10	4*	—
B707-300C	5	—
B720B	25	—
B727-200	5	6
B737-200	30	—

*To be delivered in April, June (2) and July 1973.

Marketing

Western carried a record 6,931,000 passengers in 1972, an 11.7 percent increase over the previous year. Passenger load factor for the year increased 4.5 points to 58.2 percent, its highest level since 1966.

Passenger loads were increased by strikes which affected operations of a competing regional carrier in the first quarter and of a competing trunk carrier from July through September. However, these gains were offset in part by the suspension of the company's authority to serve Juneau and Ketchikan, effective February 7, 1972. Traffic to these two Alaska cities had accounted for three percent of the company's total revenues during 1971.

Highlighting the company's marketing programs during the year were:

. . . continued advertising and promotion of first class legspace for every passenger on every flight, a Western feature that no other major carrier offers;

. . . increased emphasis on providing our passengers with the best on-time performance in the industry;

. . . a quality of total service both on the ground and in the air to give Western the best record in the industry in customer reaction;

. . . and, in order to emphasize the company's overall attitude of hospitality and sincerity for the comfort of its passengers, champagne service was selected as the company's major marketing theme for the year.

Enhanced by the teamwork and enthusiasm of the company's employees, each of these major programs was carried out efficiently and effectively.

Reaction of coach and economy passengers (who represent approximately 88 percent of the nation's air travel) continues to be enthusiastic.

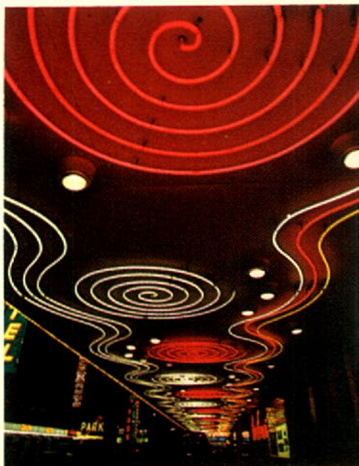
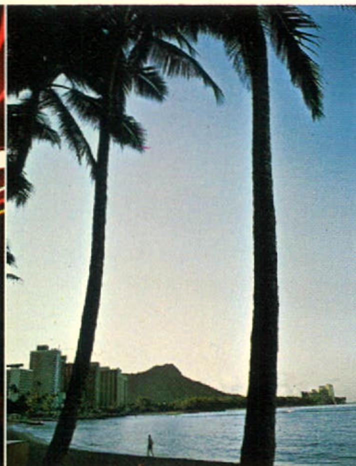
In its efforts to achieve the best possible on-time performance, your company's executive staff—president, division heads and appropriate department heads—meet every weekday at 8 a.m. to analyze the previous day's operations. As a result, based on Civil Aeronautics Board standards, Western was No. 1 in the industry in on-time performance for 1972.

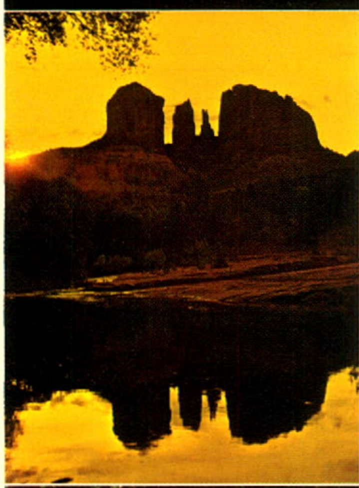
Among the methods your company uses to determine customer attitudes toward its service is careful evaluation of commendations and complaints to the company and to the Civil Aeronautics Board. In 1972, the trend of both commendations and complaints addressed to the company was highly favorable. For example, Western had fewer complaints filed with the CAB than any other trunkline and had one of the lowest ratios of complaints per 100,000 passengers carried in the industry.

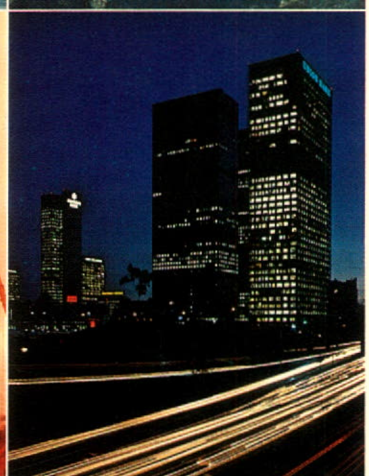
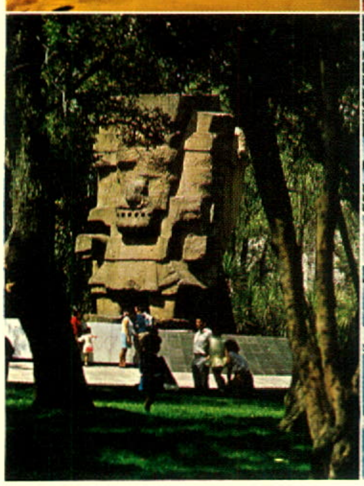
As in the past, Western continued to stress in its marketing programs the many attractive leisure destinations that we serve. In 1972, your company carried more passengers between

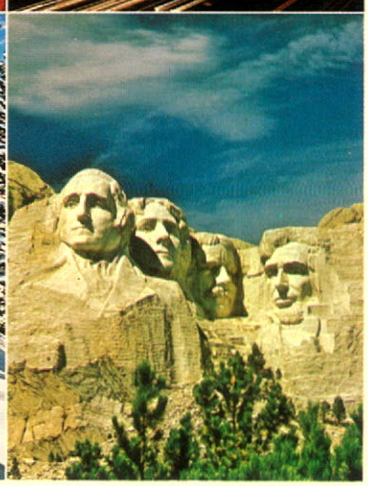
"The use of travelling is to regulate imagination by reality, and instead of thinking how things may be, to see them as they are"

— Samuel Johnson






Western
52
Ticket
Purchase

"Society is built upon trust, and trust upon one another's integrity"

—Robert South

the U.S. and Mexico than any other U.S. carrier, was the leading carrier between Alaska and the 48 contiguous states, and again was third in total traffic in the highly competitive Mainland-Hawaii market.

