Western Airlines 1980 Annual Report

WESTERN AIR LINES, INC.
1980 ANNUAL REPORT

HIGHLIGHTS OF 1980
(in millions of dollars)

	1980	1979	% Change 1980 vs. 1979
Operating revenues	**$ 995.7**	932.1	7
Operating expenses	**1,041.5**	913.9	14
Operating income (loss)	**(45.8)**	18.2	*
Other Income (Expenses):			
Interest expense, net	**(38.5)**	(24.9)	55
Gain on disposition of equipment	**32.1**	31.3	3
Other-net	**3.0**	14.8	*
Earnings (loss) before income taxes	**(49.2)**	39.4	*
Income taxes	**(19.6)**	(2.1)	*
Net earnings (loss)	**$ (29.6)**	41.5	*
Passengers carried (000)	**9,130**	11,191	(18)
Available seat miles (000,000)	**15,516**	16,630	(7)
Revenue passenger miles (000,000)	**8,832**	10,495	(16)
Passenger load factor - actual (%)	**56.9**	63.1	(10)
- breakeven (%)	**62.0**	63.2	(2)
- profit margin (point difference)	**(5.1)**	(0.1)	*

*Not computed.

Description of Business

Western Air Lines, Inc., is a certificated air carrier engaged in scheduled air transportation of passengers, cargo and mail and as such is not dependent on a single or few customers. The company was originally organized in 1925 and currently serves 40 cities in the United States, Canada, Great Britain, Mexico and The Bahamas. Western operates in competition with other airlines on nearly all route segments. The business of the company is seasonal in nature, with highest revenues of the year normally being reported in the third quarter. It is regulated by the United States and foreign governments.

LETTER TO SHAREHOLDERS

Nineteen eighty was an extremely disappointing year for Western as the company experienced its first net loss since 1970—$29.6 million, or $2.46 per share.

The reasons were not unique to Western. The scheduled airline industry, feeling the effects of the recession, experienced a five percent decrease in traffic for the year, the largest decline in history. When combined with continuing inflationary pressures on costs, especially fuel costs, the downturn in air travel produced a record loss for the industry.

In Western's case, scheduled traffic, as expressed in revenue passenger miles, declined 14 percent from the 1979 level primarily for these reasons:

...Western's markets are heavily leisure-oriented and such traffic is particularly vulnerable to changes in economic conditions;

...As a consequence of deregulation, the carriers serving the western part of the United States, and especially Western, have been subjected to extensive competition and,

...The company eliminated or reduced service in a number of markets which no longer could support the level of service provided.

Despite the decline in traffic, operating revenues increased seven percent because of fare increases which produced a 25 percent increase in yield (average revenue per passenger mile).

The fare increases were needed to offset the continuing escalation in costs, particularly the price of jet fuel. However, yield did not increase to the same extent as fares because of greater use of discount fares by our passengers. Fifty-seven percent of all passenger traffic on Western's system moved on discount fares, compared with 39 percent in the previous year. For the most part, discount fares are offered by Western to match fares introduced by competitors who are new to our markets and who are attempting to obtain a foothold in these markets—or by existing carriers with unused fleet capacity who are seeking to increase their load factors.

Operating expenses increased 14 percent and would have increased more had we not taken drastic action to reduce and control costs. More than 50 percent of the increase was caused by the escalation in the price of fuel. We spent 31 percent more for jet fuel in 1980, although we used 14 percent fewer gallons than in 1979. Wages, salaries and benefits increased eight percent despite the fact that we reduced the number of employees by eight percent during the year.

In addition to the elimination of certain flights and reduction in the number of employees, the company accelerated its plan to dispose of older, fuel-inefficient aircraft and others that became surplus to our needs. During the year, we sold our one remaining four-engine 720B, four 707s and six 737s. All of these aircraft were sold at prices in excess of book values. Our remaining 707 has been leased to an international carrier and is for sale.

The sale of these aircraft, plus the delivery of two DC-10s and five Boeing 727-200s in 1980, has provided Western with one of the most modern and fuel-efficient fleets in the industry. In fact, as of September 30, 1980, according to a Boeing report, Western's fleet had an average age of 6.35 years, the youngest of any U.S. trunkline.

While attempting to reduce and control costs, we also devoted a great deal of our attention and effort to increasing revenues. Recognizing that profitable route expansion is difficult to accomplish during a recession, we concentrated our efforts on our existing route system.

Although evaluation of flight schedules is an ongoing process in the airline industry, in the second quarter—when it became apparent that the recession would be more severe than anticipated—we undertook an intensive study of our schedule pattern to determine how we might be more competitive in markets that had a potential for profit, and how we might reduce service in markets that were not profitable.

Dominic P. Renda

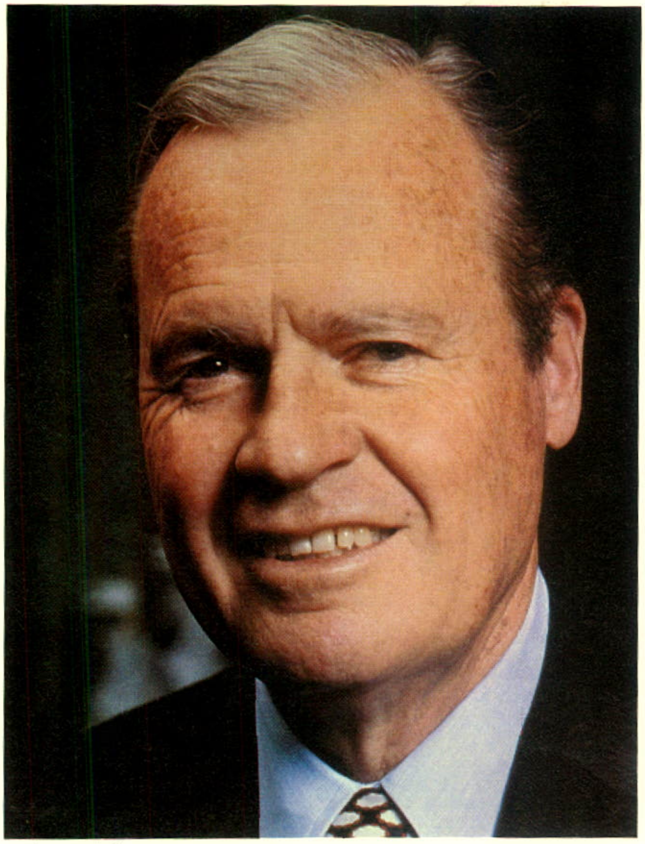
As a result of this study, we immediately improved the timing and frequency of flights on high density routes and eliminated or reduced service on other routes.

Although these efforts did not produce a return to profitable operations, they did provide noteworthy improvement in our operating performance and helped minimize our losses. In the fourth quarter of the year, our load factor showed a three percent increase and our operating loss was reduced by more than $5 million from the same quarter in 1979. It should be noted that 94 percent of our operating losses for 1980 occurred in the first six months.

On October 27, Western inaugurated service to London from Anchorage and Honolulu, completing the first step in the company's lengthy effort to obtain routes to the United Kingdom. On April 24, we will complete the second step of this expansion into long-haul international routes when we inaugurate the first nonstop service between Denver and London.

These routes are developmental in nature and may not be profitable in the first full year of operation. However, we believe they are important to the future of the company.

Last August we announced plans to once again attempt to merge Western and Continental Airlines. We took this action because we believed that the factors that may have led the CAB to disapprove the same merger in July 1979 no longer existed due to deregulation of the airline industry.



Arthur F. Kelly

On February 6, 1981, the Civil Aeronautics Board Administrative Law Judge who heard the evidence recommended approval of the proposed merger and concluded that whatever objections may have existed before no longer prevailed in the industry.

On February 9, the next business day after the law judge's decision was announced, Texas International Airlines, Inc., a subsidiary of Texas Air Corp., announced plans to make a tender offer for a minimum of four million shares of Continental stock, with an option to purchase up to an additional two million shares. In its announcement, Texas International disclosed that it already owned a total of 1,459,200 shares, or approximately 9.5 percent, of Continental's outstanding stock.

On February 13, Texas International announced the commencement of its tender offer and stated that its purpose in making the offer was to acquire a significant minority interest in Continental and, subject to CAB approval, to exercise control over Continental's business and operations.

Purchase of shares by Texas International was subject to a number of conditions, including the tender of at least four million shares and the approval by the CAB of Texas International's acquisition of up to 48.5 percent of the outstanding Continental stock and the deposit of such stock in a voting trust providing, among other things, that the trustee vote against the Continental-Western merger.

On March 2, the Civil Aeronautics Board unanimously approved the proposed Western-Continental merger, instructing its staff to prepare an order that would be sent to the White House prior to March 31 for necessary presidential review. At the same meeting, the CAB also approved Texas International's plan to attempt to purchase up to 48.5 percent of the shares of Continental stock and to place those shares in a voting trust, with authority in the trustee to vote the shares against the Continental-Western merger.

Both Western and Continental had scheduled meetings of shareholders for March 12 for the purpose of voting on the proposed merger. However, after Texas International announced on March 10 that it had acquired in excess of 43 percent of Continental's outstanding stock, Continental cancelled its shareholders' meeting and Western, upon advice of counsel, held its meeting but did not take a vote on the proposed consolidation.

The issues raised by the Texas International actions must be further studied by Western's board of directors and shareholders before any shareholder action could be taken on the Western-Continental merger. Shareholders will be advised of further developments in this matter at the appropriate time.

