PACIFIC AIR LINES

1963

24TH ANNUAL REPORT

HARRY S. WHITE

C. A. MYHRE

R. E. COSTELLO

E. ROGER DAHL

Officers and Executive Staff

HARRY S. WHITE, *President*

C. A. MYHRE, *Executive Vice President*

R. E. COSTELLO, *Vice President, Traffic and Sales*

E. ROGER DAHL, *Secretary-Treasurer*

R. C. COUK, *Director of Flight Operations*

D. G. DAVISON, *Director of Engineering and Maintenance*

W. W. LAUER, *Director of Sales*

W. H. LEVINGS, *Director of Industrial Relations*

G. M. GALVIN, *Assistant to President for Community Relations*

R. C. WITHERS, *Director of Passenger Service*

Board of Directors

HARRY S. WHITE

C. A. MYHRE

R. E. COSTELLO

B. F. EDWARDS, JR.

WILLIAM L. KEADY

WILLIAM GOETZ

FRANCIS A. MARTIN, JR.

JOSEPH MARTIN, JR.

RICHARD OSBORNE

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PACIFIC AIR LINES, INC.

General Offices: San Francisco International Airport, San Francisco 28, California

FISCAL HIGHLIGHTS

	1963	1962
Operating Revenues	$12,022,083	$12,077,382
Operating Expenses	$11,370,921	$11,335,942
Net Earnings For The Year	$ 146,065	$ 170,362
Net Earnings Per Share	$ .17	$ .20
Revenue Passenger Miles (thousands)	115,532	112,727
Revenue Passenger Load Factor	51.2%	49.5%
Average Number of Passengers Per Mile	21.6	20.6
AT END OF YEAR—		
Working Capital	$ 1,384,034	$ 1,130,981
Stockholders' Equity	$ 2,847,937	$ 2,864,458
Book Value Per Share	$3.33	$3.36

To our Stockholders:

The past year was a most eventful one for Pacific.

On June 20, 1963 Messrs. Connelly and Hayward, President and Chairman respectively, sold their stock in Pacific to West Coast Airlines, Inc. Approximately 296,000 shares, slightly more than 34% of the capital stock then outstanding, were involved in this transaction. Following the sale both Mr. Connelly and Mr. Hayward resigned from Pacific's Board of Directors and Mr. Connelly resigned as President. Upon acceptance of these resignations, the Board of Directors of Pacific then elected myself Chairman and Mr. T. R. Mitchell President of the Company.

On November 29, 1963, the Company was grieved by the death of President T. R. Mitchell. Mr. Mitchell had been associated with the Company since its inception in 1941 and had earned the respect of the entire transportation industry by his outstanding ability. His passing was a keen loss to his family and friends, as well as to all his associates of the Company.

In December I was elected President to fill the vacancy created by the death of Mr. Mitchell. The enthusiasm and cooperation expressed every day by word and action on the part of Pacific's employees has made my job easier and I am deeply convinced, as are the other officers and directors, that Pacific has rounded the corner toward increased profitability. Organizational changes in the last six months enabled the Company to take advantage of the traffic surge and, with emphasis on realistic cost control measures, to convert this surge into the most profitable first quarter in the history of the Company.

A strong operating base has been established to meet the present needs of our passengers and further service will be provided whenever it is anticipated that the revenues from the added service will exceed the additional costs. The introduction of modern and economical aircraft, continued emphasis on passenger service and cost controls, a management sensitive to the needs of the public and its stockholders, and an alert and capable group of employees—these are the ingredients of a successful airline. Pacific is fortunate to possess these ingredients.

We welcome constructive suggestions from our stockholders and are confident of your continued support and patronage.

Sincerely yours,

H S White

HARRY S. WHITE, *President*

Financial Review

Earnings Net earnings, before write-down of piston equipment book values, were $146,065 for the year, equivalent to 17 cents a share, compared with $170,362 or 20 cents a share in 1962. Net earnings rose sharply during the last half of the year, exceeding by $60,000 the net earnings realized in the last half of the prior year. This favorable trend continues so that net earnings of $122,730 were produced during the first quarter of 1964, as compared with a loss of $59,386 during the same quarter of 1963.

Concurrent with the acquisition of four additional F-27 aircraft as described on page 15, it became necessary to appraise the future utilization or disposition of the Company's piston aircraft. Following this appraisal surplus was charged with the estimated loss, $171,934 after taxes, incurred or anticipated upon disposition of the Martin aircraft. By the end of April 1964 the Company had disposed of all DC-3 and Martin 202 aircraft.

Revenues and Expenses Passenger revenues totalled $7,654,833, an increase of 3 per cent over the prior year, and total operating revenues, excluding public service revenues, rose more than 4 per cent to $8,272,304.