For 1973, your company has geared itself to be even more aggressive and innovative in pursuit of larger market shares and higher load factors.

Late in 1972, the sales and service divisions were combined into a new marketing division that also integrated product research and development and all phases of marketing into one closely knit organization. Introduced late in the year was a new internal program that encourages every employee and family member to participate more actively in selling Western's services and to receive appropriate recognition for those efforts. The program is called "Team Up." It was introduced to employees and their families by 11 teams of company officers who held meetings in every city on the system.

During 1973, Western plans to intensify its seasonal vacation-selling campaigns such as Ski Western's World, North Country Adventures and Take a Sunbreak.

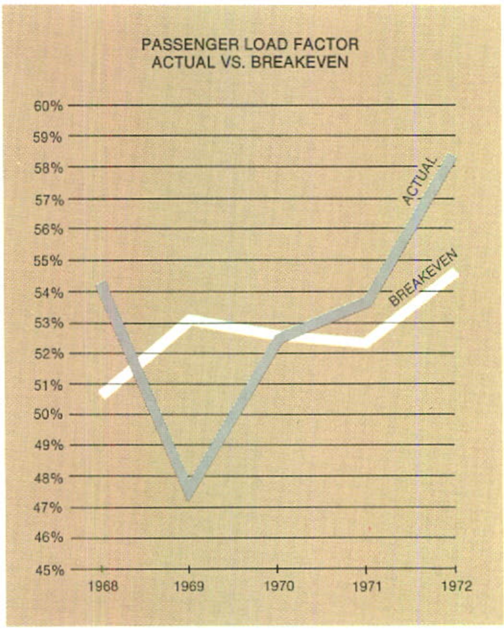
Western continues to be the industry leader in ethnic marketing. In California, for example, your company advertises in black-oriented newspapers and radio stations, Spanish-language newspapers and television, and both Japanese and Chinese-language newspapers.

The company will continue to develop group travel which maintains a steady growth, particularly in the leisure markets Western serves. A close working relationship also continues with travel agents and tour operators — who in 1972 accounted for 42 percent of the company's passenger sales.

One of the most significant developments in group travel is a "Travel Group Charter" concept approved by the Civil Aeronautics Board in 1972. Western does not plan at present to operate these charters, but instead intends to compete aggressively against them and to sell our own product which in many respects is superior. Our program will be to explain through advertising that, as a result of the complexities of the travel group charters, a passenger may be far better off to select one of Western's more reliable group package plans.

Aiding our efforts in all of these areas will be the introduction of the four DC-10s that will go into service in the summer of 1973. The additional capacity of these large wide-bodied aircraft (239 seats vs. 137 for the largest aircraft now in our fleet and much greater cargo capacity) will permit the company to gain a larger share of available passengers and air cargo during peak travel periods without increasing frequency.

Your company also will continue to expand its services to our customers who purchase travel through the use of Western's own "TravelCard" and other credit plans. In 1972, credit purchases on all credit plans utilized by



our customers increased 20 percent to a total of $95,759,000, or 29 percent of total passenger sales.

Personnel

As of December 31, Western had 9,676 employees, compared to 9,039 at the end of 1971.

Wages and salaries for 1972 amounted to $126,618,000 (37.0 percent of operating expenses) compared to $111,584,000 (36.1 percent of operating expenses) in the previous year. Company contributions to Social Security, group insurance and employee retirement plans increased 33.4 percent to $20,664,000.

Approximately 85 percent of the company's employees are represented by four unions. Following is the contractual status for each group of these employees.

Employee Group	No. of Employees on 12/31/72	Contract Open for Amendment
Clerical, Office, Fleet & Passenger Service	3,673	October 1, 1972 (in mediation on date of this report)
Pilots	1,222	March 1, 1973
Dispatchers	39	June 30, 1973
Mechanics & Related Employees	1,830	November 16, 1973
Stock Clerks	117	November 16, 1973
Flight Attendants	1,312	April 1, 1974

Management Changes

Elected to the board of directors at the board's October meeting was Walter J. Hickel, former Secretary of the Interior and governor of Alaska. Hickel succeeded William Boyd, who resigned effective September 15, 1972.

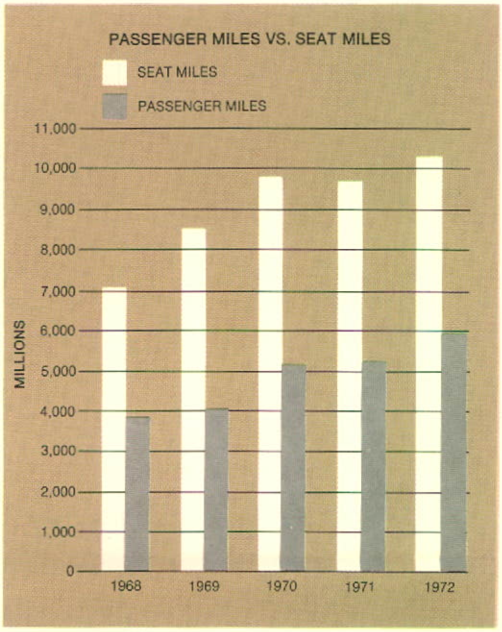
At its first meeting of 1973, the board of directors elected Arthur F. Kelly, a veteran of 35 years with the company, president and chief executive officer to succeed J. Judson Taylor, 64, who was elected vice chairman at the same meeting.