On December 18, 1980, Western received an unsolicited request from UNC Resources, Inc. of Falls Church, Virginia, to negotiate a merger between Western and UNC. The request recognized that Continental and Western have an existing merger agreement with which a merger with UNC would be inconsistent. No definitive merger proposal has been submitted by UNC, and no negotiations between Western and UNC for a merger of the two companies have taken place. Western is unaware of the intentions of UNC.

The outlook for the airline industry in 1981 is not bright. Traffic for the first half of the year is expected to be down slightly from 1980. We hope there will be an upturn in the economy and traffic during the third quarter, but to date there are no positive signs that this will occur. Significant improvement in industry traffic may not come until late in 1981 or 1982.

At the same time, we see no apparent relief in 1981 from the inflationary pressures on costs that have buffeted our industry in recent years. The decontrol of domestic oil prices and recently announced increases in the price of imported crude will escalate the price of jet fuel during the coming year. There has been no softening in the demands of labor unions for improvements in wages and benefits. Travel agency commissions will be up as a result of the newly deregulated environment which allows for individually negotiated commission rates. Interest expenses will be higher because of higher interest rates and increased borrowing to finance new aircraft.

Despite this outlook, the management of your company is confident it can return Western to profitability. We now have an efficient fleet of aircraft. The actions taken in 1980 have improved our productivity. We are better able to compete. The task will not be easy, but we believe we have the company properly postured to take advantage of the turnaround in the economy which we hope will occur later this year.

Your continued support and understanding will be appreciated.

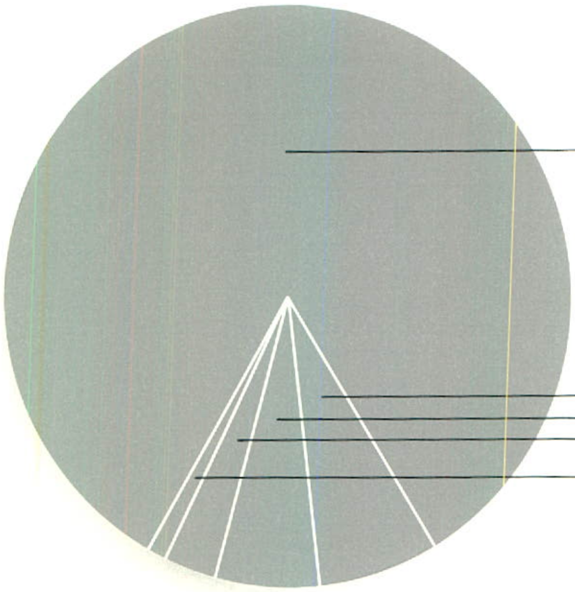
Arthur Kelly

Arthur F. Kelly
Chairman of the Board

Dominic P. Renda

Dominic P. Renda
President and Chief
Executive Officer

March 13, 1981



Revenue Dollars (dollars in thousands)		Percent of total
Coach passenger service	$ 821,748	83%
Deluxe passenger service	66,153	7
Cargo	63,821	6
Transport related	32,158	3
Charter	2,538	–
Other	9,337	1
	$ 995,755	100%

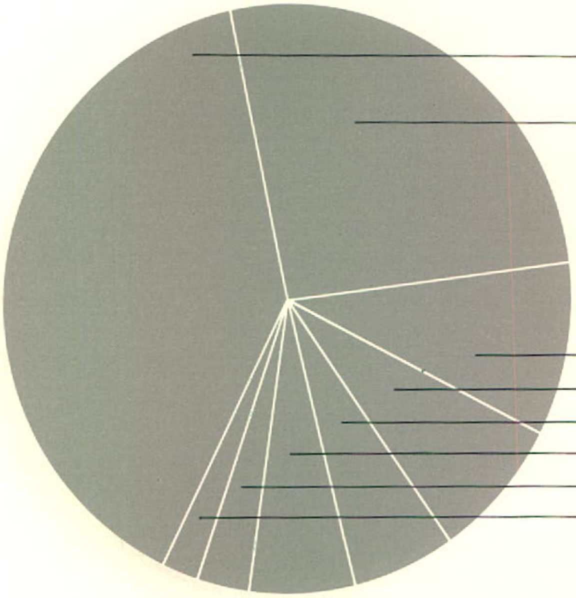
Results of Operations

Results of operations during the last three years were seriously impacted by a combination of circumstances over which Western had no control. The factor which had the most direct effect on operating results in the 1978 - 1980 period was the nationwide recession which became progressively worse during those three years. Western suffered a modest decline in traffic in terms of revenue passenger miles between 1978 and 1979 but between 1979 and 1980 revenue passenger miles decreased by 16 percent. Western's markets are heavily leisure-oriented and such traffic is particularly vulnerable to changes in economic conditions. As a consequence Western's revenue passenger load factor, which is an index of profitability in the airline business, declined steadily from 1978 to 1980.

Inflation affected results in all three years, but inflationary pressures on costs were largely offset by traffic gains in 1978. In 1979 and 1980 the increases in wages, salaries and employee benefits and in the price of fuel ran far ahead of revenue growth. For example, wages, salaries and employee benefits increased by nearly 25 percent between 1978 and 1980 principally as a result of collective bargaining. Fuel expenses almost doubled during the same period, although the amount of fuel consumed declined. Together these two items of expense accounted for more than 82 percent of the increase in operating expenses during the period. Western is unable to predict when inflation in these two areas will be brought under control. Fuel expense is expected to increase substantially in 1981 because of decontrol; the extent to which this can be offset by fare increases authorized by the CAB is presently unknown.

Depreciation and interest expense also increased over the three year period which was the direct result of the acquisition of new aircraft at inflated prices. These purchases were financed largely by additional long-term debt which, coupled with escalating interest rates, produced substantial increases in interest expense. For further discussion of the impact of inflation on operating results see Note 12 to Financial Statements.

Another factor which seriously impacted operating results in the 1978 - 1980 period was deregulation of the airline industry. Passage of the Airline Deregulation Act in November 1978 marked the transition from an era of controlled competition to an era of unrestricted entry. The Act also gave carriers complete freedom to reduce fares by as much as 50 percent and to increase fares by as much as five percent. As a consequence Western has been subjected to increased competition



Expense Dollars (dollars in thousands)		Percent of total
Wages, salaries and employee benefits	$ 384,201	37%
Fuel	296,365	28
Other	106,644	10
Material and services	84,855	8
Depreciation	61,310	6
Commissions	57,672	6
Food and beverages	28,419	3
Rentals	22,050	2
	$1,041,516	100%

on many routes and has been faced with the necessity to meet discounted fares put into effect by both old and new competitors.

Since January 1, 1978, the Civil Aeronautics Board has granted periodic increases in excess of five percent in standard first class and coach fares designed to meet increases in operating expenses. These fare increases were the sole reason for the increase in passenger revenues in 1980. Nevertheless, the fare increases have not been sufficient to offset the decreasing load factors resulting from excessive competition and the dilutive effect on yield of low discount fares.

Also affecting 1979 operating results was the grounding of all DC-10 aircraft for 38 days during the summer, the effect of which was partially offset by traffic gains realized as a result of interruption of service on United Airlines and Mexicana Airlines because of labor problems.

Liquidity and Capital Resources

As is characteristic of the airline industry Western operates with very small, and often negative, working capital. Generally, the cash generated through operations is sufficient to fund current operations and amortization of long-term debt. Proceeds from long-term obligations and the disposition of equipment, together with internally generated funds, have been relied on to finance the purchases of new aircraft. Purchases of aircraft at steadily escalating prices over the last ten years have resulted in substantial increases in Western's long-term debt.

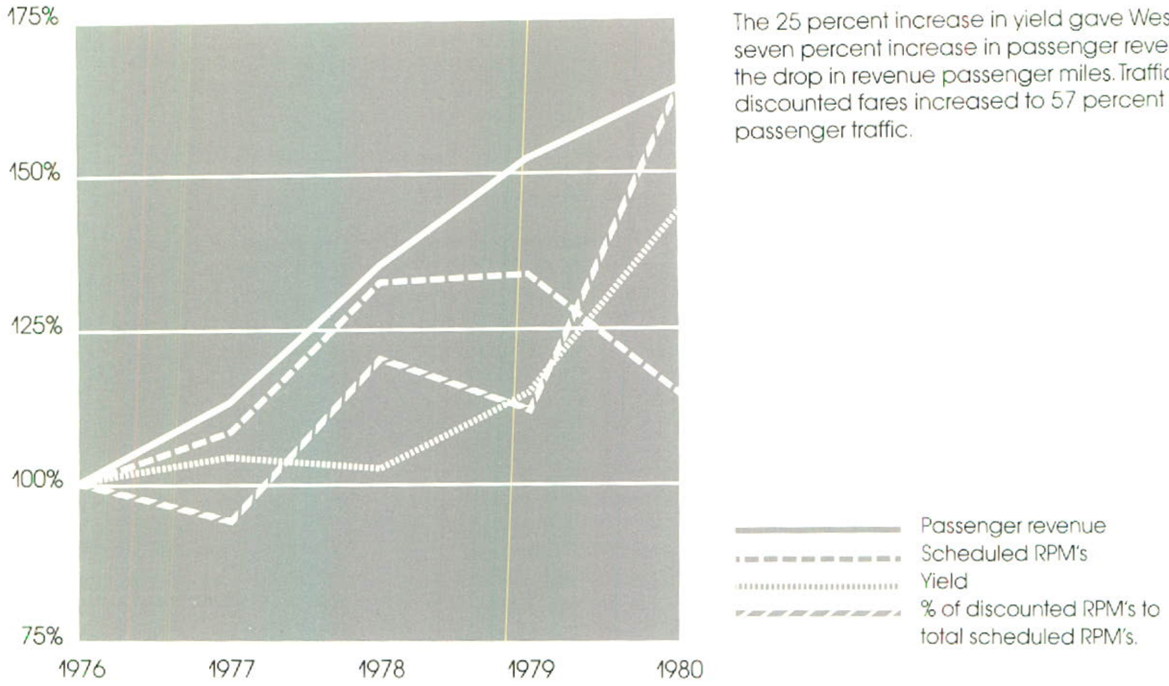
As additional aircraft have been acquired and additional long-term debt incurred, certain relevant ratios have been adversely affected, for example:

	1980	1979	1978
Current assets to current liabilities	.78	.86	1.01
Long-term debt to total capital	.69	.58	.57
Long-term debt to equity	2.20	1.37	1.34

With the addition of three 727-200s and one long-range DC-10 Western believes that its fleet of three-engine and twin-engine aircraft will be adequate to operate its system for the next two years. Nevertheless, Western like every other airline is constantly reviewing its need for new and improved types of aircraft, especially the new generation of more fuel efficient aircraft which are now being developed.