REVENUE COMPARISON	***1963***	***1962***	***Increase (Decrease)***
Passenger Revenues	$7,654,833	$7,425,887	3.1%
Revenue passenger miles flown (000)	115,532	112,727	2.5%
Average number of passengers per mile flown	21.6	20.6	4.9%
Revenue ton miles (000)	11,491	11,180	2.8%
Passenger revenues per scheduled mile flown	$1.43	$1.36	5.1%
Total revenues, excluding public service revenues	$8,272,304	$7,944,433	4.1%
Public service revenues	$3,749,779	$4,132,949	(9.3%)

Pacific subscribes to the philosophy of subsidy reduction and, in 1963, was among the lowest of the local service carriers in terms of total subsidy funds received. However, Pacific has been opposed to arbitrary reductions which have resulted in abnormally low subsidy rates for some carriers and abnormally high rates to others and believes that it is necessary to reappraise the purpose of subsidy in light of current needs of the public and the carriers. The concept of subsidy, as applied to air transportation, is often misunderstood by the general public and even by some members of Congress. Basically, the purpose of subsidy is to provide air service to those smaller cities and towns which, otherwise, could not economically justify such service. In the last analysis, then, it is the passengers and citizens of these cities that are being subsidized and, until service to these areas achieves self-sufficiency, based upon the then current revenue and cost levels, subsidy must be continued at a rate sufficient to meet the break-even and return needs of the individual carrier.

Operating expenses rose less than ½ of 1 per cent during the year and, expressed in costs per revenue ton mile, decreased from 101.1 cents in 1962 to 98.9 cents in 1963; operating costs during the last half of the year were down by more than $200,000 from the same period in the preceding year. This favorable expense trend has continued through the first quarter of 1964.

Interest, a non-operating expense item, was $288,582 in 1963 compared with $335,130 in 1962, a decline of almost $47,000. This decline reflects the corresponding decrease of $666,720 in the Company's term indebtedness.

Taxes aggregating $1,895,552 were paid to Federal, State and local governments in 1963 as follows:

TAXES PAID DIRECTLY BY THE COMPANY—	
State and Federal fuel taxes	$ 85,447
Federal and State payroll taxes	225,489
Federal and State income taxes applicable to 1963 (excluding tax credit on extraordinary loss)	167,747
Property and other taxes	131,497
	$ 610,180
TAXES COLLECTED BY THE COMPANY—	
Federal transportation taxes collected from passengers	$ 402,951
Federal and State payroll taxes collected from employees	882,421
	$1,285,372
Total taxes	$1,895,552

The combined total of $1,895,552 represents 50 per cent of the Public Service Revenues received by the Company in 1963.

Financial Position The excellent financial position of the Company at the end of the year is reflected by the following favorable indicators:

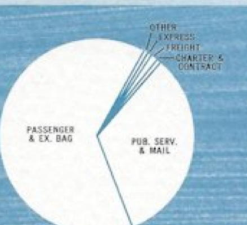
	At end of—		Increase
	1963	1962	(Decrease)
Cash	$1,691,296	$1,561,258	$ 130,038
Current assets	$3,624,354	$3,483,484	$ 140,870
Current liabilities	$2,240,320	$2,352,503	$(112,183)
Working capital	$1,384,034	$1,130,981	$ 253,053
Long term debt	$4,248,426	$4,915,146	$(666,720)

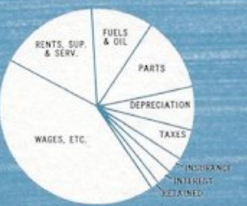
This favorable financial position enabled the Company to obtain, in March 1964, a non-Government-guaranteed loan for $4,000,000 for the purpose of acquiring four additional F-27 aircraft due to commence service late in June 1964. As a condition of the new loan the Company paid off a prior loan having a balance of $411,826 soon after the new loan was granted and also agreed to remit to the Bank, as promptly as possible, all proceeds from the sale of the Company's piston aircraft and equipment. In accordance with this commitment the Company has remitted to the Bank the proceeds from sale of DC-3 and Martin 202 aircraft and is exerting all efforts to dispose of the Martin 404 aircraft which will become surplus upon delivery of the additional F-27 aircraft.

During the year debentures having a value of $10,400 were converted into 2,310 shares of capital stock and, during the first quarter of 1964, debentures valued at $282,500 were also converted. Such conversions not only reduce the Company's term indebtedness and interest costs but also increase the amount of equity for all stockholders.

Source and Disposition of Funds

WORKING CAPITAL AT BEGINNING OF YEAR—	*1963*	*1962*
Current assets	$3,483,484	$3,459,550
Current liabilities	2,352,503	2,554,064
Working capital	$1,130,981	$ 905,486
Additions during the year:		
Net earnings before gain or loss on sale of equipment	$ 154,153	$ 145,575
Depreciation and amortization	869,544	829,359
Deferred debt discount expensed	16,014	15,009
Overhaul costs expensed	602,356	583,966
Sale of property and equipment	56,174	122,420
Increase future income taxes	49,399	19,330
Reduction in investments	11,549	—
Reduction in Federal income taxes arising from write-down of piston equipment	138,000	—
All Other	—	5,098
	$1,897,189	$1,720,757
Used during the year:		
Purchase of property and equipment, less value of equipment traded in	$ 374,822	$ 556,509
Overhaul costs capitalized	596,475	599,522
Reduce long term debt	656,320	285,145
Route development costs	15,468	50,445
All Other	1,051	3,641
	$1,644,136	$1,495,262
Net increase during year	$ 253,053	$ 225,495
WORKING CAPITAL AT END OF YEAR—		
Current assets	$3,624,354	$3,483,484
Current liabilities	2,240,320	2,352,503
Working capital	$1,384,034	$1,130,981