Mr. Kelly, who had been promoted from senior vice president-marketing to executive vice president in October, joined the company in 1937 as a regional manager. He was elected vice president in 1949, a senior vice president in 1965 and to the board of directors in 1968.

Also elected a vice chairman at the October directors' meeting was Stanley R. Shatto, former executive vice president-transportation. Mr. Shatto, 64, had headed up the company's operations division since 1947.

Returning to Western as an executive vice president on January 1, 1973, was Dominic P. Renda, a veteran of 27 years in the air transportation industry. Mr. Renda had served with Western at the executive level from 1946 to 1968 and for the past five years has been senior vice president-international and public affairs of Continental Airlines and president of Air Micronesia. At the board of directors' first meeting of 1973, Mr. Renda also was elected to the board succeeding Edwin W. Pauley who resigned and was named a director-emeritus.

Other officers elected to increased responsibilities during 1972 were: Charles J. J. Cox to



senior vice president-finance from vice president-finance; Arthur F. Gardner to senior vice president-operations from line captain; Gerald P. O'Grady to senior vice president-legal and secretary from vice president-corporate affairs and secretary; Philip E. Peirce to senior vice president-marketing from senior vice president-service; Richard O. Hammond to vice president and treasurer from treasurer and assistant secretary; Roderick G. Leith to vice president and controller from assistant treasurer and controller; and Robert Leinster from assistant vice president-service (staff) to vice president. In January 1973, Robert O. Kinsey, formerly vice president and assistant to the president, was named vice president-corporate planning.

Regulatory Matters

Merger Case—On July 28, 1972, the Civil Aeronautics Board denied the application of Western and American Airlines for approval of a merger that had been proposed in an agreement reached in late 1970. The CAB indicated that the application was denied principally because approval of the merger would have given American routes to Hawaii from the western states which would have been inconsistent with the CAB's 1969 decision on Transpacific route patterns.

Alaska Service Case Appeal—In December 1971, the CAB suspended effective February 7, 1972, the company's authority to serve Ketchikan and Juneau for a period of seven years. Western appealed the decision to the U.S. Court of Appeals for the District of Columbia Circuit seeking a reversal of the CAB decision on the grounds that the agency exceeded its statutory authority and set a dangerous precedent when it took away from one carrier a profitable, permanently certificated route not for the purpose of correcting any deficiencies in service but for the purpose of providing financial assistance to another carrier. Arguments before the court were completed on June 16, 1972, but at the time this report was written no decision had been announced.

The Miami-Los Angeles Competitive Nonstop Case—Western is an applicant, along with eight other carriers, for competitive authority on the Miami-Los Angeles nonstop route which is now served exclusively by National Airlines. Hearings in the case were completed on February 12, 1973. A final decision is not expected until late in 1973 or early 1974.

Reopened San Diego Service Case—In 1970, Western was awarded authority to provide the first nonstop service between San Diego and Denver and inaugurated the service in June of that year. In April 1971, the CAB ordered further hearings to receive additional evidence on the question of authorizing competition over the route. On December 12, 1972, the CAB decided to permit Western to continue to operate the route on an exclusive basis.

Certain parties have requested the CAB to reconsider and reverse its December action and to authorize a competing carrier over the route. Such requests remain pending at the time of the writing of this report.

Las Vegas/Reno—Portland/Seattle Nonstop Service Investigation—Western is an applicant for the nonstop service between Las Vegas and Portland/Seattle, between Reno and Portland/Seattle and between Las Vegas and Reno. The administrative law judge's initial decision issued in January 1971, concluded that Western should be authorized to operate between Las Vegas and Portland/Seattle, that another carrier should be authorized to operate between Reno and Portland/Seattle and that Western's request for authority to operate between Las Vegas and Reno should be denied. Upon review, the CAB remanded the case to the administrative law judge for further proceedings. Hearings were completed on February 15, 1973. A final decision is not expected until late 1973 or early 1974.

"Eternal vigilance is the price of liberty"

—John Philpot Curran

Strict security measures, including checkpoints similar to this one at Los Angeles International Airport, are in effect at all Western facilities and airports served by the company.

