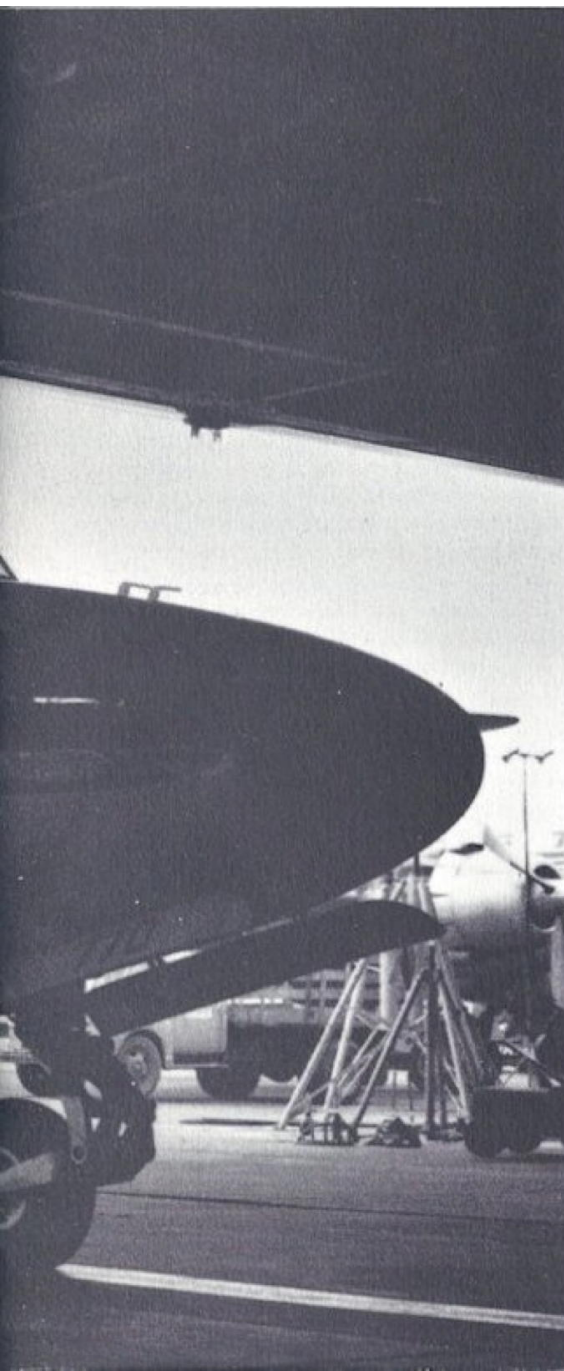


TWENTY
FIRST
ANNUAL
REPORT
1960





CONDENSED COMPARATIVE STATEMENT OF EARNINGS
SIX MONTHS ENDING JUNE 30, 1961 AND JUNE 30, 1960

REVENUES	SIX MONTHS ENDING	
	JUNE 30, 1961	JUNE 30, 1960
Passengers	\$3,034,334	\$3,018,432
Mail and cargo	161,779	128,758
Public service revenues	1,946,663	1,996,957
Other	358,349	361,559
	\$5,501,125	\$5,505,706
OPERATING EXPENSES	5,085,155	5,867,776
Operating income (loss)	\$ 415,970	\$(362,070)
INTEREST AND OTHER EXPENSES	168,279	115,882
	\$ 247,691	\$(477,952)
ESTIMATED FEDERAL INCOME TAXES	128,800	248,535
NET EARNINGS (LOSS)	\$ 118,891	\$(229,417)

COMPARATIVE OPERATING STATISTICS

SCHEDULED MILES FLOWN	2,488,124	3,144,170
AVAILABLE SEAT MILES FLOWN (in thousands)	99,971	120,085
REVENUE PASSENGER MILES FLOWN (in thousands)	47,793	50,174
REVENUE PASSENGER LOAD FACTOR	47.8%	41.8%
REVENUE PASSENGERS CARRIED	207,386	219,060



OFFICERS AND EXECUTIVE STAFF

JOHN H. CONNELLY, President and General Manager
T. R. MITCHELL, Executive Vice President
C. A. MYHRE, Vice President, Finance, Assistant Secretary
HARRY WHITE, Vice President, Operations
R. E. COSTELLO, Vice President, Traffic
MAX A. KING, Vice President, Public Relations
E. ROGER DAHL, Treasurer
WALTER ROCHE, Secretary
R. C. COUK, Director of Flight Operations
D. G. DAVISON, Director of Engineering
R. J. DIXON, Director of Sales and Advertising
W. H. LEVINGS, Director of Personnel