The Revenue Dollar

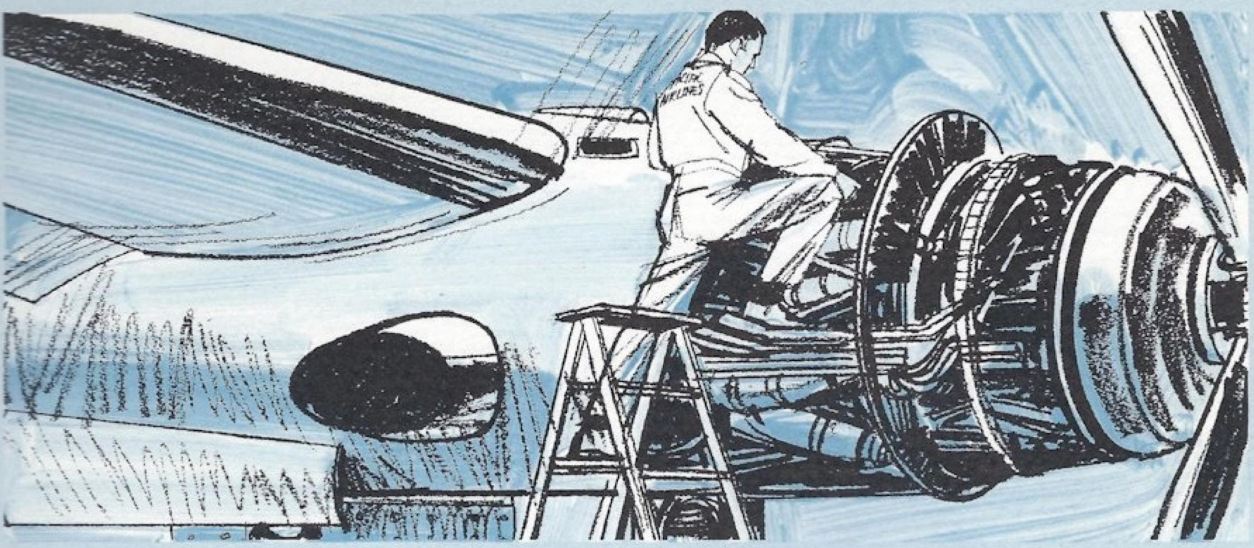
SOURCE

	1963		*1962*
Passenger and excess baggage	$ 7,692,656	64.0¢	61.7¢
Public service revenue and mail	3,972,997	33.0	35.6¢
Charter and contract	56,678	.5	.2
Freight	162,050	1.3	1.4
Express	82,857	.7	.6
Other	54,845	.5	.5
	$12,022,083	100.0¢	100.0¢

DISPOSITION

Wages and employee benefits	$ 5,075,491	42.2¢	41.6¢
Rents, supplies and services	1,975,558	16.4	16.0
Fuel and oil for aircraft	1,206,234	10.1	9.9
Parts and supplies for aircraft	1,513,227	12.6	12.7
Depreciation and amortization	869,544	7.2	6.8
Taxes	610,181*	5.1	5.8
Insurance	337,201	2.8	3.0
Interest	288,582	2.4	2.8
Retained in the business	146,065*	1.2	1.4
	$12,022,083*	100.0¢	100.0¢

*Excludes effect of extraordinary losses incurred or anticipated on disposition of Martin aircraft.



Comparative Financial and Operating Statistics

REVENUE AIRPLANE MILES FLOWN	*1963*	*1962*	*1961*	*1960*	*1959*
Scheduled service	5,352,293	5,470,054	5,010,206	6,117,367	5,456,087
Charter and contract service	27,048	12,782	287,071	535,792	554,237
Total revenue miles flown	5,379,341	5,482,836	5,297,277	6,653,159	6,010,324
SCHEDULED SERVICES					
Available seat miles (000)	225,620	227,681	203,092	235,646	190,304
Revenue passenger miles (000)	115,532	112,727	98,119	103,374	93,636
Revenue passengers	532,042	493,301	424,319	451,472	421,813
Average number of passengers per mile	21.6	20.6	19.6	16.9	17.2
Average length of trip (miles)	217	229	231	229	222
Passenger load factor	51.2%	49.5%	48.3%	43.9%	49.2%
Passenger revenue per passenger mile	6.6¢	6.6¢	6.5¢	6.0¢	6.2¢
Available ton miles	22,155,128	22,305,567	19,945,837	22,655,560	17,728,993
Revenue ton miles:					
Passenger	10,975,572	10,709,109	9,321,311	9,820,529	8,895,385
U.S. Mail	275,637	223,346	201,510	196,837	174,320
Freight	133,789	138,162	114,022	106,908	99,024
Express	62,068	64,471	54,481	53,891	56,276
Excess baggage	44,118	44,842	43,774	42,677	38,838
	11,491,184	11,179,930	9,735,098	10,220,842	9,263,843
Miles of route at end of year	2,585	2,570	2,257	2,260	2,260
Number of airports served at end of year	31	30	23	25	25
Number of aircraft operated at end of year	16	18	21	23	22
Number of employees at end of year	693	736	658	698	668
Number of common shares outstanding at end of year	854,075	851,765	851,410	671,410	671,410
Book value per share at end of year	$3.33	$3.36	$3.16	$2.46	$2.76
Net earnings per share	$0.17*	$0.20	$0.37	NIL	0.03