Ten Years of Growth

Financial	1972/1971	1972	1971	1970
Revenues:[7]				
Passenger	+ 15.9%	$ 342,851	295,807	274,792
Express, freight and excess baggage	+ 4.9	15,819	15,075	13,993
Mail	− 3.0	5,000	5,156	4,752
Other	− 24.9	7,174	9,557	7,272
Provisions for mutual aid payments		(5,181)	—	(2,700)
Total Revenues	+ 12.3	365,663	325,595	298,109
Operating Expenses:[7]				
Depreciation and amortization	+ 3.1	36,224	35,144	36,583
Payroll	+ 13.5	126,618	111,584	100,629
Other	+ 10.2	179,214	162,561	149,086
Total Operating Expenses	+ 10.6	342,056	309,289	286,298
Operating Income (Loss)[7]	+ 44.8	23,607	16,306	11,811
Interest expense, net of amounts capitalized[7]	− 21.3	(8,787)	(11,162)	(14,586)
Other Income and Expenses—Net[7]	− 19.6	2,696	3,353	1,120
Earnings (loss) before extraordinary gains and taxes on income[5,7]	+106.1	17,516	8,497	(1,655)
Taxes on Income (Tax Credits)[7]	+142.3	6,300	2,600	(2,250)
Earnings (loss) before extraordinary gains[5,7]	+ 90.2	11,216	5,897	595
Extraordinary gains (less applicable income taxes)[5,7]		—	560	—
Net Earnings (Loss)[7]	+ 73.7	$ 11,216	6,457	595
Primary earnings (loss) per share before extraordinary items[2,5]		$ 0.81	0.42	0.04
Primary net earnings per share[2]		$ 0.81	0.46	0.04
Fully diluted earnings (loss) per share before extraordinary items[5]		$ 0.74	0.41	0.04
Fully diluted net earnings (loss) per share		$ 0.74	0.45	0.04
Return on investment %[6]		6.35	5.93	5.22
Cash dividends paid per share[3]		$ 0.09	—	—
Stock dividends paid per share (3% in April 1973)		—	10%	—
Shares outstanding—actual[7]	+150.6	13,521	5,395	4,904
—adjusted[7]	+ 0.2	13,926	13,894	13,890
Shareholders' equity—total[7]	+ 12.0	$ 96,723	86,397	79,905
Shareholders' equity—a share		6.95	6.22	5.75
Working capital[7]	− 61.3	20,592	53,207	35,238
Long-term debt[7]	− 14.2	130,487	152,040	174,184
Property and equipment—net[7]	+ 10.3	239,029	216,738	247,426
Total assets[7]	+ 0.6	342,531	340,352	355,168
Operations				
Airplanes operated at end of year:				
Boeing 720-B		25	25	26
Boeing 707-300C		5	5	5
Boeing 737		30	30	30
Boeing 727-200—owned		5	—	—
Boeing 727-200—leased		6	6	6
Other		—	4	5
Airplane miles flown[7]	+ 5.2	90,925	86,425	86,298
Available ton miles[7]	+ 5.0	1,328,871	1,266,130	1,266,124
Revenue ton miles[4,7]	+ 12.9	675,825	598,448	584,554
Available seat miles[7]	+ 5.4	10,300,178	9,776,869	9,839,299
Revenue passenger miles[4,7]	+ 14.2	5,995,925	5,251,989	5,159,081
Express, freight and mail revenue ton miles[7]	+ 4.1	76,233	73,249	68,646
Passengers carried[4]	+ 11.7	6,930,874	6,206,440	6,187,527
Express, freight and mail tons carried	− 2.7	75,649	77,731	73,140
Passenger load factor—actual	+ 4.5 pts	% 58.2	53.7	52.4
—breakeven point	+ 2.2 pts	% 54.4	52.2	52.7
Average length in miles per passenger trip	+ 2.2%	865	846	834
Operating expenses per available seat mile	+ 5.1	$ .0332	.0316	.0291
Average revenue per revenue passenger mile	+ 0.2	$ .0578	.0577	.0542
Employees at end of year	+ 7.0	9,676	9,039	8,830

[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 the weighted average number of shares of the Company outstanding during the respective periods, adjusted to give retroactive effect to the 3% stock dividend declared January 22, 1973, the 2½-for-1 stock split effected September 13, 1972, 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 dividends and the stock splits.

1969[4]	1968	1967	1966[4]	1965	1964	1963
220,530	205,753	178,527	164,186	129,704	121,928	103,183
11,969	9,331	7,581	6,848	5,991	5,897	5,055
4,503	4,128	4,221	4,255	3,135	2,962	2,603
3,350	2,741	2,153	1,895	1,768	2,095	3,472
—	—	—	—	—	—	—
240,352	221,953	192,482	177,184	140,598	132,882	114,313
34,821	25,051	20,085	15,779	14,676	12,980	12,373
87,495	71,885	57,975	47,350	38,731	34,500	30,114
130,437	105,335	89,082	77,708	62,391	57,650	50,969
252,753	202,271	167,142	140,837	115,798	105,130	93,456
(12,401)	19,682	25,340	36,347	24,800	27,752	20,857
(14,748)	(6,536)	(3,011)	(3,239)	(2,553)	(2,491)	(2,916)
(125)	15	17	775	253	783	621
(27,274)	13,161	22,346	33,883	22,500	26,044	18,562
(15,075)	4,725	10,125	15,558	10,337	12,493	9,252
(12,199)	8,436	12,221	18,325	12,163	13,551	9,310
—	—	—	—	883	—	191
(12,199)	8,436	12,221	18,325	13,046	13,551	9,501
(0.88)	0.61	0.89	1.34	0.89	0.99	0.68
(0.88)	0.61	0.89	1.34	0.95	0.99	0.70
(0.88)	0.58					
(0.88)	0.58					
0.71	6.54	10.28	16.28	15.37	18.72	14.49
0.18	0.35	0.35	0.35	0.28	0.23	0.13
—	—	—	—	—	—	—
4,904	4,902	4,893	4,835	4,826	4,826	1,609
13,890	13,884	13,860	13,696	13,670	13,670	13,670
79,310	93,862	90,016	81,750	67,361	57,748	46,988
5.71	6.76	6.50	5.97	4.93	4.22	3.44
20,447	25,764	19,585	18,047	11,522	8,274	5,031
197,150	183,718	80,189	54,867	47,411	33,938	41,106
285,757	284,787	183,106	145,771	124,096	99,928	93,284
367,588	349,039	231,342	192,008	157,973	138,335	125,806
26	27	27	22	18	12	10
5	5	—	—	—	—	—
30	17	—	—	—	—	—
—	—	—	—	—	—	—
6	—	—	—	—	—	—
11	15	24	26	26	35	35
72,650	60,125	51,692	42,830	36,554	36,746	33,388
1,077,657	891,001	728,200	585,378	483,033	450,856	400,395
448,420	418,856	360,791	314,137	244,588	231,303	191,229
8,509,441	7,096,229	5,879,442	4,800,901	4,016,921	3,794,648	3,335,083
4,021,296	3,841,864	3,327,160	2,898,088	2,243,695	2,124,582	1,753,037
60,514	47,446	38,940	33,070	26,435	24,625	20,622
5,752,072	5,692,947	5,107,672	4,700,839	3,807,706	3,717,189	2,970,909
66,107	58,129	48,579	42,714	33,511	30,956	25,890
47.3	54.1	56.6	60.4	55.9	56.0	52.5
53.1	50.7	49.5	47.9	46.2	44.4	44.3
699	675	651	616	589	572	590
.0297	.0285	.0284	.0293	.0288	.0277	.0280
.0551	.0537	.0537	.0567	.0578	.0574	.0589
9,225	8,919	7,282	6,294	5,068	4,719	4,126

