Western Airlines 1979 Annual Report

WESTERN AIR LINES, INC.
1979 ANNUAL REPORT

HIGHLIGHTS OF 1979
(in thousands of dollars)

	1979	1978	Change 1979 vs. 1978
Operating revenues	**$932,119**	834,513	12%
Operating expenses	**913,883**	779,657	17
Operating income	**18,236**	54,856	−67
Other Income (Expenses):			
Interest expense, net	**(24,894)**	(20,179)	23
Gain on disposition of equipment	**31,332**	6,754	*
Other—net	**14,765**	3,924	*
Earnings before income taxes and cumulative effect of a change in accounting principle	**39,439**	45,355	−13
Income taxes	**(2,101)**	6,808	*
Earnings before cumulative effect of a change in accounting principle	**41,540**	38,547	8
Cumulative effect of a change in accounting principle	—	16,201	*
Net earnings	**$ 41,540**	54,748	−24
Passengers carried (000)	**11,191**	10,447	7%
Available seat miles (000,000)	**16,630**	16,255	2
Revenue passenger miles (000,000)	**10,495**	10,635	−1
Passenger load factor—actual (%)	**63.1**	65.4	−4
—breakeven (%)	**63.2**	61.1	3
—profit margin (point difference)	**(0.1)**	4.3	*

*Not computed.

Description of Business
Western Air Lines, Inc., is a certificated air carrier engaged in scheduled air transportation of passengers, cargo and mail. The company was organized in 1925 and currently serves 44 cities in 16 states plus the District of Columbia, Canada and Mexico. Western operates in competition with other airlines on nearly all route segments. It is regulated by the United States and foreign governments.

Cover:
Western inaugurated daily flights into Washington, D.C., through close-in National Airport, in June of 1979. Using 727-200s, Western offers twice daily nonstop service to Minneapolis/St. Paul and points west.

LETTER TO SHAREHOLDERS

Dominic P. Renda

Arthur F. Kelly

Fellow Shareholders:

Nineteen seventy-nine was a difficult year for Western and the airline industry. Western and most carriers in the industry were bombarded by a series of unexpected events, and earnings from operations dropped sharply. Profits for the industry declined from $1.2 billion in 1978 to approximately $340 million in 1979. Profit margins went from five cents on each dollar of revenue in 1978 to approximately one cent in 1979. In Western's case, although we had net income of $41.5 million, or $2.99 per share, our results from operations were disappointing. In fact, had we not taken prompt action during the year to control costs and improve yield, the operating results would have been even more disappointing.

The major problems faced by Western and others during the year were:

...the uncontrollable escalation in the price of jet fuel;

...the lengthy grounding of the industry's DC-10 fleet;

...new and increased competition on many of our most important routes, as the result of deregulation;

...a decline in traffic, particularly in leisure markets.

Although we had anticipated an increase in the price of turbine fuel during 1979, the amount of the increase—

from 40 cents per gallon in January to 74 cents per gallon in December—was much larger than expected.

As a result, we paid almost $71 million more for fuel in 1979 than we did in 1978, despite the fact that we used three million gallons less.

In an effort to offset these uncontrollable increases, we implemented a series of Civil Aeronautics Board-approved fare increases. Unfortunately, the Board's actions were not adequate to keep up with the continuing escalation in jet fuel prices and other major cost increases.

At the same time, we experienced a decline in traffic which we attribute to increased competition and a downturn in leisure travel.

This reduction of travel emerged in the third quarter and became even more pronounced in the fourth quarter.

Also frustrating and costly was the 38-day grounding of the DC-10s, which we believe was unjustified. Western operated only nine of the large tri-jets at the time of the grounding; however, they produced approximately 29 percent of the company's revenue passenger miles. We revised schedules for our remaining aircraft; unfortunately, we were able to salvage only a small amount of traffic normally carried by the DC-10s and the grounding proved very costly to Western. The company's DC-10s were inspected repeatedly in accordance with Federal Aviation Administration directives and were found to be completely free of the structural damages experienced by a few other carriers. Nevertheless, we were unable to persuade the FAA that the grounding was unnecessary or that the grounding order should have been lifted at an earlier date.

Early in 1979, we concluded that in the latter part of the year we would experience a slowing in traffic growth. As a result, we accelerated the retirement of our remaining four-engine Boeing 720B's, withdrawing them from the flight schedule in September. A short time later, we also made plans to speed up the retirement and sale of our five Boeing 707s which, like the 720B's, were made uneconomic by rising fuel prices. The 720B's have been sold; the 707s have been withdrawn from scheduled flying and are being offered for sale. At the same time, we also placed stringent controls on headcount and on other expenditures.

We were, of course, disappointed that the merger with Continental Airlines was not approved by the CAB. We continue to believe this consolidation would have been in the best interests of the two companies, their shareholders and the traveling public. With the denial of the merger, we increased our emphasis on expansion into long-haul international markets and, in particular, to England where Western had in process route applications to London from Anchorage, Minneapolis/St. Paul, Denver and Miami.

The administrative law judge in the Anchorage-London case has recommended that Western receive the route. The CAB's decision, which also must be approved by the President, is expected by late April.

On February 15, 1980, the CAB announced its decision in the "Wild Card Case," awarding a Minneapolis/St. Paul-London route to another carrier and overturning, as it did in the merger case, a decision by the administrative law judge that was favorable to Western.

On March 5, 1980, the United States and the United Kingdom announced a new agreement in which Denver, along with several other U.S. cities, was selected for a nonstop route to London, effective this spring. In the Wild Card Case, both the law judge and the CAB's Bureau of International Aviation had recommended that if the CAB should select Denver—rather than Minneapolis/St. Paul—that Western should be designated to operate the route. Western will be a vigorous applicant in whatever proceeding is instituted to determine the U.S. carrier to operate the Denver-London route in 1980.

In the Miami-London case, the administrative law judge recommended that another airline be given the authority for that route. However, under the terms of the new U.S.-U.K. agreement, a second U.S. carrier will be authorized to operate the route beginning in January 1981.

Nineteen eighty will be a difficult year for the airline industry. Western will be no exception. Traffic comparisons with last year, particularly in the first half, will be unfavorable. As a consequence, we reduced scheduled flying by nine percent for the first quarter and will continue to make appropriate adjustments to our level of seat mile production for the balance of the year.

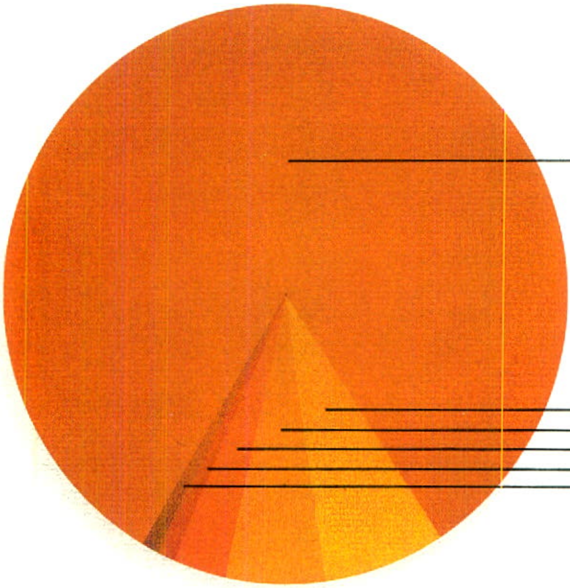
Our primary goals to which we are dedicating renewed effort are to schedule our aircraft more effectively, to produce a more competitive product on the ground and in the air and to outsell our competitors in order to make 1980 another profitable year for Western.

We shall do our very best to make the year a successful one and will appreciate your continued support in this endeavor.

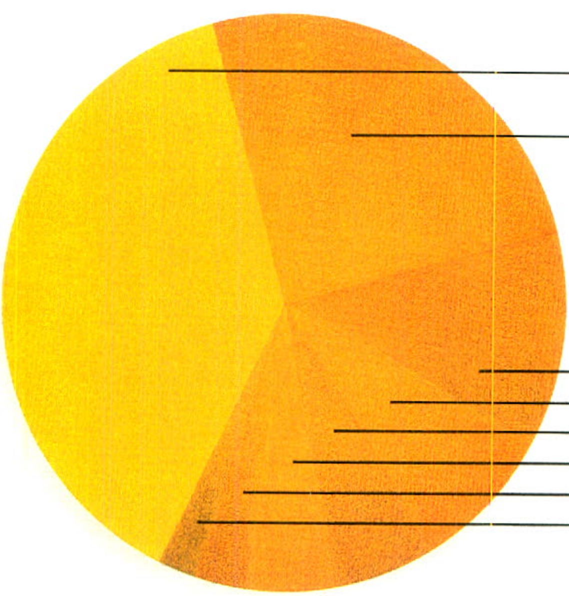
Arthur F. Kelly
Chairman of the Board

Dominic P. Renda
President and Chief Executive Officer

March 12, 1980



Revenue Dollar *(dollars in thousands)*		*Percent of total*
Coach passenger service	$764,874	82%
Deluxe passenger service	62,801	7
Cargo	61,209	6
Transport related	26,137	3
Charter	9,268	1
Other	7,830	1
	$932,119	100%



Expense Dollar *(dollars in thousands)*		*Percent of total*
Wages, salaries and employee benefits	$356,621	39%
Fuel	225,682	25
Other	111,231	12
Materials and services	75,980	8
Depreciation	50,058	6
Commissions	48,251	5
Food and beverages	28,675	3
Rentals	17,385	2
	$913,883	100%

Management's Discussion

1979 Versus 1978:
Western's net earnings for 1979 totaled $41.5 million, compared to earnings before the cumulative effect of a change in accounting principle of $38.5 million in 1978. The 1979 results included pre-tax gains of $31.3 million from the sale of aircraft and insurance proceeds from the loss of an aircraft and $10 million from a settlement with a vendor. In 1978, pre-tax gains from aircraft sales totaled $6.8 million. Net earnings of $54.7 million for 1978 included $16.2 million from the cumulative effect of a change in accounting principle.

Revenues:
Operating revenues for 1979 were $932.1 million, compared to $834.5 million for 1978. The increase resulted primarily from higher passenger and cargo yields. The following table shows the increases (decreases) in operating revenues and traffic:

	1979 Versus 1978		
	Increase (Decrease)		Percent of Total
	Amount	Percent	Increase
	(millions)		
Operating Revenues			
Passenger	$ 93.7	13	96
Cargo	4.2	8	4
Other (including charter)	(.3)	(1)	—
	$ 97.6	12	100
Revenue Passenger Miles			
48 States and Canada	300.6	5	
Mexico	197.5	27	
Alaska	(102.1)	(13)	
Hawaii	(326.5)	(12)	
Total Scheduled	69.5	1	
Charter (mostly Hawaii)	(209.5)	(47)	
Total System	(140.0)	(1)	
Cargo Revenue Ton Miles	(14.3)	(8)	

The passenger revenue growth reflects a 12 percent increase in the average revenue per passenger mile from 7.20 cents in 1978 to 8.07 cents in 1979. General fare increases accounted for approximately half of this growth while declines in discounted traffic and the low-yield Hawaii market accounted for the remainder. Discounted traffic represented 39 percent of the scheduled revenue passenger miles, compared to 42 percent in 1978.

Revenue passenger miles on scheduled flights increased only one percent over 1978. While a strike against United Airlines in April and May favorably impacted traffic, the gains were offset by the adverse effects of the grounding of all DC-10 aircraft for 38 days during the summer and a strike by Western's Mexico employees during the first 12 days of July.

The four percent growth in scheduled available seat miles came from additional aircraft and increased seating capacity, which were partially offset by the grounding. This increase, coupled with a one percent increase in scheduled revenue passenger miles, resulted in a scheduled load factor of 63 percent, down from the record 65 percent load factor of 1978.

Two of Western's four major market areas showed growth in scheduled service. Mexico had the largest rate of traffic growth for the year. Contributing to this growth was the Los Angeles-Guadalajara service, which was operated for the full year in 1979 but for only six months in 1978. A 26-day strike against Mexicana Airlines during the fourth quarter also enhanced Western's Mexico traffic.