*Excludes losses incurred or anticipated upon disposition of piston aircraft.

Statement of Earnings

	Year ended December 31 1963	1962
Operating revenues:		
Passenger	$ 7,654,833	$ 7,425,887
Mail	223,218	178,074
Charter and contract operations	56,678	25,432
Express, freight and excess baggage	282,730	274,703
Other	54,845	40,337
	8,272,304	7,944,433
Public service revenue	3,749,779	4,132,949
	12,022,083	12,077,382
Operating expenses:		
Flying operations	3,088,967	3,111,336
Maintenance	2,559,038	2,665,323
Passenger service	412,428	442,762
Aircraft and traffic servicing	2,410,815	2,218,298
Promotion and sales	1,230,415	1,234,058
General and administrative	799,714	834,806
Depreciation	761,286	792,602
Amortization of pre-operating and route development costs	108,258	36,757
	11,370,921	11,335,942
Operating income	651,162	741,440
Other income and (expenses):		
Interest	(288,582)	(335,130)
Net gain (loss) on disposition of assets	(8,088)	24,787
Other, net	(40,680)	(8,683)
	(337,350)	(319,026)
	313,812	422,414
Estimated federal income taxes	(167,747)	(252,052)
Net earnings for the year	146,065	170,362
Extraordinary losses incurred or anticipated on disposition of Martin aircraft, less applicable federal income tax credit of $138,000 (Note 6)	(171,934)	—
Earnings retained for use in the business:		
Balance, beginning of year	1,560,437	1,390,075
Balance, end of year (Notes 1 and 2)	$ 1,534,568	$ 1,560,437

ASSETS	***December 31*** 1963	1962
CURRENT ASSETS:		
Cash (includes time deposit: 1963 and 1962—$1,000,000)	$ 1,691,296	$ 1,561,258
Accounts receivable:		
United States Government:		
Mail, passenger and other	570,358	728,961
Refundable federal income taxes	51,000	—
Traffic and agents	477,803	431,104
Miscellaneous, less allowance for possible losses (1963 and 1962 $8,000)	86,754	106,133
Expendable parts and supplies, at approximate cost	666,476	561,126
Prepaid expenses	80,667	94,902
	3,624,354	3,483,484
PROPERTY AND EQUIPMENT, at cost—pledged under notes payable (Notes 1 and 6):		
Flight equipment	9,218,170	9,515,195
Ground and other equipment	1,122,366	1,066,245
	10,340,536	10,581,440
Less—Accumulated depreciation and amortization	4,853,977	4,239,229
	5,486,559	6,342,211
Construction in progress	89,110	—
	5,575,669	6,342,211
INVESTMENTS, at cost	4,720	16,269
DEFERRED CHARGES, less amortization:		
Route extension and development expense	56,281	125,779
Pre-operating cost of new flight equipment	6,790	30,082
Debt discount and expense	179,387	195,401
	242,458	351,262
	$ 9,447,201	$10,193,226

LIABILITIES	***December 31*** ***1963***	***1962***
CURRENT LIABILITIES:		
Notes payable—current instalments (Note 1)	$ 656,320	$ 656,320
Accounts payable	947,299	981,339
Taxes collected or withheld from others	186,304	157,622
Accrued expenses	273,473	216,437
Unearned transportation revenue	176,924	131,785
Estimated federal income taxes	—	209,000
	2,240,320	2,352,503
LONG-TERM DEBT:		
Notes payable to bank (Note 1)	2,460,426	3,116,746
6½% convertible subordinated debentures, due July 1, 1976 (Note 2)	1,788,000	1,798,400
	4,248,426	4,915,146
FEDERAL INCOME TAXES DEFERRED TO FUTURE YEARS	110,518	61,119
STOCKHOLDERS' EQUITY (Notes 1, 2 and 3):		
Common stock:		
Authorized, 40,000,000 shares of 50c par value per share		
Outstanding, 1963—854,075 shares, 1962—851,765 shares	427,037	425,883
Paid-in surplus	886,332	878,138
Earnings retained for use in the business, per accompanying statement	1,534,568	1,560,437
	2,847,937	2,864,458
	$ 9,447,201	$10,193,226

See notes to Balance Sheet on page 10

Notes to Financial Statements

1. Notes payable:	***Due in 1964***	***Due after 1964***
5¼%, payable in monthly instalments of $38,550 to February 1969	$462,600	$1,986,700
6%, payable in monthly instalments of $5,583 to July 1967	67,000	167,500
6%, payable in monthly instalments of $10,560 to October 1967	126,720	306,226
	$656,320	$2,460,426

Substantially all of the Company's equipment is pledged as security under chattel mortgages for the loans.

