

WESTERN AIRLINES 1984 ANNUAL REPORT

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FIVE YEARS AT A GLANCE (in millions of dollars except per share amounts)

	1984	1983	1982	1981	1980
Operating revenues	\$ 1,181.9	1,142.6	1,065.3	1,059.8	995.7
Operating expenses	1,170.5	1,199.0	1,096.1	1,125.8	1,041.5
Operating Income (loss)	11.4	(56.4)	(30.8)	(66.0)	(45.8)
Other Income (Expenses):					
Interest expense, net	(58.1)	(51.5)	(46.7)	(45.0)	(38.5)
Gain on asset dispositions and other income, net	17.5	11.6	14.0	18.2	35.1
Loss before income taxes and extraordinary item	(29.2)	(96.3)	(63.5)	(92.8)	(49.2)
Income tax (benefits)	—	(0.3)	(3.6)	(19.4)	(19.6)
Loss before extraordinary item	(29.2)	(96.0)	(59.9)	(73.4)	(29.6)
Extraordinary item:					
Gain on pension plan terminations	—	41.5	15.9	—	—
Net loss	\$ (29.2)	(54.5)	(44.0)	(73.4)	(29.6)
Loss per common share:					
Before extraordinary item	\$ (1.37)	(6.22)	(4.78)	(5.81)	(2.46)
Extraordinary item	—	2.62	1.22	—	—
Net Loss	\$ (1.37)	(3.60)	(3.56)	(5.81)	(2.46)
Average common shares outstanding (000)	24,104	15,821	13,044	13,037	13,031
Passengers carried (000)	8,307	9,134	8,441	8,402	9,130
Available seat miles (000,000)	16,318	16,654	15,125	14,496	15,516
Revenue passenger miles (000,000)	9,417	9,416	8,893	8,548	8,832
Passenger load factor—actual(%)	57.7	56.5	58.8	59.0	56.9
—breakeven (%)	59.9	62.5	63.1	65.8	62.0

In Recognition...

The newest aircraft in Western's fleet, the new generation Boeing 737-300, is featured on the cover of this year's Annual Report. The first 737-300 was delivered in March 1985. Inside this year's Report to Shareholders, men and women representing the thousands whose efforts make Western the quality airline of the West are featured.



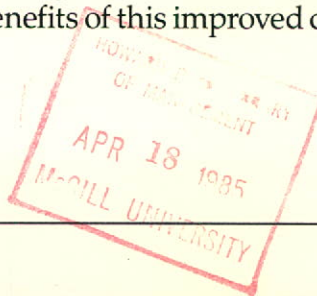
*Chief Executive Officer Gerald Grinstein,
Chairman Lawrence H. Lee and President Robin H.H. Wilson.*

REPORT TO SHAREHOLDERS:

Western Airlines turned the corner in 1984. The company reported its first full-year operating profit in five years as well as a fourth quarter operating profit of \$6.9 million, Western's highest fourth quarter ever. Although the company still finished the year with a net loss, it was reduced by \$25 million from 1983. Not counting an extraordinary gain in 1983, the net loss reduction was \$67 million. At the same time, the company was positioned to return to full profitability in 1985. These results begin to demonstrate what many within the company have believed for some time — that Western can operate profitably in the deregulated airline industry.

The successes of 1984 did not come about by chance. They are the result of strategies designed in the preceding year, and of management and labor reaching the understanding that both sides can cooperate in key areas to assure Western's future success.

The prime example of this cooperation was the development and successful implementation of the Competitive Action Plan (CAP), which has provided Western with a new, highly competitive cost structure. Building on the foundation established by the Partnership Program in 1983, the company and its five domestic unions negotiated new labor agreements, making Western the first major airline to restructure its costs permanently through the collective bargaining process. The benefits of this improved cost structure began to be



felt in the fourth quarter and will be even more evident in 1985.

Western's employees will share the benefits. As a result of the Partnership and CAP efforts, Western's employees now own nearly a third of the airline's common stock, and four union representatives have joined the company's board of directors.

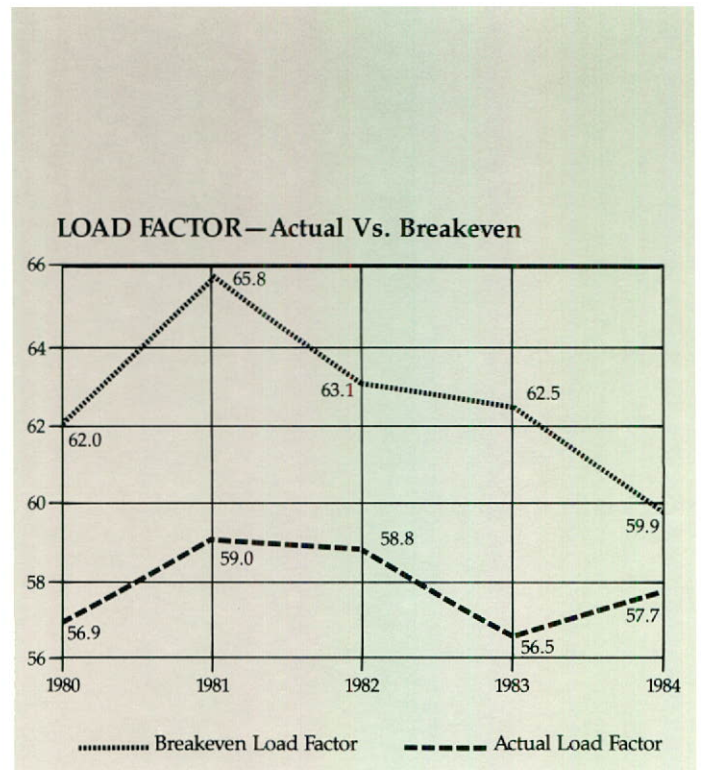
The company has significantly improved its internal financial budgeting and reporting procedures in order to keep all expenses at the lowest possible level. The system provides for tight cost accountability from first line managers to the office of the Chief Executive.

MARKETING THE AIRLINE OF THE WEST

Management moved aggressively in 1984 to position Western to be the dominant full service carrier of the western United States by refining schedules and strengthening connecting operations at Salt Lake City and Los Angeles, the airline's primary hubs.

Western is by far the largest airline operating at Salt Lake City with over 70 percent of the airport's daily departures. The terminal capacity of Western's domestic connecting complex was expanded by 40 percent in 1984, with the opening of Concourse D in October. Flights now operate from 21 second-level boarding gates. A further 29 percent increase in departures in April 1985 will give Western 108 daily flights serving 38 non-stop destinations.

Customer Service's Thelma Conklin, Debbie Bennett, Dennis VanCampen, Linda Rasmussen, Bob Lee and Claudia Taylor.



Flight Control's Sandy Hansen, Darcy Zucco and Alan Nakao, Aircraft Routing's Leonard Scott and Parmy Castillo of Flight Control.



Maintenance's Robert Montgomery, Virgil Hans, Dick Snyder, Tom Tiara and Frank Purkart.



The Salt Lake City hub is operating smoothly, and it is an increasingly attractive alternative to Denver for passengers throughout the western United States. Western continues to be grateful for the help and cooperation received from the people of Salt Lake City and the State of Utah in the development of this important facility.

Western also boosted its schedule at Los Angeles International Airport. The airline now operates the most daily departures from Los Angeles. With nonstop flights to 25 cities, Western serves more points nonstop from Los Angeles than any other airline. In addition, the Los Angeles operation is scheduled as a connecting gateway, with service to Canada, Hawaii and Mexico, all key pleasure travel destinations.

With an unsurpassed mix of sun and snow destinations and the combination of quality full service at competitive fares, Western will continue to attract a high percentage of discretionary travelers in the West. The company is also taking action, however, to gain a larger portion of the business travel market through improved schedules and service as well as a fleet-wide upgrade in the design and configuration of the aircraft interiors.

Western's current schedule provides convenient morning, midday and evening departures, and enables same-day travel to and from most markets. Services geared to the business traveler such as advance seat assignment and roundtrip check-in have been added. In addition, Western enriched its

Travel Pass II frequent flyer program in 1984 to maintain its competitive edge through a simple structure and fast rewards.

WESTERN'S FLEET

	Boeing 727-200	Boeing 737-200	Boeing 737-300	McDonnell Douglas DC-10-10
Owned	36	11		7
Leased	8	10		3
Delivery				
1985			3	
1986			3	
1987		6		
1988			3	

During this past year, the airline began a longer-term program of redesigning its aircraft interiors. First class sections, reflecting the commitment to full service and providing a key incentive for the frequent flyer program, will be available on all Western flights. Equally important is the upgrading of coach sections throughout the fleet, adding newly designed seats to give passengers additional leg room without sacrificing capacity. Larger overhead bins have been installed aboard 727 aircraft to accommodate demand for carry-on space and the same is being done on 737 aircraft.

Finally, all of Western's aircraft will be given a face-lift, replacing the red, white and black paint scheme of the last 15 years with a simple, bright red Western "W" outlined in blue and white on a

In-Flight's Ellen Rush and Jim Grimes with Pilots Dudley Moore and John Billon and In-Flight's Pat Silva.



Payroll's Sumi Yodogawa, Susie Johnson, Arnold Binder, Sue Endo, Mario Perez, Cheryl Kunis and Pat Heitz.



Telecommunications' Elaine Shue, Doris Parrish, Bob Yoder, Linda Guevara and Donn Smith.



gleaming aluminum fuselage. (One of the first airplanes to sport this new design, a new generation Boeing 737-300, is pictured on the cover of this report.)

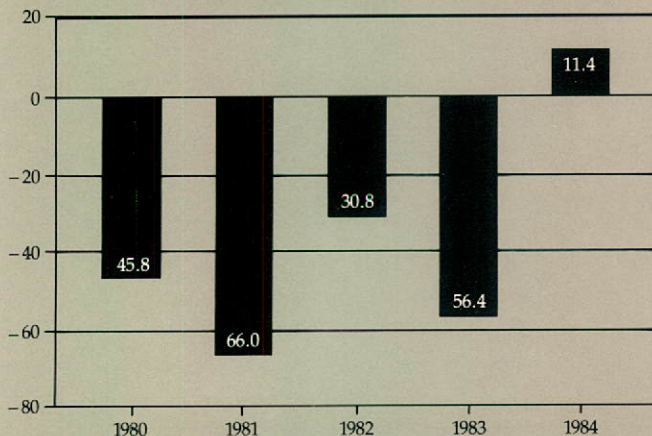
All of these changes position Western to take advantage of new opportunities in what is and will be a rapidly changing competitive environment in the western United States.

STRENGTHENING MANAGEMENT

Western continues to strengthen its management and board of directors. Gerald Grinstein, Western's president and chief operating officer since January 1984, was elected chief executive officer in February 1985. He succeeds Lawrence H. Lee, who remains chairman of the board. Robin H.H. Wilson also joined the company in February as president and chief operating officer after three years as president and general manager of the Long Island Rail Road where he is credited with a major turnaround. He previously spent 17 years with Trans World Airlines in operations, planning and marketing. He was senior vice president-operations when he left TWA.

In connection with these appointments, Western implemented a new organization involving fewer layers of management, thus enabling the company to respond more quickly to changes in the marketplace. Under the new organization, six staff functions and the chief operating officer report to Mr. Grinstein, while nine operating func-

OPERATING INCOME \$ Millions



tions report directly to Mr. Wilson.

The company was also fortunate to attract Thomas J. Roeck, Jr., as senior vice president-finance and chief financial officer. Mr. Roeck came to Western from Global Marine Inc., where he spent 18 years, most recently as vice president and treasurer.

In addition to Mr. Wilson, Western has six new directors who expand the expertise and broaden the background of Western's board. The two new outside directors are Archie R. Boe and Joseph T. Casey. Mr. Boe is the retired president of Sears and the former chairman and chief executive officer of the Allstate Companies. Mr. Casey is executive vice president and chief financial officer of Litton Industries. Representing Western's employees on the board are J.A. Kammermeyer of the Air Line Pilots Association; Dr. Charles Levinson, an international trade unionist and economist who is representing employees affiliated with the International Brotherhood of Teamsters and the Transport Workers Union; Susan Edwards Pace, Chairwoman of Western Airlines Master Executive Council of the Association of Flight Attendants, and James J. Shields, National President of the Air Transport Employees.

Western's management is pleased with the company's progress in 1984 and believes that the far-reaching changes of the last few years provide the company with a new and stronger position enabling it to compete and grow in the deregulated

Reservation's Margie Luis, Cindy Avila, Jerry Wood, Philip Gaskin, Carol Johnson and Avis Johnson.



Ramp Service's Bruce L. Cass, Luke Myles, Laura Lee, Barry Smith, Randy Bates, Jeff Sanborn, Frank Godfrey and Troy Coyle.



Fleetservice's Michael O'Malley, Rilbert Martinez, Thom Lemmon, Felix Salazar, Michael Delaney, James Walker, Larry McCarthy, Nick Vella and Sandor Toth.



Computer Operations' Stu Koren, Hal Healy and Susan Riemer.



environment. Western's passengers already are responding to improvements the company has been making: Western's load factor in recent months has been among the highest in the industry. Equally important, the investment community is beginning to realize the significance of the changes at Western, which can result in more attractive financing opportunities for the company.

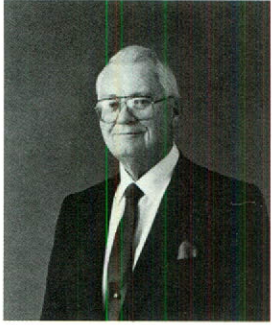
Western is grateful for the support of its shareholders, passengers, travel agents, and most of all, its employees, over the last few difficult years. The company is confident that support will be rewarded in the years to come.