The 48 States and Canada, the other growth market, continued to be Western's largest market, representing 62 percent of the 1979 revenue passenger miles, up from 58 percent in 1978. The growth rate in this market was five percent. New services—including Minneapolis/St. Paul to Washington, D.C.—accounted for 82 percent of that growth.

Favorably impacted in 1978 by a strike against Northwest Airlines, the Alaska market declined in 1979. New traffic over the San Francisco-Anchorage route, inaugurated in May 1979, did not offset the impact of the grounding nor overcome the inflated 1978 traffic volume.

The greatest decrease in scheduled revenue passenger miles occurred in Hawaii. The decline resulted from the DC-10 grounding and a planned reduction in available seat miles. Hawaii was the only Western market with fewer available seat miles in 1979 than in 1978.

Cargo revenue was up eight percent over the previous year as yield (revenue per cargo ton mile) increased 17 percent. An eight percent decrease in revenue ton miles—attributable primarily to the grounding and increased competition—partially offset the growth in yield.

Charter revenues declined 41 percent reflecting management's decision to curtail low-yield charter activity.

Expenses:
Operating expenses for 1979 were $913.9 million, compared to $779.6 million for 1978. The following table shows the increases (decreases):

	1979 Versus 1978		
	Increase (Decrease)		Percent of Total
	Amount	Percent	Increase
	(millions)		
Wages and salaries	$ 39.2	15	29
Employee benefits	8.0	14	6
	47.2	15	35
Fuel	70.8	46	53
Depreciation	3.0	6	2
Other			
Commissions	7.2	17	5
Services purchased	4.6	18	4
Advertising	3.0	22	2
Other	(1.5)	(1)	(1)
	13.3	5	10
Total operating expenses	$134.3	17	100
Available Seat Miles	375.6	2	

Higher jet fuel prices were responsible for over half of the increase. The average price per gallon increased from 38.6 cents in 1978 to 56.7 cents in 1979, and by December 1979, the price had jumped to 73.5 cents per gallon. Fuel costs thus rose 46 percent to $225.7 million for 1979, while fuel consumed decreased one percent.

The second largest component of the increase in operating expenses—wages, salaries, and employee benefits—rose to $356.6 million for the year. Approximately 60 percent of the rise was attributable to wage increases, 24 percent to increased personnel and 16 percent to work rules.

The acquisition of new aircraft during the year increased depreciation expense. This was partially offset by a reduction in depreciation of four-engine aircraft; Western's 720B aircraft became fully depreciated at the end of 1978.

Commissions to travel agents increased because of higher fare levels and increased sales made by travel agents. Almost 65 percent of total passenger sales were made by travel agents in 1979, compared to 60 percent in 1978.

Services purchased increased in the areas of janitorial, cleaning, security and other support services, and in credit card service fees. Support service increases resulted mostly from higher rates, while credit card service fees rose with higher sales volume.

Additional advertising expenses were incurred in the promotion of Western's new domestic routes.

The decrease in other expenses was attributable to $9.8 million paid to a struck carrier in 1978 under the Mutual Aid Agreement. This agreement was terminated effective January 1, 1979.

1978 Versus 1977:

Net earnings for 1978 were $54.7 million, compared to net earnings of $12.7 million for 1977. The change to the flow-through method of accounting for investment credits increased net earnings for 1978 by $29 million of which $16.2 million was the cumulative effect of the change on prior years.

Revenues:

Operating revenues for 1978 were $834.5 million, compared to $691.5 million for 1977. The following table shows the increases in operating revenues and traffic:

	1978 Versus 1977		
	Increase		Percent of Total
	Amount	Percent	Increase
	(millions)		
Operating revenues			
Passenger	$119.4	19	83
Cargo	9.3	20	7
Other (including charter)	14.3	49	10
	$143.0	21	100
Revenue passenger miles			
48 States and Canada	1,057.9	21	58
Hawaii	372.0	16	21
Mexico	210.8	40	12
Alaska	172.2	29	9
Total scheduled	1,812.9	22	100
Charter (mostly Hawaii)	233.1	109	
Total system	2,046.0	24	
Cargo revenue ton miles	19.0	12	

The increase in passenger revenue was attributable to a 22 percent growth in scheduled traffic over the previous year. Average revenue per passenger mile decreased from 7.34 cents for 1977 to 7.20 cents for 1978. General fare increases were more than offset by the increased use of discount fares. Discount revenue passenger miles for 1978 increased to 42 percent of the scheduled revenue passenger miles, compared to 33 percent for 1977.

Revenue passenger miles on scheduled flights increased significantly over 1977, in part because of a strike against a major competitor, Northwest Airlines, whose operations were substantially suspended from April 29, 1978, through August 15, 1978. Scheduled available seat miles increased by only seven percent over 1977. This, coupled with the 22 percent increase in scheduled revenue passenger miles, resulted in a scheduled load factor for 1978 of 65 percent compared to 57 percent for 1977.

Of the four major market areas, the greatest rate of growth in scheduled service was in Mexico, a reversal of a downward trend in traffic that had resulted from the devaluation of the peso in September 1976. The new Los Angeles-Guadalajara route inaugurated June 30, 1978, accounted for 44 percent of the growth and 12 percent of total passenger miles in the Mexico market.

The 48 States and Canada continued to account for the greatest portion of the scheduled market growth with 58 percent of the 1978 total.

Alaska routes, which had a slowing of traffic growth in 1977, experienced a 29 percent rate of growth in 1978, the increase coming primarily from discount traffic.

Scheduled revenue passenger miles in Hawaii markets had the lowest growth rate of all the markets for 1978, but with the inclusion of Hawaii charters—which represent 80 percent of system charters in 1978—the overall rate of growth for Hawaii equaled that of the 48 States and Canada.

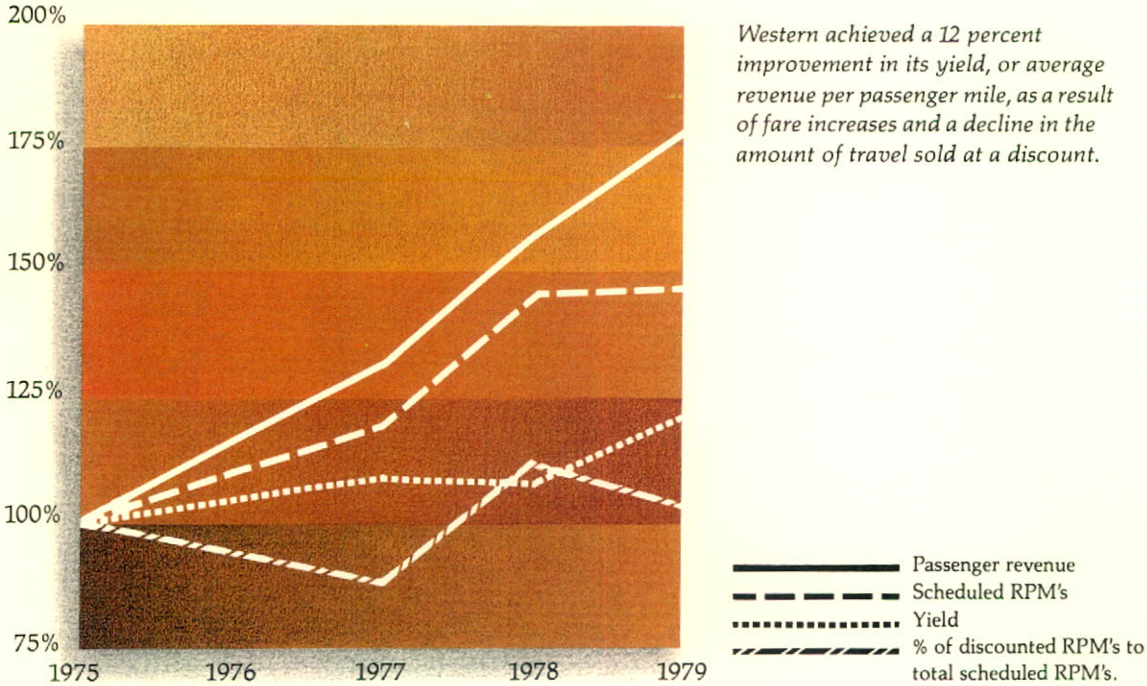
Cargo revenue increased 20 percent over 1977 as a result of the positive combination of a yield increase of 6.7 percent and a 12.1 percent increase in revenue ton miles.

Other revenue increased principally from expanded charter business in 1978. Charter traffic increased 109 percent and charter revenue increased 120 percent, accounting for 60 percent of the growth in other revenue.

Expenses:

Operating expenses for 1978 were $779.6 million, compared to $662 million for 1977. Wages, salaries and employee benefits totaled $309.4 million and fuel expense totaled $154.9 million.

Passenger Revenue—1975=100%



Western achieved a 12 percent improvement in its yield, or average revenue per passenger mile, as a result of fare increases and a decline in the amount of travel sold at a discount.

The following table represents increases in selected operating expenses:

	1978 Versus 1977		
	Increase		Percent of Total
	Amount	Percent	Increase
	(millions)		
Wages and salaries	$ 37.2	17	32
Employee benefits	9.1	19	8
	46.3	18	40
Depreciation	4.4	10	4
Fuel	16.9	12	14
Other			
Materials and repairs	9.6	25	8
Commissions	9.5	30	8
Services purchased	4.6	22	4
Food and beverage	3.5	15	3
Travel-flight crews	2.7	25	2
Passenger service claims	2.8	72	2
Communications	1.1	15	1
Other	16.2	20	14
	50.0	23	42
Total operating expenses	$117.6	18	100
Available Seat Miles	1,291.1	9	

Wages, salaries, employee benefits and fuel had the greatest dollar impact, accounting for 54 percent of the total operating expense increase over the previous year.

Higher rates of pay, resulting from scheduled periodic increases in collective bargaining agreements, were primarily responsible for 65 percent of the increase in wages and salaries.

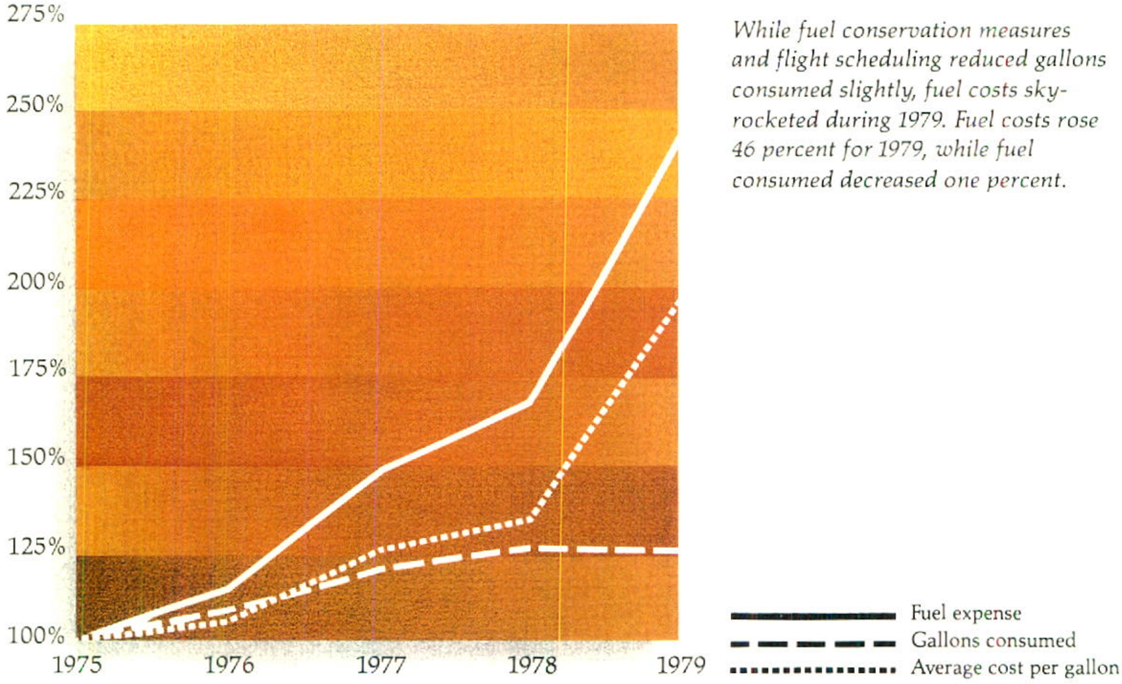
Employee benefit costs consist of pensions, group insurance and payroll taxes. Pension costs accounted for 51 percent of the increase in employee benefits and were up 21 percent over the previous year. Three quarters of this increase was due to improved benefits and higher wages while the balance was attributable to an increase in the number of employees. The cost of group medical, dental and life insurance rose by 15 percent. Payroll taxes increased 17 percent because of legislated rate increases and higher wage rates.