The Civil Aeronautics Board, under agreements dated December 1, 1958 and May 9, 1960, guaranteed 90% of the principal amount and 100% of the interest on the 5¼% loan and the 6% loan payable to July 1967.

Under the terms of the loan agreements, the Company has agreed that (1) it will not, without the prior consent of the bank, pay any dividends (except in stock) or purchase, redeem or otherwise acquire for value any of its outstanding shares, and (2) it will 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.

On March 4, 1964 the Company entered into a bank loan agreement to finance the purchase of new flight equipment (see Note 6) and provision was made for repayment of the balance due under the 6% loan payable to October 1967. The new loan in the amount of $4,000,000 is payable commencing April 5, 1964 in 84 equal monthly instalments of $47,619 plus interest at 5¾% per annum and is secured by the new flight equipment.

2. Debentures: Under the terms of the indenture relating to the 6½% convertible subordinated debentures, annual sinking fund payments of $90,000 each, commencing in 1966, are required. The debentures are convertible into common stock of the Company at conversion prices per share of $4.50 on or before January 1, 1964, $6.00 on or before June 30, 1966 and $8.00 after June 30, 1966.

The terms of the indenture restrict the payment of cash dividends and the purchase or redemption of common stock by the Company to the sum of $100,000 plus 66⅔% of the earnings of the Company accumulated subsequent to December 31, 1960. (See Note 1 for restrictions on payment of dividends imposed by bank loan agreements.)

3. Warrants: 40,000 shares of unissued common stock are reserved for the exercise of outstanding warrants for the purchase of such shares at a price of $5.25 until August 1964.

4. Pension plans: The Company has several pension plans for pilots and other employees, all of which are contributory except for the fixed benefit plan for pilots. During 1963 earnings were charged with $186,288 representing the Company's share of current and past service pension costs. As at December 31, 1963 unfunded past service costs under the plans amounted to $520,000 and will be funded over future years at a rate which will accumulate sufficient funds to meet pension obligations to employees as they retire.

5. Long-term leases: At December 31, 1963 the Company had long-term leases on land, terminal facilities and radio equipment with aggregate rental commitments of $1,380,000 payable as follows: 1964—$132,000, 1965—$96,000, 1966—$92,000 and 1967 to 1990—$1,060,000. In addition to the foregoing, the Company was occupying certain terminal facilities while negotiating a lease for a term of 30 years from April 1962 at a minimum annual fixed rental of approximately $30,000 subject to renegotiation at five-year intervals.

6. Commitment for new flight equipment: In January 1964 the Company completed arrangements to purchase four new Fairchild F-27A turbo-prop aircraft for a total cost including interior furnishings of approximately $4,000,000. Financing of the purchase will be principally from the proceeds of a bank loan entered into in March 1964 as mentioned in Note 1.

In connection with the above purchase the Company evaluated its future requirements with respect to flight equipment and as of December 31, 1963 provided for extraordinary losses incurred or anticipated in the disposition of Martin piston aircraft no longer required.

PRICE WATERHOUSE & CO.

120 MONTGOMERY STREET

SAN FRANCISCO 94104

March 20, 1964

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

In our opinion, the accompanying statements present fairly the financial position of Pacific Air Lines, Inc. at December 31, 1963 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.

Traffic and Sales

Promotional activities were extensive during the year.

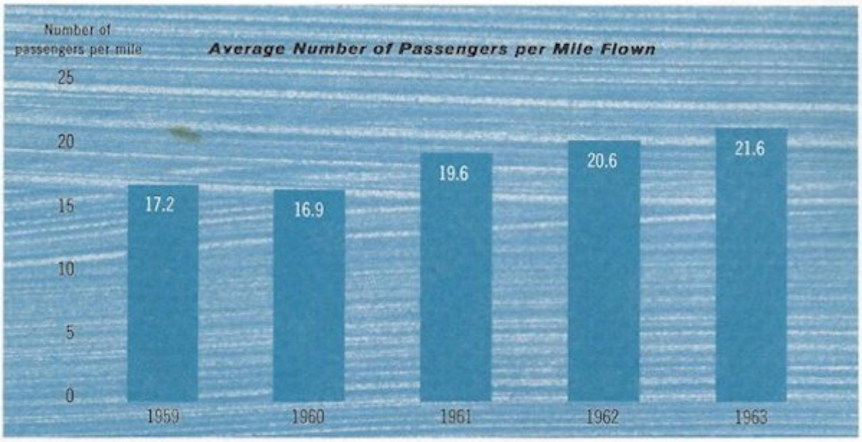
The QUICKET, a write-your-own-ticket designed to replace our credit card, was introduced in January with an intensive promotion campaign involving direct mail, newspaper, and radio advertising. Originally designed for one-way fares only, it was later made even more convenient by expanding its use to the round-trip excursion fare passenger. As a result the number of credit customers had increased almost 50 per cent by the end of the year.