[4] Operations of a competing trunk carrier were substantially suspended from June 30, 1972, to October 2, 1972. Operations of a competing regional carrier were substantially suspended from December 15, 1971 to April 10, 1972. 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, 1972 and 1971
(in thousands of dollars)

ASSETS	**1972**	**1971**	**Change**
Current Assets:			
Cash	$ 10,506	$ 13,446	− 21.9%
Certificates of deposit	19,502	30,056	− 35.1
Short-term securities (at amortized cost, including accrued interest, which approximates market)	25,374	37,522	− 32.4
	55,382	81,024	− 31.6
Receivables (net of allowance for doubtful accounts of $475 in 1972 and $475 in 1971)	28,760	22,943	+ 25.4
Flight equipment expendable parts, at average cost less allowance for obsolescence of $5,371 in 1972 and $4,281 in 1971 *(Note 1)*	10,456	9,733	+ 7.4
Prepaid expenses	4,332	5,422	− 20.1
Total current assets	98,930	119,122	− 17.0
Properties and Equipment at Cost:			
Flight equipment	363,957	345,539	+ 5.3
Ground equipment	63,604	60,925	+ 4.4
Deposits on aircraft purchase contracts *(Notes 1 and 4)*	24,772	7,148	+246.6
	452,333	413,612	+ 9.4
Less allowance for depreciation and amortization (including reserves for overhauls of flight equipment of $18,164 in 1972 and $20,237 in 1971) *(Notes 1 and 9)*	213,304	196,874	+ 8.3
	239,029	216,738	+ 10.3
Deferred Charges and Other Assets:			
Flight equipment for sale	2,952	2,214	+ 33.3
Other items	1,620	2,278	− 28.9
	4,572	4,492	+ 1.8
	$342,531	$340,352	+ 0.6

See accompanying Notes to Financial Statements.

LIABILITIES AND SHAREHOLDERS' EQUITY	1972	1971	Change
Current Liabilities:			
Accounts payable	$ 20,726	$ 16,606	+ 24.8%
Accrued salaries, wages and vacation benefits	15,550	13,374	+ 16.3
Accrued liabilities	7,459	6,893	+ 8.2
Accrued income taxes	6,297	2,298	+174.0
Advance ticket sales	6,843	5,281	+ 29.6
Current maturities of long-term debt *(Note 3)*	21,463	21,463	—
Total current liabilities	78,338	65,915	+ 18.8
Long-Term Debt *(Note 3)*	130,487	152,040	– 14.2
Deferred Credits *(Notes 1 and 2):*			
Deferred federal taxes on income	19,033	19,433	– 2.1
Unamortized investment tax credits	12,596	12,271	+ 2.6
Reserves for overhauls of leased flight equipment	1,707	1,632	+ 4.6
Other	3,647	2,664	+ 36.9
	36,983	36,000	+ 2.7
Shareholders' Equity *(Notes 3, 6 and 8):*			
Common stock—$1.00 par value per share Authorized 25,000,000 shares Issued 13,521,000 and 5,395,000 shares	13,521	5,395	+150.6
Capital in excess of par value	21,951	29,750	– 26.2
Retained earnings	61,251	51,252	+ 19.5
	96,723	86,397	+ 12.0
Commitments and Contingent Liabilities *(Note 4).*			
	$342,531	$340,352	+ 0.6

Statement of Earnings

For the years ended December 31, 1972 and 1971
(in thousands of dollars)

	1972	1971	Change
Operating Revenues:			
Passenger	$342,851	$295,807	+ 15.9%
Express, freight and excess baggage	15,819	15,075	+ 4.9
Mail	5,000	5,156	– 3.0
Other	7,174	9,557	– 24.9
Provisions for mutual aid payments *(Note 7)*	(5,181)	—	
	365,663	325,595	+ 12.3
Operating Expenses:			
Flying operations	91,213	82,958	+ 10.0
Maintenance	37,102	39,422	– 5.9
Passenger service	40,964	34,652	+ 18.2
Aircraft and traffic servicing	69,390	58,173	+ 19.3
Marketing and administrative	67,163	58,940	+ 14.0
Depreciation and amortization *(Notes 1 and 9)*	36,224*	35,144	+ 3.1
	342,056	309,289	+ 10.6
Operating income	23,607	16,306	+ 44.8
Other Income (Expense):			
Interest expense	(10,240)	(11,278)	– 9.2
Interest capitalized *(Note 1)*	1,453	116	
Interest income	2,832	3,190	– 11.2
Other – net	(136)	163	
Earnings before taxes on income and extraordinary gain	17,516	8,497	+106.1
Taxes on income *(Notes 1 and 2)*	6,300	2,600	+142.3
Earnings before extraordinary gain	11,216	5,897	+ 90.2
Extraordinary gain net of income taxes *(Note 2)*	—	560**	
Net earnings	$ 11,216	$ 6,457	+ 73.7
Per share data *(Note 10)*:			
Primary:			
Earnings before extraordinary gain	$ 0.81	$ 0.42	
Net earnings	0.81	0.46	
Fully diluted (assuming conversion of the debentures):			
Earnings before extraordinary gain	0.74	0.41	
Net earnings	0.74	0.45	

*Includes write-down of Boeing 720 nonfan aircraft amounting to $1,000 ($500, or $0.04 a share, after taxes).