Lawrence H. Lee
Chairman

Gerald Grinstein
Chief Executive Officer

March 20, 1985

BOARD OF DIRECTORS



Fred Benninger*
President
Tracinda Corporation
Las Vegas



Archie R. Boe
Retired President
Sears, Roebuck & Co.
Chicago



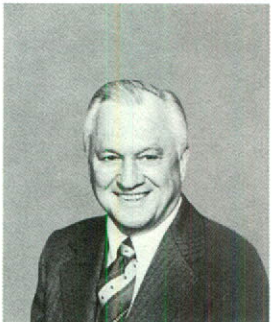
Victor L. Brown*
Presiding Bishop
The Church of Jesus Christ
of Latter-Day Saints
Salt Lake City



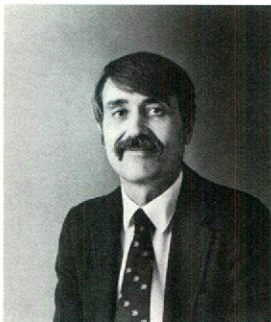
Joseph T. Casey
Executive Vice President
Chief Financial Officer
Litton Industries
Beverly Hills



Gerald Grinstein*
Chief Executive Officer
Western Air Lines, Inc.
Los Angeles



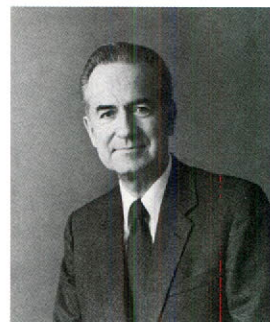
Walter J. Hickel
Chairman of the Board
Hickel Investment Company
Anchorage



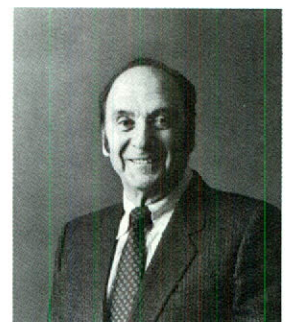
John A. Kammermeyer
Air Line Pilots Association
Los Angeles



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



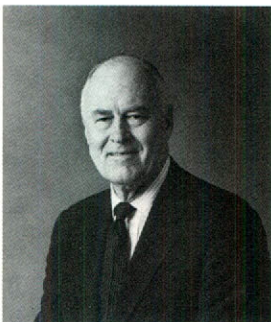
Lawrence H. Lee*
Chairman of the Board
Western Air Lines, Inc.
Los Angeles



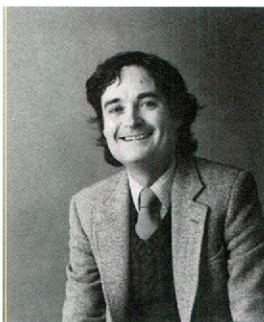
Charles Levinson
International Trade
Unionist and Economist
Geneva



Susan Edwards Pace
Chairwoman
Western Air Lines Master
Executive Council
Assoc. of Flight Attendants
Los Angeles



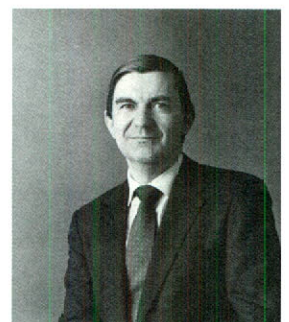
Spencer R. Stuart*
Chairman of the Board and
Chief Executive Officer
InveQuest Incorporated
Dallas



James J. Shields
National President
Air Transport Employees
Los Angeles

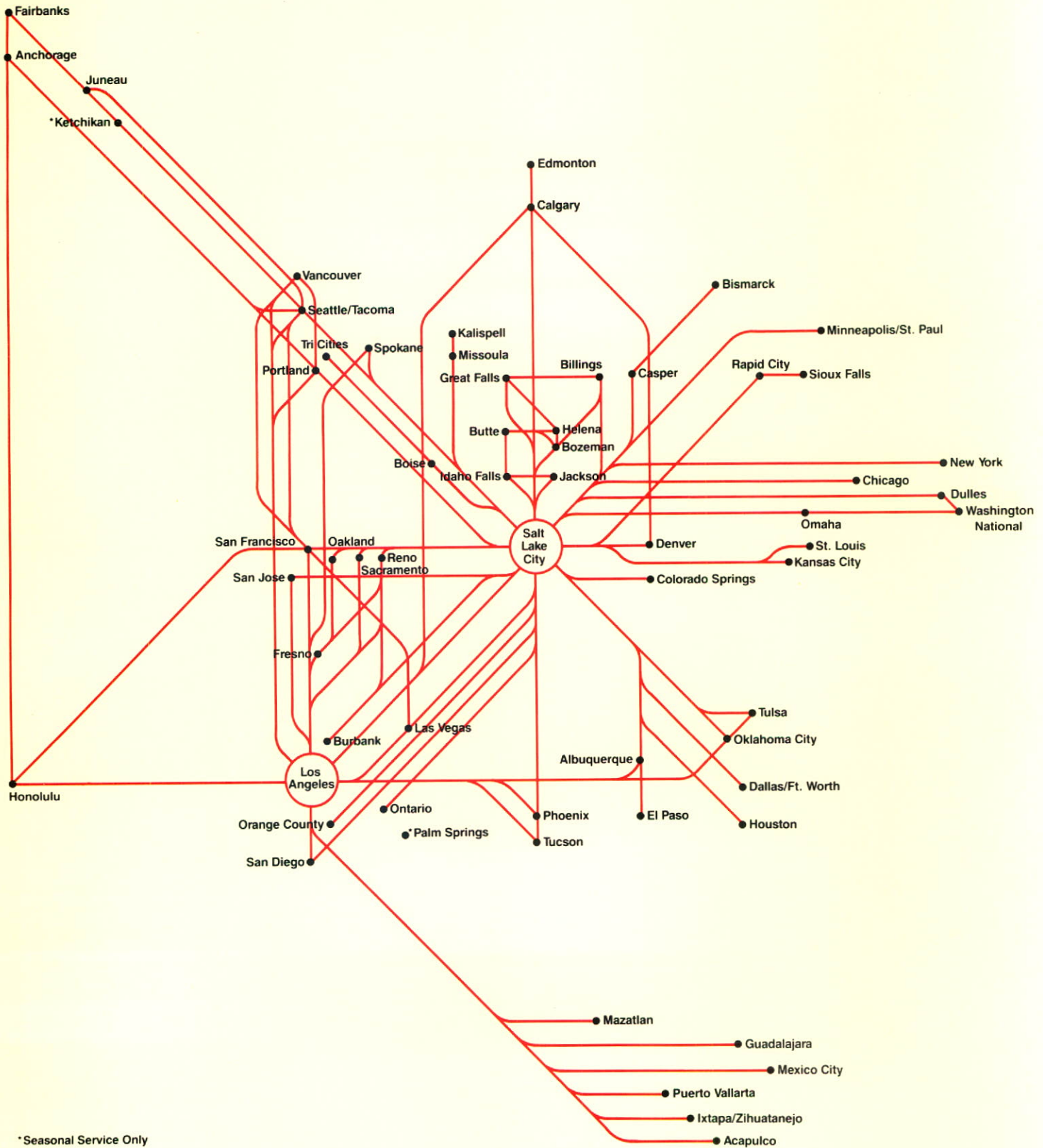


Robert H. Volk
Chairman and Chief
Executive Officer
Martin Aviation, Inc.
Santa Ana



Robin H.H. Wilson
President and Chief
Operating Officer
Western Air Lines, Inc.
Los Angeles

* Executive Committee



* Seasonal Service Only

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For fiscal year ended December 31, 1984

Commission File Number 1-1521

WESTERN AIR LINES, INC.

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction
of incorporation or organization)

95-1360150
(I.R.S. Employer
Identification No.)

6060 Avion Drive, Los Angeles, California 90045
(Address of Principal Executive Offices)

Registrant's telephone number, including area code: (213) 216-3000

Securities registered pursuant to Section 12(b) of the Act:

<u>Title of Each Class</u>	<u>Name of Each Exchange on Which Registered</u>
Common Stock—\$1 par value	New York and Pacific Stock Exchanges
\$2 Series A Cumulative Convertible Preferred Stock	
\$2.1375 Series B Cumulative Convertible Preferred Stock	New York Stock Exchange
5¼% Convertible Subordinated Debentures	
10¾% Senior Secured Trust Notes	
14% Senior Secured Convertible Notes	
Warrants to Purchase Common Stock	

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months, and (2) has been subject to such filing requirements for the past 90 days. Yes No

Registrant's Common Stock outstanding at March 27, 1985 was 24,151,157 shares.

The aggregate market value of the voting stock of the Registrant held by non-affiliates of the Registrant at March 27, 1985 was \$144,906,942.

DOCUMENTS INCORPORATED BY REFERENCE

<u>Title of Document</u>	<u>Part Hereof Into Which Document is Incorporated</u>
Definitive Proxy Statement Relating to 1985 Annual Meeting of Shareholders	Part III

PART I

ITEM 1. BUSINESS

General

Western is a commercial airline serving the continental United States, Alaska, Hawaii, Canada and Mexico. It is the eighth largest domestic airline in terms of 1984 United States revenue passenger miles. Western's operations serve principally the western portion of the United States where it provides service to virtually all major cities. The Company's service is based on a "hub-and-spoke" system, with its principal hubs in Salt Lake City and Los Angeles. The Company emphasizes the use of short-haul, narrow body aircraft suitable for hub-and-spoke operations and focuses its scheduling and marketing to attract the frequent business traveler.

Routes and Services

The Company provides air transportation services to 63 destinations, on routes extending from New York and Washington, D.C. in the east to Honolulu and Anchorage in the west. Other principal cities on Western's routes include Albuquerque, Chicago, Dallas/Ft. Worth, Denver, Houston, Kansas City, Las Vegas, Los Angeles, Minneapolis/St. Paul, Oakland, Phoenix, Portland, St. Louis, Sacramento, Salt Lake City, San Diego, San Jose, San Francisco and Seattle/Tacoma. Western's international certificates authorize service to Canada and Mexico. Western serves Vancouver from Los Angeles, San Francisco and Portland and Calgary/Edmonton from Denver, Los Angeles and Salt Lake City. Western provides service from Los Angeles to six cities in Mexico including Mexico City, Acapulco, Guadalajara, Puerto Vallarta, Mazatlan and Ixtapa/Zihuatanejo.

Western's passenger traffic mix reflects the fact that, in addition to serving the principal business centers in the western United States, it also serves most of the major vacation areas in western North America. Western estimates that presently more than half of its passenger traffic is vacation or pleasure oriented and believes that this portion of its business is particularly susceptible to changes in general economic conditions. Marketing programs introduced by Western during 1984 are designed to attract frequent business travelers.

The business of Western is seasonal in nature, with the highest revenues of the year normally being recorded in the third quarter. This seasonality is attributable to the propensity of the public to take pleasure trips during the summer months of the year. Western's new business traveler marketing programs are designed to attract revenue throughout the year.

Revenue and Traffic Information

The following table set forth certain statistics relating to Western's operations during the five years ending December 31, 1984:

	Year Ended December 31,				
	1984	1983	1982	1981	1980
Revenue Components as Percent of Total Operating Revenue:					
Passenger	88%	87%	87%	90%	89%
Cargo	6	6	6	6	6
Contract service and other	6	7	7	4	5
Total	100%	100%	100%	100%	100%
Traffic:					
Aircraft operated at end of period	76	74	72	70	71
Average daily utilization per aircraft (block hours)	8:22	8:42	8:09	7:57	8:24
Passengers carried (000,000)	8.3	9.1	8.4	8.4	9.1
Available seat miles (000,000)	16,318	16,654	15,125	14,496	15,516
Revenue passenger miles (000,000)	9,417	9,416	8,893	8,548	8,832
Passenger load factor					
—actual (%)	57.7	56.5	58.8	59.0	56.9
—breakeven (%)	59.9	62.5	63.1	65.8	62.0
Passenger revenue per revenue passenger mile ("yield")	\$.1108	\$.1055	\$.1042	\$.1113	\$.1010
Operating expense per available seat mile	\$.0717	\$.0720	\$.0725	\$.0777	\$.0671
Average length in miles per passenger trip	1,134	1,031	1,053	1,017	965
Available ton miles (000,000)	2,090	2,150	1,964	1,941	2,071
Cargo revenue ton miles (000,000) ..	156	167	156	151	163
Cargo tons carried (000)	106	117	114	110	121
Average number of employees	10,264	10,355	9,670	10,120	10,657

Passenger load factor is the ratio of revenue passenger miles ("RPMs") to available seat miles ("ASMs"). The breakeven passenger load factor represents the approximate percentage of available seats which must be occupied for revenues to cover all expenses except income taxes, assuming no changes in yield and expenses.

Revenue Management

Concurrently with the route and capacity adjustments described above, the Company is improving its system of revenue management so as to improve yields by capturing a higher percentage of full fare passengers on flights with high demand by monitoring demand and adjusting the availability of discount fares on such flights. For example, the percentage of full fare passengers carried by Western in the continental United States and Canadian markets has increased from 12.0% for 1983 to 15.5% for 1984.

Cost Controls

The Company has instituted improved procedures for controlling costs, including measures to assure minimum but effective staffing levels while still providing high quality passenger service. The use of computer modeling for manpower levels was implemented by the Company in 1983 to help optimize field and reservation staffing. A new system of labor and material cost collection in the maintenance area was implemented in early 1984. This system has enabled costs to be more readily identified with specific

functions and provides information necessary for the development of standard costs and profitability analyses. Improved methods of inventory control have been implemented for aircraft spare parts, which should result in lower investment costs and better utilization of existing inventories. In addition, the Company has improved its procedures for budgetary review of operating and capital expenditures.

Travel Agents

Western's business is substantially dependent upon sales made by travel agents. During 1984 and 1983 approximately 76% and 73%, respectively, of Western's passenger sales were generated by travel agents. See "Risk Factors and Certain Recent Developments—Industry Conditions."

Recently the CAB eliminated the exclusivity held by the travel agent industry for the sale of airline tickets. Consequently, airline tickets now may be distributed through any retail channel, and airlines are free to reach individual agreements with such outlets. This decision by the CAB could have a substantial impact on airline distribution methods in 1985.

Fuel

Western's arrangements with suppliers of aircraft fuel presently provide for substantially all of its actual and anticipated needs.

Western purchases the bulk of its fuel from major oil companies under annual agreements which guarantee supply but not price. However, the ability of Western's suppliers to furnish Western with fuel is dependent upon a number of factors, including national and international petroleum supplies and government regulation. Western expects fuel supplies to remain more than adequate for the foreseeable future. In recent years Western has faced a tightening of credit terms by fuel suppliers.

Price of fuel, rather than supply, has been the major problem in recent years. For many years, prices of fuel continued to escalate and the cost of fuel has become a major item of expense for Western and all other airlines. In 1984 fuel costs were \$300 million and accounted for 26 percent of Western's total operating expenses compared to 20 percent in 1978. The difference was due entirely to the increased price of fuel since the amount of fuel consumed actually declined between 1978 and 1984. During 1982 fuel prices first leveled off and then began to decline somewhat, averaging six percent below 1981 levels. The trend of lower fuel prices continued during 1983 averaging twelve percent below 1981 levels. Prices through 1984 continued to decline, averaging seventeen percent less than in 1981. The impact of fuel prices upon total operating costs is illustrated by the fact that based upon Western's fuel consumption during 1984, a one cent per gallon change in fuel prices would have resulted in an increase or decrease of approximately \$3.5 million in Western's annual fuel costs.

Western's operating procedures are designed to keep fuel consumption to a minimum, primarily through reduced airspeeds and elimination of excess weight.

The following table sets forth Western's fuel consumption and related information for the past five years:

	Consumption (Millions of Gallons)	Average Price Per Gallon	Total Fuel Cost (Millions)	Total Operating Expense (Millions)	Fuel Cost As a Percent of Operating Expense
1980.....	342	\$0.87	\$296.4	\$1,041.5	28.5
1981.....	315	1.04	326.6	1,125.8	29.0
1982.....	320	0.98	312.0	1,096.1	28.5
1983.....	354	0.91	320.0	1,199.0	26.7
1984.....	348	0.86	300.2	1,170.5	25.6

Western understands that the California State Board of Equalization, which is auditing various of Western's fuel suppliers for periods during 1978 through 1982, may challenge the qualification for exemption from California sales tax of certain fuel sales by the suppliers to Western and other airlines. No

claim or demand has yet been made upon Western or, to Western's knowledge, upon any of Western's fuel suppliers. In the event that deficiencies with respect to fuel sales to Western are imposed against Western's suppliers, the suppliers could be expected to seek indemnity from Western under their contracts with Western. While any such deficiencies could be substantial, Western believes that its fuel purchases qualified for exemption from the tax and plans to contest vigorously any deficiencies that may be asserted. Western believes that these matters will not have a material adverse effect on its financial position or operations.