Depreciation expense increased with the acquisition of two DC-10 and five 727-200 aircraft during the first seven months of the year.

Fuel increased 12 percent, of which 54 percent was attributable to higher average prices and 46 percent to increased consumption.

Commissions to travel agents were higher as a result of two factors: increased traffic and an increase in sales by travel agents. Sales by travel agents were 60 percent of total passenger sales in 1978 compared to 57 percent in 1977.

Fuel Expense—1975=100%



While fuel conservation measures and flight scheduling reduced gallons consumed slightly, fuel costs sky-rocketed during 1979. Fuel costs rose 46 percent for 1979, while fuel consumed decreased one percent.

Services purchased were higher in 1978 primarily in two areas: credit card service fees and costs of security, janitorial, cleaning and other support services. Service fees were related to increased traffic and support services were related to higher rates.

Food and beverage expenses increased because of a growth in passenger traffic and to a lesser extent, from higher prices.

Flight crew travel expenses were up primarily as a result of a new contract requiring individual accommodations for flight attendant personnel while away from their home bases.

Passenger service claims were up because of increased passenger traffic, weather problems and changes in mandatory payments related to flight interruptions and baggage claims.

Communications expense increased with the installation of additional equipment, increased usage of communications facilities and higher service rates.

Other expenses increased by $16.2 million, attributable in the main to payments of $9.8 million to a struck carrier under the Mutual Aid Agreement.

Interest expense increased 15 percent, with the issuance of equipment trust certificates to finance the acquisition of one DC-10 and five 727-200 aircraft. The gain on sale of equipment reflects the sale of seven aircraft in 1978.

Shareholders and Stock

Western's net earnings per common share for 1979 were $2.99. The 1978 earnings per common share were $2.82 before inclusion of $1.27 per share from the cumulative effect of a change in accounting principle.

Holders of common stock were paid 40 cents per share through quarterly cash dividends of 10 cents per share in 1979 and 1978.

The 1979 net earnings increased shareholders' equity to $233 million at the end of the year, compared to $199 million at the end of 1978. Equity per share of common stock (or book value) was $15.56, compared to $12.96 at the end of 1978.

As of December 31, 1979, there were outstanding 13,030,483 shares of Western common stock held by approximately 18,000 individuals and institutions.

Western has 2,992,350 shares of common stock reserved for issuance upon conversion of its preferred stock and an additional 2,062,078 shares reserved for issuance upon conversion of its 5¼ percent Convertible Subordinated Debentures. Holders of the debentures receive interest payments on February 1 and August 1; as of December 31, 1979, the debentures were held by 528 individuals and institutions. The $2.00 Series A Cumulative Convertible Preferred Stock was held by 1,778 individuals and institutions who are paid dividends quarterly.

Western's common and preferred stock were traded on the New York Stock Exchange at the following prices:

	Common Stock		Preferred Stock	
1979	High	Low	High	Low
First Quarter	9⅞	7¾	28⅜	23¾
Second Quarter	9⅜	7⅞	26	23⅜
Third Quarter	12	8	30⅛	24
Fourth Quarter	11⅛	7⅜	28¼	21½
1978				
First Quarter	8⅜	7	25¼	23
Second Quarter	12⅜	7⅞	30½	23¾
Third Quarter	14⅝	10⅞	37	27
Fourth Quarter	11⅞	8⅛	31	25

Marketing

Western's marketing planners recognized early in the year that 1979 would be a "whole new ball game," and programs were geared for a bold introduction of Western in new markets and for holding market share in the face of new competition on existing routes.

The new Washington, D.C., flights, as well as those to Spokane and Milwaukee and new nonstop services between cities Western had long served, were entered with lively advertising programs and sales blitzes aimed at travel agents and commercial accounts. The "Big Red W" and Western's popular "Very Important Bird" were featured in newspaper and radio/television campaigns as Western made its debut in new markets.

Heightened foreign interest in the United States as the best value vacation destination enhanced the effectiveness of Western's worldwide and inter-airline marketing activities. Western actively participated in this activity through its marketing office in Tokyo, and direct representation by sales agents throughout Australia, Europe, the Middle East and Latin America. Advertising in travel agent and airline publications in these areas supported this effort.

New competition on Western's important domestic routes was anticipated, and it came as 15 airlines inaugurated new service over 30 of Western's routes. Competition for passenger and cargo business was keener than at any time in the company's history.

Intensified marketing activities by Western and others, along with the wide variety of discount fares, continued to strain the industry's reservations telephone capabilities. Recognizing the need for improved efficiency in handling telephone inquiries, especially those regarding fares, Western developed an innovative "Super Value Pricing" concept for its computerized reservations system in 1979. This industry "first" permits reservations sales personnel to immediately find the lowest fare and determine when seats are available at that fare on any flight segment. While improving service to potential customers, the new program has benefited Western by reducing the time spent on the telephone with "fare shoppers" by over 50 percent.

For many years Western has led the industry in recognizing the independent travel agent as its prime passenger marketing outlet. New vacation packages to Hawaii, Alaska, Canada, Mexico and Florida were introduced to encourage agents to sell the company's services. As a result, travel agents accounted for approximately 65 percent of the company's passenger sales during 1979, one of the highest ratios in the airline industry.

Western continues to seek new ways to improve the travel agent's ability to sell air travel. Working with the Bell System, Western has developed Direct Access Reservations Terminals (DART), a program designed specifically to provide for the first time the medium-to-small travel agency with inexpensive and efficient direct access to the airline's seat inventory, airfare quotes and booking capability. Introduced to the travel agent community in late 1979, DART met with early success as 200 units were ordered by travel agents within the first two months.

For larger travel agencies, Western serves as co-host with American Airlines in the installation of SABRE, a computerized reservations system that provides direct access to Western's reservations as well as other advantages.

Western has long been known for its success in leisure travel marketing. Seeking to balance this strength, the airline set the increasing of its share of the business travel market as a prime marketing objective in 1979. Specialized programs, such as membership in the VIB Club which offers unique customer discounts and amenities, were directed to frequent travelers and designed to make them familiar with Western's services. Selective approaches were also found effective in cargo marketing where Priority Reserved Freight and the Speedpak small package services were featured.

As part of its emphasis on preparing for the new era, and ensuring that it would have the best ideas and resources available, Western undertook a full-fledged advertising agency review in late 1979. Nearly 100 advertising agencies were considered for Western's $12.5 million account and six of the nation's top advertising companies were selected to make formal presentations. McCann-Erickson Inc. was appointed as a result of the evaluation and introduced its first campaign in early March 1980.

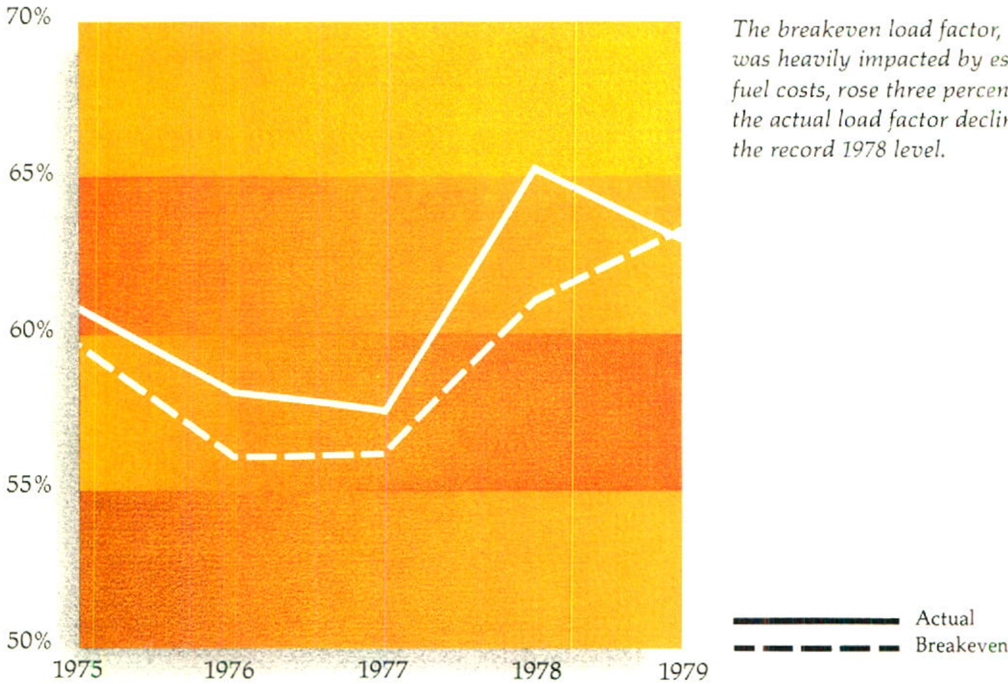
Pricing

Pricing of Western's product in terms of passenger fares and cargo rates presented a challenge requiring delicate balance in 1979.

The airline industry in 1979 found itself moving from an era of declining yields, brought about by the proliferation of deep discount fares, into one of escalating costs and heightened competition due to deregulation. Western determined early in the year that it must improve its yield, or average revenue per passenger mile, in order to cover increased costs and maintain profitability. At the same time, however, the company was determined to remain price-competitive in all markets.

By taking advantage of fare increases granted by the Civil Aeronautics Board during 1979 and by carefully limiting the availability of discount fares, Western was

Load Factor—Actual vs. Breakeven



The breakeven load factor, which was heavily impacted by escalating fuel costs, rose three percent while the actual load factor declined from the record 1978 level.

able to make improvements in its yield starting with the second quarter.

The Civil Aeronautics Board, taking into account the rises in the price of fuel and other commodities, allowed increases in basic fares over all routes in 1979. In total, these represented increases of 34 percent in the 48 states, 22 percent between the Mainland and Hawaii, and 19 percent between the Mainland and Alaska. With the concurrence of the foreign governments involved, fares were increased eight percent between the Mainland and Canada, 15 percent between Hawaii and Canada, and 20 percent between the U.S. and Mexico. However, most of the fare increases occurred in the second half of the year, and as a result the yield for the year was up only 12 percent but increased 19 percent in the third quarter and 27 percent in the fourth, compared to the same 1978 quarters.

While striving to improve its yields, Western has attemped to maintain its posture as a low fare carrier. Peak and off-peak pricing concepts were utilized throughout the year in certain markets, such as Las Vegas, where passengers who are willing to travel at less-popular flight times may do so at discounts.

New services, such as those to Washington, D.C., and Milwaukee, were inaugurated with half-price sales which in most cases ran for one month.

Competitive factors played a decisive role in Western's pricing programs during 1979. As new carriers inaugurated services over Western's routes, they too brought introductory price packages which Western had to meet in order to maintain its market share.

Since the Airline Deregulation Act of 1978 encourages competitive pricing, the public can expect to see a variety of price offerings with discount and promotional fares available during low travel periods.

Western's Fleet

	In Operation*	1980 Delivery	1981 Delivery	1982 Options
DC-10-10	10	2		3
727-200	39	5	3	5
737-200	21			

*As of February 15, 1980

Three DC-10s and twelve 727s are leased.