**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, 1972 and 1971
(in thousands of dollars)

	1972	1971
Sources of Working Capital:		
Earnings before extraordinary gain	$ 11,216	$ 5,897
Add back charges (credits) which did not affect working capital:		
Depreciation, amortization and provision for overhauls *(Notes 1 and 9)*	35,254	38,607
Taxes *(Notes 1 and 2)*:		
Deferred income taxes	(3,275)	2,600
Investment credits applied and deferred to future periods	5,500	1,200
Amortization of investment credits	(2,300)	(2,325)
Other	811	438
Total from operations before extraordinary gain	47,206	46,417
Extraordinary gain, after deducting credits of $1,960 which did not affect working capital	—	(1,400)*
Total from operations	47,206	45,017
Proceeds from disposition of property:		
Involuntary conversion of an aircraft	—	4,900*
Other	1,689	526
Exercise of stock options	236	35
Other	130	183
Total sources of working capital	49,261	50,661
Applications of Working Capital:		
Cash dividends	1,217	—
Purchases of property and equipment, net of deposits previously made	36,403	3,400
Deposits on aircraft purchase contracts *(Notes 1 and 4)*	22,793	7,148
Payments of long-term debt and transfers to current liabilities	21,463	22,144
Total applications of working capital	81,876	32,692
Increase (Decrease) in Working Capital	$ (32,615)	$17,969
Summary of Changes in Working Capital:		
Increases (decreases) in current assets:		
Cash, certificates of deposit, and short-term securities	$ (25,642)	$16,423
Inventories, receivables, and prepaid expenses	5,450	684
Decreases (increases) in current liabilities	(12,423)	862
Increase (decrease) in working capital	$ (32,615)	$17,969

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

See accompanying Notes to Financial Statements.

Statement of Shareholders' Equity

For the years ended December 31, 1972 and 1971
(in thousands of dollars)

	Common Stock $1.00 Par Value	Capital in Excess of Par Value	Retained Earnings	Shareholders' Equity
Balance at December 31, 1970	$ 4,904	$19,235	$55,766	$79,905
Exercise of stock options	1	34	—	35
10% stock dividend	490	10,481	(10,971)	—
Net earnings	—	—	6,457	6,457
Balance at December 31, 1971	5,395	29,750	51,252	86,397
Exercise of stock options	16	220	—	236
Conversion of debentures	3	88	—	91
2½ for 1 stock split *(Note 8)*	8,107	(8,107)	—	—
Net earnings	—	—	11,216	11,216
Cash dividends ($0.09 per share)	—	—	(1,217)	(1,217)
Balance at December 31, 1972 *(Notes 3 and 8)*	$13,521	$21,951	$61,251	$96,723

See accompanying Notes to Financial Statements.

Notes to Financial Statements

Note 1. Summary of Significant Accounting Policies.

a. **Depreciation Method:** Depreciation is provided by allocating costs of property and equipment, exclusive of estimated residual values, over estimated useful lives by using the straight-line method. See Note 9 for estimated useful lives.

b. **Preoperating Costs:** When new types of aircraft are introduced, major costs, principally related to training, necessary to put new aircraft into service are deferred and amortized during the estimated periods to be benefited.

c. **Reserves for Aircraft Overhauls:** The estimated future costs of airframe and engine overhauls are provided for by charges to maintenance expense based on hours flown.

d. **Interest Capitalized:** Interest related to deposits on aircraft purchase contracts with manufacturers is capitalized and amortized over the useful lives of the equipment.

e. **Investment Tax Credits:** Investment tax credits generated by acquisitions of assets to the extent used to reduce current and/or deferred taxes are amortized to income over the useful lives of the related assets.

f. **Obsolescence of Expendable Parts:** An allowance for obsolescence of flight equipment expendable parts is accrued over the useful lives of the related aircraft types.

Note 2. Taxes on Income: The 1972 and 1971 income taxes are summarized as follows (in thousands):

	1972	1971
Exclusive of taxes related to extraordinary gain:		
Current income taxes—		
Federal	$5,300	$ 150
State	1,075	975
Deferred income taxes (credit)	(3,275)	2,600
Investment credits applied and deferred to future periods	5,500	1,200
Amortization of deferred investment credits	(2,300)	(2,325)
	6,300	2,600
Related to extraordinary gain:		
Current income taxes	—	1,400
Deferred income taxes (credit)	—	(850)
	—	550
	$6,300	$3,150

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

Investment credits unapplied on tax returns amounted to $14,434,000 at December 31, 1972 ($17,308,000 – 1971) with $8,205,000 expiring in 1978 and $6,229,000 expiring in 1979.

Of the $12,596,000 unamortized investment credit balance at December 31, 1972 ($12,271,000 – 1971), $3,000,000 ($1,340,000—1971) remains from investment credits utilized by reduction of taxes paid and $9,596,000 ($10,931,000—1971) is related to investment credits not yet utilized for reduction of taxes paid.

The federal income tax returns for 1968, 1969 and 1970 are being examined by the Internal Revenue Service.

Note 3. Long-term Debt (Unsecured): At December 31, 1972, and December 31, 1971, long-term debt was as follows (in thousands):

	1972	1971
Senior Debt:		
Installment note* due December 31, 1975, with quarterly principal payments of $4,865. The interest rate is ¼ % over the bank's prime commercial rate	$ 58,388	$ 77,850
5¼ % installment notes due September 1, 1981, with annual principal payments of $1,000 from September 1, 1972, which will increase to $4,000 a year starting in 1976	27,000	28,000

	1972	1971
6⅝% installment notes due September 1, 1984, with annual principal payments of $1,000 from September 1, 1972, which will increase to $2,000 a year starting in 1975 and further increase to $7,000 a year starting in 1982 . . .	37,000	38,000
	122,388	143,850
Less current maturities . . .	21,463	21,463
	100,925	122,387
Subordinated Debt:		
5¼% convertible subordinated debentures due February 1, 1993, with sinking fund payments of $1,500 a year starting in 1979	29,562	29,653
	$130,487	$152,040

*The agreement under which the installment note to a bank is issued was amended in late 1972 to provide for an additional $65,000,000 line of credit. The new borrowings will be on a revolving basis until December 31, 1973, at which time the amount borrowed may be converted by Western into a term loan due June 30, 1979, and payable in substantially equal quarterly installments commencing March 31, 1976. The interest rate will be ¼% over the bank's prime rate until the end of 1973 when it will become ½% over the bank's prime rate prevailing during the remaining term of the loan.