Competitive Action Plan

In September 1984 Western received approval from each of its major unions for a combination of pay reductions and productivity improvements (the "Competitive Action Plan" or "CAP") designed to achieve substantial reductions in labor costs, effective September 1, 1984 through December 31, 1986. In contrast to temporary concessions obtained by Western in the past, these new agreements have no contractual provisions for reversions to higher wage levels in the future. Western began implementation of CAP in September 1984. The full effect of the CAP provisions will first be felt in the first quarter of 1985. Had the CAP cost structure been in effect during all of 1984, the Company estimates that breakeven load factor would have decreased from 59.9% to 55.5% and that it would have recorded an operating profit of approximately \$84 million in lieu of actual operating profit of \$11.4 million and net earnings of approximately \$43 million in lieu of an actual net loss of \$29.2 million, reflecting a reduction of \$47.1 million in cash labor expense and \$25.5 million in non-cash stock issuance expense for 1984. Such estimates may not, however, be indicative of actual results under CAP in 1985.

In addition, CAP provides for an increase in profits subject to distribution annually under a profit sharing plan adopted pursuant to the Company's 1983 Partnership Plan to 20% of the first \$75 million of annual profits and 35% of profits thereafter (profits for this purpose are pre-tax profits exclusive of extraordinary items and gains from disposition of property), for a reduction in the monthly management budget by 12.5%, by a combination of pay and head count adjustments and for the nomination for election to the Board of four union representatives (rather than the two representatives to which the unions were previously entitled). All of such directors have been elected.

Each of the CAP proposals also provides that if, after September 1, 1984, Western agrees to pay increases or productivity reductions for any group of employees, then similar increases or reductions will be afforded employees represented by other unions.

Employee Relations

The number of Western employees during 1984 averaged 10,264, down from an average of 10,355 in 1983. Labor unions represent approximately 92% of Western's employees. Western has not suffered a significant work stoppage by its employees during the past fourteen years, and considers its relations with its employees to be satisfactory. If Western were to suffer a strike or work stoppage, it could have a material adverse effect on the Company. Western's business also can be adversely affected by strikes or work stoppages by non-employees. For example, the air traffic controllers' strike during 1981 had an adverse impact on Western's operations and earnings.

The following table sets forth Western's union-represented employees by classification as of December 31, 1984:

<u>Employee Group</u>	<u>Number of Employees</u>	<u>Union</u>	<u>Contract Open for Amendment</u>
Agent and Clerical (U.S.)	4,491	Air Transport Employees	December 31, 1986
Flight Attendants	1,783	Association of Flight Attendants	December 31, 1986
Mechanics and Related Employees	1,396	International Brotherhood of Teamsters	December 31, 1986
Pilots	1,196	Air Line Pilots Association	December 31, 1986
Stock Clerks	81	International Brotherhood of Teamsters	December 31, 1986
Flight Operations Ground School Instructors	30	International Brotherhood of Teamsters	December 31, 1986
Flight Superintendents	29	Transport Workers Union	December 31, 1986
Agent and Clerical (Mexico)	150	Sindicato Nacional de Trabajadores de Aviacion y Similares	January 19, 1986
Agent and Clerical (Canada)	137	Air Transport Employees	July 1, 1984*

* In conciliation.

Competition

Western is presently subject to multiple carrier competition on most major domestic routes that it serves. Some of Western's competitors are larger with more extensive route systems and with greater financial or other resources. Western's hub-and-spoke system centered in Salt Lake City competes with similar systems of other carriers centered in other cities, such as Denver where three competing carriers maintain hubs. Other competitors of Western are regional and newly-formed carriers, some of which have lower cost structures or efficient hubs enabling them to compete effectively on particular routes.

Airlines are operating in an environment where price is a major and, in many instances, the most significant element of competition. Since domestic fare reductions are no longer government-controlled, the airlines are now free to offer lower basic fares and promotional fares involving virtually unlimited discounts. Many airlines, including Western, have taken advantage of this freedom to offer low basic fares or deep discounts on major routes. Carriers, including Western, generally have elected to match such fares when offered by competitors. See "Risk Factors and Certain Recent Developments—Industry Conditions."

Western's services to both Canada and Mexico are subject to competition by carriers of those countries, but on most routes only one such airline has been authorized by each country. Fares between United States points and Canada and Mexico are still controlled by the governments concerned, and the International Air Transportation Competition Act of 1979, which authorized airlines to reduce international fares up to 50% or increase them up to 5% without justification for changes, has not had substantial impact to date on the fare structures on United States-Canada and United States-Mexico routes.

Economic Regulation of Air Transportation

From 1938 to 1978 the airline industry was subject to the comprehensive economic regulatory jurisdiction of the CAB. Under that framework of regulation, authority to operate new services could be obtained only by proving a public need therefor, competition was restricted, rates and fares were tightly controlled, intercarrier arrangements for cooperative purposes were closely supervised and mergers and consolidations between air carriers were carefully scrutinized.

The Airline Deregulation Act of 1978 (the "Deregulation Act") materially changed the statutory scheme of regulation of domestic air transportation. Under the Deregulation Act, the CAB lost its authority with respect to domestic routes on December 31, 1981, and its authority over fares and intercarrier transactions, including mergers, as of January 1, 1983. Under the Deregulation Act, the CAB went out of existence as of January 1, 1985, and certain of its functions were transferred to the Department of Transportation. The Deregulation Act made no changes in the law as it relates to authority to engage in foreign air transportation, except the CAB's power to grant exemptions for temporary authority was liberalized. Nevertheless, the United States government has followed a practice of trying to convince foreign governments that multiple carrier designations on international routes should be authorized by intergovernment agreement. While many countries have acceded to the position of the United States government, Mexico and Canada have not.

The airlines presently operate in an environment of unrestricted competition in domestic air transportation. Carriers no longer have an obligation to provide service but can start and stop service on any route virtually at will (subject to slot and gate availability, and small community essential air service requirements) and have complete freedom in pricing their products.

Western is unable to predict the ultimate effect of the Deregulation Act on its operations, but if the increased competition that has resulted since the Deregulation Act became effective continues to result in overcapacity and uneconomically low fares, the financial position of the Company could be materially adversely affected.

Environmental Regulation

For a number of years the federal government has been tightening its controls over aircraft noise. Pursuant to Congressional directive, the FAA in 1969 prescribed aircraft noise limits for all aircraft designed after 1969. In 1973 and again in 1977 the FAA broadened the application of these noise limits and promulgated a phased compliance schedule whereby essentially all non-complying commercial jet aircraft must be replaced or modified by 1985 in order to meet the prescribed limits. All of the Company's aircraft are in compliance at this time.

California authorities have promulgated noise standards in an attempt to limit the total noise impact of airport operations on surrounding communities throughout the state. In connection therewith these authorities have asserted jurisdiction over such matters as curfews at local airports, even to the extent of attempting to override the decisions of airport proprietors. In addition, proprietors at several airports have adopted or are considering noise regulations that are more stringent than the pertinent federal or state standards. The stricter standards could hinder carriers, including Western, from commencing or continuing operations at those airports.

ITEM 2. PROPERTIES

Flight Equipment

The following table summarizes the composition of Western's fleet of 75 jet aircraft and aircraft on order:

	Seating Configuration First Class/ Coach	Fleet Composition at March 12, 1985		
		Owned*	Leased*	On Order
Boeing				
727-200.....	12/136	36	8	—
737-200.....	0/121	11	10	6
737-300.....	8/120	—	—	9
McDonnell Douglas				
DC-10-10.....	24/267	7	3	—
Total		<u>54</u>	<u>21</u>	<u>15</u>

* See Note 2 to Financial Statements for aggregate lease obligations and lease terms, and Note 6 to Financial Statements for information on pledged assets.

Western's system of hubs relies heavily on "feed" traffic which is best served by narrow-bodied aircraft. The lower operating costs of the Boeing 737 make it particularly well-suited to Western's routes, a significant number of which involve markets where the smaller capacity of this aircraft is adequate to meet normal demand. This cost advantage is attributable, among other things, to the fewer pilots and flight attendants required for the operation of this model aircraft as compared to the 727-200 and its two-engine versus three-engine configuration, which results in lower fuel consumption and maintenance costs than the 727-200. The DC-10 aircraft is a high capacity, wide-body aircraft well-suited for medium to long haul routes, such as Western's Hawaii routes, but is not well-suited for short haul routes. It is the Company's current intention to dispose of a portion of its 727-200 and DC-10 aircraft as new 737 aircraft on order are delivered. The Company has recently entered into an agreement for the sale of a DC-10-10 aircraft early in the second quarter of 1985, from which the Company expects to receive proceeds, net of amounts applied to release security arrangements, of approximately \$9 million.

Western has on order three Boeing 737-300 aircraft scheduled for delivery in the spring of 1985, six 737-300 aircraft scheduled for delivery in 1986 and 1988, and six 737-200 aircraft scheduled for delivery in 1987. The total cost of all aircraft on order is approximately \$394 million, of which approximately \$43 million was on deposit at December 31, 1984. Western is currently negotiating terms for financing the three aircraft scheduled for delivery in the spring of 1985; however, no commitments for financing the aircraft have been obtained and no assurance can be given that financing will be concluded. Failure by Western to complete the purchase of any of these aircraft could result in significant damages. If the changes in investment tax credits and deductions for accelerated depreciation proposed by the Treasury Department were to be adopted, the Company's ability to arrange lease financing for the acquisition of aircraft could be adversely affected.

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 Western 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 under certain circumstances on March 31, 1988, or any March 31 thereafter. Upon such termination or expiration, the improvements revert to the city. Western also leases hangars at Seattle/Tacoma and San Francisco, as well as terminal facilities at most airports served, plus ticket and administrative offices throughout its system. Public airports are utilized for flight operations generally under contractual arrangements with municipalities or agencies controlling them.

Western expects to expend a total of approximately \$5.4 million during 1985 in connection with improvements in its passenger terminal facilities at Salt Lake City, modification of its Los Angeles customs clearance facilities and expansion or remodeling projects at other airports in its system.

ITEM 3. LEGAL PROCEEDINGS

During the last several years Western and other airlines have been parties to numerous actions regarding the subjects of aircraft noise and engine emissions. Such actions have included both suits brought directly against the airlines and cross-complaints against the airlines in suits brought against airport proprietors. Unfavorable decisions in such actions could have a material adverse effect on the Company.

While extensive in recent years, such litigation has substantially diminished during the last year and Western does not believe any material liability will result to Western. In light of this litigation, however, operators of certain airports, including those at San Jose, Orange County and Burbank, California, and Washington, D.C.'s National, have imposed or are considering imposition of limitations on frequency and timing of airline flights or upon the proportion of any airline's fleet which may continue to operate without complying with specified noise standards. In general, enforcement of such restrictions at a major airport served by Western could have a material adverse effect on its operations.

Western is also involved in various other litigation, including cases alleging discrimination (including age discrimination) in employment practices. In one such action involving the ability of Western pilots to continue after age 60 as second officers, a judgment was entered during 1981 directing the Company to allow three pilots to continue working as second officers after age 60, and awarding those pilots back pay and attorneys' fees. That case was affirmed on appeal by a federal appellate court and Western's appeal to the U.S. Supreme Court is pending. Additionally, at least one other similar action has been filed. Western does not believe such claims will result in any material liability to Western.

In an action filed by Western in the Los Angeles County Superior Court for breach of contract arising from the failure of defendants to pay for contract maintenance services performed by Western on certain DC-10 aircraft, the defendants, International Air Leases Inc. and Capitol Air Inc., filed cross-complaints in September and October 1983 seeking damages in excess of \$37 million, plus punitive damages. The cross-complaints allege that Western's maintenance services were not performed adequately, all of which allegations Western has denied. Subsequent to the filing of the cross-complaints, Capitol Air Inc. was the subject of an involuntary petition in bankruptcy and Western was advised that a mandatory stay of all actions involving Capital Air Inc. had resulted. Western believes that these cross-complaints will not result in any material liability to Western.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

No matters were submitted to a vote of security holders during the fourth quarter of 1984.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

As of December 31, 1984, the 24,147,290 shares of outstanding Western Common Stock were held by approximately 15,000 stockholders of record. There were 1,196,270 shares of Series A Preferred Stock issued and outstanding and 979,500 shares of Series B Preferred Stock issued and outstanding held by approximately 1,300 stockholders of record. The Common Stock and Series A Preferred Stock are listed on the New York and Pacific Stock Exchanges. The Series B Preferred Stock is listed on the New York Stock Exchange. The following table sets forth the high and low sale prices of the Common Stock on the New York Stock Exchange ("NYSE") as reported by the National Quotation Bureau, Inc. for the periods indicated:

	Price Range	
	High	Low
1983		
1st quarter	7¼	4⅞
2nd quarter.....	6½	4¾
3rd quarter	6¾	3⅞
4th quarter.....	4⅞	4
1984		
1st quarter	5½	4
2nd quarter.....	4¼	2⅞
3rd quarter	4	2⅞
4th quarter.....	4⅞	3¼

Because of continuing losses and restrictions in various loan agreements, the Company has not paid dividends on its Common Stock since the third quarter of 1980. Resumption of dividends on the Common Stock will depend upon the Company's earnings, financial condition, capital requirements and terms of financings. The Company does not anticipate the payment of cash dividends on the Common Stock in the foreseeable future.

ITEM 6. SELECTED FINANCIAL DATA

The following financial information should be read in conjunction with the Financial Statements and Notes thereto contained elsewhere herein.

