

The Flying Tiger Line Inc. Annual Report 1968





Highlights

	1968	1967
Operating revenues (\$000)	\$ 76,699	\$ 87,031
Operating income (\$000)	\$ 2,694	\$ 12,280
Net income before extraordinary items (\$000)	\$ 94	\$ 7,586
Per share	\$.02	\$ 1.67
Net income (loss) after extraordinary items (\$000)	\$ (5,270)	\$ 6,785
Per share	\$ (1.16)	\$ 1.50
Domestic cargo statistics —		
Available ton miles (000)	263,224	246,415
Revenue ton miles (000)	166,041	163,250
Load factor	63.1%	66.2%
Revenue per ton mile	12.91¢	13.29¢
Aircraft miles flown for Military Airlift Command (000)	14,249	18,121

Results for the year 1968 show a nominal profit before a substantial writedown of equipment values established an overall loss for the period. The adverse operating conditions experienced were reported to shareholders periodically during the year and are reviewed briefly here.

A six-month delay in delivery of our new DC8-63F aircraft affected almost every phase of the company's activities throughout the year. The following major factors, along with their many side effects, were direct results of the delay:

—A serious gap in our domestic jet fleet, forcing us to rely primarily upon turbo-prop equipment in this vital market. Competing against all-jet carriers we were not able to keep pace with overall industry gains in air cargo. This is reflected directly in revenue and profit figures. The latter was particularly affected, since our turbo-prop equipment flew every mile at an operating loss.

—A drop of almost 20 per cent in Military Airlift Command revenue, based on MAC's decision to give priority to all-jet equipment in both cargo and passenger operations.

—The inability to commit all-jet equipment early in the year to the profitable May-September charter business.

—The prior commitment to lease two Boeing jets to other lines, further depleting our jet fleet when the DC8-63F aircraft were not delivered on schedule.

The net effect of these factors was held to a minimum only by the dedication and professional competence of Flying Tiger men and women. Air crews, ground crews, and administrative personnel made every effort to operate our older equipment profitably while at the same time phasing in the new fleet in an orderly manner.

An explanation of extraordinary items is found in the section immediately following.

The transitional effects of the past year were indeed costly yet they were most significant to our future and have placed us in a sound position for efficient and profitable operations in the years ahead.

When you receive this report we will have completed our changeover to an all DC8-63F fleet, marking the first time in Flying Tiger

history that we have been in the enviable position of flying, maintaining, and training crews for only one type aircraft. The economies of this have already been felt in operating costs.

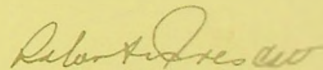
The DC8-63F, in either cargo or passenger configuration, offers greater profit potential than any aircraft we have ever flown. The new fleet will give us 60 per cent more available ton mile capacity at only a 30 per cent increase in costs.

New air freight tariffs, which became effective late in the past year, are already having a marked effect on profits.

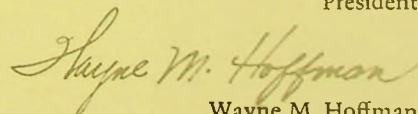
The establishment of each Flying Tiger terminal as an independent unit, responsible for its own sales and profits, is now completed. This profit center concept, along with the modernization of our terminals for more efficient freight handling, should affect revenues and profits favorably throughout 1969.

One other major factor should contribute to a successful current year and toward continued growth for Flying Tiger in the future. Late in 1968 President Johnson awarded our company a Trans-Pacific route of major importance. Flying Tiger was the only cargo carrier recommended for this route by the CAB. President Nixon subsequently cancelled all awards pending a complete review by his administration. We are confident that this review will result in favorable action on our behalf.

To summarize, the past year was one of the most significant in the company's history. The preparations made during 1968 for this year and the years ahead were costly. We are confident that these preparations were vital to both the competitive position and profit potential of Flying Tiger Line as it enters a new era of tremendous growth for air cargo.