BOARD OF DIRECTORS

LELAND HAYWARD, Chairman	WILLIAM GOETZ
JOHN H. CONNELLY	JOSEPH MARTIN, JR.
B. F. EDWARDS, JR.	RICHARD OSBORNE
WALTER ROCHE	HARRY WHITE

REGISTRAR

BANK OF AMERICA, 300 Montgomery Street, San Francisco

TRANSFER AGENT

CROCKER-ANGLO NATIONAL BANK, 1 Montgomery Street, San Francisco

GENERAL OFFICES

SAN FRANCISCO INTERNATIONAL AIRPORT, San Francisco 28, California

PRESIDENTS REPORT TO THE STOCKHOLDERS, EMPLOYEES AND CUSTOMERS

The year 1960 may be looked upon as transitional and a year in which major effort was devoted to building for the future. As previously reported to you, the Company introduced the Fairchild F-27 turbo-prop aircraft in the latter half of 1959 and the integration of these aircraft continued into 1960, with the usual heavy initial introductory costs common to all new aircraft.

During 1960 the Company purchased and integrated eight pressurized air-conditioned Martin 404's and disposed of five Martin 202 non-pressurized aircraft. Consequently, with the exception of two Martin 202's, now used only as spares, the entire fleet is pressurized and air-conditioned, which has resulted in increased revenue through improved acceptance of Pacific's service. To complete the modernization program a radar installation, now required by the Federal Aviation Agency, was engineered for the 404's.

The Martin 404 is a later model and a larger aircraft than the 202 and is well suited to our needs. The earning potential is considerably improved through greater passenger appeal of well-spaced luxurious full-sized seats, pressurization, and larger freight capacity.

Under F.A.A. regulations five of these aircraft required complete major overhauls before being placed into service and, in addition, all of our pilots and mechanics were required to undergo costly extensive flight training and ground training courses to meet the Company's and F.A.A.'s high standards of proficiency. As a result of the continued integration of the F-27 into 1960, the introduction of the Martin 404, with the attendant costly training programs involved, the Company ended the year with a net loss of \$226,745.

Considering the above circumstances, the loss for the year may be deemed reasonable as the training and integration costs of the F-27 and the Martin 404 aircraft are non-recurring; and, I am most pleased to report that, due to the substantially improved passenger acceptance of these aircraft, the favorable results of the first six months of 1961 reflect the successful planning of 1960. During the period, which historically is not as productive as the

last six months, the Company had an operating profit of \$415,970, in contrast to an operating loss of \$362,070 for the same quarter of the previous year.

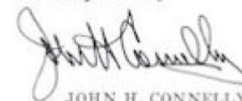
Of significant importance to the future earnings of your company is the Class Mail Rate method of administering federal subsidy, introduced by the Civil Aeronautics Board and made effective January 1, 1961. Based upon the Company's capital structure, this Class Mail Rate permits earnings as high as 12.75% after taxes, but before interest expense. Earnings between 12.75% and 15% are shared with the Civil Aeronautics Board on a 50-50 basis and 25% of the earnings in excess of 15% may be retained.

Other advantages of the Class Rate are opportunities to improve scheduling for the greater development of traffic, according to management's best judgment within the limits of our Certificate of Public Convenience and Necessity; forecasting future financial results with a greater degree of reliability; and virtual elimination of disallowances on a post-review basis of the C.A.B. staff.

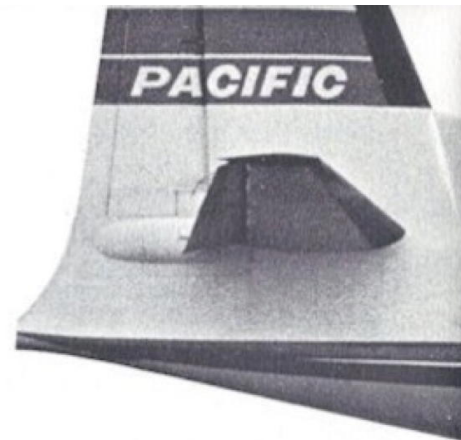
In view of the achievement of a profit in the first half of 1961 against a loss for the same period of the prior year; the completion of the costly reequipment and training programs; the stabilization of mail pay under the Class Rate; the increased earnings permitted on investment; and the normal substantial increase in revenues forthcoming as we move into our high-traffic-producing seasons, coupled with a most determined cost-control program, your management projects the year 1961 should result in the highest earnings in the Company's history.