Income Statement Information:

(in millions except per share amounts)

	Year Ended December 31,				
	1984	1983	1982	1981	1980
Operating Revenues:					
Passenger	\$1,041.4	\$ 993.4	\$ 925.8	\$ 949.6	\$ 887.9
Cargo	69.3	72.2	68.0	62.9	63.8
Contract service and other	71.2	77.0	71.5	47.3	44.0
Total operating revenues	<u>1,181.9</u>	<u>1,142.6</u>	<u>1,065.3</u>	<u>1,059.8</u>	<u>995.7</u>
Operating Expenses:					
Wages, salaries, and employee benefits	412.1	422.7	368.5(a)	403.4	384.2
Fuel	300.2	320.0	312.0	326.6	296.4
Other	458.2	456.3	415.6	395.8(b)	360.9
Total operating expenses	<u>1,170.5</u>	<u>1,199.0</u>	<u>1,096.1</u>	<u>1,125.8</u>	<u>1,041.5</u>
Operating income (loss)	11.4	(56.4)	(30.8)	(66.0)	(45.8)
Interest expense, net	(58.1)	(51.5)	(46.7)	(45.0)	(38.5)
Gain on asset dispositions and other income, net	17.5	11.6	14.0	18.2	35.1
Earnings (loss) before income taxes and extraordinary item	(29.2)	(96.3)	(63.5)	(92.8)	(49.2)
Income taxes (benefits)	—	(0.3)	(3.6)	(19.4)	(19.6)
Earnings (loss) before extraordinary item	(29.2)	(96.0)	(59.9)	(73.4)	(29.6)
Extraordinary Item:					
Gain on pension plan terminations(c)	—	41.5	15.9	—	—
Net earnings (loss)	<u>\$ (29.2)</u>	<u>\$ (54.5)</u>	<u>\$ (44.0)</u>	<u>\$ (73.4)</u>	<u>\$ (29.6)</u>
Earnings (Loss) per Common Share(d):					
Before extraordinary item	\$ (1.37)	\$ (6.22)	\$ (4.78)	\$ (5.81)	\$ (2.46)
Net earnings (loss)	(1.37)	(3.60)	(3.56)	(5.81)	(2.46)
Cash dividends paid per share of Common Stock(e)	—	—	—	—	0.25

Balance Sheet Information:
(in millions)

	At December 31,				
	1984	1983	1982	1981	1980
Current assets	\$173.3	\$197.2	\$168.7	\$167.2	\$191.1
Property and equipment—net	611.1	595.0	634.8	662.4	718.8
Total assets	803.6	812.2	808.6	834.6	917.0
Current liabilities	277.6	262.7	284.1	278.4	246.5
Long-term obligations less current installments	428.2	437.9	411.5	401.9	435.1
Shareholders' equity	62.5	86.7	77.6	121.7	197.3

- (a) During 1982 actuarial assumption changes to pension plans were made reducing the net loss by \$7.2 or \$0.55 per share (primary) for the year 1982.
- (b) Effective January 1, 1981, Western revised its procedures for recognizing commission expense to more closely identify the expense with the period in which the related revenue is recognized. This change reduced the 1981 net loss by \$3.3 or \$0.26 per share (primary).
- (c) See Note 4 to Financial Statements.
- (d) Fully diluted earnings per share amounts are equal to primary because the inclusion of the assumed exercise of stock options and warrants and conversion of convertible securities would be anti-dilutive.
- (e) The Company does not anticipate the payment of cash dividends on its Common Stock in the foreseeable future. See "MARKET FOR REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS."

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Results of Operations

Years Ended December 31, 1984, 1983 and 1982

Although operating results for 1984 are significantly improved over 1983, Western incurred a net loss for the year 1984. Western has not recorded an annual profit since 1979.

In 1984 Western produced an \$11.4 million operating profit, the first in five years, as compared to operating losses of \$56.4 million in 1983 and \$30.8 million in 1982. Western had a net loss of \$29.2 million in 1984, compared to net losses of \$54.5 million in 1983 and \$44.0 million in 1982. The 1983 and 1982 net losses reflect extraordinary gains of \$41.5 million and \$15.9 million, respectively, resulting from terminations of certain pension plans.

The disastrous fare wars that began in mid-1982 continued into the first half of 1983. At the same time, Western's operating costs increased, primarily due to the significant expansion begun in May 1982. Higher traffic was obtained in part by selling Western's product at a lower price and therefore failed to produce a revenue increase sufficient to cover the increased operating costs. The operating loss increased from \$14.1 million for the first half of 1982 to \$59.2 million in the same 1983 period.

During the second half of 1983, Western's management began to redirect the Company's efforts toward the business traveler and took other steps designed to return the carrier to profitability.

Major areas of emphasis included: (i) implementation of a partnership plan, including cash wage concessions from each of the Company's domestic labor groups in return for establishment of an employee stock plan, a cash profit sharing plan and the right to name two nominees for election to the Board of

Directors; (ii) strengthening the Salt Lake City hub and developing Los Angeles International Airport as a more effective second hub to feed Hawaii, Canada and Mexico; (iii) focusing scheduling and marketing efforts to attract the frequent business traveler; (iv) adjusting capacity to meet seasonal fluctuations in demand; (v) emphasizing short-haul narrow body aircraft suitable for the hub-and-spoke system; (vi) establishing more effective revenue and yield management systems; and (vii) instituting improved cost control measures.

Certain of these steps, combined with the general economic recovery, resulted in a significant yield increase in the second half of 1983 compared to the second half of 1982 and the first half of 1983, with only a slight decrease in load factor. Revenues rose eight percent from the 1982 second half, while operating expenses were up only 4.4 percent, and Western recorded an operating profit for the second half for the first time since 1978.

For the year 1983, Western's capacity (ASMs) rose 10.1 percent, while traffic (RPMs) rose only 5.9 percent. Load factor declined to 56.5%, the lowest level since 1971. The significant yield increases in the second half of 1983 resulted in a slightly higher yield for the year (\$.1055 vs. \$.1042). Revenue rose 7.3 percent. Although unit costs (cost per ASM) declined from \$.0725 to \$.0720, total operating costs rose 9.4 percent due primarily to increased flying and higher labor rates. Some of the wage concessions obtained in early 1982 expired in early 1983. New wage concessions were obtained from all domestic labor groups beginning in October and November 1983.

Increased flying, combined with institution of service to several cities not previously served, required additional employees in 1983. Fuel expense and other operating expenses also rose as a result of the increased flying and higher traffic levels. Fuel expense rose only 2.6 percent, as lower prices substantially offset a 10.6 percent increase in fuel used. Other operating expenses rose 12.2 percent, reflecting significant increases in ground handling services purchased from other airlines, landing fees, rents, maintenance, food and beverage, commissions to travel agents, and crew travel expenses.

Interest expense rose 10.4 percent, reflecting both higher debt levels and higher rates resulting from the Company's refinancing activities.

In 1984, the improvement in operating results continued, primarily as a result of increased passenger revenue, coupled with reductions in labor and fuel expenses. Western's passenger revenue for 1984 increased five percent from the 1983 level as a result of a yield increase of five percent. Capacity decreased two percent, while traffic was relatively unchanged. Load factor for 1984 versus 1983 increased from 56.5 to 57.7 percent.

The yield improvement, which started in the second half of 1983, continued into the first half of 1984 and was partially offset by slight decreases in late 1984. Yield for the year 1984 was \$.1108, an increase of 5.0 percent from 1983 and 6.3 percent from 1982.

Operating expenses decreased two percent, primarily in fuel and labor expenses. Fuel cost decreased six percent as a result of a five percent price decrease, combined with a one percent decrease in consumption.

Wages, salaries, and employee benefits decreased three percent as a result of Western's five labor groups agreeing to new contracts effective September 1984, which contain lower pay rates and improved productivity provisions. The contracts are open for amendment December 31, 1986. The new contract wage rates are lower than the rates in place since late 1983 under the partnership plan with employees as described above. The amortization of the employee stock plan expense relating to the 1983 partnership plan terminated in October 1984, and totalled \$25.5 million for 1984. Excluding the employee stock plan expense, labor cost would have decreased seven percent for 1984 versus 1983.

Interest expense rose 13% in 1984 primarily reflecting higher debt levels.

Gains on asset dispositions were \$11.3 million, \$9.0 million, and \$7.4 million in 1984, 1983, and 1982, respectively.

Liquidity and Capital Resources

Western's cash and cash equivalents totalled \$57.5 million at December 31, 1984, up from \$46.3 million at December 31, 1983 and from \$47.4 million at December 31, 1982. Western's cash balances fluctuate significantly from day to day and have increased from December 31, 1983, primarily as the result of proceeds from asset dispositions, drawing down under the Credit Agreement and operating profits, offset by interest and debt repayments. The Company's working capital deficit was \$104.3 million at December 31, 1984, up from \$65.5 million at December 31, 1983, primarily due to the financing of advance deposits related to aircraft deliveries, additional borrowings, and the amortization of the employee stock plan. The Company anticipates refinancing the deposits in conjunction with delivery of the aircraft. Because airlines typically have no product inventories and revenues are generated principally by utilizing long term assets, minimal or negative working capital balances are not uncommon. Since mid-1981 cash generated from operations has not been sufficient to fund debt repayment. However, Western has made all debt repayments by supplementing cash generated from operations with other cash resources.

In order to maintain liquidity during 1982, 1983 and 1984, Western sold certain assets, terminated certain pension plans, deferred progress payments on aircraft purchase contracts and instituted new borrowing and financing arrangements. The most significant of these transactions were as follows:

In April 1982 Western sold for \$21 million the conditional sales contracts covering an earlier sale of two DC-10 aircraft, and terminated a pension plan, receiving \$15.9 million in cash.

During December 1982 Western sold privately \$12.5 million principal amount of 12% convertible subordinated debentures due December 1992, and entered into a term loan and security agreement to borrow \$33.4 million from an affiliate of an aircraft manufacturer. At the same time, Western placed an order for three 737-300 aircraft and utilized \$3 million of the proceeds as deposits for those aircraft. The term loan has been substantially repaid. The outstanding balance at December 31, 1984 was \$2.9 million.

In January 1983 the Company terminated a pension plan and received \$33.4 million in cash in 1983.

In June 1983 the Company completed a public offering of units consisting in the aggregate of \$90 million principal amount 10 $\frac{3}{4}$ % Senior Secured Trust Notes due June 15, 1998, 3,240,000 shares of Common Stock and warrants to purchase an additional 9,000,000 shares of Common Stock. The net proceeds of approximately \$84 million were used in part to repay \$78 million of debt.

In 1983 and 1984 Western obtained agreements from an aircraft manufacturer to finance aircraft advance deposit payments through the manufacturer until after February, 1985.

In September 1983 Western entered into the Credit Agreement to provide it with a revolving line of credit of \$22 million through August 31, 1984.

In December 1983 the Company completed a public offering of \$65 million principal amount of 14% Senior Secured Convertible Notes due December 1, 1998 of which approximately \$28.8 million of the net proceeds of \$61.2 million were used to repay debt. In conjunction with the December 1983 public offering, the Company's lenders agreed to allow the Company to extend the Credit Agreement beyond August 31, 1984, to provide an \$11 million revolving line of credit through June 30, 1985.

In April 1984, Western issued one million shares of \$2.1375 Series B Cumulative Convertible Preferred Stock ("Series B Preferred Stock"), convertible into Common Stock at \$5 per share, subject to adjustment. The net proceeds of \$13.6 million were used to prepay \$2.6 million of debt, and for payment of \$5.4 million of dividend arrearages on the \$2.00 Series A Cumulative Convertible Preferred Stock ("Series A Preferred Stock"). In conjunction with the issuance of the Series B Preferred Stock, the Company's lenders agreed to extend the Credit Agreement to provide a \$20 million revolving line of credit through August 31, 1985. On April 27, 1984, Western drew down \$10 million under the Credit Agreement. In August 1984, Western drew down the remaining \$10 million available under the Credit Agreement. In

March 1985 Western repaid the full \$20 million under the Credit Agreement, which remains available. Subject to documentation, Western's lenders have agreed in principle to extend the Credit Agreement through June 30, 1986.

During 1984 Western sold two Boeing 727-200 aircraft for \$16.3 million.

The Company has recently entered into an agreement for the sale of a DC-10-10 aircraft early in the second quarter of 1985, from which the Company expects to receive proceeds, net of amounts applied to release security arrangements, of approximately \$9 million.

Substantially all of Western's owned aircraft and engines are pledged as collateral for debt and other obligations. In addition, some of the Company's agreements require that collateral be maintained at specified levels.

Reference is made to Note 6 to Financial Statements for a discussion of Western's covenants under debt agreements.

In November and December 1984, Western took delivery of six B737-200 aircraft and two spare engines that were previously on order from the manufacturer. In that connection, Western entered into 14-year operating lease agreements for the spare engines and four of the aircraft and sold the remaining two aircraft to a foreign carrier. Western was reimbursed for previously recorded capitalized interest and buyer-furnished equipment on the six aircraft and spare engines.

In March 1985, Western issued \$30 million of 14¼% Senior Notes due April 1, 1988. The net proceeds of approximately \$28.3 million will be used for general corporate purposes including working capital.

In March 1985, Western also filed a registration statement with the Securities and Exchange Commission for a public offering of up to 1,500,000 shares of Series D Cumulative Convertible Preferred Stock.

Western has on order from the manufacturer three Boeing 737-300 aircraft scheduled for delivery in the spring of 1985 at a cost of approximately \$73 million, of which approximately \$25 million is on deposit. Western is currently negotiating terms for financing the aircraft; however, no commitments for financing the aircraft have been obtained and no assurance can be given that financing will be concluded. Failure to take delivery of these aircraft could result in significant assessments against Western for manufacturer's damage claims. An additional 12 Boeing 737 aircraft are scheduled for delivery during 1986 through 1988 for which no financing has yet been arranged. If the changes in investment tax credits and deductions for accelerated depreciation proposed by the Treasury Department were to be adopted the Company's ability to arrange lease financing for the acquisition of aircraft could be adversely affected. See Note 3 to Financial Statements.

ITEM 8. FINANCIAL STATEMENTS

ACCOUNTANT'S REPORT

The Board of Directors
Western Air Lines, Inc.:

We have examined the balance sheets of Western Air Lines, Inc. as of December 31, 1984 and 1983 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, 1984. 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 connection with our examinations of the financial statements, we have also examined the supporting schedules as listed in the index located elsewhere in this Form 10-K.

In our opinion, the aforementioned financial statements present fairly the financial position of Western Air Lines, Inc. at December 31, 1984 and 1983 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, 1984, in conformity with generally accepted accounting principles applied on a consistent basis. Also in our opinion, the related supporting schedules, when considered in relation to the basic financial statements taken as a whole, present fairly in all material respects the information set forth therein.

PEAT, MARWICK, MITCHELL & CO.

Los Angeles, California
February 19, 1985, except for the twelfth
and thirteenth paragraphs of Note 6,
which are as of March 20, 1985.

WESTERN AIR LINES, INC.

BALANCE SHEETS
(In thousands of dollars)

A S S E T S

	December 31,	
	1984	1983
Current Assets:		
Cash and cash equivalents.....	\$ 57,476	\$ 46,336
Receivables (less allowance for doubtful accounts of \$12,551—1984 and \$8,758—1983)	81,486	91,019
Flight equipment expendable parts at average cost (less allowance for obsolescence of \$18,068—1984 and \$17,073—1983).....	18,652	21,238
Prepaid expenses.....	11,946	34,957
Other current assets.....	3,789	3,648
Total current assets.....	173,349	197,198
Property and Equipment at Cost:		
Flight equipment.....	856,049	851,831
Facilities and ground equipment.....	154,482	144,915
Deposits on equipment purchase contracts.....	42,921	35,108
	1,053,452	1,031,854
Less accumulated depreciation and amortization	442,327	436,879
	611,125	594,975
Other Assets	19,121	19,991
	\$ 803,595	\$ 812,164

See accompanying Notes to Financial Statements.

WESTERN AIR LINES, INC.