In response to the escalation of fuel prices and in anticipation of a slowing of traffic growth, Western moved decisively in 1979 to accelerate the retirement of its remaining four-engine aircraft while taking delivery on more fuel-efficient three-engine aircraft.

The last nine Boeing 720B's, out of a fleet that had once numbered 30, were retired and have been sold. In January 1980, Western's five Boeing 707s were removed from service and offered for sale.

These moves have given Western the most fuel-efficient fleet available today and a fleet that, with the exception of the two-engine 737s, meets federal noise regulations well in advance of the 1985 deadline.

Western has been an industry leader in terms of daily aircraft utilization. In 1979, the average daily revenue utilization for all aircraft types was 8 hours 55 minutes, up from 8 hours 38 minutes in 1978. As in previous years, Western continued to lead all DC-10 Series 10 operators with the 1979 figure standing at 11 hours 30 minutes.

Western's People

The people of Western Airlines have traditionally been its greatest strength, and, although involved in an increasingly complex and challenging business, Western's personnel continue to share a pride in the quality of service that has been Western's hallmark for 54 years.

Management: The management organization is headed by a board of directors which represents the business and civic interests of the major areas the company serves. Four of the 12 directors are Western officers. They are Arthur F. Kelly, 67, chairman of the board and of the board's executive committee; Dominic P. Renda, 66, president and chief executive officer; Robert O. Kinsey, 63, senior vice president-finance and administration, and Richard P. Ensign, 61, senior vice president-marketing.

During 1979, the board of directors elevated Mr. Renda to president and chief executive officer from president and chief operating officer.

Donald K. Hall was elected senior vice president, general counsel and secretary, upon the retirement of Gerald P. O'Grady. Mr. Hall, 61, had been with the Los Angeles law firm of Darling, Hall, Rae & Gute (Western's general counsel) since 1953 and while there had handled the Western account and had been involved in many phases of the company's legal matters.

Other principal officers of Western include Anton B. Favero, 66, senior vice president-operations; James L. Mitchell, 58, senior vice president-corporate planning; Richard O. Hammond, 50, vice president and treasurer, and Roderick G. Leith, 51, vice president and controller.

In addition to Mr. Hall, two of Western's senior officers have held positions outside the company within the last five years. Mr. Ensign held senior officer positions with Pan American World Airways, Inc., between 1971 and 1975, while Mr. Mitchell was a vice president at Continental Airlines between 1968 and 1977. Both had previously served as officers of Western.

Employees: Western employed an average of 11,256 people during 1979, compared to 10,787 during 1978.

The company is committed to a policy of equal employment opportunity with hiring and advancement being determined on the basis of merit and ability. Consistent with its policies of advancement from within, Western filled 81 percent of its management and administrative or technical job vacancies in 1979 with people already working for the company. Western's results-oriented affirmative action plans are submitted annually to government agencies.

Labor unions represent approximately 93 percent of Western's employees. These unions include the Airline Pilots Association, Association of Flight Attendants, Brotherhood of Railway and Airline Clerks, International Brotherhood of Teamsters, Sindicato Nacional de Trabajadores de Aviacion y Similares and the Transport Workers Union.

Following is the contractual status of each of these collective bargaining groups:

Employee Group	Number of Employees 1-1-80	Union	Contract Open for Amendment
Mechanics & Related Employees and Stock Clerks	1,959	IBT	Jan. 1, 1981
Pilots	1,603	ALPA	Sept. 1, 1981
Flight Attendants	2,076	AFA	Dec. 1, 1979 (In negotiation)
Agent & Clerical—			
U.S.	4,171	BRAC	June 30, 1980
Canada	121	BRAC	July 1, 1980
Mexico	208	SNTA	Jan. 18, 1981
Flight Superintendents	29	TWU	Oct. 31, 1980
Ground School Instructors	38	IBT	Jan. 1, 1981

Route Matters

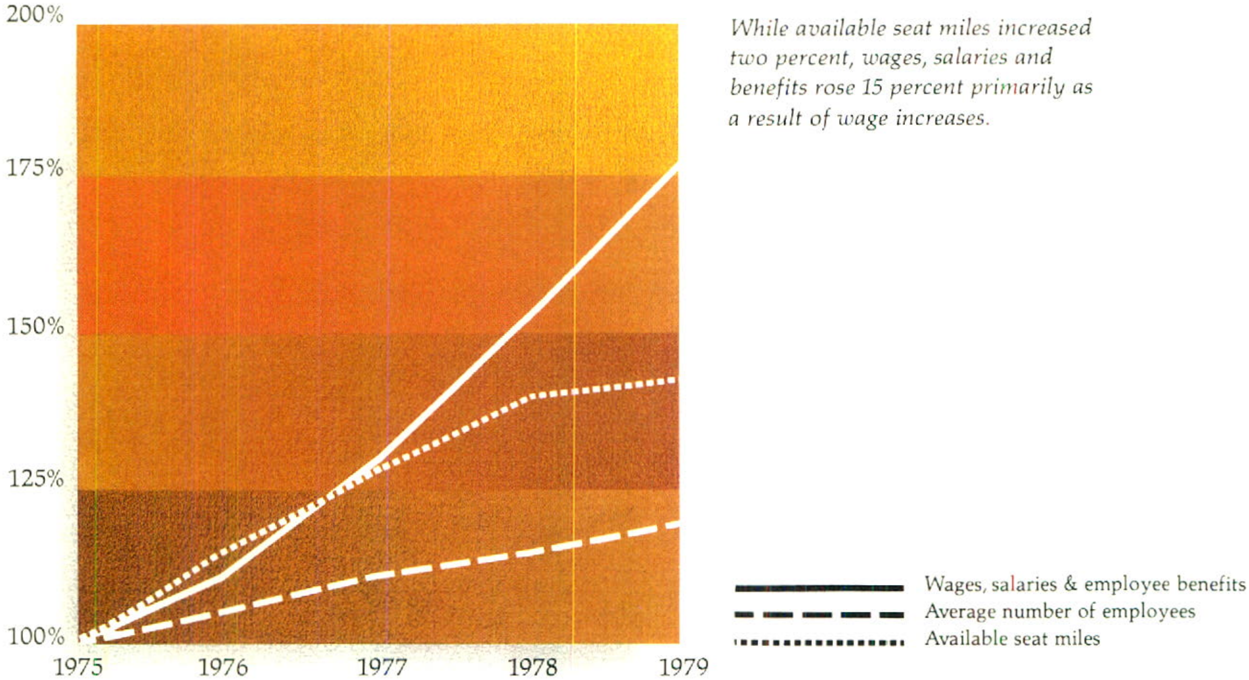
Although moving cautiously into the deregulated environment that resulted from the enactment of the Airline Deregulation Act of 1978, Western inaugurated a number of new routes in 1979. The most important of these was an extension of Western's system into Washington, D.C., through National Airport. The landing of Western's first scheduled flight at the nation's capital represented the culmination of many years of effort. The Washington route, which also provided Western service to Spokane, represented the company's first expansion east from Minneapolis/St. Paul.

Milwaukee also was added to Western's system with service from Minneapolis/St. Paul. Western provides the Wisconsin city with service to cities in South Dakota and to Denver.

Taking advantage of new domestic route authority, Western initiated a number of new services between cities it already served. Included in this program were new nonstop services between Salt Lake City and Phoenix, Phoenix and Las Vegas, Reno and Seattle, San Francisco and Anchorage and Billings-Minneapolis/St. Paul. Daily Edmonton-Denver nonstops will be added April 1, 1980, and twice-weekly service will be extended to Nassau, The Bahamas, from Miami on April 27.

Western moved during the year to suspend service to a number of small cities. Service to Cheyenne, Wyo., was terminated on November 7, 1979, and to Helena, Mont., on January 31, 1980. Although the company had asked permission to suspend service to Pocatello, Ida., West Yellowstone, Mont., and Sheridan, Wyo., as well, the CAB

Wages, Salaries & Employee Benefits—1975=100%



While available seat miles increased two percent, wages, salaries and benefits rose 15 percent primarily as a result of wage increases.

has required a continuation of service until replacement air carriers are found. In other scheduling adjustments, the company discontinued a number of flights which had proven unprofitable.

Authority for literally hundreds of new routes was granted to Western and other airlines during 1979. Under the current policies of the CAB, this authority is permissive rather than mandatory and will continue to give Western opportunities for expansion into new areas should it be found profitable in the future.

Western established London authority as its top international route priority, with four U.S. gateways—Minneapolis/St. Paul, Miami, Denver and Anchorage—as the focal points of these efforts.

Western originally proposed service from the Twin Cities to London as part of the TransAtlantic Route Case in 1973. Minneapolis/St. Paul-London authority was not granted in that case, but the CAB subsequently initiated the "Wild Card" case in which one U.S. city and one U.S. airline were to be selected for new service to London.

In a meeting January 24, 1980, Minneapolis/St. Paul was selected for the new nonstop service; however, on February 15, 1980, the CAB selected Northwest rather than Western for the new route.

The U.S.-United Kingdom Bilateral Agreement which authorized the selection of a "Wild Card" city also contained authority for a U.S. carrier to operate between Anchorage and London. Because of its existing service between Honolulu and Anchorage, Western had been the leading advocate for the inclusion of Anchorage-London in the bilateral agreement.

The administrative law judge in the Anchorage-London Service Case has recommended awarding the route to Western over two other applicants. The decision is awaiting approval of the CAB and the President of the United States.

To further enhance its opportunities in the European market, Western also is an applicant for a Miami-London route which became available when the CAB approved a merger between Pan American and National Airlines but did not approve the transfer of the route, that had been operated by National, to the merged carrier. The administrative law judge has recommended another carrier for the route. However, under the new agreement announced on March 5, 1980, between the United States and the United Kingdom, a second U.S. carrier will be authorized to operate the route in January 1981.

The new U.S.-U.K. agreement also provides for a Denver-London route to be served this spring. Western's request for this route authority will be considered in an expedited proceeding. Western has been awarded new authority to the Mexican cities of Zihuatanejo and Manzanillo as a result of the California/Southwest-

Western Mexico Route Proceeding which was concluded in 1979. The company now plans to inaugurate service to these developing resort cities on October 1, 1980.

In the Texas-Alberta-Alaska route case, the administrative law judge has selected Western for authority between Houston/Dallas/Ft. Worth and Calgary/Edmonton and between these Canadian cities and Anchorage/Fairbanks.

Legal Proceedings

Western and other airlines are parties to numerous actions in state courts wherein owners of property located in the vicinity of major airports, primarily Los Angeles International Airport, are seeking to enjoin certain aircraft operations at the airports and/or to recover damages because of aircraft noise and engine emissions.

Most of these cases have been brought in the Los Angeles County Superior Court against the City of Los Angeles, which in turn cross-complained against the airlines for indemnification. The aggregate amount of damages sought in cases against the city has been reported by the city to be in excess of $3 billion. The aggregate amount of damages sought in actions to which Western is a party as cross-defendant is in excess of $36 million.

Western and its counsel in these actions feel that the damages claimed are not a realistic measure of the airlines' exposure and that in most cases the request for relief is wholly out of proportion to any actual damage that may have been suffered. Western's counsel in these actions, which also represents most of the other airlines, is of the opinion that based on the current law, the airlines have substantial defenses to the imposition of any liability. Moreover, in each case to date in which the issue of the airlines' duty to indemnify the airport proprietor has been tried the airlines have obtained favorable rulings.

However, all the issues of law involved in these matters have not been finally settled, and, pending further clarification, the relative rights and liabilities among such owners of adjacent areas, the airport owners, the airport operators, the air carriers and the federal, state and local governments are not entirely clear. Unfavorable decisions against Western in these actions could have a materially adverse effect. Further, any liability of airport operators, or the granting of any injunctive relief against them, could result in higher costs to air carriers, through, for example, higher landing fees.