Western presently has on order three Boeing 727-200 aircraft for delivery in the spring of 1981, and six of the new model Boeing 767 aircraft for delivery in 1983 and 1984. Western's total commitment for the purchasing of

Passenger Revenue—1976=100%



The 25 percent increase in yield gave Western a seven percent increase in passenger revenues despite the drop in revenue passenger miles. Traffic moving on discounted fares increased to 57 percent of all passenger traffic.

these aircraft is $303,400,000 of which $30,100,000 has been recorded as advance deposits at December 31, 1980. Equipment trust financing is contemplated for the purchase of these aircraft. Also available to Western is capital lease financing. Western will lease a long-range DC-10 aircraft which is required to operate nonstop between Denver and London.

Another source of funds which might be utilized to finance a portion of Western's capital requirements is the $75,000,000 balance remaining under a $125,000,000 revolving line of credit with a group of banks, although the amount actually available at any one time may be limited by certain lender restrictions. At December 31, 1980 Western had borrowed $50,000,000 under this line of credit for general corporate purposes. At June 30, 1982 borrowings under the revolving line of credit must be repaid or replaced by a term note in an amount not to exceed $75,000,000, maturing in eight years.

Shareholders and Stock

Western's results for 1980 represented a loss of $2.46 per common share, compared to earnings of $2.99 per share in 1979.

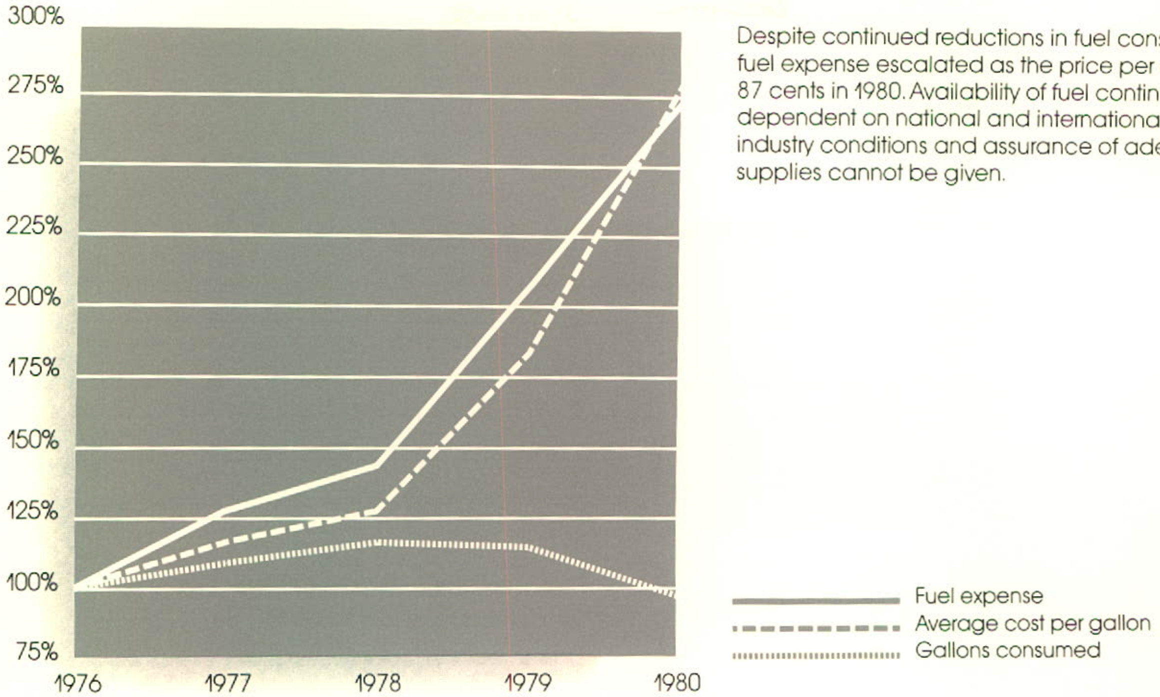
Holders of common stock were paid 10 cents per share in each of the four quarters of 1979 and in both the first and second quarters of 1980 and five cents per share in the third quarter. As a result of continuing losses, the board of directors voted following the third quarter not to pay a dividend on the company's common stock. Certain agreements relating to Western's long-term debt limit the amounts available for payment of cash dividends. At December 31, 1980, the amount available for that purpose was $34,304,000.

The 1980 net results brought shareholders' equity to $197,346,000 at the end of the year, compared to $232,625,000 at the end of 1979. Equity per common share (or book value) was $12.85, compared to $15.56 at the end of 1979.

As of December 31, 1980, there were 13,030,915 shares of Western common stock outstanding. This stock was held by approximately 17,000 individuals and institutions.

Western has 2,992,350 shares of common stock reserved for issuance upon conversion of its preferred stock and an additional 2,040,000 shares reserved for issuance upon conversion of its 5¼% Convertible Subordinated Debentures. Holders of the debentures receive interest payments on February 1 and August 1; as of December 31, 1980, the debentures were held by 511 individuals and institutions. The $2.00 Series A Cumulative Convertible Preferred Stock was held by 1,651 individuals and institutions who are paid dividends quarterly. There were 1,196,940 shares of preferred

Fuel Expense—1976=100%



Despite continued reductions in fuel consumption, fuel expense escalated as the price per gallon rose to 87 cents in 1980. Availability of fuel continues to be dependent on national and international petroleum industry conditions and assurance of adequate future supplies cannot be given.

stock outstanding at December 31, 1980.

Western's common and preferred stock were traded on the New York and Pacific stock exchanges 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
1980				
First Quarter	11⅝	6	29	19
Second Quarter	7⅞	6¼	23⅛	19
Third Quarter	8¾	6	24¾	21¾
Fourth Quarter	10	6¾	25	20⅝

Route Matters

Western's long and determined efforts to serve London were realized in 1980 as the Civil Aeronautics Board awarded the company new nonstop routes from Anchorage and Denver to London.

The London-Anchorage route was inaugurated in October with two flights a week which continue on to Honolulu. Western's entry marked the first U.S. airline service between London and Anchorage and opened the shortest air route between Great Britain and the Pacific.

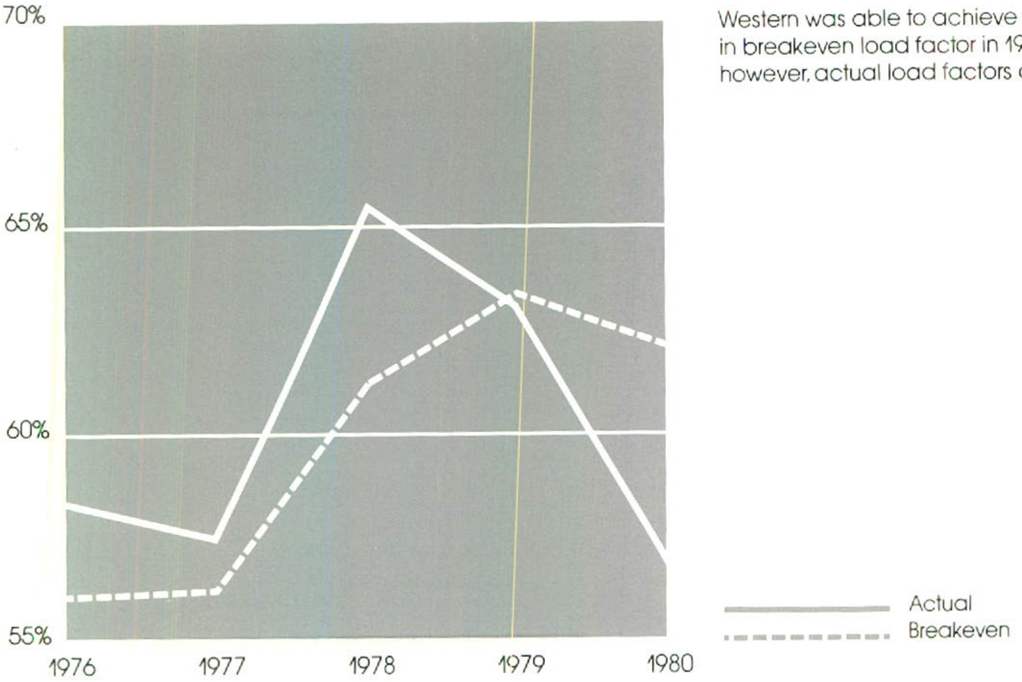
Western's inauguration of Denver-London service on April 24 represents a significant move for both the company and the State of Colorado as well as the Rocky Mountain area. This will give Denver its first nonstop service to and from Great Britain. Under terms of the bilateral agreement, Western's authority on this route will be exclusive for a three-year period.