BALANCE SHEETS

(In thousands of dollars)

LIABILITIES AND SHAREHOLDERS' EQUITY

	December 31,	
	<u>1984</u>	<u>1983</u>
Current Liabilities:		
Current installments of debt.....	\$ 64,948	\$ 30,958
Current installments of capital leases.....	7,739	12,353
Notes payable.....	2,275	3,642
Accounts payable.....	55,357	63,890
Airline traffic liability.....	79,603	78,822
Salaries, wages and vacation benefits payable.....	36,210	43,090
Accrued pension plan contributions.....	14,950	7,387
Other current liabilities.....	16,533	22,584
Total current liabilities.....	<u>277,615</u>	<u>262,726</u>
Long-term Obligations, Less Current Installments:		
Debt.....	335,531	337,424
Capital leases.....	92,682	100,429
	<u>428,213</u>	<u>437,853</u>
Deferred Credits and Other Liabilities:		
Deferred taxes on income.....	10,328	10,328
Deferred gain on sale and lease-back of aircraft.....	2,334	4,667
Other.....	22,638	9,930
	<u>35,300</u>	<u>24,925</u>
Shareholders' Equity:		
Preferred stock—authorized 25,000,000 shares:		
\$2 Series A Cumulative Convertible, \$25 stated value per share.		
Liquidation preference at stated value plus accrued and unpaid		
dividends, outstanding 1,196,270 shares—1984 and 1983.....	29,907	29,907
\$2.1375 Series B Cumulative Convertible, \$1 stated value per share.		
Liquidation preference at \$15 per share plus accrued and unpaid		
dividends, outstanding 979,500 shares—1984.....	980	—
Common stock—authorized 70,000,000 shares, \$1 par value per share,		
outstanding 24,147,290 shares—1984 and 24,085,790 shares—1983.....	24,147	24,086
Additional paid-in capital.....	87,464	83,533
Retained earnings (deficit).....	(80,031)	(50,866)
	62,467	86,660
Commitments and Contingent Liabilities		
	<u>\$803,595</u>	<u>\$812,164</u>

See accompanying Notes to Financial Statements.

WESTERN AIR LINES, INC.

STATEMENTS OF OPERATIONS

(In thousands of dollars except per share amounts)

	Year ended December 31,		
	1984	1983	1982
Operating Revenues:			
Passenger.....	\$1,041,412	\$ 993,428	\$ 925,735
Cargo.....	69,293	72,195	68,020
Contract service and other.....	71,180	76,939	71,515
	1,181,885	1,142,562	1,065,270
Operating Expenses:			
Wages, salaries, and employee benefits.....	412,108	422,741	368,503
Fuel.....	300,198	319,980	311,999
Depreciation and amortization.....	59,565	59,379	61,751
Other.....	398,602	396,834	353,815
	1,170,473	1,198,934	1,096,068
Operating income (loss).....	11,412	(56,372)	(30,798)
Other Income (Expenses):			
Interest, principally on long-term obligations.....	(64,136)	(54,542)	(49,195)
Interest capitalized.....	6,070	2,977	2,508
Interest income.....	3,642	2,480	5,604
Gain on disposition of property and equipment.....	11,279	8,956	7,385
Gain on foreign currency translation.....	1,208	—	—
Other, net.....	1,360	166	994
	(40,577)	(39,963)	(32,704)
Loss before income taxes and extraordinary item.....	(29,165)	(96,335)	(63,502)
Income taxes (benefits).....	—	(330)	(3,556)
Loss before extraordinary item.....	(29,165)	(96,005)	(59,946)
Extraordinary Item:			
Gain on pension plan terminations.....	—	41,520	15,930
Net loss.....	\$ (29,165)	\$ (54,485)	\$ (44,016)
Loss per Common Share:			
Before extraordinary item.....	\$ (1.37)	\$ (6.22)	\$ (4.78)
Extraordinary item.....	—	2.62	1.22
Net loss.....	\$ (1.37)	\$ (3.60)	\$ (3.56)

See accompanying Notes to Financial Statements.

WESTERN AIR LINES, INC.

STATEMENTS OF CHANGES IN FINANCIAL POSITION

(In thousands of dollars)

	Year ended December 31,		
	1984	1983	1982
Sources of Working Capital:			
Loss from operations, exclusive of extraordinary item.....	\$(29,165)	\$(96,005)	\$(59,946)
Add (Deduct) Items Which did not Affect Working Capital:			
Depreciation and amortization.....	58,256	58,348	59,968
Deferred income taxes	—	(419)	(432)
Gain on disposition of property and equipment.....	(11,279)	(8,956)	(7,385)
Other.....	(5,042)	(2,977)	(2,508)
Total provided (used) by operations exclusive of extraordinary item.....	12,770	(50,009)	(10,303)
Extraordinary item.....	—	41,520	15,930
Portion of extraordinary item which did not affect working capital	—	(7,897)	(51)
Total provided by extraordinary item	—	33,623	15,879
Total provided (used) by operations	12,770	(16,386)	5,576
Issuance of long-term obligations	33,125	123,928	62,986
Disposition of property and equipment.....	22,710	10,290	9,269
Issuance of common stock and warrants	—	31,325	—
Issuance of common stock to employee stock plan	—	32,175	—
Issuance of \$2.1375 Series B Cumulative Convertible Preferred Stock, net of expense.....	13,625	—	—
Reimbursement of deposits and capital expenditures upon entering operating leases for B737-200 aircraft.....	43,884	—	—
Reclassification of pension plan liabilities to long-term liabilities	—	—	7,218
Other, net	9,434	—	—
Total sources.....	135,548	181,332	85,049
Applications of Working Capital:			
Reduction of long-term obligations including transfers to current liabilities	42,117	97,623	53,349
Purchase of and deposits on property and equipment	123,516	16,382	30,933
Cash dividends on preferred stock.....	8,653	—	—
Debt issue costs.....	—	7,735	—
Other, net	—	9,748	4,898
Total applications.....	174,286	131,488	89,180
Increase (decrease) in working capital	\$(38,738)	\$ 49,844	\$ (4,131)
Summary of Increases (Decreases) in Working Capital:			
Cash and cash equivalents.....	\$ 11,140	\$ (1,014)	\$ 23,293
Receivables, net	(9,533)	8,352	(26,856)
Flight equipment expendable parts, net	(2,586)	(124)	409
Prepaid expenses	(23,011)	20,957	4,761
Other current assets.....	141	282	(41)
Current installments of debt.....	(33,990)	12,080	(16,388)
Current installments of capital leases.....	4,614	(2,947)	(1,444)
Notes payable	1,367	9,467	6,891
Accounts payable.....	8,533	(2,701)	15,315
Airline traffic liability.....	(781)	10,999	(8,815)
Salaries, wages and vacation benefits payable	6,880	(2,727)	1,475
Accrued pension plan contribution	(7,563)	2,745	(4,469)
Other current liabilities.....	6,051	(5,525)	1,738
Increase (decrease) in working capital	\$(38,738)	\$ 49,844	\$ (4,131)

See accompanying Notes to Financial Statements.

WESTERN AIR LINES, INC.

STATEMENTS OF SHAREHOLDERS' EQUITY

Years Ended December 31, 1984, 1983 and 1982

(In thousands of dollars)

	Preferred Stock		Common Stock	Additional Paid-In Capital	Retained Earnings (Deficit)	Total Shareholders' Equity
	Series A	Series B				
Balance at December 31, 1981 ..	\$29,923	\$ —	\$13,044	\$31,062	\$ 47,635	\$121,664
Other items.....	(2)			(1)		(3)
Net loss.....					(44,016)	(44,016)
Balance at December 31, 1982 ..	29,921	—	13,044	31,061	3,619	77,645
Conversion of preferred stock	(14)		1	13		
Conversion of debentures...			1	4		5
Issuance of common stock ..			3,240	14,580		17,820
Issuance of warrants				13,500		13,500
Issuance of common stock under Employee Stock Plan.....			7,800	24,375		32,175
Net loss.....					(54,485)	(54,485)
Balance at December 31, 1983 ..	29,907	—	24,086	83,533	(50,866)	86,660
Issuance of 1,000,000 shares of preferred stock		1,000		12,625		13,625
Conversion of 20,500 shares of preferred stock		(20)	61	(41)		
Cash dividends on preferred stock				(8,653)*		(8,653)
Net loss.....					(29,165)	(29,165)
Balance at December 31, 1984 ..	\$29,907	\$ 980	\$24,147	\$87,464	\$(80,031)	\$ 62,467

* Includes payment of 1983 and 1982 preferred stock dividends which were in arrears.

See accompanying Notes to Financial Statements.

WESTERN AIR LINES, INC.

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 amortized over the life of the lease by the straight-line method. The estimated useful lives and residual values of owned aircraft are as follows:

<u>Aircraft Type</u>	<u>Estimated Useful Life</u>	<u>Residual Value</u>
DC-10	16 years	10%
727 (New)	15 years	15%
727 (Used)	8 years	—
737	14 years	15%

Estimated useful lives of ground equipment range from four to ten years. Buildings and improvements on leased property are generally depreciated over the life of the lease. Amortization 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 Flight Equipment Expendable Parts

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

Revenue Recognition

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

Cargo and contract service and other revenues are recognized as services are provided and billed.

WESTERN AIR LINES, INC.

NOTES TO FINANCIAL STATEMENTS (Continued)

Note 2. Lease Commitments

Western leases certain flight equipment and facilities and ground equipment. Lease terms for flight equipment are 11½ to 15 years for 727 aircraft, 2½ to 14 years for 737 aircraft, and 15 to 18 years for DC-10 aircraft. Lease terms for facilities and ground equipment range up to 29 years. Equipment under capital leases included in the balance sheets at December 31, 1984 and 1983 was as follows:

	<u>1984</u>	<u>1983</u>
Flight equipment.....	\$129,110	\$159,306
Less accumulated amortization	55,561	75,570
	<u>\$ 73,549</u>	<u>\$ 83,736</u>

At December 31, 1984 minimum lease payments under leases expiring after December 31, 1985 were as follows:

	<u>Capital Leases</u>	<u>Operating Leases</u>
1985	\$ 19,624	\$ 33,899
1986	19,630	31,682
1987	19,552	28,823
1988	19,741	27,987
1989	19,915	26,699
Thereafter.....	70,666	227,703
Total minimum lease payments.....	169,128	<u>\$376,793</u>
Less amount representing interest	68,707	
Present value of capital lease obligations.	100,421	
Less current installments of capital leases	7,739	
Long-term capital lease obligations	<u>\$ 92,682</u>	

Rental expense for operating leases amounted to \$38,497, \$38,165, and \$33,222 in 1984, 1983, and 1982, respectively.

Note 3. Commitments and Contingent Liabilities

At December 31, 1984, Western had on order from the manufacturer six Boeing 737-200 aircraft for delivery in 1987 and nine Boeing 737-300 aircraft for delivery in 1985, 1986 and 1988. The cost of all aircraft on order is approximately \$394,000, of which approximately \$43,000 is already on deposit. Western is currently negotiating terms for financing the aircraft scheduled for delivery in 1985; however, no firm commitments for financing any of the aircraft have been obtained.

Payments due under existing purchase commitments for aircraft and ground properties and equipment during the five years ending December 31, 1989 are:

1985	\$ 72,321
1986	96,541
1987	127,698
1988	68,603
1989	—
	<u>\$365,163</u>

WESTERN AIR LINES, INC.

NOTES TO FINANCIAL STATEMENTS (Continued)

Note 3. Commitments and Contingent Liabilities— (Continued)

During 1984, Western took delivery of six Boeing 737-200 aircraft under existing purchase commitments. The Company entered into 14-year operating lease agreements for four of the aircraft and sold the remaining two aircraft to a foreign carrier.

For information regarding the status of legal proceedings at December 31, 1984, see "Legal Proceedings" elsewhere in this Form 10K.

Note 4. Retirement Plans

Western has retirement plans 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 assumes an eight percent rate of return in determining the actuarial present value of accumulated plan benefits.

Western participates in a collectively bargained multi-employer pension plan covering its IBT-represented employees and is, therefore, subject to the provisions of the Multi-employer Pension Plan Amendments Act of 1980. Under this complex law, the union plan's Board of Trustees, as sponsor, is required to obtain an actuarial valuation of the present value of vested and nonvested accumulated plan benefits. Western has been advised that its share of the liability for unfunded vested benefits in this plan is not available. 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 follows:

	January 1,		
	1984	1983	1982
Actuarial Present Value of Accumulated Plan Benefits:			
Vested	\$38,631	\$31,301	\$120,550
Nonvested	3,883	4,207	9,212
	\$42,514	\$35,508	\$129,762
Net assets available for benefits	\$45,065	\$38,208	\$132,959

The amounts in the table above for 1984 and 1983 do not include information regarding a defined benefit retirement plan for pilots, which Western terminated during the first quarter of 1983. The termination allowed Western to recover that portion of excess funds in the plan which related to Company contributions. Elimination of a deferred credit related to the plan of \$8,115 and cash proceeds of \$33,405 resulted in a gain of \$41,520 (\$2.62 per share) for the year ended December 31, 1983. The gain is reported as an extraordinary item. In conjunction with terminating the defined benefit retirement plan, Western made increased contributions to the defined contribution retirement plan for pilots in 1983 and 1984. Western has pledged certain assets to secure its obligations regarding other employee benefits for pilots.

The amounts in the table above for all years do not include information regarding a defined benefit retirement plan for non-union employees, which Western terminated during the second quarter of 1982. The termination allowed Western to recover excess funds, and as a result recognize \$15,930 (\$1.22 per share) for the year ended December 31, 1982. The Company subsequently adopted a new, defined contribution, pension plan for non-union employees.

WESTERN AIR LINES, INC.

NOTES TO FINANCIAL STATEMENTS (Continued)

Note 4. Retirement Plans—(Continued)

The cost of the retirement plans, including the union-sponsored plan, charged to operating expense was \$25,883, \$27,578, and \$18,802 for 1984, 1983, and 1982, respectively. These costs included amortization of prior service costs over periods ranging from 10 to 20 years for certain of the plans.

Actuarial assumption changes to pension plans during 1982 decreased the retirement plan expense. Western adopted recommendations by its actuaries to revise the assumed rate of return used in determining the actuarial present value of accumulated plan benefits from six to eight percent. The effect of this and other changes decreased operating expense for the year by \$7,173 (\$0.55 per share). A further decrease of \$6,486 (\$0.50 per share) in 1982 was caused by the termination of the retirement plan for non-union employees and a temporary reduction in Company contributions to a pilots' defined contribution retirement plan.

In addition to providing pension benefits, the Company provides certain health care and life insurance benefits for retired employees. Substantially all of the Company's employees may become eligible for those benefits if they reach normal retirement age while still working for Western. The life insurance premiums are expensed monthly based on the number of participants. The medical and dental benefits are self-funded, and their expense is based on actual claims paid. For 1984, the annual cost of providing both life and health care benefits was approximately \$1,806.

Note 5. Income Taxes

Income taxes are summarized as follows:

	<u>1984</u>	<u>1983</u>	<u>1982</u>
Current:			
Federal	\$ —	\$ (111)	\$(3,124)
State	—	200	—
	—	89	(3,124)
Deferred:			
Provision.....	576	3,765	(2,290)
Operating loss carryforward	(576)	(4,184)	1,964
Investment credits	—	—	71
	—	(419)	(255)
Amortization of deferred investment credits	—	—	(177)
	\$ —	\$ (330)	\$(3,556)

Under applicable law, investment credits could be applied against 90 percent of Federal income tax liabilities in 1982. The Tax Equity and Fiscal Responsibility Act of 1982 reduced the application to 85 percent for 1983 and beyond.

WESTERN AIR LINES, INC.