I should like to again remind you as an owner that Pacific Air Lines' routes cover the very heart of the Pacific area, where the population increases have been and are forecast in the future as explosive. Consequently, your management looks forward with confidence to potentially greater earnings and increased value of your Company.

Respectfully



JOHN H. CONNELLY, PRESIDENT



Throughout its entire history Pacific Air Lines has experienced dynamic growth. The year 1960 was no exception. Substantial gains were recorded in volume of business, both passenger and cargo.

In the past five years, total revenues have increased over 100 percent and revenue passenger miles have increased 85 percent. These gains have been accomplished primarily through intensive development of Pacific's permanently certificated route system.

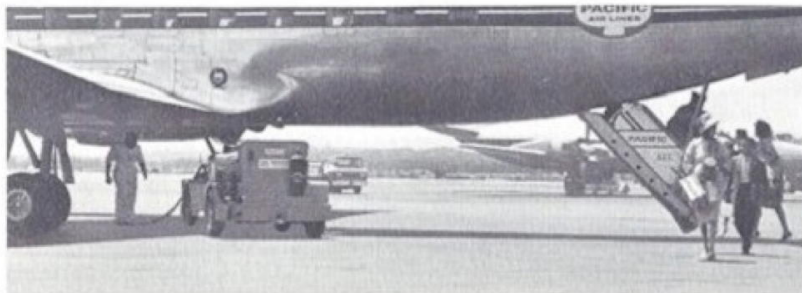
In the year 1960 the Company also completed its re-equipment program and is now operating a fleet of modern 44 passenger pressurized and air conditioned aircraft, equipped with the latest in radio and radar installations.

The future holds every promise of continuing the rapid growth experienced in the past. With modern equipment, good labor relations, well-trained and enthusiastic employees who have contributed so much to our past successes, your Company looks forward to a most successful future year.

	1956	1960	Percentage Increase
MILES FLOWN	4,049,000	6,653,000	64
PASSENGER MILES	55,917,000	103,374,000	85
PASSENGERS CARRIED	259,500	451,500	74
PASSENGER REVENUE	\$3,129,900	\$6,186,300	98
TOTAL REVENUES	\$5,369,500	\$11,073,700	106
TON-MILES CARRIED:			
Passenger	5,642,700	10,907,000	93
Mail	96,000	197,000	105
Cargo	171,200	203,500	19
ROUTE MILES OPERATED	1,622	2,260	39
AIRPORTS SERVED	24	25	4
AIRCRAFT OPERATED	18	23	28

GROWTH

RATES





Two significant developments occurred during the year 1960 which will contribute substantially to the future strength and stability of your Company.

The Civil Aeronautics Board issued its decision in the *Local Service Rate of Return Investigation*, August 26, 1960.

The Board initiated this investigation in 1956 to determine whether the rate of return or profit element allowed the local service carriers in the past had been generally fair and reasonable and, if not, to determine a fair and reasonable rate of return for the local service carriers as a class.

In determining the permitted rate of return for future periods, the Board will use the actual capital structure of the particular carrier. The rates to be applied are 5.5 percent on debt capital, which is all long-term debt of the carrier plus 75 percent of current maturities, and 21.35 percent on the equity portion of the carrier's capital structure, which is the sum of its common stock, capital surplus and earned surplus. These rates are subject to an overall minimum of 9 percent and a maximum of 12.75 percent on total invested capital, after applicable income taxes but before interest.

The Civil Aeronautics Board instituted proceedings in the *Local Service Class Subsidy Rate Investigation*.

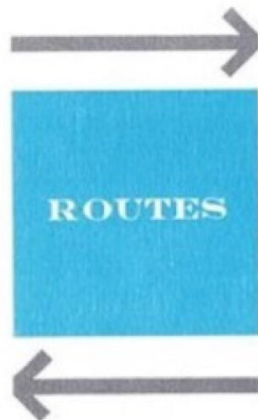
On December 23, 1960, the Board instituted the *Local Service Class Subsidy Rate Investigation* for the purpose of determining whether it should establish a class rate for local service carriers effective January 1, 1961.