In another international route case, Western was selected for authority between Texas, Alberta and Alaska. The initial phase of this service will be started April 26 with a daily round trip between Houston, Dallas/Ft. Worth and Calgary. Concurrent with this, Western will discontinue the equipment interchange with Braniff International between Calgary, Denver and Dallas/Ft. Worth.

On its domestic routes, Western did considerable restructuring during 1980 as costs escalated, traffic declined and competition increased. Service was suspended to Helena, Pocatello, Sheridan, Kodiak, Hilo, Milwaukee and Spokane, between San Diego and Honolulu and numerous schedule patterns were changed.

Early in 1981, the company also decided to suspend service between Miami and Nassau, The Bahamas. The suspension will be effective April 26.

Load Factor—Actual vs. Breakeven



Western was able to achieve a two percent reduction in breakeven load factor in 1980 despite higher cost; however, actual load factors dropped 10 percent.

Since the passage of the Airline Deregulation Act of 1978, Western and other certificated airlines have been given authority for literally hundreds of new routes throughout the United States. In that this authority is permissive rather than mandatory, it provides opportunity for expansion into new areas or for the connection of areas currently served whenever it is deemed economically appropriate.

Marketing

Selling Western's product in the face of a declining economy, new competition and escalation of basic fares represented a monumental challenge in 1980.

The nationwide recession had a noticeable impact on leisure traffic, which is so important to Western. In the Hawaii market, which represented about 24 percent of Western's passenger business, the company's traffic was off 13 percent for the year.

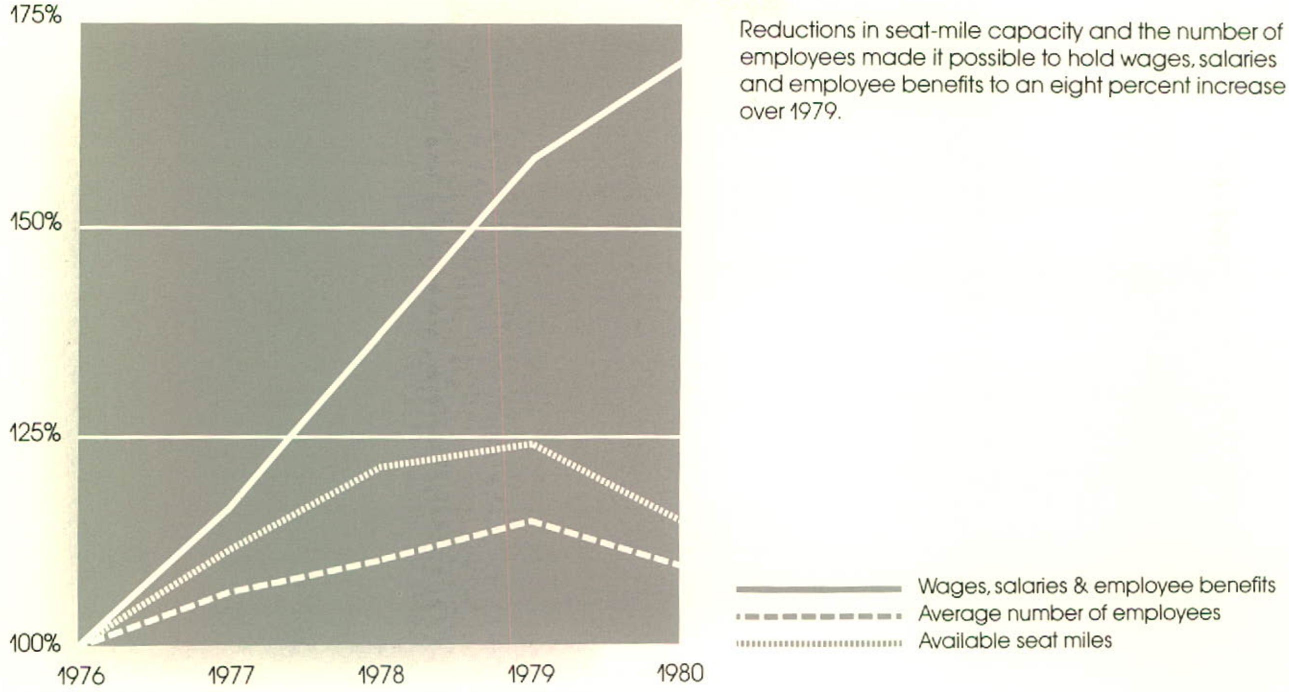
In the 48 states and Canada, which produced approximately 59 percent of Western's passenger traffic, new competition was experienced on every prime nonstop segment, and this along with a general decline in travel resulted in traffic over these segments declining 18 percent, compared with 1979. Western's third largest market—Latin America—experienced a three percent decline in traffic, and Alaska, which represented six percent of Western's traffic, was off 21 percent.

Western moved aggressively to capture new business travel. In the summer of 1980, the company introduced a unique program in Travel Pass, a card which is validated each time a customer flies over selected segments. After five validations, the customer can redeem the card for $50 in travel anywhere on Western's system or 10 of the cards may be saved up for a total of $500 off. This program, which is aimed at the frequent traveler, had been expanded by mid-February 1981 to 85 flights a day throughout Western's system.

The inauguration of Honolulu-Anchorage-London service in October and the Denver-London nonstops being started in April, will give Western an advantageous position with the burgeoning influx of British and European travelers who are attracted to the United States by vacation values. Western also is using its leisure travel expertise to develop value vacations in Great Britain.

Airline deregulation advanced a step farther in mid-1980 as the Civil Aeronautics Board ruled that the unified industry commission structure for travel agents was unacceptable and prescribed open commissions. Travel agents handled nearly 70 percent of Western's passenger business in 1980, and consequently, Western's commission rates must be competitive with other carriers. Initially, Western offered U.S. travel agents an eight percent commission on coach and economy travel and 10 percent on first class and promotional

Wages, Salaries & Employee Benefits—1976=100%



Reductions in seat-mile capacity and the number of employees made it possible to hold wages, salaries and employee benefits to an eight percent increase over 1979.

fares, compared with a four-tier structure ranging from seven to 11 percent just prior to the effective date of the new commission environment. In January 1981, competitive circumstances required an increase in the eight percent level to nine percent.

Basic fares increased in all of Western's markets during 1980; the compound effect of those increases was approximately 43 percent. Western's yield, or average revenue per passenger mile, however, increased only 25 percent, from 8.07 cents in 1979 to 10.10 cents in 1980. This discrepancy between fare and yield increases results from the proliferation of discount fares and their increased use during 1980. Discount fare traffic represented 57 percent of Western's passenger traffic during 1980.

Cargo, including mail and freight, represented six percent of Western's total revenues. It is an important market in that Western's cargo shipments move on scheduled passenger flights. Especially in wide-bodied DC-10s, considerable cargo capacity is available, and Western has developed strong marketing programs around its cargo capabilities.

Deregulation of air cargo in late 1977 permitted all-cargo carriers to move into routes which had previously been confined to passenger/cargo operations; this resulted in considerable new competition for Western and other passenger carriers. Additionally, it has made it possible for large freight forwarders to develop their own air carrier capability.

Western's Fleet

	In Operation*	1981 Delivery	1983/84 Delivery	Options
DC-10-10	12			
DC-10-30		1		3
727-200	44	3		
737-200	13			
767			6	6

*As of March 15, 1981. Three DC-10s and twelve 727s are leased.

Having completed the retirement of its four-engine jet fleet in January of 1980, Western's fleet now is one of the most modern in aircraft technology and fuel efficiency.

In early 1981, Western made preliminary arrangements for the lease of one DC-10-30 for use on the Denver-London route. Those arrangements included a lease-option for a second DC-10-30.

The next step toward improved fuel efficiency in medium-to-long range commercial aircraft will come with the introduction of the Boeing 767 and 757. In preparation for this, Western has placed orders for six 767 twinjets and taken options for an additional six. Deliveries of the 767 will begin in the Spring of 1983.

Western's present fleet is in compliance with federal noise regulations with the exception of the two-engine 737s. An undetermined number of these aircraft will be retrofitted at a cost of approximately $255,000 each in advance of the 1985 deadline for compliance.

Recognition of Western's environmental consciousness as it relates to noise came in the form of an award of merit from the National Organization to Insure a Sound-Controlled Environment. In additon to its conformance to federal noise regulations, Western has structured its take-off and landing patterns to lessen the noise impact on neighboring areas.

Western's aircraft utilization remained at a high level in 1980, despite schedule cutbacks. Average daily hours flown on all aircraft during 1980 was eight hours, 24 minutes, and as in the past several years, Western continued to lead all DC-10 Series 10 operators with a daily utilization of 10 hours, 46 minutes compared with an all-operators average of eight hours, 40 minutes.

Ground Properties and Equipment

Western's general offices and principal overhaul and maintenance base are located at Los Angeles International Airport. These facilities, including a DC-10 hangar and a parking structure completed in 1975, have been built by the company as improvements on leased land. The lease on the land and buildings expires in 1993, subject to the right of the City of Los Angeles to terminate the lease on March 31, 1988, or any March 31 thereafter.

Western also leases hangars at Seattle/Tacoma, Denver, San Francisco and Minneapolis/St. Paul, as well as terminal facilities at all airports served, plus ticket and administrative offices throughout its system. Public airports are utilized for flight operations under contractual arrangements with municipalities or agencies controlling them.

Western's People

The challenges of a difficult 1980 touched every one of Western's employees. The company employed an average of 10,657 during 1980, down from the 11,256 average in 1979.

MANAGEMENT: The board of directors which heads Western's management organization represents the business and civic interests of the major areas the company serves. Four of the 11 directors are Western officers. They are Arthur F. Kelly, 68, chairman of the board and chairman of the board's executive committee; Dominic P. Renda, 67, president and chief executive officer; Robert O. Kinsey, 64, executive vice president and chief operating officer, and Richard P. Ensign, 62, executive vice president—marketing.