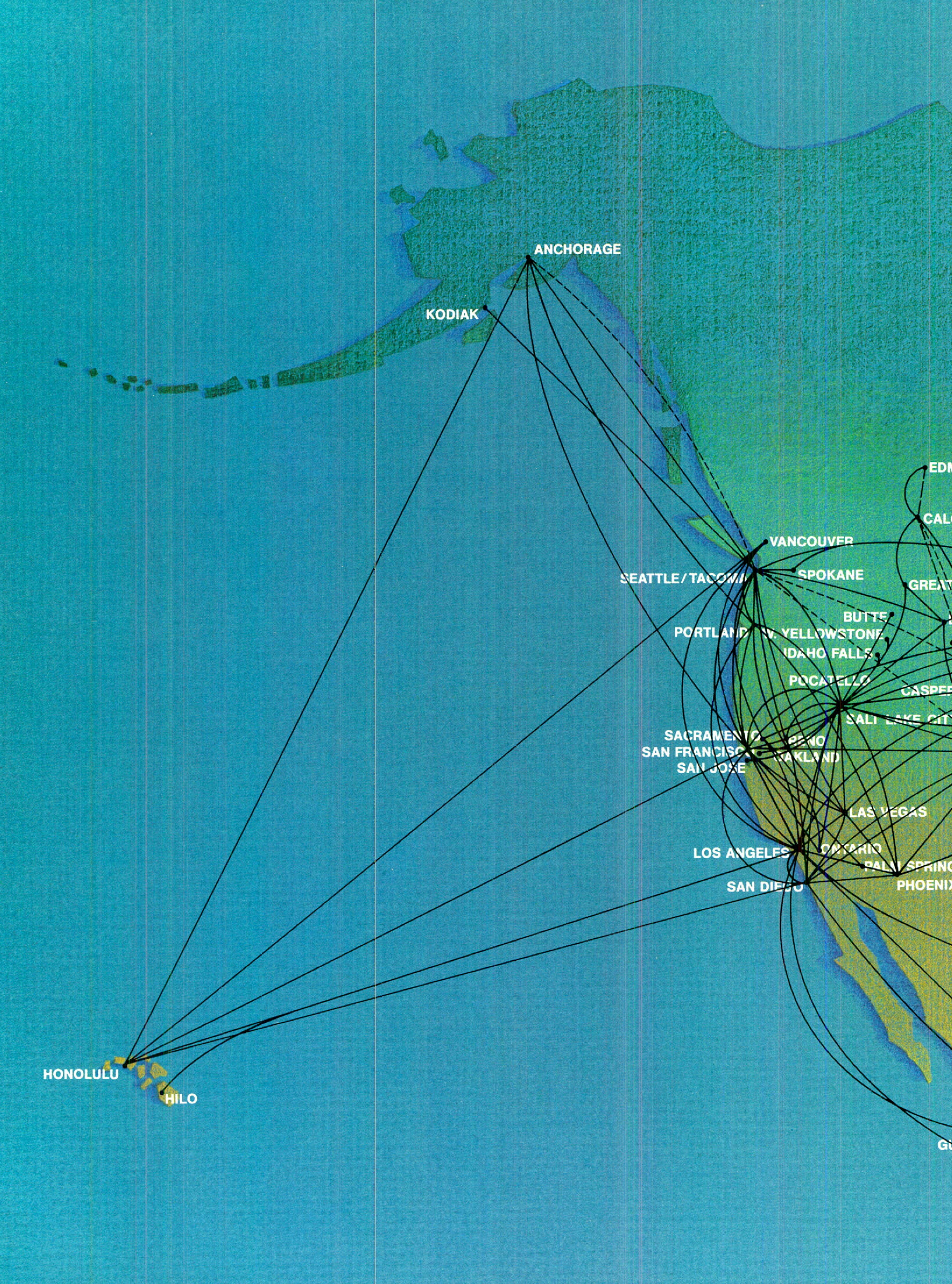
The California Supreme Court has decided that jet noise damage litigation is not appropriate for class action determination because of an insufficient community of interest to sustain a class suit. This holding has significance with respect to the Los Angeles situation where several of the cases purportedly are on behalf of classes.

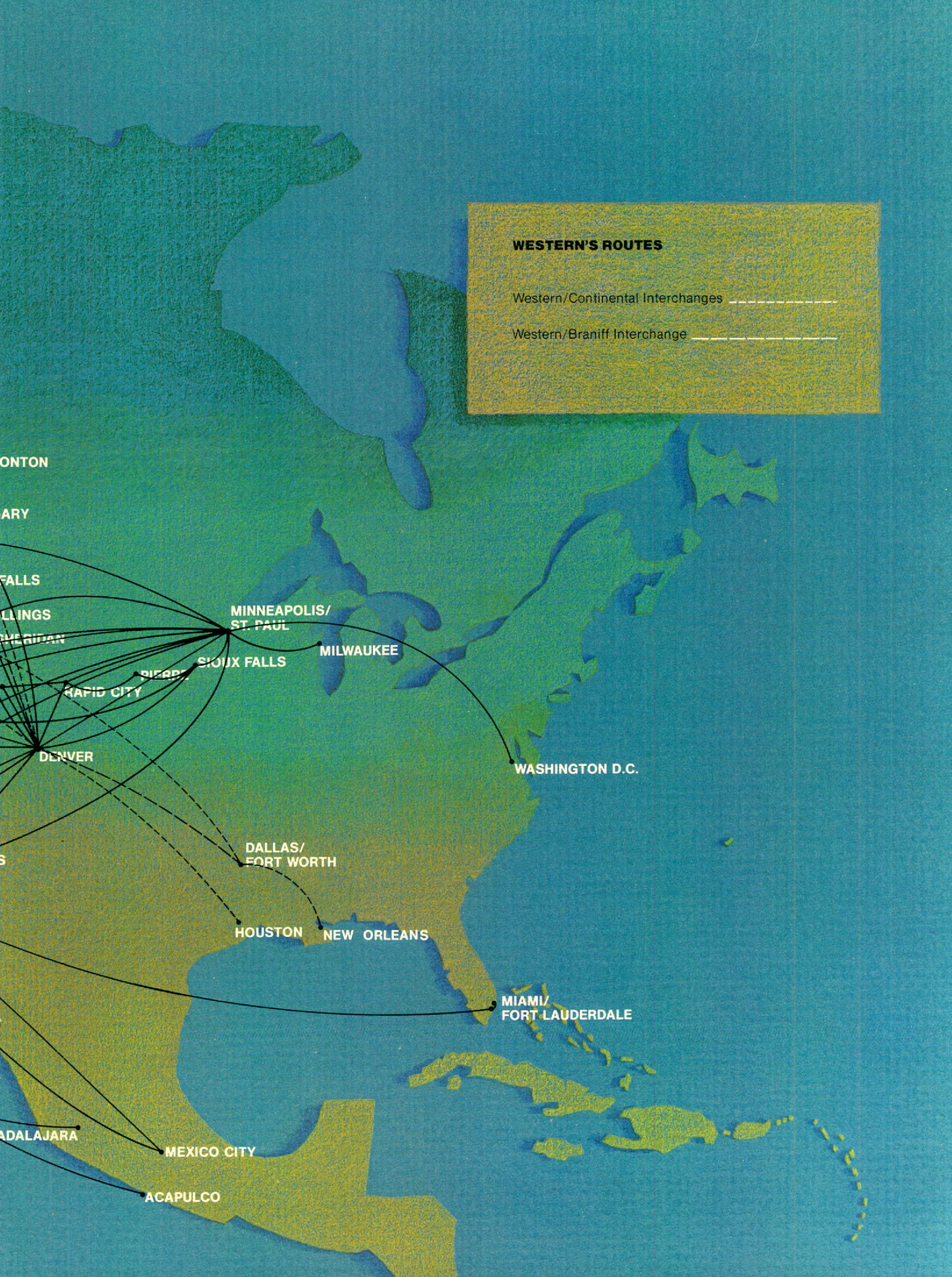
In light of this litigation certain communities which own and operate airports, including Los Angeles and San Diego, have imposed or are considering imposition of limitations on frequency and timing of airline flights or upon the proportion of an airline's fleet which may continue to operate without complying with federal noise standards. Enforcement of such restrictions at a major airport served by Western could have a materially adverse effect upon its operations.

Western and two other airlines are defendants in an action brought in November 1973 by a defunct tour operator-travel agency in the United States District Court for the Northern District of California in which the defendants are charged with having conspired and attempted to monopolize and with actually monopolizing the group leisure tour market in competition with said agency by packaging their own tours and appropriating tour packages developed by said agency. The complaint seeks injunctive damages according to proof plus punitive damages. In the opinion of Western's counsel, the action will not result in any material liability to Western.

Several actions have been filed, and more are expected, both in federal and state courts, against Western and other defendants, seeking damages for death or injury suffered in the October 31, 1979, crash at Mexico City. Western has ample insurance coverage for this type of accident although punitive damages, which are sought in several of the actions, may not be covered. Western does not believe that it will have any material liability resulting from claims for punitive damages.

Western is also involved in various other litigation, including certain cases alleging discrimination in employment practices, that management believes will not have a materially adverse effect upon Western.


ANCHORAGE
KODIAK
VANCOUVER
SEATTLE/TACOMA
SPOKANE
PORTLAND
YELLOWSTONE
BUTTE
IDAHO FALLS
POCATELLO
CASPER
SALT LAKE CITY
SACRAMENTO
SAN FRANCISCO
SAN JOSE
RENO
OAKLAND
LAS VEGAS
LOS ANGELES
ONTARIO
SAN DIEGO
PHOENIX
HONOLULU
HILO



WESTERN'S ROUTES
Western/Continental Interchanges
Western/Braniff Interchange
MINNEAPOLIS/ ST. PAUL
MILWAUKEE
SIOUX FALLS
PIERRE
RAPID CITY
DENVER
WASHINGTON D.C.
DALLAS/ FORT WORTH
HOUSTON
NEW ORLEANS
MIAMI/ FORT LAUDERDALE
MEXICO CITY
ACAPULCO

TEN YEARS OF WESTERN PROGRESS

(in millions except per share amounts and other items indicated by *)

Summary of Operations	1979	1978
Operating revenues:		
Passenger	$ 827.7	734.0
Cargo, charter, and other	104.4	100.5
Total operating revenues	932.1	834.5
Operating expenses:		
Wages, salaries, and employee benefits	356.6	309.4
Fuel	225.7	154.9
Other[a]	331.6	315.3
Total operating expenses	913.9	779.6
Operating income	18.2	54.9
Interest expense, net	(24.9)	(20.2)
Other income (expense) net	46.1	10.7
Earnings (loss) before income taxes and cumulative effect of changes in accounting principles	39.4	45.4
Income taxes[c]	(2.1)	6.9
Earnings (loss) before cumulative effect of changes in accounting principles	41.5	38.5
Cumulative effect of changes in accounting principles[b, c]	—	16.2
Net earnings (loss)	41.5	54.7
Preferred stock dividends	2.4	2.4
Net earnings (loss) available for common stock	$ 39.1	52.3
Earnings (loss) per common share[d]:		
Primary:		
Before cumulative effect of changes in accounting principles	$ 2.99	2.82
Net earnings (loss)	$ 2.99	4.09
Fully diluted:		
Before cumulative effect of changes in accounting principles	$ 2.31	2.15
Net earnings (loss)	$ 2.31	3.04
Other Financial Data		
Cash dividends paid per share on common stock	$ 0.40	0.40
Return on investment (%)*	13.2	14.0
Average common shares outstanding[d]	13.1	12.8
Shareholders' equity	$ 232.6	198.5
Long-term obligations	$ 318.3	265.7
Property and equipment—net	$ 634.6	519.7
Total assets	$ 821.4	710.1
Operations		
Airplanes operated at end of year*	76	78
Passengers carried	11.2	10.4
Available seat miles	16,630.5	16,254.9
Revenue passenger miles	10,494.8	10,634.8
Passenger load factor—actual (%)*	63.1	65.4
—breakeven point (%)*	63.2	61.1
—profit margin (point difference)*	(0.1)	4.3
Average revenue per passenger mile*	$ .0807	.0720
Average length in miles per passenger trip*	926	994
Operating expense per available seat mile*	$ .0550	.0480
Cargo revenue ton miles	162.0	176.3
Average number of employees*	11,256	10,787

NOTES APPLICABLE TO FIVE YEARS ENDED DECEMBER 31, 1979

(in millions of dollars except per share amounts)

(a) Changes in the estimated useful lives of certain aircraft were implemented in 1978, 1976, and 1975. These changes increased net income in 1978, 1977, 1976, and 1975 by approximately \$1.5, or \$0.12 per share (primary), \$2.4, or \$0.19 per share (primary), \$0.6, or \$0.04 per share (primary), and \$2.6, or \$0.17 per share (primary), respectively.