The following schedule shows the amount of long-term debt maturing in each of the five following calendar years (assuming that $65,000,000 of funds available under the line of credit will be drawn down and converted into a long-term loan):

1973	$21,463,000
1974	21,463,000
1975	22,463,000
1976	25,460,000
1977	25,460,000

The financial agreements related to the senior debt 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. In addition, the Indenture for the debentures provides, among other things, a requirement restricting retained earnings from which cash dividend distributions can be made. Under the most restrictive requirements of these agreements, retained earnings not restricted from cash dividends were $10,387,000 at December 31, 1972 ($1,363,000—1971).

At December 31, 1972, 2,213,000 shares of common stock were reserved for conversion of debentures (2,279,000 shares at a conversion price of $12.97 a share after giving effect to the three percent stock dividend declared on January 22, 1973).

Note 4. 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 $4,000,000 at December 31, 1972 ($3,200,000—1971). Annual rentals through 1984 under a lease agreement covering six Boeing 727 aircraft aggregate $4,130,000.

At December 31, 1972, Western had on order four McDonnell Douglas DC-10 aircraft for delivery in April, June (two) and July 1973. The cost, including spare parts and five spare engines, is estimated to be $90,000,000 of which $22,793,000 has been paid in advance deposits.

At December 31, 1972, 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. In three such actions against the City of Los Angeles, judgments (one of which is being appealed) have been entered against the City for damages aggregating $1,184,000 to approximately 578 property owners on the theory of inverse condemnation. In another action wherein the plaintiff was awarded judgment against the City for $14,000, the court decided in favor of the airline cross-defendants on the issue of indemnification and the City has appealed such ruling.

Western is a defendant along with other domestic airlines in numerous actions seeking repayment and damages involving the collection of allegedly illegal fares. 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. Western and other domestic airlines are also defendants in various purported class actions including actions seeking refunds of alleged overcharges in construction of joint fares over interline routings. In the opinion of management, such action will not result in a material adverse effect upon Western's financial statements.

Note 5. Retirement Plans: Retirement plans cover all classes of employees except mechanics and related employees who are covered by a union sponsored plan toward which the company makes monthly contributions. Costs of company sponsored plans are funded annually as benefits accrue. Actuarial gains and losses and costs of changes in benefits are amortized over ten-year periods. The costs of all plans charged to operating expenses totaled $9,622,000 in 1972 and $6,504,000 in 1971. The increase in 1972 costs over 1971 costs was caused primarily by an increased number of pilots becoming eligible for coverage. The company's actuaries are of the opinion that the assets under each company administered plan exceed the related liabilities for the accrued vested benefits.

Note 6. Stock Options: The qualified stock option plan for officers is summarized as follows (adjusted for stock splits and stock dividends):

	1972		1971	
	Shares	Average per share	Shares	Average per share
Granted	17,382	$15.20	16,738	$12.20
Exercised . . .	25,542	9.25	3,811	9.17
Exercisable at end of year . . .	182,775	9.64	125,300	9.42
Outstanding at end of year . . .	311,248	9.90	319,408	9.56

An additional 186,809 shares were reserved at December 31, 1972, for the issuance of additional options.

Note 7. Mutual Aid Agreement: Western is a party to the Mutual Aid Agreement which provides for mutual financial aid in the event that any of the participating carriers is forced to suspend operations because of certain types of strikes. Operations of a competing trunk carrier were substantially suspended from June 30 to October 2, 1972, and operations of a competing local service carrier were substantially suspended from December 15, 1971, to April 10, 1972. Both of these carriers were parties to this agreement.

Note 8. Stock Split and Stock Dividend: An increase in authorized capital stock from 10,000,000 to 25,000,000 shares and a two and one-half for one stock split were effected September 13, 1972. The stock split, requiring issuance of 8,107,000 additional shares, was recorded by a transfer of $8,107,000 from capital in excess of par value to common stock.

On January 22, 1973, a three percent stock dividend, requiring issuance of 405,000 additional shares was declared payable on April 10, 1973, to shareholders of record on February 20, 1973. The dividend will be recorded in 1973 by a transfer from retained earnings of $405,000 to common stock and of $4,513,000 to capital in excess of par value.

Note 9. Depreciation and Amortization: The estimated useful lives over which costs of operating property and equipment are amortized are as follows: for the five Boeing 707-300C aircraft acquired in 1968, the thirty Boeing 737-200 aircraft acquired in 1968 and 1969, and the five Boeing 727 aircraft acquired in 1972, 12 years to a residual value of 15%; for the seventeen Boeing 720B aircraft acquired during 1961 to 1965, 10 to 15 years with a common retirement of December 31, 1975 and a residual value of $100,000 per aircraft; and for the eight Boeing 720B aircraft acquired in 1966 and 1967, 10 years to a residual value of $100,000 per aircraft. For ground equipment the useful lives range from four to ten years. For buildings and improvements on leased property the estimated useful lives are generally the period of the leases.

Note 10. Earnings per Share: Earnings per common share are based on the weighted average number of shares of common stock outstanding during the respective periods, adjusted when appropriate to give retroactive effect to stock splits and stock dividends including the 3% stock dividend declared on January 22, 1973. Earnings per common share assuming dilution from conversion of the debentures are calculated as if the debentures were converted at the beginning of the period with related adjustments to interest and income tax expense. Outstanding stock options have no material dilutive effect on earnings per common share.