Other principal officers of Western include Donald K. Hall, 62, senior vice president, general counsel and secretary; James L. Mitchell, 59, senior vice president—long range planning; Roderick G. Leith, 52, vice president—finance; Rick O. Hammond, 51, vice president and treasurer, and Glen L. Stewart, 38, vice president and controller.

Two of Western's principal officers have held positions outside the company within the last five years: Mr. Hall was elected to his present post in 1979, coming to the company from the Los Angeles law firm of Darling, Rae & Gute, where he had been since 1953. Mr. Mitchell was a vice president at Continental Air Lines between 1968 and 1977. He had previously served as an officer of Western.

EMPLOYEES: Western is committed to a policy of equal employment opportunity with hiring and advancement being determined on the basis of merit and ability. Results-oriented affirmative action plans are submitted annually to government agencies. Consistent with its policy of advancement from within, Western filled 68 percent of its management and administrative or technical job vacancies in 1980 with people already working for the company.

Labor unions represent approximately 93 percent of Western's employees. These unions include the Air Line Pilots Association, Air Transport Employees, 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:

	Number of Employees 1-1-81	Union	Contract Open for Amendment
Mechanics & Related Employees and Stock Clerks	2,150	IBT	Jan. 1, 1981 (In mediation)
Pilots	1,515	ALPA	Sept. 1, 1981
Flight Attendants	1,917	AFA	Dec. 1, 1981
Agent & Clerical—			
U.S.	3,886	ATE	June 30, 1982
Canada	123	BRAC	July 1, 1982
Mexico	189	SNTA	Jan. 18, 1982
Flight Superintendents	33	TWU	Oct. 31, 1983
Ground School Instructors	31	IBT	Jan. 1, 1981 (In mediation)

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 airport 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 a number of these cases has 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 $57 million. 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, O'Melveny & Myers of Los Angeles, believe 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, based on the current state of the law, that 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 judicial clarification, the relative rights and liabilities among such owners of adjacent areas, 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 on the company. Further, any liability of airport operators, or the granting of any injunctive relief against them, could result in higher costs to air carriers, for example through 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, three other airlines and the International Air Transport Association are defendants in an action brought on November 19, 1973, by a defunct tour operator-travel agency in the United States District Court in San Francisco 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 in violation of the Federal antitrust laws. In 1980 summary judgment was entered dismissing the action as to Western, which judgment is subject to appeal in due course.

A number of actions have been filed, in both federal and state courts, against Western and other defendants seeking damages for death or injury suffered in the October 31, 1979, crash of a Western aircraft at the Mexico City airport. Western has ample insurance coverage for this type of accident, although insurance may not cover liability for punitive damages which are sought in several of the actions premised on bodily injury. Western does not believe that such claims for punitive damages will result in any material liability to Western.

Western is also involved in various other litigation, including cases alleging discrimination in employment practices. Western does not believe that any of such cases will result in material liability to Western.


Western/Continental interchanges
*Effective in April
OAKLAND
ORANGE COUNTY
SAN DIEGO
HONOLULU


*TO LONDON VIA NORTH ATLANTIC
GREAT FALLS
BILLINGS
RAPID CITY
PIERRE
CASPER
MINNEAPOLIS/ST. PAUL
SIOUX FALLS
DENVER
WASHINGTON, D.C.
PHOENIX
*DALLAS/FT. WORTH
HOUSTON
FT. LAUDERDALE
MIAMI
GUADALAJARA
MEXICO CITY
ACAPULCO

TEN YEARS OF WESTERN PERFORMANCE
SELECTED FINANCIAL DATA

(In millions except per share amounts and other items indicated by *)	1980	1979
Summary of Operations		
Operating Revenues:		
Passenger	$ 887.9	827.7
Cargo, charter, and other	107.8	104.4
Total operating revenues	995.7	932.1
Operating Expenses:		
Wages, salaries, and employee benefits	384.2	356.6
Fuel	296.4	225.7
Other[a]	360.9	331.6
Total operating expenses	1,041.5	913.9
Operating income (loss)	(45.8)	18.2
Interest expense, net	(38.5)	(24.9)
Other income, net	35.1	46.1
Earnings (loss) before income taxes and cumulative effect of changes in accounting principles	(49.2)	39.4
Income taxes	(19.6)	(2.1)
Earnings (loss) before cumulative effect of changes in accounting principles	(29.6)	41.5
Cumulative effect of changes in accounting principles	—	—
Net earnings (loss)	(29.6)	41.5
Preferred stock dividends	2.4	2.4
Net earnings (loss) available for common stock	$ (32.0)	39.1
Earnings (Loss) per Common Share:		
Primary:		
Before cumulative effect of changes in accounting principles	$ (2.46)	2.99
Net earnings (loss)	$ (2.46)	2.99
Fully Diluted:		
Before cumulative effect of changes in accounting principles	$ (2.46)	2.31
Net earnings (loss)	$ (2.46)	2.31
Number of Shares Used to Compute Earnings (Loss) per Share:		
Primary	13.0	13.1
Fully diluted	13.0	18.2
Other Financial Data		
Cash dividends paid per share of common stock	$ 0.25	0.40
Total assets	$ 917.0	821.4
Property and equipment—net	$ 718.8	634.6
Long-term obligations	$ 435.1	318.3
Shareholders' equity	$ 197.3	232.6
Return on investment (%)*	(4.0)	13.2
Operations		
Airplanes operated at end of year*	71	76
Passengers carried	9.1	11.2
Available seat miles	15,515.6	16,630.5
Revenue passenger miles	8,832.1	10,494.8
Passenger load factor—actual (%)*	56.9	63.1
—breakeven point (%)*	62.0	63.2
—profit margin (point difference)*	(5.1)	(0.1)
Average revenue per passenger mile*	$ .1010	.0807
Average length in miles per passenger trip*	965	926
Operating expense per available seat mile*	$ .0671	.0550
Cargo revenue ton miles	163.2	162.0
Average number of employees*	10,657	11,256

NOTES APPLICABLE TO FIVE YEARS ENDED DECEMBER 31, 1980

(In millions of dollars except per share amounts)

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

1978	1977	1976	1975	1974	1973	1972	1971
734.0	614.6	544.2	465.1	437.3	376.7	342.9	295.8
100.5	76.9	61.0	53.9	51.1	44.6	31.1	32.2
834.5	691.5	605.2	519.0	488.4	421.3	374.0	328.0
309.4	263.1	226.4	201.7	182.3	165.4	147.3	127.1
154.9	138.0	108.3	93.1	71.4	44.5	40.1	38.7
315.3	260.9	235.1	211.1	192.5	168.3	160.8	144.1
779.6	662.0	569.8	505.9	446.2	378.2	348.2	309.9
54.9	29.5	35.4	13.1	42.2	43.1	25.8	18.1
(20.2)	(17.5)	(16.3)	(14.4)	(15.3)	(13.0)	(11.8)	(14.2)
10.7	7.8	3.1	4.3	13.8	4.2	2.7	4.5
45.4	19.8	22.2	3.0	40.7	34.3	16.7	8.4
6.9	7.1	8.2	(1.5)	17.2	14.4	5.9	2.6
38.5	12.7	14.0	4.5	23.5	19.9	10.8	5.8
16.2[b]	—	—	7.2	—	—	—	—
54.7	12.7	14.0	11.7	23.5	19.9	10.8	5.8
2.4	.5	—	—	—	—	—	—
52.3	12.2	14.0	11.7	23.5	19.9	10.8	5.8
2.82	0.96	1.03	0.30	1.55	1.32	0.72	0.39
4.09	0.96	1.03	0.77	1.55	1.32	0.72	0.39
2.15	0.85	0.92	0.29	1.38	1.18	0.66	0.38
3.04	0.85	0.92	0.70	1.38	1.18	0.66	0.38
12.8	12.7	13.6	15.2	15.1	15.1	15.0	15.0
18.2	15.9	16.1	17.6	17.6	17.5	17.5	17.5
0.40	0.40	0.40	0.47	0.39	0.23	0.08	—
710.1	574.9	515.1	488.3	448.8	431.7	372.7	372.0
519.7	427.9	378.6	367.6	350.3	316.4	262.1	242.0
265.7	214.5	192.5	175.4	167.4	178.0	158.6	181.6
198.5	147.4	112.1	133.9	129.3	110.8	94.4	84.5
14.0	9.1	9.5	5.9	12.4	11.9	8.5	6.8
78	77	75	75	72	74	71	70
10.4	8.8	8.1	7.5	7.4	7.4	6.9	6.2
16,254.9	14,963.8	13,450.4	11,696.5	11,123.5	11,175.5	10,300.2	9,776.9
10,634.8	8,588.8	7,833.8	7,102.9	6,747.5	6,476.1	5,995.9	5,252.0
65.4	57.4	58.2	60.7	60.7	57.9	58.2	53.7
61.1	56.1	56.0	59.7	56.1	52.5	54.6	52.4
4.3	1.3	2.2	1.0	4.6	5.4	3.6	1.3
.0720	.0734	.0705	.0665	.0660	.0593	.0578	.0577
994	966	963	942	902	877	865	846
.0480	.0442	.0424	.0433	.0401	.0338	.0338	.0317
176.3	157.3	135.0	108.6	95.2	76.5	76.2	73.2
10,787	10,413	9,799	9,357	9,696	9,826	9,383	8,951

(b) 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.

BALANCE SHEETS

WESTERN AIR LINES, INC.