NOTES TO FINANCIAL STATEMENTS (Continued)

Note 5. Income Taxes—(Continued)

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

	<u>1984</u>	<u>1983</u>	<u>1982</u>
Depreciation and amortization	\$ 3,890	\$ 1,349	\$ (6,868)
Capital leases	337	(416)	721
Interest capitalized.....	(1,592)	1,334	1,464
Employee benefits.....	(3,087)	326	717
Gain on sale and leaseback of flight equipment.....	1,821	1,074	1,074
Other	(793)	98	602
	<u>\$ 576</u>	<u>\$ 3,765</u>	<u>\$ (2,290)</u>

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

	<u>1984</u>	<u>1983</u>	<u>1982</u>
Income taxes at the United States statutory rate	\$(13,416)	\$(25,215)	\$(21,884)
Increases (reductions) in taxes resulting from:			
Effect of operating loss carryforward for which no tax benefit may be recognized	13,416	24,796	(13,017)
Amortization of deferred investment credits	—	—	(177)
Reversal of investment credits previously recognized on flow-through method	—	—	29,362
State income taxes net of federal income tax benefit	—	200	—
Capital gains.....	—	—	4,798
IRS audit adjustments	—	—	(2,452)
Other.....	—	(111)	(186)
Income tax benefits.....	<u>\$ —</u>	<u>\$ (330)</u>	<u>\$ (3,556)</u>

Minimal tax benefits have been recognized for 1983 and 1984 because, for reporting purposes, virtually all benefits which could be recognized by offsetting deferred tax credits were recognized prior to 1983.

In 1981 Western intended to relinquish the right to carryback the 1981 net operating loss to offset prior years' taxable income, since the Company's tax liability in those prior years had been substantially eliminated by application of investment tax credits. During 1982 Western decided to carryback the 1981 loss to prior years and obtain a refund of the tax that had been paid. As a result, 1982 amounts shown above reflect increased benefit of net operating losses, substantially offset by reversal of previously recognized application of investment tax credits.

Net operating losses of \$148,000 have not been utilized on tax returns. For income tax purposes, they expire as follows:

1995.....	\$34,000
1996.....	1,000
1997.....	20,000
1998.....	60,000
1999.....	33,000

For financial statement purposes, \$106,000 of the carryforward has not been recognized.

WESTERN AIR LINES, INC.

NOTES TO FINANCIAL STATEMENTS (Continued)

Note 5. Income Taxes—(Continued)

Investment credits available to reduce future years' Federal income tax expense for financial and tax purposes amount to \$60,600 at December 31, 1984. For income tax purposes, available credits expire in the following years:

1992.....	\$ 3,500	1996.....	\$2,000
1993.....	13,700	1997.....	1,300
1994.....	17,000	1998.....	1,500
1995.....	19,000	1999.....	2,600

Note 6. Debt and Pledged Assets

Long-term debt is comprised of:

	<u>December 31,</u>	
	<u>1984</u>	<u>1983</u>
9.55% equipment trust certificates due May 1, 1993, with semi-annual principal payments of \$3,349.....	\$ 56,940	\$ 63,638
10% equipment trust certificates due April 1, 1994, with quarterly principal payments of \$1,000.....	36,993	40,992
Floating-rate equipment trust certificates due June 30, 1995, (interest rate 9.75% at December 31, 1984) with semi-annual principal payments of \$2,609.....	49,854	55,073
13.29% installment notes due May 1, 1995, with semi-annual principal payments of \$1,100.....	23,100	25,300
\$90,000 face amount 10¾% senior secured trust notes due June 1998, net of \$30,494—1984 and \$31,053—1983 unamortized discount, (effective interest rate 17.3%) with annual sinking fund payments of \$9,000 starting June 15, 1989.....	59,506	58,947
14% senior secured convertible notes due December 1, 1998, with annual sinking fund payments of \$6,020 face amount December 1, 1989, and \$6,500 annually thereafter.....	64,520	65,000
Floating-rate note payable to manufacturer due February 1985 with payments of \$1,500 in January 1985 and \$1,350 in February 1985.....	2,850	7,350
9.25% conditional sales agreement due May 1, 1994.....	11,535	—
Floating-rate five-year term loan due November 15, 1989, (interest rate 13.25% at December 31, 1984), with quarterly principal payments of \$1,250.....	25,000	—
Deferred deposits with manufacturer due upon delivery of aircraft (See Note 3), interest at prime rate plus 1%.....	18,181	11,750
Revolving line of credit.....	20,000	—
5¼% convertible subordinated debentures due February 1, 1993, with annual sinking fund payments of \$1,500.....	19,500	20,995
12% convertible subordinated debentures due December 1992.....	12,500	12,500
10% subordinated sinking fund notes due April 15, 1984.....	—	6,837
	<u>400,479</u>	<u>368,382</u>
Less: Current installments.....	(64,948)	(30,958)
	<u>\$335,531</u>	<u>\$337,424</u>

The 12% convertible subordinated debentures are convertible into 2,336,448 shares of Common Stock at \$5.35 per share, subject to adjustment in certain cases. Interest is payable semi-annually.

WESTERN AIR LINES, INC.

NOTES TO FINANCIAL STATEMENTS (Continued)

Note 6. Debt and Pledged Assets—(Continued)

Notes payable at December 31, 1984, consisted of loans payable to two financial lending institutions. These notes are secured by Western's Universal Air Travel Card and air freight receivables, which total \$11,867 at December 31, 1984. Under these agreements Western can borrow, up to a limit, a percentage of the receivable balances. The interest rates are prime plus 3.25 percent.

Effective January 18, 1983, Western entered into a \$30,000 revolving credit agreement with a group of financial institutions. Upon signing the agreement, Western paid a fee of $\frac{1}{4}$ of 1% of the commitment and issued 550,000 warrants for the purchase of Common Stock. In conjunction with drawdowns under the agreement a borrowing fee of \$82 was paid and 146,774 additional warrants were issued. The exercise price and number of warrants are subject to adjustment. At December 31, 1984, 709,921 shares of common stock were reserved for exercise at a price of \$5.30 per share. The warrants expire on January 18, 1993.

The following schedule shows the amount of long-term debt due in the five years ending December 31, 1989.

1985.....	\$64,948
1986.....	25,934
1987.....	25,577
1988.....	25,669
1989.....	38,127

At December 31, 1984, 3,027,950 shares of Common Stock were reserved for conversion of 5 $\frac{1}{4}$ % debentures at a conversion price of \$6.44 per share.

In June 1983 the Company completed a public offering of units, consisting in the aggregate of \$90,000 principal amount 10 $\frac{3}{4}$ % Senior Secured Trust Notes due June 15, 1998, 3,240,000 shares of Common Stock, and warrants to purchase 9,000,000 shares of Common Stock. The warrants are exercisable at \$9.50 per share, subject to adjustment, and expire on June 15, 1993. The exercise price may be paid using 10 $\frac{3}{4}$ % Senior Secured Trust Notes, which will be accepted at par. The expiration date may be accelerated by the Company to no earlier than June 15, 1988 and the warrants may be called on or after June 15, 1986 if the price of the common stock attains specified levels.

Western entered into a new revolving credit agreement in September 1983 which provided a \$22,000 line of credit through August 31, 1984 (the "Credit Agreement"). In April 1984, Western issued one million shares of \$2.1375 Series B Cumulative Convertible Preferred Stock ("Series B Preferred Stock"), convertible into Common Stock at \$5 per share, subject to adjustment. The net proceeds of \$13,600 were used to prepay \$2,600 of debt, and for payment of \$5,400 of dividend arrearages on the \$2 Series A Cumulative Convertible Preferred Stock. In conjunction with the issuance of this Series B Preferred Stock, the Company's lenders agreed to extend the Credit Agreement to provide a \$20,000 revolving line of credit through August 31, 1985. At December 31, 1984, the entire \$20,000 under the Credit Agreement was drawn down. The Credit Agreement and a related agreement affecting other indebtedness of the Company contain two principal financial covenants. One requires the maintenance of adjusted net worth (defined as tangible net worth plus the long-term portion of subordinated indebtedness) of not less than \$45,000 prior to September 30, 1985, increasing \$30,000 annually to \$200,000 by October 1989. The second requires that the ratio of debt, defined to include lease obligations and other liabilities but to exclude the long-term portion of subordinated indebtedness, to adjusted net worth, cannot exceed eleven to one prior to September 30, 1985, declining to a ratio of three to one by October 1989. As of December 31, 1984, the Company had adjusted net worth of \$80,400 and debt, as defined, of \$471,200 and the ratio described above was 5.86 to one. The Credit Agreement also places certain restrictions on dividend payments. The Credit Agreement is secured by liens on certain aircraft.

WESTERN AIR LINES, INC.

NOTES TO FINANCIAL STATEMENTS (Continued)

Note 6. Debt and Pledged Assets—(Continued)

At December 31, 1984, 12,503,875 shares of Common Stock were reserved for conversion of 14% Senior Secured Convertible Notes at a conversion price of \$5.16.

In May 1984, Western borrowed \$13,125 under a conditional sales agreement to finance approximately 75 percent of the purchase price of a B737-200 aircraft. This loan is stated in Japanese yen and requires semi-annual yen payments at a stated interest rate of 9.25 percent. Since the payments are in yen, the outstanding United States dollar loan balance will fluctuate as a result of being translated at the exchange rate in effect at the balance sheet date. At December 31, 1984, Western had recorded a gain of \$1,208 as a result of the foreign currency translation.

In November 1984, the Company entered into a five-year term loan agreement for \$25,000. The interest rate is prime plus 2.5 percent. The proceeds of this loan were used to finance the \$35,500 purchase price of six used B727-200 aircraft and three spare engines previously on lease.

In March 1985, Western issued \$30,000 of 14¼% Senior Notes due April 1, 1988. On April 1, 1988, the Senior Notes, at the election of the Company, will be converted into either Convertible Subordinated Debentures due April 1, 1998 or Series C Cumulative Convertible Preferred Stock (but not both). If on or prior to February 1, 1988, the holder serves notice not to convert the Senior Notes, such notes will be repaid at 100% of the principal amount plus accrued interest. At March 31, 1985, 3,333,333 shares of Common Stock were reserved for conversion of either the Debentures due 1998 or the Series C Preferred Stock.

In March 1985, Western also filed a registration statement with the Securities and Exchange Commission for a public offering of up to 1,500,000 shares of Series D Cumulative Convertible Preferred Stock.

Substantially all of Western's property and equipment is pledged as collateral for debt and other obligations. Several of the agreements require that collateral be maintained at specified levels.

Note 7. Stock Options

Western has two stock option plans for officers and key personnel. The first plan was adopted in 1974, and provided for options to purchase a maximum of 1,030,000 shares of Common Stock at prices not less than the fair market value of the Common Stock at date of grant. Options granted under the 1974 Plan are not intended to qualify as "Incentive Stock Options" under the Internal Revenue Code. The options under this plan are exercisable in equal annual increments over a five-year period and expire ten years after the date of grant. No options may be granted under the 1974 Plan after January 20, 1984. The second plan is the Executive Stock Option and Stock Appreciation Right Plan (the "1982 Plan"). The 1982 Plan provides for granting of incentive stock options, non-qualifying stock options, and stock appreciation rights. A maximum of 1,800,000 shares of Common Stock may be issued under this plan. Options granted under the 1982 Plan expire ten years from the date of grant and the purchase price specified in each option may not be less than the fair market value of the Common Stock at the date of the grant.

The balances of options granted under the plans follow:

	1974 Plan		1982 Plan	
	Number	Average Price	Number	Average Price
Options Granted and Outstanding at:				
December 31, 1984.....	152,780	\$8.30	612,500	\$5.15
December 31, 1983.....	561,250	\$8.49	802,500	\$5.14
Options Exercisable at:				
December 31, 1984.....	150,580	\$8.28	500,500	\$5.15
December 31, 1983.....	556,750	\$8.48	505,500	\$4.89

No options were exercised during 1984. At December 31, 1984 and 1983, 152,780 and 962,885 shares of Common Stock, respectively, were reserved for the exercise of current and future grants under the 1974 Plan, and 1,800,000 shares were similarly reserved under the 1982 Plan.

WESTERN AIR LINES, INC.

NOTES TO FINANCIAL STATEMENTS (Continued)

Note 8. Loss per Common Share

Loss before extraordinary item and net loss per common share are calculated as follows:

Primary:

	Year Ended December 31,		
	1984	1983	1982
Loss Before Extraordinary Item per Common Share:			
Loss before extraordinary item	\$(29,165)	\$(96,005)	\$(59,946)
Preferred stock cash dividends	<u>(3,868)</u>	<u>(2,393)</u>	<u>(2,394)</u>
Loss before extraordinary item applicable to Common Stock	<u>\$ (33,033)</u>	<u>\$ (98,398)</u>	<u>\$ (62,340)</u>
Loss before extraordinary item per common share, primary.	<u>\$ (1.37)</u>	<u>\$ (6.22)</u>	<u>\$ (4.78)</u>
Net Loss per Common Share:			
Net loss	\$(29,165)	\$(54,485)	\$(44,016)
Preferred stock cash dividends	<u>(3,868)</u>	<u>(2,393)</u>	<u>(2,394)</u>
Loss applicable to Common Stock	<u>\$ (33,033)</u>	<u>\$ (56,878)</u>	<u>\$ (46,410)</u>
Net loss per common share, primary	<u>\$ (1.37)</u>	<u>\$ (3.60)</u>	<u>\$ (3.56)</u>
Weighted average shares outstanding (in thousands)	<u>24,104</u>	<u>15,821</u>	<u>13,044</u>

Fully Diluted:

Fully diluted earnings per share are not presented, as the exercise of stock options and Common Stock Warrants and the conversion of convertible subordinated debentures and preferred stock into Common Stock would be anti-dilutive.

Note 9. Preferred Stock

The shares of \$2 Series A Preferred Stock are convertible into Common Stock at the rate of 2.5 shares of Common Stock for each share of Series A Preferred Stock, subject to adjustment under certain conditions, and may be redeemed at any time at the option of Western. The redemption price of \$25.60 at December 31, 1984, decreases periodically until 1987 after which it remains at \$25 per share. At December 31, 1984, 2,990,675 shares of Common Stock were reserved for conversion of Series A Preferred Stock.

The Company had omitted payment of the quarterly dividends on the Series A Preferred Stock beginning the first quarter of 1982. In April 1984, in connection with the issuance of the \$2.1375 Series B Cumulative Convertible Preferred Stock, all covenants restricting the payment of dividends on preferred stock were lifted. From the net proceeds of this offering, \$4,785 was used to bring current the dividend arrearages on the Series A Preferred Stock.

The shares of \$2.1375 Series B Preferred Stock are convertible into Common Stock at the rate of three shares of Common Stock for each share of Series B Preferred Stock, subject to adjustment under certain conditions, and may be redeemed at any time after March 1, 1986 at the option of Western. The redemption price of \$16.71 at March 1, 1986, decreases periodically until 1994 after which it remains at \$15 per share. At December 31, 1984, 2,938,500 shares of Common Stock were reserved for conversion of Series B Preferred Stock.

WESTERN AIR LINES, INC.