In March, 1961, the Board adopted the Class Rate method of subsidy administration for the local service carriers. Under this method the subsidy receivable each month shall be a rate per seat mile flown, determined on the basis of the average number of revenue plane miles flown per station per day in the month, applied to the total seat miles flown in the month.

The permitted return on investment, above, is implemented through the class rate with two significant improvements. A profit sharing feature is added, permitting a carrier to retain a return on investment, after applicable income taxes, in excess of 12.75 percent on total capital. The carrier may retain 50 percent of its earnings between its calculated differentiated rate and 15 percent and 25 percent of earnings over the 15 percent level. The excesses are refunded to the Board, except that they may be offset by any earnings deficiencies in the two preceding calendar years, beginning after January 1, 1961.

The class rate provides for automatic adjustment of subsidy for new routes, equipment, and financing. Contrary to the many uncertainties involved in the former method of subsidy administration, the class rate permits management to conduct its operations with current appraisal of the anticipated final results and with a greater degree of control than has been heretofore possible.

All final mail pay due the Company as of December 31, 1960, has been received and it has been receiving mail pay under the class rate since January 1, 1961.



Applications on file with the Civil Aeronautics Board, as shown on the map, are designed to improve and strengthen the present system and provide a service required in the public interest.

Oral Argument has been heard by the Civil Aeronautics Board and a final decision is expected soon in the *Pacific Southwest Local Service Case*. Application was made herein to extend our present route to Reno, Nevada, and San Diego, California, and to add the cities of Fresno, Long Beach, Inyokern, Ontario, and Palm Springs, California. Liberalization of operating restrictions was also requested so as to authorize non-stop flights between San Francisco/Oakland and Los Angeles/Burbank, California; San Francisco/Oakland, California, and Las Vegas, Nevada; Los Angeles/Burbank and Sacramento, California; and Burbank, California, and Las Vegas, Nevada. It is expected the Board will issue final decision in this case later this year.

Hearings have just been concluded in the *Southern Rocky Mountain Area Local Service Case*. This case was instituted by the Board to consider the local air service needs of communities in California, Nevada, Utah, Colorado, Arizona, New Mexico, and Texas. The Company has filed numerous applications in this case. Decision is not anticipated until late in 1962 at the earliest.

Other route applications filed with the Board, but which have not been set for hearings, include application for authority to serve between Portland, Oregon, and Seattle/Tacoma, Washington, and between Medford and Portland, Oregon.



**PACIFIC
AIR LINES, INC.
BALANCE
SHEET**



ASSETS

DECEMBER 31 1960

DECEMBER 31 1959

CURRENT ASSETS:

Cash	\$ 226,753	\$ 577,074
Accounts receivable:		
United States Government: Mail, passenger and other	1,112,745	584,677
Refundable federal income taxes (Note B)	205,000	
Traffic and agents	446,912	431,022
Miscellaneous, less allowance for possible losses (1960—\$10,000; 1959—\$3,678)	100,177	73,858
Inventories of materials and supplies, at approximate cost, not in excess of market	465,262	272,496
Prepaid expenses	291,537	244,179
	<u>2,848,386</u>	<u>2,183,306</u>

PROPERTY AND EQUIPMENT, AT COST:

Flight equipment—pledged under notes payable	9,520,000	9,288,267
Ground and other equipment	937,431	850,554
	<u>10,457,431</u>	<u>10,138,821</u>
Less—Accumulated depreciation and amortization	3,049,520	3,549,040
	<u>7,407,911</u>	<u>6,589,781</u>
Construction in progress	51,945	14,831
Deposit on purchase of flight equipment		9,694
	<u>7,459,856</u>	<u>6,614,306</u>

INVESTMENTS, AT COST	9,414	4,321
--------------------------------	-------	-------

FUNDS SET ASIDE FOR REPLACEMENT OF FLIGHT EQUIPMENT		<u>43,767</u>
---	--	---------------

DEFERRED CHARGES:

Route extension and development expense	68,436	57,584
Pre-operating cost of new flight equipment, less amortization	76,666	94,070
Other	10,545	11,769
	<u>155,647</u>	<u>163,423</u>

	<u>\$10,473,303</u>	<u>\$9,009,123</u>
--	---------------------	--------------------

LIABILITIES

DECEMBER 31 1960

DECEMBER 31 1959

CURRENT LIABILITIES:

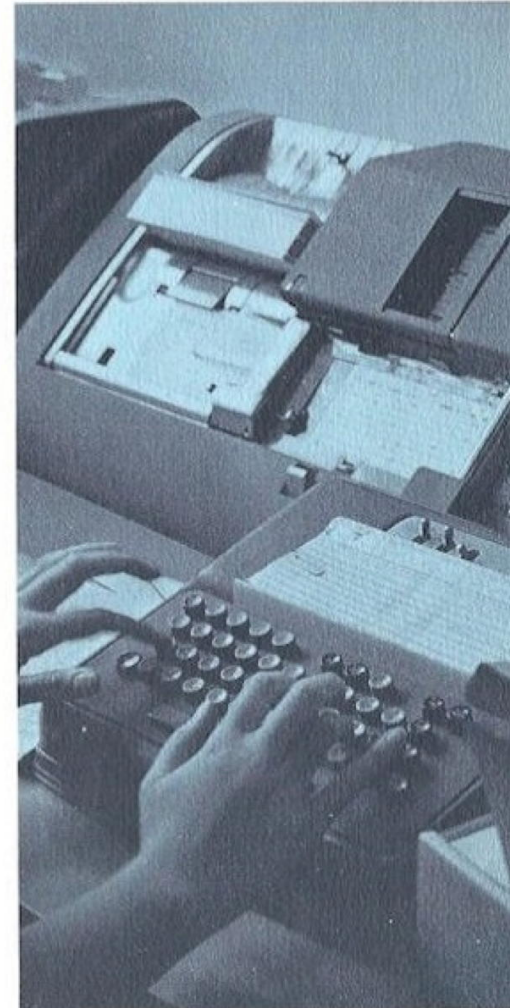
Notes payable—current instalments	\$ 1,182,271	\$ 663,000
Accounts payable	2,552,664	1,148,961
Taxes collected or withheld from others	212,783	150,439
Accrued expenses	265,273	227,256
Transportation sold, not yet used or refunded	110,455	44,894
Estimated federal income taxes (Note B)	125,296	438,753
	<u>4,448,742</u>	<u>2,673,303</u>

LONG-TERM DEBT (NOTE A)	<u>4,310,128</u>	<u>4,436,300</u>
-----------------------------------	------------------	------------------

PROVISION FOR FEDERAL INCOME TAXES OF FUTURE YEARS	<u>59,454</u>	<u>44,142</u>
--	---------------	---------------

STOCKHOLDERS' EQUITY:

Common stock:		
Authorized, 40,000,000 shares of 50¢ par value per share		
Issued, 671,410 shares	335,705	335,705
Paid-in surplus	246,324	246,324
Earnings retained for use in the business, per accompanying statement (Note A)	1,072,950	1,273,349
	<u>1,654,979</u>	<u>1,855,378</u>
	<u>\$10,473,303</u>	<u>\$9,009,123</u>



YEAR ENDED DECEMBER 31
1960 1959

	1960	1959
OPERATING REVENUES:		
Passenger	\$ 6,186,267	\$5,764,854
Mail	149,993	134,919
Charter and contract operations	667,905	655,128
Express, freight and excess baggage	138,582	124,644
Other	30,257	26,164
	<u>7,173,004</u>	<u>6,705,709</u>
FEDERAL SUBSIDY	3,900,697	2,506,588
	<u>11,073,701</u>	<u>9,212,297</u>
OPERATING EXPENSES (NOTE C):		
Flying operations	3,351,219	2,789,462
Maintenance	2,867,977	2,039,088
Passenger service	561,358	426,630
Aircraft and traffic servicing (Note E)	1,974,551	1,664,414
Promotion and sales (Note E)	1,060,727	831,300
General and administrative	813,841	536,023
Depreciation	732,210	665,495
	<u>11,361,883</u>	<u>8,952,412</u>
OPERATING INCOME (LOSS)	(288,182)	259,885
OTHER INCOME AND (EXPENSES):		
Interest	(279,723)	(183,982)
Amortization of route extension and development expenses and pre-operating costs	(33,198)	(17,558)
Net gain (loss) on disposition of assets	55,915	(7,083)
Other, net	(8,244)	412
	<u>(265,250)</u>	<u>(208,211)</u>
ESTIMATED FEDERAL INCOME TAXES	(553,432)	51,674
FEDERAL INCOME TAX CREDIT (Note B)	326,687	(31,611)
NET EARNINGS (LOSS) FOR THE YEAR (Note C)	(226,745)	20,063
SPECIAL CREDITS (NET OF FEDERAL INCOME TAXES THEREON):		
Retroactive subsidy for 1959	26,346	
Excess of insurance proceeds over carrying value of aircraft destroyed		43,767
Amounts provided in prior years for unredeemed passenger tickets determined to be in excess of requirements		12,000
EARNINGS RETAINED FOR USE IN THE BUSINESS:		
BALANCE, BEGINNING OF YEAR	1,273,349	1,197,519
BALANCE, END OF YEAR	<u>\$ 1,072,950</u>	<u>\$1,273,349</u>