December 31, 1980 and 1979
(In thousands of dollars)

ASSETS	1980	1979
Current Assets:		
Cash (Note 6)	$ 8,759	11,110
Temporary investments	25,579	39,203
	34,338	50,313
Receivables (less allowance for doubtful accounts of $2,379—1980 and $2,078—1979)	121,859	105,291
Flight equipment expendable parts at average cost (less allowance for obsolescence of $14,062—1980 and $13,228—1979)	26,908	20,021
Prepaid expenses and other current assets	8,025	5,769
Total current assets	191,130	181,394
Properties and Equipment at Cost (Notes 2, 3, and 6):		
Flight equipment	848,111	764,592
Facilities and ground equipment	130,703	127,710
Deposits on equipment purchase contracts	37,966	50,981
	1,016,780	943,283
Less allowance for depreciation and amortization	297,962	308,642
	718,818	634,641
Deferred charges and other assets	7,100	5,405
	$ 917,048	821,440

See accompanying notes to financial statements.

LIABILITIES AND SHAREHOLDERS' EQUITY	1980	1979
Current Liabilities:		
Accounts payable	$ 58,965	54,353
Salaries, wages, and vacation benefits payable	43,624	40,438
Accrued liabilities	22,947	22,980
Airline traffic liability	90,058	71,014
Current portion of debt (Note 6)	23,756	16,217
Current portion of capital leases (Note 2)	7,183	6,380
Total current liabilities	246,533	211,382
Long-term Obligations:		
Debt (Note 6)	353,525	229,337
Capital leases (Note 2)	81,526	89,000
	435,051	318,337
Deferred Credits and Other Liabilities:		
Deferred taxes on income (Note 5)	29,067	49,727
Other	9,051	9,369
	38,118	59,096
Shareholders' Equity (Note 6, 7, 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—1980 and 1979	29,923	29,923
Common stock—authorized 35,000,000 shares $1.00 par value per share Issued 13,031,000—1980 and 13,030,000—1979	13,031	13,030
Additional paid-in capital	30,963	30,959
Retained earnings	123,429	158,713
	197,346	232,625
Commitments and Contingent Liabilities (Notes 2 and 3)		
	$917,048	821,440

STATEMENTS OF OPERATIONS

Years ended December 31, 1980, 1979 and 1978
(in thousands of dollars except per share amounts)

	1980	1979	1978
Operating Revenues:			
Passenger	$ **887,901**	827,675	734,005
Cargo	**63,821**	61,209	56,936
Charter and other	**44,033**	43,235	43,572
	995,755	932,119	834,513
Operating Expenses:			
Wages, salaries, and employee benefits (Note 4)	**384,201**	356,621	309,445
Fuel	**296,365**	225,682	154,876
Depreciation and amortization	**61,310**	50,058	47,094
Other	**299,640**	281,522	268,242
	1,041,516	913,883	779,657
Operating income (loss)	**(45,761)**	18,236	54,856
Other Income (Expenses):			
Interest, principally on long-term obligations	**(43,507)**	(29,600)	(23,089)
Interest capitalized	**4,940**	4,706	2,910
Interest income	**3,168**	4,957	3,666
Gains on disposition of equipment	**32,099**	31,332	6,754
Settlement with vendor		10,000	
Other, net	**(178)**	(192)	258
	(3,478)	21,203	(9,501)
Earnings (loss) before income taxes and cumulative effect of a change in accounting principle	**(49,239)**	39,439	45,355
Income taxes (Note 5)	**(19,607)**	(2,101)	6,808
Earnings (loss) before cumulative effect of a change in accounting principle	**(29,632)**	41,540	38,547
Cumulative effect of a change in accounting principle (Note 5)			16,201
Net earnings (loss)	$ **(29,632)**	41,540	54,748
Earnings (Loss) per Common Share (Note 8):			
Primary:			
Earnings (loss) before cumulative effect of a change in accounting principle	$ **(2.46)**	2.99	2.82
Cumulative effect of a change in accounting principle			1.27
Net earnings (loss)	$ **(2.46)**	2.99	4.09
Fully Diluted:			
Earnings (loss) before cumulative effect of a change in accounting principle	$ **(2.46)**	2.31	2.15
Cumulative effect of a change in accounting principle			0.89
Net earnings (loss)	$ **(2.46)**	2.31	3.04

See accompanying notes to financial statements.

STATEMENTS OF CHANGES IN FINANCIAL POSITION

Years ended December 31, 1980, 1979 and 1978
(In thousands of dollars)

	1980	1979	1978*
Sources of Working Capital:			
Earnings (loss) before cumulative effect of a change in accounting principle	**$ (29,632)**	41,540	38,547
Add (Deduct) Items Which did not Affect Working Capital:			
Depreciation and amortization	**60,146**	49,581	46,715
Deferred income taxes	**(20,660)**	(4,225)	5,552
Amortization of deferred investment credits	**(559)**	(563)	(558)
Gains on disposition of equipment	**(32,099)**	(31,332)	(6,754)
Other	**(3,557)**	(4,706)	(2,246)
Total provided (used) by operations (the cumulative effect of a change in accounting principle did not affect working capital)	**(26,361)**	50,295	81,256
Reimbursements of deposits and capital expenditures upon acquisition of aircraft	**10,746**	10,563	12,633
Proceeds from disposition of equipment	**50,120**	50,950	10,794
Proceeds from issuance of long-term obligations	**198,350**	104,941	71,785
Total sources	**232,855**	216,749	176,468
Applications of Working Capital:			
Purchase of and deposits on property and equipment	**171,123**	182,752	150,747
Reduction of long-term obligations including transfers to current liabilities	**81,667**	52,402	20,540
Cash dividends	**5,652**	7,604	7,524
Other, net	**(172)**	5,097	(4,867)
Total applications	**258,270**	247,855	173,944
Increase (decrease) in working capital	**$ (25,415)**	(31,106)	2,524
Summary of Increases (Decreases) in Working Capital:			
Cash and temporary investments	**(15,975)**	(21,147)	19,799
Receivables	**16,568**	13,252	21,249
Expendable parts and prepaid expenses	**9,143**	3,718	2,048
Current liabilities	**(35,151)**	(26,929)	(40,572)
Increase (decrease) in working capital	**$ (25,415)**	(31,106)	2,524

*Reclassified to conform to the 1980 presentation.
See accompanying notes to financial statements.

STATEMENTS OF SHAREHOLDERS' EQUITY

Years ended December 31, 1980, 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	Total 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	29,923	13,030	30,959	158,713	232,625
Conversion of debentures		1	4		5
Net loss				(29,632)	(29,632)
Cash Dividends:					
Preferred stock				(2,394)	(2,394)
Common stock				(3,258)	(3,258)
Balance at December 31, 1980 (Notes 6, 7, and 9)	$29,923	13,031	30,963	123,429	197,346

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

Owned property and equipment, exclusive of residual values, are depreciated over the estimated useful lives by the straight-line method. Assets recorded under capital leases are depreciated over the life of the lease by the straight-line method. 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%

Estimated useful lives of ground equipment range from four to ten years. Buildings and improvements on leased property are depreciated over the life of the lease. Depreciation expense for assets recorded under capital leases is included in depreciation and amortization expense.

Interest Capitalized

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

Investment Credits

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

Obsolescence of Expendable Parts

An allowance for obsolescence of expendable parts is accrued over the estimated 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 billed by other carriers for transportation provided by them.

Note 2. Lease Commitments

Western leases certain 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. 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, 1980 and 1979, as follows:

	1980	1979
Flight equipment	**$113,219**	113,219
Ground equipment	**2,006**	3,278
	115,225	116,497
Less allowance for depreciation	**49,028**	42,638
	$ 66,197	73,859

At December 31, 1980 minimum lease payments under leases expiring after December 31, 1981 were as follows:

	Capital Leases	Operating Leases
1981	$ 15,270	13,516
1982	15,270	13,331
1983	15,270	12,694
1984	14,886	12,010
1985	10,757	11,843
Thereafter	66,541	104,489
Total minimum lease payments	137,994	167,883
Less amount representing interest	49,285	
Present value of obligations—capital leases	88,709	
Less current portion of capital leases	7,183	
Long-term obligations—capital leases	$ 81,526	

Rental expense for operating leases amounted to $22,050, $17,384 and $15,239 in 1980, 1979 and 1978, respectively.

Note 3. Commitments and Contingent Liabilities

At December 31, 1980 Western had on firm order flight equipment which included three 727-200 aircraft scheduled for delivery in 1981, six 767-200 aircraft scheduled for delivery in 1983 and 1984 and three 767 engines scheduled for delivery in 1983. Western recorded advance deposits on these orders which amounted to $30,100 as of December 31, 1980. The balance of the purchase price payable on delivery will be approximately $273,300.

Western has options to purchase six 767-200 aircraft for delivery in 1984 and 1985, and three DC-10-30 aircraft for delivery by 1984. Deposits on these options amounted to $1,400 at December 31, 1980. Outstanding commitments for flight equipment modification and spare parts amounted to approximately $4,000 and for facilities and ground equipment amounted to approximately $5,100 as of December 31, 1980.

For information regarding the status at December 31, 1980 of legal proceedings, see "Legal Proceedings" on page 10 of this report.

Note 4. Retirement Plans

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

Western participates in a collectively bargained multi-employer pension plan and is therefore subject to the provisions of the recently enacted Multi-employer Pension Plan Amendments Act of 1980.

Under this complex law the union plan Board of Trustees, as sponsor, is required to obtain an actuarial valuation of the present value of vested and nonvested accumulated plan benefits. Western will be provided with an estimate of its share of the liability for unfunded vested benefits in this plan. Western has been advised that this information is not available at this time. Accordingly, the table that follows excludes data applicable to this multi-employer pension plan.