The promotion of travel between San Jose and the Los Angeles area was expanded, featuring the accessibility of the San Jose airport versus the time and expense involved in travelling via surface means to the San Francisco airport.

The Lake Tahoe service was inaugurated with ribbon cutting ceremonies in various cities enroute between Los Angeles and Lake Tahoe in which civic officials participated. Excellent radio, television and newspaper coverage was received.

Overall sales activity was intensified through an active direct mail campaign, newspaper and radio advertising and a personal-call program.

A useful indicator of the scheduling efficiency and revenue trend of an airline is the average number of passengers carried per mile flown. Pacific consistently has been one of the leaders in the local service industry in this respect and, in 1963, carried an average of 21.6 passengers per mile, compared with an industry average of 15.5 passengers.



Passenger Service

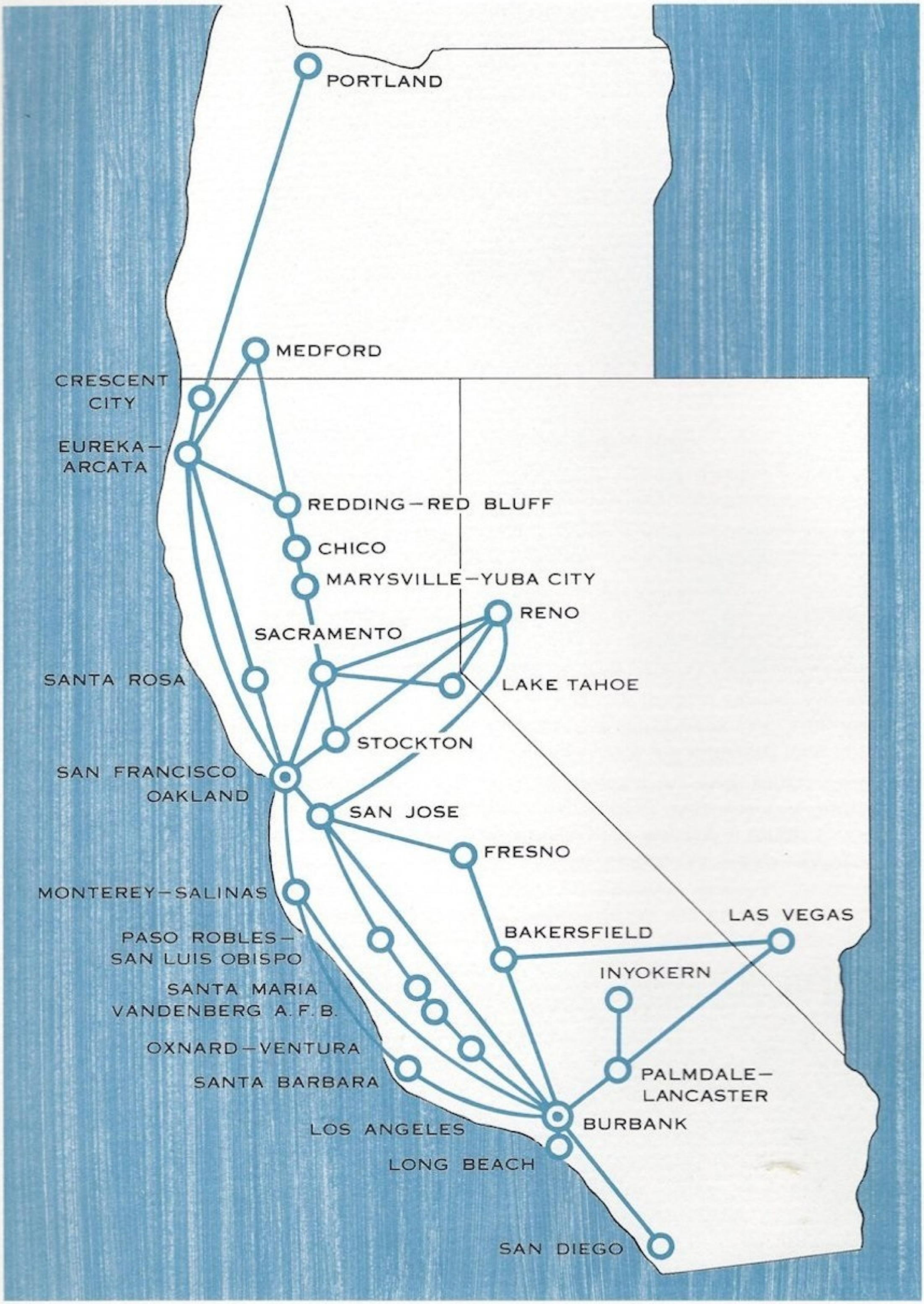
During the year vigorous progress was achieved in the area of passenger service. Major accomplishments included the following:

Closed circuit television was installed in San Francisco and Los Angeles to provide instantaneous flight information to passengers.