NOTES TO FINANCIAL STATEMENTS (Continued)

Note 10. Related Party Transactions

In December 1982 Western leased two new 737-200 aircraft from a subsidiary of Alaska International Industries, Inc. ("AII"). AII is wholly owned by Neil G. Bergt, who was Chairman and Chief Executive Officer of Western from December 1981 to April 1983. The leases are for a term of 12 years with options to extend for two years at fair rental value and/or purchase the aircraft at fair market value subject to specified minimum amounts at the end of the fifth and each subsequent year. The liability for these capital leases at December 31, 1984 was \$19,509. The rental is \$160 per aircraft per month. In addition to amounts paid pursuant to the leases, Western paid \$1,150 to AII and its subsidiaries during 1982 to reimburse them for expenditures incurred on behalf of Western for equipment, facilities and personnel. Approximately \$1,000 of this amount was paid for reimbursement of expenses billed by AII in connection with Mr. Bergt's aircraft expenses while traveling for Western and personnel on loan to Western (Mr. Frank P. Moolin, Jr., then President of AII, served as Mr. Bergt's assistant at Western while receiving his salary from AII).

Note 11. Quarterly Financial Data (Unaudited)

Summarized quarterly financial data for 1984 and 1983 is as follows:

	<u>March 31</u>	<u>June 30</u>	<u>September 30</u>	<u>December 31</u>
1984				
Operating revenues.....	\$287,344	\$293,888	\$322,293	\$278,360
Operating income (loss).....	(12,903)	(5,843)	23,235	6,923
Earnings (loss) before extraordinary item	(23,018)	(13,653)	13,013	(5,507)
Net earnings (loss).....	(23,018)	(13,653)	13,013	(5,507)
Earnings (Loss) per Common Share:				
Primary:				
Earnings (loss) before extraordinary item.....	<u>\$ (0.98)</u>	<u>\$ (0.61)</u>	<u>\$ 0.44</u>	<u>\$ (0.27)</u>
Net earnings (loss)	<u>\$ (0.98)</u>	<u>\$ (0.61)</u>	<u>\$ 0.44</u>	<u>\$ (0.27)</u>
Fully Diluted:				
Earnings (loss) before extraordinary item.....	<u>\$ (0.98)</u>	<u>\$ (0.61)</u>	<u>\$ 0.32</u>	<u>\$ (0.27)</u>
Net earnings (loss)	<u>\$ (0.98)</u>	<u>\$ (0.61)</u>	<u>\$ 0.32</u>	<u>\$ (0.27)</u>
1983				
Operating revenues.....	\$257,259	\$281,518	\$323,004	\$280,781
Operating income (loss).....	(38,706)	(20,462)	20,653	(17,857)
Earnings (loss) before extraordinary item	(51,845)	(25,438)	10,980	(29,702)
Net earnings (loss).....	(17,845)	(23,723)	16,736	(29,653)
Earnings (Loss) per Common Share:				
Primary:				
Earnings (loss) before extraordinary item.....	<u>\$ (4.02)</u>	<u>\$ (1.97)</u>	<u>\$ 0.50</u>	<u>\$ (1.46)</u>
Net earnings (loss)	<u>\$ (1.41)</u>	<u>\$ (1.84)</u>	<u>\$ 0.73</u>	<u>\$ (1.46)</u>
Fully Diluted:				
Earnings (loss) before extraordinary item.....	<u>\$ (4.02)</u>	<u>\$ (1.97)</u>	<u>\$ 0.42</u>	<u>\$ (1.46)</u>
Net earnings (loss)	<u>\$ (1.41)</u>	<u>\$ (1.84)</u>	<u>\$ 0.60</u>	<u>\$ (1.46)</u>

During the first quarter of 1983 Western terminated a defined benefit retirement plan for pilots. This termination produced extraordinary gains of \$34,000, \$1,715, \$5,756 and \$49 recorded in the first, second, third and fourth quarters of 1983, respectively.

WESTERN AIR LINES, INC.

NOTES TO FINANCIAL STATEMENTS (Continued)

Note 12. Competitive Action Plan

In September 1984 Western received approval from each of its major unions for a combination of pay reductions and productivity improvements (the "Competitive Action Plan" or "CAP") designed to achieve substantial reductions in labor costs, effective September 1, 1984 through December 31, 1986. In contrast to temporary concessions obtained by Western in the past, these new agreements have no contractual provisions for reversions to higher wage levels in the future. Western began implementation of CAP in September 1984.

In addition, CAP provides for an increase in profits subject to distribution annually under a profit sharing plan adopted pursuant to the Company's 1983 Partnership Plan to 20% of the first \$75 million of annual profits and 35% of profits thereafter (profits for this purpose are pre-tax profits exclusive of extraordinary items and gains from disposition of property), for a reduction of 12.5% in the monthly management budget by a combination of pay and head count adjustments, and for the nomination for election to the Board of four union representatives (rather than the two representatives to which the unions were previously entitled). All of such directors have been elected.

Each of the CAP proposals also provides that if, after September 1, 1984, Western agrees to pay increases or productivity reductions for any group of employees, then similar increases or reductions will be afforded employees represented by other unions.

Under the Company's 1983 partnership plan, 7.8 million shares of Common Stock are held by an independent trustee. All shares held by the trustee will be voted in proportion to the vote of all other shares voted except that on any question regarding the merger or acquisition of the Company, the creation by the Company of another airline, the sale of all or substantially all of the Company's assets or the liquidation of the Company, the trustee will vote in accordance with employee instructions. Voting on all matters will be passed through to individual employees if the Company's intention to qualify the plan as an Employee Stock Ownership Plan under the Internal Revenue Code is realized.

Note 13. Impact of Current Cost Data (Unaudited)

Current cost accounting is defined by Statements of Financial Accounting Standards 33 and 82 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. Current cost methodology involves the use of assumptions and estimates; therefore, the resulting measurements should be viewed as estimates, rather than as precise indications of the effects of current prices.

The amounts reported in the summary 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 provision for income taxes.

WESTERN AIR LINES, INC.

NOTES TO FINANCIAL STATEMENTS (Continued)

Note 13. Impact of Current Cost Data (Unaudited) — (Continued)

Current costs for aircraft were determined by using the direct pricing method. Current costs for spare engines, parts, and assemblies included in property and equipment were computed based on the ratio by which the current cost of the aircraft fleet exceeds the historic cost of such fleet. Current costs for other property and equipment were valued at their historical cost.

Net (loss) as reported in the statement of operations	\$(29,165)
Adjustment to restate costs for the effect of specific prices (current cost):	
Depreciation and amortization expense.....	<u>(19,569)</u>
Net (loss) adjusted for changes in specific prices.....	<u>\$(48,734)</u>
Gain from decline in purchasing power of net amounts owed	<u>\$ 19,640</u>
Increase in specific prices (current cost) of properties and equipment held during the year*	\$158,687
Effect of increase in general price level.....	<u>(31,976)</u>
Excess of increase in specific prices over increase in the general price level.....	<u>\$126,711</u>

* At December 31, 1984, current cost of property and equipment, net of accumulated depreciation and amortization was \$893,488.

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 prices to dollar amounts expressed in terms of average 1984 dollars as measured by CPI-U follows:

	Year Ended December 31,				
	1984	1983	1982	1981	1980
Operating revenues.....	\$1,181,885	\$1,188,264	\$1,150,489	\$1,208,219	\$1,254,651
Historical Cost Information Adjusted for Current Cost Information:					
Net earnings (loss).....	(48,734)	(68,282)	(64,931)	(151,264)	(89,483)
Net earnings (loss) per common share.....	(2.38)	(4.32)	(4.98)	(11.81)	(7.09)
Net assets at year-end*.....	401,481	230,150	214,236	260,280	846,643
Gain from decline in purchasing power of net amounts owed	19,640	6,249	20,040	47,556	59,027
Cash dividends paid per common share.....	—	—	—	—	.32
Market price per common share at year-end	3.25	4.42	5.67	5.55	11.50
Average Consumer Price Index	311.1	298.4	289.1	272.4	246.8

* Prior to 1981, direct prices were based on selling prices for new aircraft provided by the Air Transport Association of America. For 1981 forward, current appraisals of Western's existing fleet were available for determination of current cost.

ITEM 9. DISAGREEMENTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

There have been no disagreements on accounting and financial disclosure matters in 1984.

PART III

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

Incorporated by reference to the Company's definitive proxy statement to be filed pursuant to Regulation 14A not later than 120 days after December 31, 1984.

ITEM 11. EXECUTIVE COMPENSATION

Incorporated by reference to the Company's definitive proxy statement to be filed pursuant to Regulation 14A not later than 120 days after December 31, 1984.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

Incorporated by reference to the Company's definitive proxy statement to be filed pursuant to Regulation 14A not later than 120 days after December 31, 1984.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

Incorporated by reference to the Company's definitive proxy statement to be filed pursuant to Regulation 14A not later than 120 days after December 31, 1984.

PART IV

ITEM 14. EXHIBITS, FINANCIAL STATEMENT SCHEDULES AND REPORTS ON FORM 8-K

- (a)(1) Accountants' Report
 - Balance Sheets at December 31, 1984 and 1983
 - Statements of Operations for Years Ended December 31, 1984, 1983, and 1982
 - Statements of Changes in Financial Position for Years Ended December 31, 1984, 1983, and 1982
 - Statements of Shareholders' Equity for Years Ended December 31, 1984, 1983, and 1982
 - Notes to Financial Statements
- (a)(2) Schedule V Property, Plant, and Equipment
- Schedule VI Accumulated Depreciation and Amortization of Property, Plant and Equipment
- Schedule VIII Valuation and Qualifying Accounts
- Schedule X Supplementary Income Statement Information

Schedules not included above have been omitted because they are not applicable or the required information is shown in the Financial Statements or Notes thereto included in Item 8 of this Form 10-K.

(a)(3) Exhibits

- 3(a)* —Composite Certificate of Incorporation of the Company, as amended (filed as Exhibit 3(a) to Form 10-K for fiscal year ended December 31, 1983, File Number 1-1521)
- 3(b)* —By-Laws of the Company, as amended (filed as Exhibit 3(b) to Form 10-K for fiscal year ended December 31, 1983, File Number 1-1521)

- 10(a)(1)* —Assignment and Amendment and Restatement of Chattel Mortgage and Security Agreement dated as of August 1, 1983 (filed as Exhibit 10(a)(5) to Registration No. 2-87623)
- 10(a)(2)* —Collateral Agreement dated as of August 1, 1983 (filed as Exhibit 10(a)(4) to Registration No. 2-87623)
- 10(a)(3)* —Amendment No. 1 dated as of November 1, 1983 to Collateral Agreement dated as of August 1, 1983 (filed as Exhibit 10(a)(3) to the Annual Report on Form 10-K for year ended December 31, 1983, File No. 1-1521)
- 10(a)(4)* —Amendment No. 2 dated as of April 1, 1984 to Collateral Agreement dated as of August 1, 1983 (filed as Exhibit 10.3 to Registration No. 2-95812)
- 10(a)(5)* —Amendment No. 3 dated as of October 17, 1984 to Collateral Agreement dated as of August 1, 1983 (filed as Exhibit 10.4 to Registration No. 2-95812)
- 10(a)(6)* —Supplemental Chattel Mortgage No. 1 dated as of November 1, 1983 between Western and Union Bank as Collateral Agent (filed as Exhibit 10(a)(4) to the Annual Report on Form 10-K for year ended December 31, 1983, File No. 1-1521)
- 10(a)(7)* —Supplemental Chattel Mortgage No. 2 dated as of January 30, 1984 between Western and Union Bank as Collateral Agent (filed as Exhibit 10(a)(5) to the Annual Report on Form 10-K for year ended December 31, 1983, File No. 1-1521)
- 10(a)(8)* —Supplemental Chattel Mortgage No. 3 dated as of April 18, 1984 between Western and Union Bank as Collateral Agent (filed as Exhibit 10.7 to Registration No. 2-95812)
- 10(a)(9)* —Supplemental Chattel Mortgage No. 4 dated as of May 29, 1984 between Western and Union Bank as Collateral Agent (filed as Exhibit 10.8 to Registration No. 2-95812)
- 10(a)(10)* —Supplemental Chattel Mortgage No. 5 dated as of November 1, 1984 between Western and Union Bank as Collateral Agent (filed as Exhibit 10.9 to Registration No. 2-95812)
- 10(a)(11)* —Amendment No. 1 dated as of November 1, 1983 to Revolving Credit Agreement dated as of August 1, 1983 (filed as Exhibit 10(a)(6) to the Annual Report on Form 10-K for year ended December 31, 1983, File No. 1-1521)
- 10(a)(12)* —Amendment No. 2 dated as of April 1, 1984 to Revolving Credit Agreement dated as of August 1, 1983 (filed as Exhibit 10.11 to Registration No. 2-95812)
- 10(a)(13)* —Revolving Credit Agreement dated as of August 1, 1983 among certain lenders and Western (filed as Exhibit 10(a)(6) to Registration No. 2-87623)
- 10(a)(14)* —Warrant Agreement dated as of January 18, 1983 between certain lenders and Western (filed as Exhibit 10(a)(35) to Annual Report on Form 10-K for year ended December 31, 1982, File No. 1-1521)
- 10(a)(15)* —Warrant Agreement dated as of June 15, 1983 between Western and The Bank of New York as Warrant Agent (filed as Exhibit 10(a)(7) to Registration No. 2-87623)
- 10(a)(16)* —Warrant Agreement dated as of November 1, 1983 between Western and certain lenders (filed as Exhibit 10(a)(10) to the Annual Report on Form 10-K for year ended December 31, 1983, File No. 1-1521)
- 10(a)(17)* —Agreement between Western and Associates Commercial Corporation dated June 14, 1983 (filed as Exhibit 10(a)(13) to Registration No. 2-87623)
- 10(a)(18)* —Equipment Trust Agreement dated as of June 15, 1983 between Western and The Bank of New York, Trustee (filed as Exhibit 4 to Quarterly Report on Form 10-Q for the quarter ended June 30, 1983, File No. 1-1521)
- 10(a)(19)* —Equipment Trust Agreement dated as of November 30, 1983 between Western and NCNB National Bank of North Carolina, Trustee (filed as Exhibit 4 to Registration No. 2-87623)
- 10(a)(20)* —Purchase Agreement No. 1165 dated December 22, 1982 between Western and Boeing Company, as supplemented (filed as Exhibit 10(a)(14) to Annual Report on Form 10-K for year ended December 31, 1983, File No. 1-1521)
- 10(a)(21)* —Purchase Agreement No. 1190 dated as of January 27, 1983 between Western and Boeing Company, as supplemented (filed as Exhibit 10(a)(15) to Annual Report on Form 10-K for year ended December 31, 1983, File No. 1-1521)
- 10(a)(22)* —Airport Use Agreement dated as of July 1, 1978 between Salt Lake City Corporation and Western, as amended (WAL Contract No. 6235) (filed as Exhibit 10(a)(16) to Annual Report on Form 10-K for year ended December 31, 1983, File No. 1-1521)
- 10(a)(23)* —Lease Agreement dated as of September 13, 1961, as amended, between the City of Los Angeles and Western (filed as Exhibit 10(a)(44) to registration No. 2-82762)