A comparison of accumulated plan benefits and plan net assets for the Company-sponsored defined benefit plans is as follows:

	January 1,	
	1980	1979
Actuarial Present Value of Accumulated Plan Benefits:		
Vested	**$137,246**	114,597
Nonvested	**9,876**	9,015
	$147,122	123,612
Net assets available for benefits	**$139,000**	111,559

The weighted average assumed rate of return used in determining the actuarial present value of accumulated plan benefits was six percent for both years.

The cost of the retirement plans, including the union-sponsored plan, charged to operating expense, was $34,193, $30,304 and $26,606, for 1980, 1979 and 1978, respectively, which included amortization of prior service costs over periods ranging from ten to twenty years for certain of the plans.

Note 5. Income Taxes

Income taxes are summarized as follows:

	1980	1979	1978
Current:			
Federal:			
Provision	**$ (3,647)**	18,901	23,447
Investment credits applied	**5,751**	(17,792)	(23,447)
	2,104*	1,109*	*
State	**(492)**	1,578	1,814
Deferred:			
Provision	**(5,073)**	(5,597)	(2,655)
Tax loss carryforward	**(15,533)**		
Investment Credits:			
Applied	**5,697**	(16,420)	(15,240)
Transferred to current	**(5,751)**	17,792	23,447
	(20,660)	(4,225)	5,552
Amortization of deferred investment credits	**(559)**	(563)	(558)
	$(19,607)	(2,101)	6,808

*The Tax Reform Act of 1976 provided for 100% application of unapplied investment credits against Federal income tax liabilities for 1978. This 100% application was 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 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.

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

	1980	1979	1978
Depreciation	**$(3,454)**	(4,825)	109
Capital leases	**(1,084)**	(114)	(1,108)
Interest capitalized	**1,140**	1,903	1,124
Employee benefits	**(718)**	(1,626)	(2,201)
Preoperating expense	**(393)**	(383)	(502)
Other	**(564)**	(552)	(77)
	$(5,073)	(5,597)	(2,655)

Reconciliations of income taxes at the United States statutory rate to the provision for income taxes follow:

	1980	1979	1978
Income taxes at the United States statutory rate	**$(22,650)**	18,142	21,770
Increases (reductions) in taxes resulting from:			
Amortization of deferred investment credits	**(559)**	(563)	(558)
Investment credits recognized on flow-through method	**5,697**	(16,420)	(15,240)
State income taxes net of federal income tax benefit	**(266)**	852	943
Capital gains		(3,800)	
Other	**(1,829)**	(312)	(107)
Income taxes	**$(19,607)**	(2,101)	6,808

Investment credits available to reduce future years' Federal income tax liability for financial and tax purposes amount to $22,000 at December 31, 1980. For income tax purposes, $5,800 expires in 1986 and $16,200 expires in 1987.

Note 6. Debt

At December 31, 1980 and 1979 long-term debt included:

	1980	1979
Secured:		
9.55% equipment trust certificates due May 1, 1993, with semi-annual principal payments of $3,458 starting November 1, 1979	**$ 86,440**	93,355
10% equipment trust certificates due April 1, 1994, with quarterly principal payments of $1,000 starting September 30, 1980	**52,991**	54,991
Floating-rate equipment trust certificates due June 30, 1995, with semi-annual principal payments of $2,609 starting June 30, 1984	**60,000**	
13.29% installment notes due May 1, 1995, with semi-annual principal payments of $1,100 starting November 1, 1980	**31,900**	
	231,331	148,346
Unsecured:		
Senior:		
Revolving credit notes	**50,000**	10,000
5¼% installment notes due September 1, 1981, with annual principal payments of $4,000 on September 1	**4,000**	8,000
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	**23,000**	25,000
7¾% installment notes due May 4, 1986, with semi-annual principal payments of $352 starting November 4, 1981	**2,869**	
Notes payable to manufacturers, 8¾% and ¼% above prime, payable in varying installments to 1985	**29,844**	15,362
	109,713	58,362
Subordinated:		
5¼% convertible subordinated debentures due February 1, 1993, with annual sinking fund payments of $1,500 starting in 1983	**23,562**	23,817
10% subordinated sinking fund notes due April 15, 1984, with annual sinking fund payments of $2,300	**12,675**	15,029
	36,237	38,846
	377,281	245,554
Less current portion	**23,756**	16,217
	$353,525	229,337

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 would 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, then 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 agreement is ½% per year on the lesser of $75,000 or the average unused portion of the revolving line of credit. 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 maintained at December 31, 1980 were $11,250.

Western's various debt agreements limited amounts available for payments of cash dividends to $34,304 at December 31, 1980. These agreements also contain, among other things, requirements pertaining to cash and working capital levels and provisions which may restrict additional borrowings.

Floating-rate equipment trust certificates totaling $60,000 and 13.29% installment notes totaling $33,000 were issued during 1980 for the purchase of flight equipment. The total obligations under equipment trust certificates and the 13.29% installment notes are secured by aircraft and engines with a net book value of $270,108.

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

1981	$23,756	1984	44,045
1982	29,317	1985	31,862
1983	43,541		

At December 31, 1980, 2,040,000 shares of common stock were reserved for conversion of debentures at a conversion price of $11.55 per share.

Note 7. Stock Options

Western had a qualified stock option plan for officers, which was adopted in 1964 and expired in 1974. The 75,611 options (average price $10.93) still outstanding under that plan expired on April 30,1978. The Company presently has a non-qualified stock option plan adopted in 1974 for officers and key personnel. This plan provides for options to purchase a maximum of 1,030,000 shares of Western's common stock at prices not less than the fair market value of the stock at date of grant. The options are exercisable in equal annual increments over a five-year period. The options expire ten years after the date of grant. A summary of activity in the 1974 plan follows:

	Number of Shares	Average Price
Options granted and outstanding at December 31, 1977	724,420	$8.68
Options granted	116,280	7.81
Options exercised	(33,315)	8.69
Options cancelled or expired	(16,550)	8.54
Options granted and outstanding at December 31, 1978	790,835	8.56
Options granted	71,000	8.62
Options exercised	(17,630)	8.47
Options cancelled or expired	(6,550)	9.12
Options granted and outstanding at December 31, 1979	837,655	8.56
Options granted	21,500	7.27
Options cancelled or expired	(12,500)	8.65
Options granted and outstanding at December 31, 1980	846,655	$8.53
Options Exercisable at:		
December 31, 1980	683,493	$8.63
December 31, 1979	585,887	$8.70

At December 31, 1980, 128,280 shares (137,280 shares at December 31, 1979) were reserved for the issuance of future grants.

Note 8. Earnings (Loss) per Common Share

Earnings (loss) per common share are calculated as follows:

	1980	1979	1978	
	Net (Loss)	Net Earnings	Earnings Before Cumulative Effect of a Change in Accounting Principle	Net Earnings
Adjustment of Net Earnings (Loss):				
Primary:				
Net earnings (loss)	**$(29,632)**	41,540	38,547	54,748
Preferred dividends	**(2,394)**	(2,394)	(2,397)	(2,397)
Net earnings (loss) available for common stock	**$(32,026)**	39,146	36,150	52,351
Fully Diluted:				
Net earnings (loss)	**$(29,632)**	41,540	38,547	54,748
Preferred dividends	**(2,394)**			
Reduction in interest expense, net of income taxes, for the assumed conversion of 5¼% convertible subordinated debentures	*	653	680	680
Adjusted net earnings (loss) assuming full dilution	**$(32,026)**	42,193	39,227	55,428

	1980	1979	1978	
	Net (Loss)	Net Earnings	Earnings Before Cumulative Effect of a Change in Accounting Principle	Net Earnings
Adjustment of Shares Outstanding (in thousands):				
Weighted average shares outstanding	**13,031**	13,026	12,795	12,795
Assumed exercise of stock options	*	58	*	*
Total average common shares for primary	**13,031**	13,084	12,795	12,795
Adjustment Assuming Full Dilution (in thousands):				
Weighted average shares outstanding	**13,031**	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	**13,031**	18,237	18,215	18,215
Earnings (Loss) per Common Share:				
Primary	**$ (2.46)**	2.99	2.82	4.09
Fully diluted	**$ (2.46)**	2.31	2.15	3.04

*The exercise of stock options and conversion of the convertible subordinated debentures and/or the preferred stock into common shares has not been assumed, since the effect of such an assumption would be anti-dilutive.

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, 1980 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. Proposed Consolidation

The Company has entered into an Agreement of Consolidation with Continental Air Lines, Inc., to consolidate the two companies into a new company. The Boards of Directors of both companies have approved the Agreement, and it is now subject to approval by the stockholders of both companies, certain of their lenders, the Civil Aeronautics Board and the President of the United States. For information regarding further developments, see Letter to Shareholders on page 2.

Note 11. Quarterly Financial Data (Unaudited)

Summarized quarterly financial data (unaudited) for 1980 and 1979 is as follows:

	Three Months Ended			
	March 31	June 30	September 30	December 31
1980				
Operating revenues	$232,153	237,707	273,720	252,175
Operating income (loss)	(23,006)	(20,177)	7,658	(10,236)
Net (loss)	(8,868)	(5,379)	(6,397)	(8,988)
Net (Loss) per Common Share:				
Primary	$ (0.72)	(0.46)	(0.54)	(0.74)
Fully diluted	(0.72)	(0.46)	(0.54)	(0.74)
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

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). Western normally provides taxes quarterly based on the statutory rate less a pro rata portion of the estimated annual investment credit. In the third quarter of 1980 Western reversed previously recorded investment credits of $12,507 ($0.96 per share) since they would not currently be utilized.