Liquor service was inaugurated on all afternoon and evening flights. A variety of cocktails, as well as soft drinks, are offered for sale during flight and the public reception to this service has been excellent. As a result, our competitive advantage has been improved in many areas.

An extensive training program was initiated for all station personnel to make them more aware of the public service concept. Complimentary letters from passengers are distributed to all public contact personnel.

A standard station decor was selected and installed at a majority of our stations; a modern City Ticket Office was opened at the Town and Country Village in San Jose and Company personnel at Las Vegas and Los Angeles moved into new quarters.


PORTLAND
MEDFORD
CRESCENT CITY
EUREKA–ARCATA
REDDING–RED BLUFF
CHICO
MARYSVILLE–YUBA CITY
RENO
SACRAMENTO
SANTA ROSA
LAKE TAHOE
STOCKTON
SAN FRANCISCO OAKLAND
SAN JOSE
FRESNO
MONTEREY–SALINAS
LAS VEGAS
PASO ROBLES–SAN LUIS OBISPO
BAKERSFIELD
INYOKERN
SANTA MARIA VANDENBERG A.F.B.
OXNARD–VENTURA
SANTA BARBARA
PALMDALE–LANCASTER
LOS ANGELES
BURBANK
LONG BEACH
SAN DIEGO

Route Proceedings

On October 27, 1963 the Company inaugurated service to Lake Tahoe, California and boarded more than 10 passengers a day during the last two months of the year. Although the terms of the Company's certificate prevent non-stop service to Lake Tahoe from San Francisco or Oakland, the initial response to the service is encouraging.

As noted in the Annual Report for 1962 the Company had requested the Civil Aeronautics Board to lift certain operating restrictions which presently prevent the Company from (a) providing non-stop service between Burbank, California and Las Vegas, Nevada and between Medford and Portland, Oregon; and (b) carrying local passengers between San Diego and Los Angeles, California. On April 16, 1964 the Board denied each of these applications. During 1963 the Board also denied any futher route extensions in connection with the Southern Rocky Mountain Case.

Route applications still pending at the end of the year included an application to renew authority between Crescent City, California and Portland, Oregon, and to extend service from Portland to Seattle. Also pending is an application to extend service from Fresno to Phoenix and Tucson.

In addition, the Company has petitioned the Civil Aeronautics Board to determine whether the Board should suspend or cancel the service provided at Medford, Oregon, by United Air Lines.

Flight Equipment

Continued favorable experience with the F-27 aircraft has convinced the management of your Company that this aircraft is ideally suited to the Company's operational and traffic requirements. By the end of 1963 the Federal Aviation Agency had authorized 3,800 hours between overhauls for the Rolls Royce engines which power the F-27, and early in 1964 authorized a further extension to 4,000 hours. Early in 1964 the overhaul time on the F-27 airframe was also increased from 10,000 to 12,000 hours. These, as well as other efficiencies, enable these aircraft to be flown for almost 5 cents a mile less than the Martin 404 piston aircraft, in spite of the fact that, in 1963, depreciation was 10 cents per mile higher for the F-27 than for the Martin.

Accordingly, late in 1963, four additional F-27 aircraft were ordered and are due to commence scheduled service by the first of June, 1964. These four aircraft will enjoy a completely new decor, interior and exterior, and should provide even more appeal to our passengers. The present F-27 aircraft will be conformed to the new decor at overhaul periods.

With these deliveries the Company's equipment will consist of 10 F-27 and 10 Martin 404 aircraft and 5 or 6 of the Martin aircraft will be offered for sale. In view of the forthcoming disposition of this piston equipment it became necessary, as noted on page 3, to reduce the book value of the Martin equipment to estimated realizeable values. No further losses are anticipated upon disposition of the Company's remaining piston equipment.

The management of your Company is vitally aware of the probability that an all Jet aircraft may be required to meet future traffic growth and to maintain our competitive position with other carriers. Extensive studies are being made of all available short-range Jet aircraft to determine which aircraft meets our particular requirements. Following the pending reduction in the Company's piston equipment fleet, Pacific will be in an excellent position to move in a direction calculated to best serve the needs of our passengers and stockholders.

Industrial Relations

Collective bargaining agreements were concluded with two representative unions during the calendar year. A thirty-month contract, retroactive to December 1, 1962, was concluded with the International Association of Machinists late in the year, and earlier a three-year agreement was signed with our Dispatchers. Both settlements are considered as being of a constructive nature and in keeping with the general wage pattern currently in effect in the airline industry.

During the year the Company was favored with a substantial reduction in the rate of employee turnover. The desired trend to an increased tenure of employment is attributable to improved selection practices and to a corporate growth potential that has set forth sound job advancement opportunities. The lower attrition rate and generally lengthening of the tenure of employment will tend to improve customer service, lower unemployment taxes, and produce many other indirect benefits accruing from an experienced and well orientated staff.