- 10(a)(24)* —Lease Agreement dated as of November 12, 1973 between the City of Los Angeles and Western (filed as Exhibit 20 to Annual Report on Form 10-K for the year ended December 31, 1974, File No. 1-1521)
- 10(a)(25)* —Term Loan Agreement dated as of November 16, 1984 between Western and Midlantic National Bank (filed as Exhibit 10.24 to Registration No. 2-95812)
- 10(a)(26)* —Security Agreement and Chattel Mortgage dated as of November 16, 1984 in favor of Midlantic National Bank (filed as Exhibit 10.25 to Registration No. 2-95812)
- 10(a)(27)* —Lease Agreement dated as of November 19, 1984 between Western and UT Credit Corporation (filed as Exhibit 10.26 to Registration No. 2-95812)
- 10(a)(28)* —Lease Agreement dated as of November 27, 1984 between Western and UT Credit Corporation (filed as Exhibit 10.27 to Registration No. 2-95812)
- 10(a)(29)* —Lease Agreement dated as of November 28, 1984 between Western and UT Credit Corporation (filed as Exhibit 10.28 to Registration No. 2-95812)
- 10(a)(30)* —Conditional Sales Agreement dated as of April 20, 1984 between C. Itoh & Co., Ltd., Century Leasing System, Inc. and Showa Leasing Co., Ltd. and Western (filed as Exhibit 10.31 to Registration No. 2-95812)
- 10(a)(31)* —Purchase Agreement dated as of January 8, 1985 between Western and James W. Smith (filed as Exhibit 10.31 to Registration No. 2-95812)
- 10(b)* —Western Employees Stock Plan, dated as of December 6, 1983, as amended (filed as Exhibit 10(b) to Annual Report on Form 10-K, for the year ended December 31, 1983)
- 10(c)(1)* —Employment Agreement dated as of January 9, 1984 between Western and Lawrence H. Lee (filed as Exhibit 10(c) to Annual Report on Form 10-K, for year ended December 31, 1983, File No. 1-1521)
- 10(c)(2)* —Amendment to Employment Agreement dated as of January 17, 1985 to Employment Agreement dated as of January 9, 1984, between Western and Lawrence H. Lee (filed as Exhibit 10.34 to Registration No. 2-95812)
- 10(c)(3)* —Employment Agreement dated as of May 29, 1984 between Western and Andre C. Dimitriadis (filed as Exhibit 10.35 to Registration No. 2-95812)
- 10(c)(4)* —Employment Agreement dated as of November 13, 1984 between Western and Thomas J. Roeck, Jr. (filed as Exhibit No. 10.36 to Registration No. 2-95812)
- 10(c)(5)* —Employment Agreement dated as of January 8, 1985 between Western and Ronald D. Marasco (filed as Exhibit 10.37 to Registration No. 2-95812)
- 10(c)(6)* —Employment Agreement dated as of January 22, 1985 between Western and Robert (Robin) H. H. Wilson (filed as Exhibit 10.38 to Registration No. 2-95812)
- 24 —Consent of Independent Certified Public Accountants

* Incorporated by reference.

The foregoing list omits instruments defining the rights of holders of long-term debt of the Company and its consolidated subsidiaries where the total amount of securities authorized thereunder does not exceed 10% of the total assets of the Company and its consolidated subsidiaries. The Company hereby agrees to furnish a copy of each such instrument or agreement to the Commission upon request.

(b) Reports on Form 8-K. No reports on Form 8-K were filed during fourth quarter of 1984.

ITEM 14(d)(3). FINANCIAL STATEMENT SCHEDULES

WESTERN AIR LINES, INC.

SCHEDULE V—PROPERTY, PLANT AND EQUIPMENT(1)

For the Years Ended December 31, 1984, 1983, and 1982

(In Thousands of Dollars)

	Balance at Beginning of Period	Additions at Cost	Retirements	Balance at End of Period
Year Ended December 31, 1984:				
Flight equipment	\$ 851,831	\$ 66,339	\$ 62,121	\$ 856,049
Facilities and ground equipment	144,915	14,628	5,061	154,482
Deposits on equipment purchase contracts.....	35,108	48,619	40,806(2)	42,921
	<u>\$1,031,854</u>	<u>\$129,586</u>	<u>\$107,988</u>	<u>\$1,053,452</u>
Flight equipment not used in operations and reflected under "Other assets" on the balance sheet	\$ 3,380	\$ —	\$ 222	\$ 3,158
Year Ended December 31, 1983:				
Flight equipment	\$ 850,957	\$ 2,108	\$ 1,234	\$ 851,831
Facilities and ground equipment	140,471	9,287	4,843	144,915
Deposits on equipment purchase contracts.....	27,017	8,091	—	35,108
	<u>\$1,018,445</u>	<u>\$19,486</u>	<u>\$ 6,077</u>	<u>\$1,031,854</u>
Flight equipment not used in operations and reflected under "Other assets" on the balance sheet	\$ 3,794	\$ —	\$ 414	\$ 3,380
Year Ended December 31, 1982:				
Flight Equipment.....	\$ 828,276	\$ 23,822	\$ 1,141	\$ 850,957
Facilities and ground equipment	139,400	4,107	3,036	140,471
Deposits on equipment purchase contracts.....	21,508	5,509	—	27,017
	<u>\$ 989,184</u>	<u>\$ 33,438</u>	<u>\$ 4,177</u>	<u>\$1,018,445</u>
Flight equipment not used in operations and reflected under "Other assets" on the balance sheet	\$ 4,401	\$ 22	\$ 629	\$ 3,794

(1) For disclosure of the methods and lives used in computing the provision for depreciation see Note 1 of Notes to Financial Statements.

(2) Reimbursements upon financing of aircraft.

Reconciliation to Statements of Changes in Financial Position

	1984	1983	1982
Additions to property and equipment.....	\$129,586	\$19,486	\$33,438
Interest capitalized.....	(6,070)	(2,977)	(2,508)
Other—net	—	(127)	3
Purchase of property and equipment and advances thereon.....	<u>\$123,516</u>	<u>\$16,382</u>	<u>\$30,933</u>

WESTERN AIR LINES, INC.

SCHEDULE VI—ACCUMULATED DEPRECIATION AND AMORTIZATION OF
PROPERTY, PLANT, AND EQUIPMENT

For the Years Ended December 31, 1984, 1983 and 1982

(In Thousands of Dollars)

	Balance at Beginning of Period	Additions Charged to Costs and Expenses	Retirements	Balance at End of Period
Year Ended December 31, 1984:				
Flight equipment	\$337,138	\$48,395	\$48,612	\$336,921
Facilities and ground equipment.....	99,741	9,861	4,196	105,406
	<u>\$436,879</u>	<u>58,256</u>	<u>52,808</u>	<u>442,327</u>
Flight equipment not used in operations and reflected under "Other assets" on the balance sheet	\$ 2,817	\$ —	\$ 189	\$ 2,628
Year Ended December 31, 1983:				
Flight equipment	\$289,038	\$48,698	\$ 598	\$337,138
Facilities and ground equipment.....	94,653	9,650	4,562	99,741
	<u>\$383,691</u>	<u>\$58,348</u>	<u>\$ 5,160</u>	<u>\$436,879</u>
Flight equipment not used in operations and reflected under "Other assets" on the balance sheet	\$ 3,181	\$ —	\$ 364	\$2,817
Year Ended December 31, 1982:				
Flight Equipment.....	\$239,654	\$49,826	\$ 442	\$289,038
Facilities and ground equipment.....	87,083	10,142	2,572	94,653
	<u>\$326,737</u>	<u>\$59,968</u>	<u>\$ 3,014</u>	<u>\$383,691</u>
Flight equipment not used in operations and reflected under "Other assets" on the balance sheet	\$ 3,763	\$ —	\$ 582	\$ 3,181

Reconciliation to Statements of Operations

	1984	1983	1982
To Statements of Operations:			
Additions charged to costs and expenses	\$58,256	\$58,348	\$59,968
Depreciation of flight equipment expendable parts	1,309	1,054	1,805
	<u>59,565</u>	<u>59,402</u>	<u>61,773</u>
Deduct amounts charged to other operating expenses	—	23	22
Depreciation and amortization.....	<u>\$59,565</u>	<u>\$59,379</u>	<u>\$61,751</u>

WESTERN AIR LINES, INC.

SCHEDULE VIII—VALUATION AND QUALIFYING ACCOUNTS

For the Years Ended December 31, 1984, 1983, and 1982

(In Thousands of Dollars)

	<u>Balance at Beginning of Period</u>	<u>Additions Charged to Costs and Expenses</u>	<u>Deductions</u>	<u>Balance at End of Period</u>
Year Ended December 31, 1984:				
Allowance for obsolescence of flight equipment expendable parts.....	\$17,073	\$1,309	\$ 314(1)	\$18,068
Allowance for doubtful accounts.....	8,758	6,554	2,761(2)	12,551
Year Ended December 31, 1983:				
Allowance for obsolescence of flight equipment expendable parts.....	\$16,364	\$1,054	\$ 345(1)	\$17,073
Allowance for doubtful accounts.....	3,491	8,225	2,958(2)	8,758
Year Ended December 31, 1982:				
Allowance for obsolescence of flight equipment expendable parts.....	\$15,422	\$1,805	\$ 863(1)	\$16,364
Allowance for doubtful accounts.....	2,959	2,673	2,141(2)	3,491

(1) Charges upon retirement.

(2) Bad debts deemed uncollectible.

WESTERN AIR LINES, INC.

SCHEDULE X—SUPPLEMENTARY INCOME STATEMENT INFORMATION

For the Years Ended December 31, 1984, 1983, and 1982

(In Thousands of Dollars)

	<u>1984</u>	<u>1983</u>	<u>1982</u>
Charged to Operating Expenses:			
Maintenance and repairs	\$93,740	\$91,122	\$77,889
Taxes other than payroll and income taxes:			
Property taxes.....	5,716	6,296	6,981
Fuel and other	9,046	7,397	7,705
Advertising and publicity	23,247	24,289	23,503

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

WESTERN AIR LINES, INC.

By /s/ LAWRENCE H. LEE
 Lawrence H. Lee
 Chairman

Pursuant to the requirements of the Securities Act of 1934, this report has been signed below by the following persons on behalf of the registrant in the capacities and on the dates indicated.

<u>Signature</u>	<u>Title</u>	<u>Date</u>
/s/ LAWRENCE H. LEE Lawrence H. Lee	Chairman and Director	March 26, 1985
/s/ GERALD GRINSTEIN Gerald Grinstein	Chief Executive Officer and Director (Principal Executive Officer)	March 26, 1985
/s/ ROBERT H. H. WILSON Robert H. H. Wilson	President and Director	March 26, 1985
/s/ THOMAS J. ROECK, JR. Thomas J. Roeck, Jr.	Senior Vice President and Chief Financial Officer (Principal Financial Officer)	March 26, 1985
/s/ GREGORY P. CHAMBERS Gregory P. Chambers	Vice President and Controller (Principal Accounting Officer)	March 26, 1985
Fred Benninger	Director	March , 1985
/s/ ARCHIE R. BOE Archie R. Boe	Director	March 26, 1985
/s/ VICTOR L. BROWN Victor L. Brown	Director	March 26, 1985
/s/ JOSEPH T. CASEY Joseph T. Casey	Director	March 26, 1985
Walter J. Hickel	Director	March , 1985

<u>Signature</u>	<u>Title</u>	<u>Date</u>
/s/ JOHN A. KAMMERMEYER John A. Kammermeyer	Director	March 26, 1985
Bert T. Kobayashi, Jr.	Director	March , 1985
/s/ CHARLES LEVINSON Charles Levinson	Director	March 26, 1985
/s/ SUSAN EDWARDS PACE Susan Edwards Pace	Director	March 26, 1985
James J. Shields	Director	March , 1985
/s/ SPENCER R. STUART Spencer R. Stuart	Director	March 26, 1985
Robert H. Volk	Director	March , 1985

CORPORATE OFFICERS

Lawrence H. Lee
Chairman of the Board

Gerald Grinstein
Chief Executive Officer

Robin H. H. Wilson
President & Chief Operating Officer

Thomas J. Roeck, Jr.
Senior Vice President & Chief Financial Officer

Harold L. Achtziger
Vice President-Airport Operations

Jack W. Boisen
Vice President-Human Resources

Gregory P. Chambers
Vice President & Controller

Thomas J. Greene
Vice President, General Counsel & Secretary

Joseph C. Hilly
Vice President-Labor Relations

Robert L. Moore
Vice President-Market Planning

Ronald D. Marasco
Vice President-Maintenance & Engineering

Seth M. Oberg
Vice President-Flight Operations

Calvin L. Rader
Vice President-Information Systems

William Semos
Vice President-Corporate Communications

Glen L. Stewart
Vice President-Operations Administration

Douglas B. Swets
Vice President & Treasurer

Jorge Valencia
Vice President & General Manager-Mexico

C.F. Van Every
Vice President-Inflight Service

James R. Watson
Vice President-Passenger & Cargo Sales

General Offices

Western Air Lines, Inc.
6060 Avion Drive
Los Angeles, California 90045
(213) 216-3000

Registrar/Transfer Agent-Common & Preferred Stock

Bank of America National Trust & Savings
Association
555 South Flower St., Los Angeles, California 90071

Debenture and Subordinated Note Trustee

United States Trust Company of New York
45 Wall Street, New York, New York 10005

Exchange Listing-Common & Preferred Stock Debentures and Subordinated Notes

New York Stock Exchange
Pacific Stock Exchange

Ticker Symbols

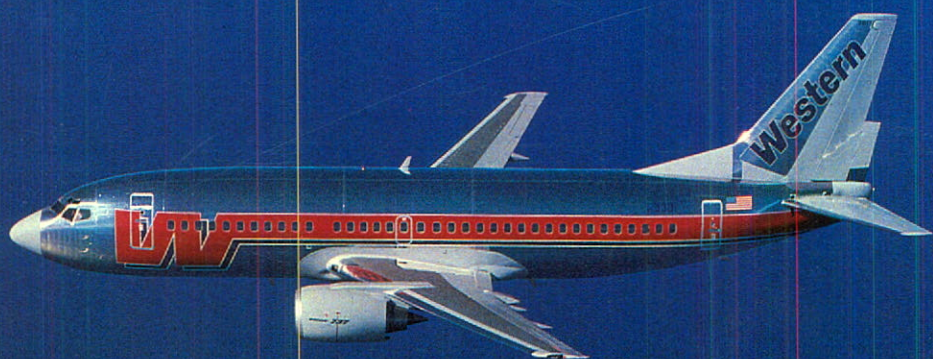
Common Stock WAL
Preferred Stock Series A-WALPRA
Preferred Stock Series B-WALPRB
5¹/₄% Debentures WAL93
10³/₄% Notes WALDC98
14% Notes WALD98
Common Stock Warrants WALWS

Independent Accountants

Peat, Marwick, Mitchell & Co.
555 South Flower Street
Los Angeles, California 90071

Annual Meeting of Shareholders

Second Thursday in May



WESTERN AIRLINES CORPORATE OFFICES 6060 AVION DRIVE, LOS ANGELES, CALIFORNIA 90045