**STATEMENT
OF
EARNINGS**

NOTES TO FINANCIAL STATEMENTS

NOTE A:

Notes payable at December 31 1960 consisted of the following bank loans:

5¼%, payable in monthly instalments of \$38,550 to February 1969	\$3,875,650
5½%, payable in monthly instalments of \$16,700 to December 1963	615,900
6%, payable in monthly instalments of \$5,583 to July 1967	441,083
6½%, payable in monthly instalments of \$3,617 to October 1965	209,766
Total secured loans	5,142,399
6½%, payable January 12 1961, unsecured	350,000
	<u>\$5,492,399</u>

All of the Company's flight equipment is pledged as security under chattel mortgages for the secured loans.

The Civil Aeronautics Board, under agreements dated November 17 1958 and May 9 1960, guaranteed 90% of the principal amount and 100% of the interest on the 5¼% and 6% loans.

Under a moratorium agreement, December 1960 loan instalments aggregating \$58,867 will not be payable until June 1961. The agreement also provides for the deferment of January and February 1961 instalments until June 1961.

Under the terms of the bank loan agreements, the Company has agreed that (1) it will not, without the prior consent of bank, pay any dividends (except in stock) or purchase, redeem or otherwise acquire for value any of its outstanding shares, and (2) after January 31 1961 maintain current assets at least equal to current liabilities; for the purpose of this computation, current instalments under the loan agreements may be excluded from current liabilities.

In 1961 the bank approved and the Civil Aeronautics Board consented to (1) deferring payment of the March and April 1961 loan instalments until June 1961 and (2) suspension of the working capital requirements until June 30 1961.

NOTE B:

Federal subsidy and the related provision for income taxes are recorded in the Company's accounts in the period to which applicable. However, retroactive subsidy settlements are not taxable until the period in which payment is received.

FEDERAL INCOME TAX CREDIT COMPRISE THE FOLLOWING:

Refundable federal income taxes arising from	
net operating loss carryback	\$205,000
Balance of 1959 federal income tax liability no longer required due to 1960 net operating loss	109,617
Provision for federal income taxes on subsidy accrued in the books in 1959, received and taxable in 1960, no longer required due to 1960 net operating loss	72,800
Other tax provisions previously provided, no longer required	36,024
	<u>423,441</u>
Deduct—Provision for income taxes on retroactive subsidy collected in 1961	\$125,296
Less—Amount applicable to 1959	28,542
	<u>96,754</u>
	<u>\$326,687</u>

NOTE C:

As a result of recommendations by the Civil Aeronautics Board the Company has increased the estimated residual value of certain flight equipment and accordingly, depreciation charged against operations and the net loss for 1960 is approximately \$70,000 less than it would have been on the basis of residual values used in the preceding year.

NOTE D:

Under contributory pension plans for employees, income was charged with \$133,698 during 1960 representing the Company's share of current and past service pension cost.

As at December 31 1960 the estimated unfunded portion of past service costs under the retirement plan for pilots, payable over the next six years, amounted to approximately \$120,000.

NOTE E:

Operating expenses for 1959 relating to (1) aircraft and traffic servicing and (2) promotion and sales have been reclassified in accordance with the Company's account classifications as revised in 1960.

PRICE WATERHOUSE & CO.

120 MONTGOMERY STREET
SAN FRANCISCO 4

MARCH 28 1961

TO THE BOARD OF DIRECTORS OF
PACIFIC AIR LINES, INC.

In our opinion, the accompanying statements present fairly the financial position of Pacific Air Lines, Inc. at December 31 1960 and the results of its operations for the year, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year. Our examination of these statements was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances. Certain receivables from the United States Government selected for tests were not confirmed by direct correspondence, but we satisfied ourselves as to these amounts by means of other auditing procedures.

Price Waterhouse & Co.