(b) In 1975 Western changed its method of accounting for costs of major flight equipment maintenance from one of charging such costs to reserves (accumulated by charges to income on an hours-flown basis) to one of direct expensing of such costs as incurred. The \$7.2 cumulative effect of this change on prior years is included in net earnings for 1975.

1977	1976	1975	1974	1973	1972	1971	1970
614.6	544.2	465.1	437.3	376.7	342.9	295.8	274.8
76.9	61.0	53.9	51.1	44.6	31.1	32.2	28.7
691.5	605.2	519.0	488.4	421.3	374.0	328.0	303.5
263.1	226.4	201.7	182.3	165.4	147.3	127.1	113.1
138.0	108.3	93.1	71.4	44.5	40.1	38.7	37.4
260.9	235.1	211.1	192.5	168.3	160.8	144.1	140.2
662.0	569.8	505.9	446.2	378.2	348.2	309.9	290.7
29.5	35.4	13.1	42.2	43.1	25.8	18.1	12.8
(17.5)	(16.3)	(14.4)	(15.3)	(13.0)	(11.8)	(14.2)	(17.6)
7.8	3.1	4.3	13.8	4.2	2.7	4.5	1.1
19.8	22.2	3.0	40.7	34.3	16.7	8.4	(3.7)
7.1	8.2	(1.5)	17.2	14.4	5.9	2.6	(3.2)
12.7	14.0	4.5	23.5	19.9	10.8	5.8	(0.5)
—	—	7.2	—	—	—	—	—
12.7	14.0	11.7	23.5	19.9	10.8	5.8	(0.5)
.5	—	—	—	—	—	—	—
12.2	14.0	11.7	23.5	19.9	10.8	5.8	(0.5)
0.96	1.03	0.30	1.55	1.32	0.72	0.39	(0.03)
0.96	1.03	0.77	1.55	1.32	0.72	0.39	(0.03)
0.85	0.92	0.29	1.38	1.18	0.66	0.38	(0.03)
0.85	0.92	0.70	1.38	1.18	0.66	0.38	(0.03)
0.40	0.40	0.47	0.39	0.23	0.08	—	—
9.1	9.5	5.9	12.4	11.9	8.5	6.8	5.5
12.7	13.6	15.2	15.1	15.1	15.0	15.0	15.0
147.4	112.1	133.9	129.3	110.8	94.4	84.5	78.7
214.5	192.5	175.4	167.4	178.0	158.6	181.6	205.0
427.9	378.6	367.6	350.3	316.4	262.1	242.0	275.5
574.9	515.1	488.3	448.8	431.7	372.7	372.0	389.3
77	75	75	72	74	71	70	72
8.8	8.1	7.5	7.4	7.4	6.9	6.2	6.2
14,963.8	13,450.4	11,696.5	11,123.5	11,175.5	10,300.2	9,776.9	9,839.3
8,588.8	7,833.8	7,102.9	6,747.5	6,476.1	5,995.9	5,252.0	5,159.1
57.4	58.2	60.7	60.7	57.9	58.2	53.7	52.4
56.1	56.0	59.7	56.1	52.5	54.6	52.4	52.6
1.3	2.2	1.0	4.6	5.4	3.6	1.3	(0.2)
.0734	.0705	.0665	.0660	.0593	.0578	.0577	.0542
966	963	942	902	877	865	846	834
.0442	.0424	.0433	.0401	.0338	.0338	.0317	.0295
157.3	135.0	108.6	95.2	76.5	76.2	73.2	68.6
10,413	9,799	9,357	9,696	9,826	9,383	8,951	8,961

(c) Effective January 1, 1978, Western changed its method of accounting for post-1971 investment credits for financial reporting purposes from the deferral to the flow-through method. The cumulative effect of the change, amounting to $16.2, has been included in net earnings for 1978.

(d) The number of common shares used in computing primary earnings per share were 13,084,000, 12,795,000, 12,659,000, 13,601,000, and 15,163,000 for 1979 through 1975, respectively. The number of shares used in computing fully-diluted earnings per share were 18,237,000, 18,215,000, 15,913,000, 16,066,000, and 17,628,000 for 1979 through 1975, respectively.

BALANCE SHEETS

WESTERN AIR LINES, INC.

December 31, 1979 and 1978
(In thousands of dollars)

ASSETS	1979	1978*
Current Assets:		
Cash (Note 7)	$ 11,110	12,506
Temporary investments	39,203	58,954
	50,313	71,460
Receivables (net of allowance for doubtful accounts of $2,078—1979 and $1,532—1978)	105,291	92,039
Flight equipment expendable parts at average cost (less allowance for obsolescence of $13,228—1979 and $12,365—1978)	20,021	14,263
Prepaid expenses and other current assets	5,769	7,809
Total current assets	181,394	185,571
Properties and Equipment at Cost (Notes 2, 3, 4, and 7):		
Flight equipment	764,592	694,908
Facilities and ground equipment	127,710	117,833
Deposits on equipment purchase contracts	50,981	36,820
	943,283	849,561
Less allowance for depreciation and amortization	308,642	329,824
	634,641	519,737
Deferred Charges and Other Assets	5,405	4,832
	$821,440	710,140

*Reclassified to conform to the 1979 presentation.
See accompanying notes to financial statements.

LIABILITIES AND SHAREHOLDERS' EQUITY

	1979	1978*
Current Liabilities:		
Accounts payable	$ 54,353	47,530
Salaries, wages, and vacation benefits payable	40,438	32,819
Accrued liabilities	22,980	20,005
Airline traffic liability	71,014	66,588
Current portion of debt	16,217	10,864
Current portion of capital leases	6,380	6,647
Total current liabilities	211,382	184,453
Long-term Obligations:		
Debt (Note 7)	229,337	158,043
Capital leases (Note 2)	89,000	107,703
	318,337	265,746
Deferred Credits and Other Liabilities		
Deferred Federal taxes on income (Note 6)	49,727	53,952
Other	9,369	7,487
	59,096	61,439
Shareholders' Equity (Notes 7, 8, and 9)		
Preferred stock—authorized 25,000,000 shares $2.00 Series A Cumulative Convertible $25.00 stated value per share Issued 1,197,000 shares	29,923	29,923
Common stock—authorized 35,000,000 shares $1.00 par value per share Issued 13,030,000 (1979) and 13,010,000 (1978)	13,030	13,010
Additional paid-in capital	30,959	30,792
Retained earnings	158,713	124,777
	232,625	198,502
Commitments and Contingent Liabilities (Notes 2 and 4)		
	$821,440	710,140

STATEMENTS OF EARNINGS

Years ended December 31, 1979 and 1978
(in thousands of dollars except per share amounts)

	1979	1978
Operating Revenues:		
Passenger	$827,675	734,005
Cargo	61,209	56,936
Charter and other	43,235	43,572
	932,119	834,513
Operating Expenses:		
Wages, salaries, and employee benefits (Note 5)	356,621	309,445
Fuel	225,682	154,876
Depreciation and amortization (Note 3)	50,058	47,094
Other	281,522	268,242
	913,883	779,657
Operating income	18,236	54,856
Other Income (Expenses):		
Interest, principally on long-term obligations	(29,600)	(23,089)
Interest capitalized	4,706	2,910
Interest income	4,957	3,666
Gain on disposition of equipment	31,332	6,754
Settlement with vendor	10,000	—
Other—net	(192)	258
	21,203	(9,501)
Earnings before income taxes and cumulative effect of a change in accounting principle	39,439	45,355
Income taxes (Note 6)	(2,101)	6,808
Earnings before cumulative effect of a change in accounting principle	41,540	38,547
Cumulative effect of a change in accounting principle (Note 6)	—	16,201
Net earnings	$ 41,540	54,748
Earnings per Common Share (Note 10):		
Primary:		
Earnings before cumulative effect of a change in accounting principle	$ 2.99	2.82
Cumulative effect of a change in accounting principle	—	1.27
Net earnings	$ 2.99	4.09
Fully diluted:		
Earnings before cumulative effect of a change in accounting principle	$ 2.31	2.15
Cumulative effect of a change in accounting principle	—	0.89
Net earnings	$ 2.31	3.04

See accompanying notes to financial statements.

STATEMENTS OF CHANGES IN FINANCIAL POSITION

Years ended December 31, 1979 and 1978
(in thousands of dollars)

	1979	1978*
Sources of Working Capital:		
Earnings before cumulative effect of a change in accounting principle	$ 41,540	38,547
Add (deduct) items which did not affect working capital:		
Depreciation and amortization	49,581	46,715
Taxes:		
Deferred income taxes	(4,225)	5,552
Amortization of deferred investment credits	(563)	(558)
Gain on disposition of equipment	(31,332)	(6,754)
Other	(4,706)	(2,246)
Total from operations (the cumulative effect of a change in accounting principle did not affect working capital)	50,295	81,256
Reimbursements of deposits and capital expenditures upon acquisition of aircraft	10,563	12,633
Proceeds from disposition of equipment	50,950	10,794
Proceeds from issuance of long-term obligations	104,941	71,785
Total Sources	216,749	176,468
Applications of Working Capital:		
Purchase of and deposits on property and equipment	182,752	150,747
Reduction of long-term obligations including transfers to current liabilities	52,402	20,540
Cash dividends	7,604	7,524
Other—net	5,097	(4,867)
Total Applications	247,855	173,944
Increase (decrease) in working capital	$(31,106)	2,524
Summary of Increases (Decreases) in Working Capital:		
Cash and temporary investments	$(21,147)	19,799
Receivables	13,252	21,249
Expendable parts and prepaid expenses	3,718	2,048
Current liabilities	(26,929)	(40,572)
Net increase (decrease)	$(31,106)	2,524

*Reclassified to conform to the 1979 presentation.
See accompanying notes to financial statements.

STATEMENTS OF SHAREHOLDERS' EQUITY

Years ended December 31, 1979 and 1978
(in thousands of dollars)

	Preferred Stock $25.00 Stated Value	Common Stock $1.00 Par Value	Additional Paid-in Capital	Retained Earnings	Shareholders' Equity
Balance at January 1, 1978	$30,000	12,659	27,227	77,553	147,439
Exercise of stock options	—	33	256	—	289
Conversion of debentures	—	310	3,240	—	3,550
Conversion of preferred stock	(77)	8	69	—	—
Net earnings	—	—	—	54,748	54,748
Cash dividends:					
—Preferred stock	—	—	—	(2,397)	(2,397)
—Common stock	—	—	—	(5,127)	(5,127)
Balance at December 31, 1978	$29,923	13,010	30,792	124,777	198,502
Exercise of stock options		17	132		149
Conversion of debentures		3	35		38
Net earnings				41,540	41,540
Cash dividends:					
—Preferred stock				(2,394)	(2,394)
—Common stock				(5,210)	(5,210)
Balance at December 31, 1979 (Notes 7, 8, and 9)	$29,923	13,030	30,959	158,713	232,625

See accompanying notes to financial statements.

NOTES TO FINANCIAL STATEMENTS

(In thousands of dollars except per share amounts)

Note 1. Summary of Significant Accounting Policies.

Property and Equipment

Property and equipment, exclusive of residual values, are depreciated over estimated useful lives by the straight-line method. Depreciation expense for assets recorded under capital leases is included in depreciation and amortization. Maintenance and repairs are expensed as incurred. Major renewals and betterments are charged to property and equipment accounts.

Preoperating Costs

Significant costs, such as those for traffic promotion and personnel training, related to the inauguration of service over major new routes and to the introduction of new types of aircraft are deferred and amortized over five years.