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, 1972 and 1971 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, 1972 and 1971, 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.

Peat, Marwick, Mitchell & Co.

Los Angeles, California
February 16, 1973

Board of Directors

James D. Aljian
General Manager, Tracinda Investment Company, Beverly Hills, California
Fred Benninger
Chairman of the Board, Western Air Lines, Inc., Los Angeles, California
Chairman of the Board, Metro-Goldwyn-Mayer, Inc., Culver City, California
Chairman of the Board, MGM Grand Hotel, Inc., Las Vegas, Nevada
Hugh W. Darling
Senior Partner, 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
Actor-Producer, Beverly Hills, California
Director and Executive, Faberge, Inc., New York, New York
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President, Western Air Lines, Inc., Los Angeles, California
Peter M. Kennedy
Chairman, Dominick & Dominick, New York, New York
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Chairman of the Board, Linkletter Productions, Beverly Hills, California
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Chairman, Union Bank, Los Angeles, California
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Bellevue, Washington
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President, Mountain States Employers Council, Inc., Denver, Colorado

Directors Emeriti

Dr. Donald H. McLaughlin
Chairman of the Board, Homestake Mining Company, San Francisco, California
Edwin W. Pauley
Chairman of the Board, Pauley Petroleum, Inc., Los Angeles, California
John M. Wallace
Walker Bank & Trust Company, Salt Lake City, Utah
Sidney F. Woodbury
President, Pine Street Company, Portland, Oregon

In Memoriam

Alexander Warden, a director from 1950 until his retirement in 1968 and a director-emeritus since that time, passed away on March 7, 1973. His contributions to the development of the company are deeply appreciated by his friends and associates at Western.

Corporate Officers

Fred Benninger, Chairman of the Board
Arthur F. Kelly, President and Chief Executive Officer
J. Judson Taylor, Vice Chairman of the Board
Stanley R. Shatto, Vice Chairman of the Board
Dominic P. Renda, Executive Vice President
Charles J. J. Cox, Senior Vice President—Finance
Arthur F. Gardner, Senior Vice President—Operations
Philip E. Peirce, Senior Vice President—Marketing

Administration Division
Dominic P. Renda, Executive Vice President
Gerald P. O'Grady, Senior Vice President—Legal and Secretary
Robert O. Kinsey, Vice President—Corporate Planning
Lawrence H. Lee, Vice President—Industrial Relations
Ray Silvius, Vice President—Public Relations
Jack M. Slichter, Vice President—Government and Industry Affairs
Henry M. deButts, Vice President—Washington, D.C.
Ernest T. Kaufmann, Vice President—Regulatory Affairs
Charles S. Fisher, Assistant Vice President—Product Planning
H. S. Gray, Assistant Treasurer—Financial Planning
Thomas J. Greene, Assistant Secretary
Neil S. Stewart, Assistant Vice President—Government Affairs
Dan A. Zaich, Assistant Vice President—Labor Relations

Finance Division
Charles J. J. Cox, Senior Vice President—Finance
Richard O. Hammond, Vice President and Treasurer
Roderick G. Leith, Vice President and Controller
Jack P. Maginnis, Vice President—Procurement
Eugene D. Olson, Vice President—Data Processing and Systems

Marketing Division
Philip E. Peirce, Senior Vice President—Marketing
Willis R. Balfour, Vice President—Marketing, Passenger Sales
Robert Leinster, Vice President—Marketing, Passenger Services
Bert D. Lynn, Vice President—Marketing, Advertising and Sales Promotion
J. S. Neel, Vice President—Marketing, Pacific Rim Division
Harry L. White, Vice President—Marketing, Central-Hawaii Division
Luis Pasquel, Vice President—Sales and Service, Mexico
David E. Holt, Assistant Vice President—Marketing for Travel Agency and Vacation Sales
S. J. Rogers, Assistant Vice President—Marketing, Pricing/Budget

Operations Division
Arthur F. Gardner, Senior Vice President—Operations
Richard B. Ault, Vice President—Engineering
Harold W. Caward, Vice President—Flight Operations
Anton B. Favero, Vice President—Maintenance
Peter P. Wolf, Vice President—Communications
Joseph M. Fogarty, Assistant Vice President—Maintenance

Western Airlines Route System

ANCHORAGE

KODIAK

JUNEAU

KETCHIKAN

VANCOUVER

CALGARY

SEATTLE/TACOMA

GREAT FALLS

HELENA

PORTLAND

BUTTE

BILLINGS

MINNEAPOLIS
ST. PAUL

W. YELLOWSTONE

SHERIDAN

PIERRE

IDAHO FALLS

RAPID CITY

SIOUX FALLS

POCATELLO

CASPER

SACRAMENTO

CHEYENNE

SAN FRANCISCO
OAKLAND
SAN JOSE

RENO

SALT LAKE
CITY

DENVER

LAS VEGAS

LOS ANGELES
LONG BEACH
ONTARIO

PALM SPRINGS

PHOENIX

SAN DIEGO

HONOLULU

HILO

Service Temporarily Suspended by Order of Civil Aeronautics Board

MEXICO CITY

ACAPULCO

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 Listing

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

Debenture Listing

Listed and traded on
New York 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

*-As of May 1, 1973, Bank of America National Trust & Savings Association will replace Security Pacific National Bank as Los Angeles Transfer Agent and Chemical Bank will replace the Chase Manhattan Bank as New York Registrar. Thereafter, Bank of America National Trust & Savings Association will function as Los Angeles Registrar-Transfer Agent and Chemical Bank will function as New York Registrar-Transfer Agent.