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 1980 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 properties and equipment were determined by indexation using the CPI-U.

An estimate of net (loss) adjusted for changing prices for the year ended December 31, 1980, follows:

Net (loss) as reported in the statement of operations	$(29,632)
Adjustment to Restate Costs for the Effect of General Inflation:	
Depreciation and amortization expense	27,126
Net (loss) adjusted for general inflation	(56,758)
Adjustment to Reflect the Difference Between General Inflation and Changes in Specific Prices (current costs):	
Depreciation and amortization expense	14,260
Net (loss) adjusted for changes in specific prices	$(71,018)
Gain from decline in purchasing power of net amounts owed	$ 46,847
Increase in specific prices (current cost) of properties and equipment held during the year*	$240,784
Effect of increase in general price level	(126,705)
Excess of increase in specific prices over increase in the general price level	$114,079

*At December 31, 1980 current cost of properties and equipment, net of accumulated depreciation and amortization, was $1,177,709.

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 1980 dollars as measured by the CPI-U follows:

	Year Ended December 31,				
	1980	1979	1978	1977	1976
Operating revenues	**$995,755**	1,062,616	1,051,486	940,391	877,547
Historical Cost Information Adjusted for General Inflation:					
Net earnings (loss)	**(56,758)**	23,860			
Net earnings (loss) per common share	**$ (4.54)**	1.62			
Net assets at year-end	**439,568**	478,042			
Current Cost Information:					
Net earnings (loss)	**(71,018)**	12,680			
Net earnings (loss) per common share	**$ (5.63)**	0.76			
Excess of increase in specific prices over increase in the general price level	**114,079**	6,528			
Net assets at year-end	**671,939**	611,433			
Gain from decline in purchasing power of net amounts owed	**46,847**	41,904			
Cash dividends declared per common share	**$ 0.25**	0.46	0.50	0.54	0.58
Market price per common share at year-end	**$ 9.13**	11.83	10.40	10.37	14.50
Average Consumer Price Index	**246.8**	217.4	195.4	181.5	170.5

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, 1980 and 1979 and the related statements of operations, shareholders' equity and changes in financial position for each of the years in the three year period ended December 31, 1980. 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, 1980 and 1979 and the results of its operations and the changes in its financial position for each of the years in the three year period ended December 31, 1980, 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 5 of notes to financial statements.

Peat, Marwick, Mitchell & Co.

January 30, 1981, except for Note 10
which is as of March 13, 1981

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.

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
Executive Vice President—Marketing,
Western Air Lines, Inc.,
Los Angeles, California

Gerald Grinstein*
Attorney-at-Law,
Preston, Thorgrimson, Ellis & Holman
Seattle, Washington

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

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

Robert O. Kinsey
Executive Vice President and Chief Operating Officer,
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,
Chairman of the Board,
Linkletter Management, Inc.,
Costa Mesa, California

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

Robert H. Volk*
President,
Martin Aviation, Inc.
Santa Ana, California

*Member, Executive Committee

DIRECTORS EMERITI

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

Leo H. Dwerlkotte
Las Vegas, Nevada

James D. Garibaldi
Attorney-at-Law,
Los Angeles, California

Dr. Donald H. McLaughlin
Chairman of the Board,
Homestake Mining Company,
San Francisco, California

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

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

Vernon O. Underwood
Chairman of the Board and Chief Executive Officer,
Young's Market Company, Inc.,
Los Angeles, California

Harry J. Volk
Union Bancorp, Inc.,
Los Angeles, California

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

Arthur G. Woodley
Bellevue, Washington

CORPORATE OFFICERS

Arthur F. Kelly
Chairman of the Board and Chairman of the Executive Committee

Dominic P. Renda
President and Chief Executive Officer

Robert O. Kinsey
Executive Vice President and Chief Operating Officer

Richard P. Ensign
Executive Vice President—Marketing

Donald K. Hall
Senior Vice President, General Counsel and Secretary

James L. Mitchell
Senior Vice President—Long Range Planning

Willis R. Balfour
Vice President—Passenger and Cargo Marketing

Anthony Colletti
Vice President—Maintenance and Engineering

Paul V. Donahue
Vice President—Procurement

Richard O. Hammond
Vice President and Treasurer

Paul R. Harding
Vice President—Central Division

David E. Holt
Vice President—Passenger Sales

Lawrence H. Lee
Vice President—Passenger and Inflight Services

Roderick G. Leith
Vice President—Finance

Fred E. Luhm
Vice President—Data Processing and Communications

Bert D. Lynn
Vice President—Advertising and Sales Promotion

William E. Newell
Vice President—Flight Operations

Lawrence A. Nichols
Vice President—Northern Division

Charles F. Schlatter
Vice President—Financial Planning

Ray Silvius
Vice President—Corporate Affairs

Jack M. Slichter
Vice President—Field Management

Glen L. Stewart
Vice President and Controller

Neil S. Stewart
Vice President—Government and Industry Affairs

Harry L. White
Vice President—Southern Division

Lynn D. Zumbrunnen
Vice President—Eastern Division

Howard L. Culver
Assistant Vice President—Regulatory Law

Donald F. Drews
Assistant Vice President—Properties and Facilities

John I. Good
Assistant Vice President—Cargo Sales and Service

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

Wayne B. Lichtgarn
Assistant Vice President—Consumer Affairs

Richard G. Peterson
Assistant Vice President—Schedule Planning

W. Jeffrey Terrill
Assistant Vice President—Route Planning

Donald W. Vena
Assistant Vice President—Personnel Relations

REGIONAL EXECUTIVES

William J. Grant
Managing Director—United Kingdom and Europe

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 South Flower St., Los Angeles, California 90071

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

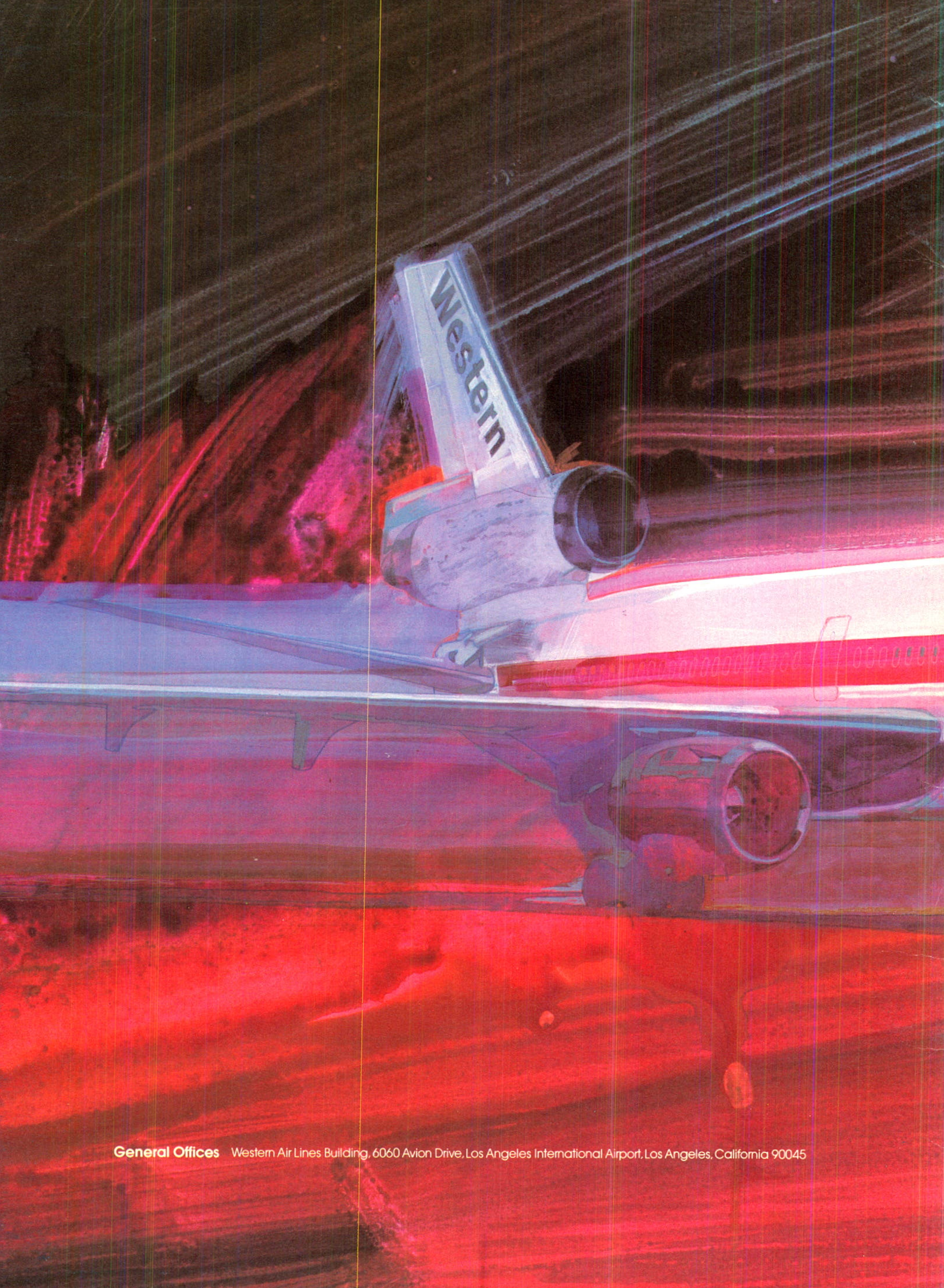
Exchange Listing—Common & Preferred Stock Debenture and Subordinated Notes
New York Stock Exchange
Pacific Stock Exchange

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



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