Interest Capitalized

Certain interest costs, primarily related to deposits on aircraft purchase contracts, are capitalized and amortized over the life of the related asset.

Investment Credits

Investment credits are accounted for under the flow-through method.

Obsolescence of Expendable Parts

An allowance for obsolescence of expendable parts is accrued over the useful lives of the related aircraft types.

Airline Traffic Liability

Passenger ticket sales are recorded as a current liability until recognized as revenues for services provided by Western, refunded, or until billed by other carriers for transportation provided by them.

Note 2. Lease Commitments.

Western leases flight equipment and facilities and ground equipment. Lease terms for flight equipment range from 11½ to 15 years for 727 aircraft and from 15 to 18 years for DC-10 aircraft. Lease terms for facilities and ground equipment range up to 29 years. The assets recorded under capital leases are amortized over the life of the lease by the straight-line method. Interest expense is accrued on the basis of the outstanding obligations under capital leases. Leased equipment under capital leases is included in the balance sheets at December 31, 1979 and 1978, as follows:

	1979	1978
Flight equipment	$113,219	126,310
Ground equipment	3,278	3,278
	116,497	129,588
Less allowance for depreciation and amortization	42,638	38,944
	$ 73,859	90,644

At December 31, 1979, minimum lease payments under leases expiring after December 31, 1980, were as follows:

	Capital Leases	Operating Leases
1980	$ 15,270	11,982
1981	15,270	11,903
1982	15,270	11,552
1983	15,270	11,167
1984	14,886	10,707
Thereafter	77,297	107,928
Total minimum lease payments	153,263	165,239
Less: Amount representing interest	57,883	
Present value of obligations—capital leases	95,380	
Less: Current portion of capital leases	6,380	
Long-term obligations—capital leases	$ 89,000	

Rental expense for operating leases for 1979 amounted to $17,384 ($15,239—1978).

Note 3. Depreciation and Amortization.

The estimated useful lives and residual values of owned aircraft are as follows:

	Estimated Useful Life	Residual Value
DC-10	16 years	10%
727	15 years	15%
737	14 years	15%
707	15 years	15%

The estimated useful lives of ground equipment range from four to ten years. For buildings and improvements on leased property, the estimated useful lives are generally the periods of the leases.

Note 4. Commitments and Contingent Liabilities.

At December 31, 1979, Western had on firm order eight 727-200 aircraft which are scheduled for delivery in 1980 and 1981 and two DC-10-10 aircraft which are scheduled for delivery in 1980. Advance payments on these aircraft were made in the amount of $44,057. The balance of the purchase price payable on or before delivery of the aircraft will be approximately $141,000. Subsequent to the end of 1979, Western held options to purchase three DC-10-30s (1980 delivery), and five 727-200s and three DC-10-10s (1982 delivery).

Outstanding commitments for flight equipment modifications and spares amounted to approximately $14,000 and for facilities and ground equipment amounted to approximately $5,000 at December 31, 1979.

For information regarding the status at December 31, 1979, of legal proceedings, see "Legal Proceedings" on page 13 in this Annual Report.

Note 5. Retirement Plans.

Western has retirement plans (including a union-sponsored plan) which cover substantially all employees. Western makes contributions to the company-sponsored plans which, together with the participants' required contributions, are sufficient to fund current service costs annually and prior service costs over 10 to 20 years. Actuarial gains and losses are amortized over ten-year periods.

The cost of retirement plans, including in certain plans the amortization of prior service costs (over periods ranging from 10 to 20 years), charged to operating expense amounted to $30,304 for 1979 ($26,606—1978).

For certain plans, the actuarially computed value of vested benefits exceeded the pension funds' assets and related balance sheet liabilities by approximately $3,500 at the most recent valuation date during 1979.

Unfunded prior service costs of the plans amounted to approximately $18,600 at the most recent valuation date during 1979.

Note 6. Income Taxes.

Income taxes are summarized as follows:

	1979	1978
Current:		
Federal:		
Provision	$ 18,901	23,447
Investment credits applied	(17,792)	(23,447)
	1,109*	—*
State	1,578	1,814
Deferred:		
Provision	(5,597)	(2,655)
Investment Credits:		
Applied	(16,420)	(15,240)
Transferred to current	17,792	23,447
	(4,225)	5,552
	(1,538)	7,366
Amortization of deferred investment credits	(563)	(558)
	$(2,101)	6,808

*The Tax Reform Act of 1976 provides for 100% application of unapplied investment credits against federal income tax liabilities for 1978. This 100% application is reduced 10% annually until 1980. Under the Revenue Act of 1978 the application remains at 80% in 1981 and returns to 90% for 1982 and beyond.

Effective January 1, 1978, Western changed its method of accounting for post-1971 investment credits for financial reporting purposes from the deferral to the flow-through method. The cumulative effect of the change on years after 1971, amounting to $16,201, has been included in net earnings for 1978. The effect of the change on the results for 1978 was to increase net earnings by $29,107, or $2.27 per common share (primary).

Deferred income taxes arise from timing differences between financial and tax reporting. The tax effects of these differences on the provision are as follows:

	1979	1978
Depreciation	$ (4,825)	109
Capital leases	(114)	(1,108)
Interest capitalized	1,903	1,124
Preoperating expense	(383)	(502)
Employee benefits	(1,626)	(2,201)
Other	(552)	(77)
	$ (5,597)	(2,655)

A reconciliation between the amount of reported income taxes and the amount computed by multiplying earnings before income taxes and cumulative effect of a change in accounting principle by the applicable Federal statutory tax rates follows:

	1979	1978
Taxes on income at 46%/48%	$ 18,142	21,770
Increases (reductions) in taxes resulting from:		
Amortization of deferred investment credits	(563)	(558)
Investment credits recognized on flow-through method	(16,420)	(15,240)
State income taxes net of federal income tax benefit	852	943
Capital gains	(3,800)	—
Other	(312)	(107)
Income taxes	$ (2,101)	6,808

The Federal income tax returns for 1973 through 1976 are being examined.

Note 7. Debt.

At December 31, 1979 and 1978, long-term debt included:

	1979	1978
Secured:		
9.55% equipment trust certificates due May 1, 1993, with semi-annual principal payments starting November 1, 1979	$ 93,355	71,785
10% equipment trust certificates due April 1, 1994, with quarterly principal payments starting October 1, 1980	54,991	—
	148,346	71,785
Unsecured:		
Senior:		
Revolving credit notes	10,000	—
5¼% installment notes due September 1, 1981, with annual principal payments on September 1 of $4,000	8,000	12,000
6⅝% installment notes due September 1, 1984, with annual principal payments of $2,000 on September 1 which will increase to $7,000 in 1982	25,000	27,000
8¾% installment notes due November 16, 1985, with quarterly principal payments of $768 starting in 1981	15,362	15,362
	58,362	54,362
Subordinated:		
5¼% convertible subordinated debentures due February 1, 1993, with annual sinking fund payments of $1,500 starting in 1983	23,817	24,480
10% subordinated sinking fund notes due April 15, 1984, with annual sinking fund payments of $2,300	15,029	18,280
	38,846	42,760
	245,554	168,907
Less: Current portion	(16,217)	(10,864)
	$ 229,33[illegible]	158,043

The revolving credit notes represent borrowings under a $125,000 revolving line of credit. The line of credit extends to June 30, 1982, at which date it can be replaced by term notes in amounts not to exceed $75,000. The term notes will mature on June 30, 1990, with quarterly principal payments beginning September 30, 1982. The interest rate on funds borrowed is equal to the agent bank's prime commercial rate until June 30, 1982, increasing by ⅛ of a percentage point over prime each year until June 30, 1989, and then remaining at prime plus one percentage point until maturity.

The commitment fee under the amended agreement is ½% per annum on the lesser of the average unused portion of the revolving line of credit or $75,000. Although the bank loan agreement does not require compensating balances, Western has informally agreed to maintain on deposit average balances equal to 5% of the total line of credit plus 10% of borrowings. The balances required by this agreement at December 31, 1979, were approximately $7,250.

Western's various debt agreements limited amounts available for payments of cash dividends to $57,735 at December 31, 1979. These agreements also contain, among other things, requirements pertaining to cash and working capital levels and provisions which may restrict additional borrowings.

Equipment trust certificates totaling $25,028 (9.55%) and $54,991 (10.00%) were issued during 1979 for the purchase of flight equipment. The total obligations under equipment trust certificates are secured by aircraft and engines with a net book value of $176,453.

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

1980	$16,217	1983	$26,037
1981	22,287	1984	30,637
1982	23,912		

At December 31, 1979, 2,062,000 shares of common stock were reserved for conversion of debentures at a conversion price of $11.55 per share.

Note 8. Stock Options.

Western had a qualified stock option plan adopted in 1964 for officers. This plan, as well as the 75,611 outstanding options (average price $10.93), expired April 30, 1978. The company presently has a non-qualified stock option plan adopted in 1974 for officers and key personnel which is summarized below:

	1979		1978	
	Number of Shares	Average Price	Number of Shares	Average Price
Options granted and outstanding at January 1	790,835	$8.56	724,420	$8.68
Options granted	71,000	8.62	116,280	7.81
Options exercised	(17,630)	8.47	(33,315)	8.69
Options cancelled and expired	(6,550)	9.12	(16,550)	8.54
Options granted and outstanding at December 31	837,655	$8.56	790,835	$8.56
Shares exercisable at December 31	585,887	$8.70	484,261	$8.82

At December 31, 1979, 136,530 shares were reserved for the issuance of future grants.

Note 9. Preferred Stock.

The shares of preferred stock are convertible into common stock at the rate of 2.5 shares of common stock for each share of preferred stock, subject to adjustment under certain conditions, and may be redeemed in whole or in part at any time at the option of Western. The redemption price at December 31, 1979, was $26.40 per share. The redemption price decreases periodically until 1987, after which it remains at $25.00 per share. The preference on liquidation is at the stated value.

Note 10. Earnings per Common Share.

Earnings per common share are based on the weighted average number of shares of common stock outstanding during the respective periods.

	1979	1978	
	Net Earnings	Earnings Before Cumulative Effect of a Change in Accounting Principle	Net Earnings
Adjustment of net earnings:			
Primary:			
Net earnings	**$41,540**	38,547	54,748
Preferred dividends	**(2,394)**	(2,397)	(2,397)
Net earnings available for common stock	**$39,146**	36,150	52,351
Fully diluted:			
Net earnings	**$41,540**	38,547	54,748
Reduction in interest expense, net of income taxes, for the assumed conversion of 5¼% convertible subordinated debentures	**653**	680	680
Adjusted net earnings assuming full dilution	**$42,193**	39,227	55,428
Adjustment of shares outstanding (in thousands):			
Primary:			
Weighted average shares outstanding	**13,026**	12,795	12,795
Assumed exercise of stock options	**58**	—	—
Total average common shares for primary	**13,084**	12,795	12,795

Fully diluted:			
Weighted average shares outstanding	13,026	12,795	12,795
Assumed conversion of subordinated debentures	2,073	2,312	2,312
Assumed conversion of preferred stock	2,992	2,997	2,997
Assumed exercise of stock options	146	111	111
Total average common shares assuming full dilution	18,237	18,215	18,215
Earnings per common share:			
Primary	$ 2.99	2.82	4.09
Fully diluted	2.31	2.15	3.04

Note 11. Summarized (unaudited) quarterly financial data for 1978 and 1979 is as follows:

	Three Months Ended			
	March 31	June 30	September 30	December 31
1978				
Operating revenues	$192,200	201,870	241,023	199,420
Operating income (loss)	11,072	11,541	33,226	(983)
Earnings (loss) before cumulative effect of a change in accounting principle	10,486	5,513	25,679	(3,131)
Net earnings (loss)	26,687	5,513	25,679	(3,131)
Earnings (loss) before cumulative effect of a change in accounting principle per common share:				
Primary	$ 0.78	0.39	1.95	(0.29)
Fully diluted	0.59	0.31	1.41	(0.29)
Net earnings (loss) per common share:				
Primary	$ 2.06	0.39	1.95	(0.29)
Fully diluted	1.49	0.31	1.41	(0.29)
1979				
Operating revenues	$210,601	241,305	251,080	229,133
Operating income (loss)	3,503	21,870	8,350	(15,487)
Net earnings	12,652	14,013	6,477	8,398
Net earnings per common share:				
Primary	$ 0.93	1.03	0.45	0.60
Fully diluted	0.71	0.78	0.36	0.47

Estimates of the annual effective tax rate were made quarterly in 1978. Had each of the 1978 quarterly estimates been made on the basis of that year's actual effective tax rate, net income (loss) for the first, second, and fourth quarters of 1978 would have been increased (decreased) by ($1,085) ($0.09 per share), $2,310 ($0.18 per share), and ($1,237) ($0.09 per share). There were no corresponding changes in 1979 because Western utilized the statutory rate less a pro rata portion of the annual investment tax credit for the quarterly provision for income taxes. Changes in estimates of employee benefit costs increased net income during the second through the fourth quarters of 1979 by $780 ($0.06 per share), $1,110 ($0.08 per share), and $1,147 ($0.09 per share).