There were no work stoppages during 1963 and contractual grievances were at a minimum level. The continued harmonious relationship between the Company and its employees is indicative of well constructed collective bargaining agreements that are clearly defined and capable of intelligent administration.

An improved group medical and life insurance plan was inaugurated during the year. The new plan offers substantial coverage improvements to our employees and their dependents.

The Annual Meeting of shareholders will be held in the Aluminum Room of the Westward Ho Hotel, Phoenix, Arizona, on June 1, 1964, at 10:00 a.m.

Stock Transfer Agents

Crocker-Citizens National Bank
1 Montgomery Street, San Francisco, California

Bankers Trust Company
New York 17, New York

Stock Registrars

Bank of America
300 Montgomery Street, San Francisco, California

The Chase Manhattan Bank
New York 15, New York

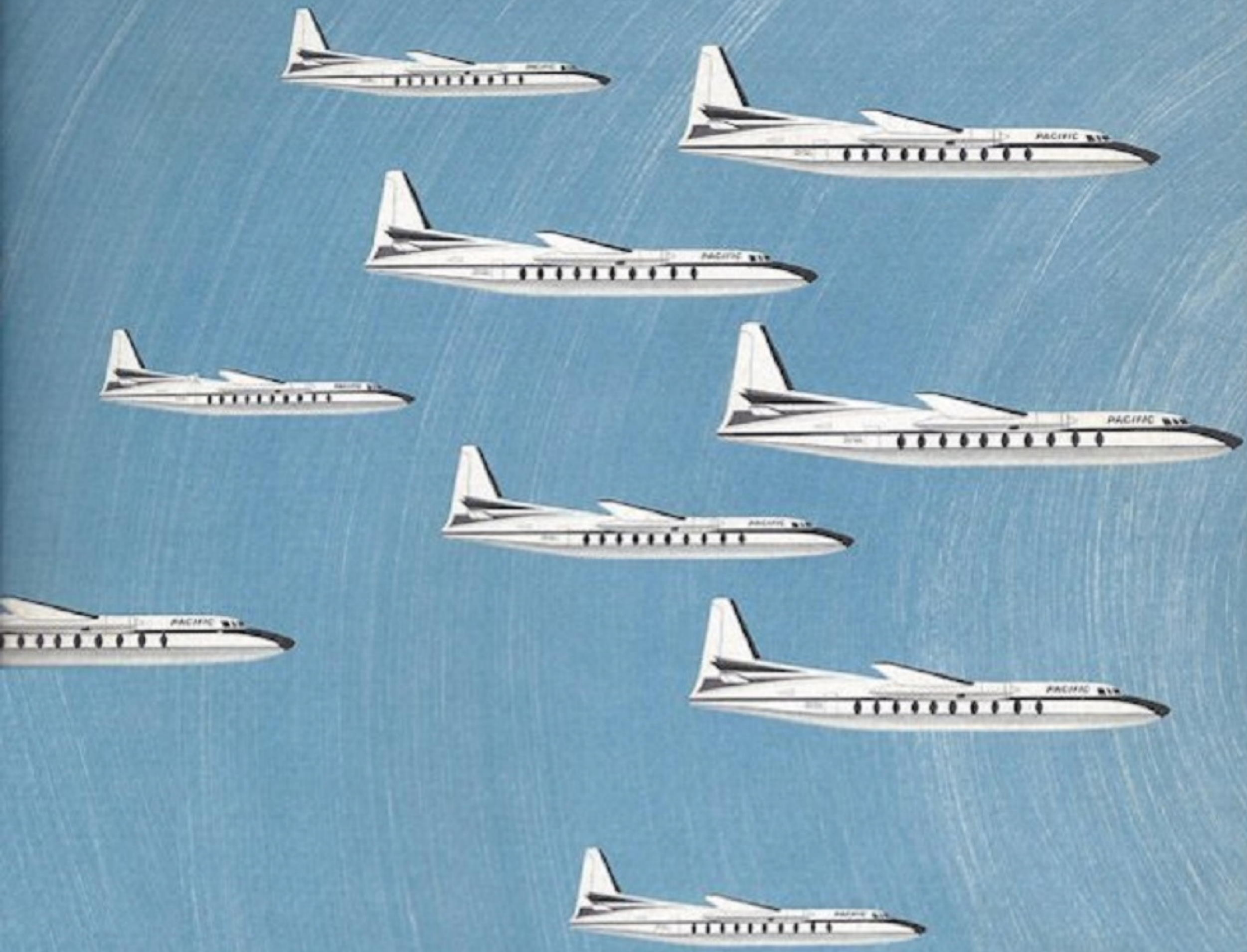
Debenture Trustee

Bank of America
300 Montgomery Street, San Francisco, California

Debenture Paying Agents

Bank of America
300 Montgomery Street, San Francisco, California

Bankers Trust Company
New York 17, New York



Serving 37 cities in California, Oregon and Nevada with a fleet of nine F-27 Propjets