Note 12. Description of Impact of Inflation (Unaudited).

Statement of Financial Accounting Standards No. 33 (SFAS No. 33) prescribes two supplementary income computations for estimating the impact of inflation. These computations estimate the effects of general inflation (constant dollars) and the effects of changes in specific prices (current cost).

SFAS No. 33 defines constant dollar accounting as a method of reporting financial statement elements in dollars each of which has the same general purchasing power. Current cost accounting is defined as a method of measuring and reporting assets and expenses associated with the use or sale of assets at their current cost or lower recoverable amount at the balance sheet date or at the date of use or sale. Both methods involve the use of assumptions and estimates. Therefore, the resulting measurements should be viewed as estimates rather than as precise indicators of the effects of inflation.

The amounts reported in the primary financial statements have been adjusted for depreciation and amortization expense. Revenues and all other operating expenses are considered to reflect the average price levels and have not been adjusted. Further, there have been no adjustments made to provisions for income taxes.

Constant dollar values were determined by restating historical costs, accumulated depreciation and amortization, and depreciation and amortization expense of property and equipment into average 1979 dollars using the Consumer Price Index for all urban consumers (CPI-U) published by the Bureau of Labor Statistics. Current costs of flight equipment were determined by the direct pricing method for those aircraft still in production. Current costs for aircraft no longer in production were determined by using the recoverable amount based on net realizable values expected to be derived from the sale of the assets. Current costs for spare engines and capital rotable spares and assemblies were computed based on the ratio by which the current cost of aircraft fleets exceed the historic cost of such fleets. Current cost for other property plant and equipment were determined by indexation using the CPI-U.

An estimate of net earnings adjusted for changing prices for the year ended December 31, 1979, follows:

Net earnings as reported in the statements of earnings	$ 41,540
Adjustment to restate costs for the effect of general inflation:	
Depreciation and amortization expense	20,610
Net earnings adjusted for general inflation	20,930
Adjustment to reflect the difference between general inflation and changes in specific prices (current costs):	
Depreciation and amortization expense	9,807
Net earnings adjusted for changes in specific prices	$ 11,123
Gain from decline in purchasing power of net amounts owed	$ 36,758
Increase in specific prices (current cost) of property, plant & equipment held during the year*	$106,528
Effect of increase in general price level	100,802
Excess of increase in specific prices over increase in the general price level	$ 5,726

*At December 31, 1979, current cost of property, plant, and equipment, net of accumulated depreciation was $908,586.

A five-year comparison indicating the effect of adjusting historical revenues, purchasing power gains or losses on net monetary items, cash dividends, and common stock market price to dollar amounts expressed in terms of average 1979 dollars as measured by the CPI-U follows:

	Year Ended December 31,				
	1979	1978	1977	1976	1975
Operating revenues	$932,119	926,309	829,757	774,662	700,613
Historical Cost Information Adjusted for General Inflation					
Net earnings	$ 20,930				
Net earnings per common share	1.42				
Net assets at year-end	419,335				
Current Cost Information					
Net earnings	$ 11,123				
Net earnings per common share	0.67				
Excess of increase in specific prices over increase in the general price level	5,726				
Net assets at year-end	536,345				
Gain from decline in purchasing power of net amounts owed	$ 36,758				
Cash dividends declared per common share	$ 0.40	0.44	0.48	0.51	0.63
Market price per common share at year-end	$ 10.38	9.16	9.15	12.80	12.49
Average Consumer Price Index	217.4	195.4	181.5	170.5	161.2

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.:

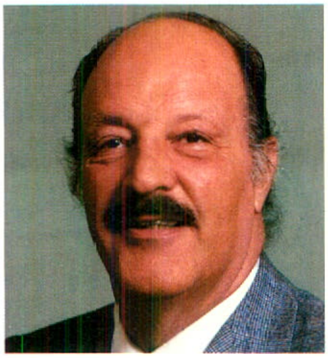
We have examined the balance sheets of Western Air Lines, Inc. as of December 31, 1979 and 1978 and the related statements of earnings, shareholders' equity and changes in financial position for the years then ended. Our examinations were made in accordance with generally accepted auditing standards, 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, 1979 and 1978 and the results of its operations and the changes in its financial position for the years then ended, in conformity with generally accepted accounting principles consistently applied during the period subsequent to the change, with which we concur, made as of January 1, 1978, in the method of accounting for investment credits as described in note 6 of notes to financial statements.

Peat, Marwick, Mitchell & Co.

February 4, 1980

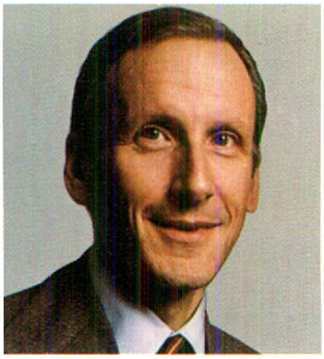
BOARD OF DIRECTORS



Miguel M. Blasquez
President
Inter-American Commercial
Arbitration Commission,
Mexico City, Mexico

Victor L. Brown*
Presiding Bishop,
The Church of Jesus Christ
of Latter-day Saints,
Salt Lake City, Utah

Richard P. Ensign
Senior Vice President—Marketing
Western Air Lines, Inc.,
Los Angeles, California



Gerald Grinstein*
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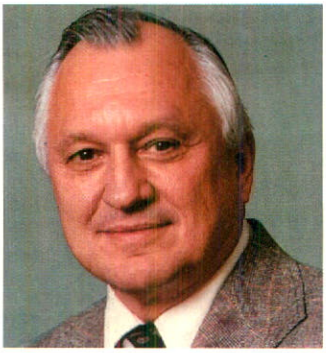
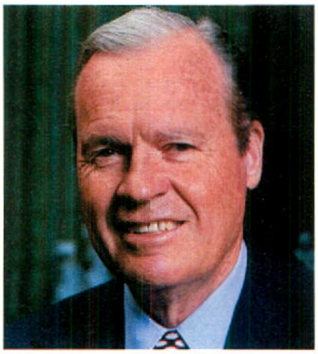
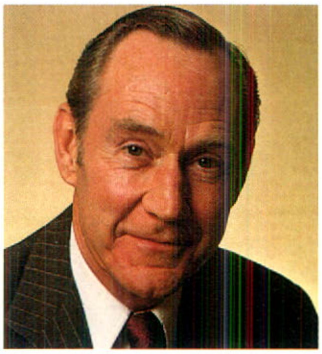
Holman and Fletcher,
Seattle, Washington



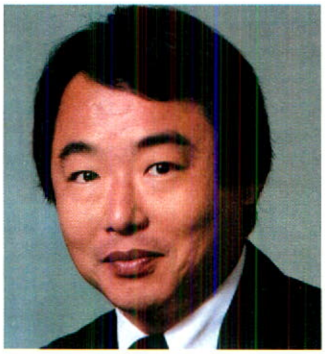
Walter J. Hickel*
Chairman of the Board
Hickel Investment Company,
Anchorage, Alaska



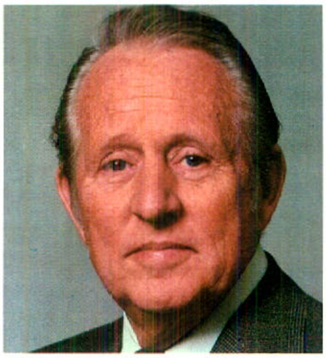
Arthur F. Kelly*
Chairman of the Board and
Chairman of Executive Committee,
Western Air Lines, Inc.,
Los Angeles, California



Robert O. Kinsey
Senior Vice President—
Finance and Administration,
Western Air Lines, Inc.,
Los Angeles, California



Bert T. Kobayashi, Jr.*
Attorney-at-Law,
Kobayashi, Watanabe, Sugita,
and Kawashima,
Honolulu, Hawaii



Arthur G. Linkletter
Television Producer and Broadcaster
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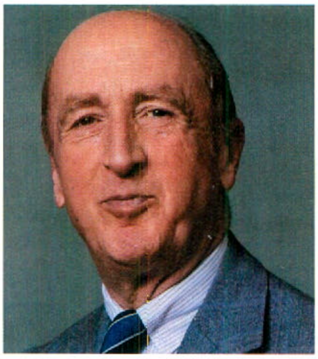
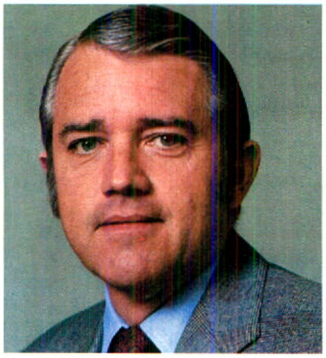
Linkletter Management, Inc.,
Costa Mesa, California



John H. Myers*
Assistant to the President,
St. John's University,
St. Paul, Minnesota

Dominic P. Renda*
President and
Chief Executive Officer,
Western Air Lines, Inc.,
Los Angeles, California



Robert H. Volk*
Attorney-at-Law
Los Angeles, California

*Member, Executive Committee

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Assistant Vice President—Regulatory Law

Thomas J. Greene
Assistant Vice President—Corporate Law and Assistant Secretary

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Vice President—Passenger and Cargo Marketing

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Vice President—Northern Division

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Lynn D. Zumbrunnen
Vice President—Eastern Division

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Anthony Colletti
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Corporate Affairs

Ray Silvius
Vice President—Corporate Affairs

Wayne B. Lichtgarn
Assistant Vice President—Consumer Affairs

Government and Industry Affairs

Neil S. Stewart
Vice President—Government and Industry Affairs

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Allen F. Hoss
Vice President—Hawaii

Grant G. Murray
Vice President—Los Angeles

Luis Pasquel L.
Vice President—Mexico

Raymond M. Waters
Vice President—Alaska

Registrar/Transfer Agent—Common & Preferred Stock
Bank of America National Trust & Savings Assn.
555 So. Flower St., Los Angeles, California 90071

Debenture & Subordinated Note Trustee
The Chase Manhattan Bank
1 New York Plaza, New York, New York 10015

Exchange Listing—Common & Preferred Stock
Debenture & Subordinated Notes
New York Stock Exchange
Pacific Stock Exchange

Ticker Symbols

Common Stock	WAL
Preferred Stock	WALA
5¼% Debentures	WALK
10% Notes	WAL.

Independent Accountants
Peat, Marwick, Mitchell & Co.
555 So. Flower St., Los Angeles, California 90071

Annual Meeting
Fourth Thursday in April

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 Pricing and Domestic Aviation, Civil Aeronautics Board, Washington, D.C. 20428.

Form 10-K: Stockholders may obtain free of charge a copy of the company's annual report on form 10-K as filed with the Securities and Exchange Commission by writing to the Secretary, P.O. Box 92005, World Way Postal Center, Los Angeles, California 90009.

General Offices Western Air Lines Building, 6060 Avion Drive, Los Angeles International Airport, Los Angeles, California 90045