Robert W. Prescott
President



Wayne M. Hoffman
Chairman of the Board



Earnings —

The Company's 1968 net income before extraordinary charges was \$94,168. In connection with the Company's plan for an all DC8-63F fleet, the carrying value of various aircraft to be disposed of and related costs were written down to reflect the estimated realizable value. This write-down resulted in an extraordinary charge against earnings of \$5,364,212, net of tax effect, consisting of the following items:

- a. Write-off of all deferred training expenses on B707 and CL44 aircraft amounting to \$1,311,133;
- b. Reduction in carrying values of CL44 aircraft and spares and B707 spares of \$3,261,652 and \$188,744, respectively;
- c. Write-down of carrying value of Constellation aircraft and spares of \$602,684 to reflect the value due upon disposition of this equipment.

Despite the Company's net loss of \$5,270,044 after the extraordinary charges referred to above, the cash flow for the year 1968 was \$9,571,800.

Revenues —

Revenues reported in 1968 amounted to \$76,698,672 compared to \$87,031,494 reported in 1967. This decrease resulted from a drop in business performed for the Military Airlift Command in 1968.

Expenses —

Consistent with industry experience, operating expenses continued to increase. The overall aircraft miles flown in 1968 were reduced, but increased costs offset any appreciable reduction in overall operating expenses which should have resulted from less miles flown. Also contributing to higher expenses was the fleet transition during the year. It is anticipated that with an all DC8-63F fleet, substantial economies will be achieved.

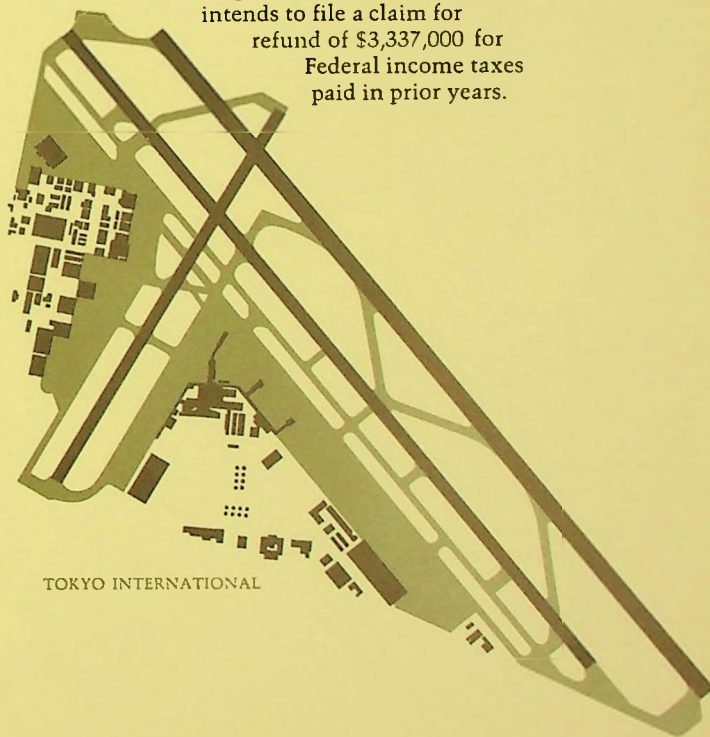
Financing —

At December 31, 1968, the Company's fleet included nine DC8-63F aircraft, one of which was leased from another airline under a short-term lease and eight were financed by the issuance of equipment trust certificates. In January 1969, two additional aircraft were acquired and financed with proceeds from equipment trust certificates. With respect to the remaining seven DC8-63F aircraft ordered, the Company has found it advantageous to finance these aircraft under lease contracts. Details of the contracts were finalized at favorable lease rates.

Subsequent to year-end, the Company sold privately \$25,000,000 of 5¾% Subordinated Convertible Notes, due 1979-1989, to a group of banks and institutional investors. The proceeds of the sale will be used to improve working capital as well as to provide for future expansion and growth.

Refund of Federal Income Taxes —

As a result of deductions arising from additional depreciation and other additional deductions for tax purposes, the Company intends to file a claim for refund of \$3,337,000 for Federal income taxes paid in prior years.



TOKYO INTERNATIONAL

Speed and range of the versatile DC8-63F, shown over Mt. Fuji, brings bases throughout the world within hours of Flying Tiger cargo terminals across the United States.

In the last quarter of 1968 major changes occurred in the company's operations as the new DC8-63F fleet reached full scheduled service on domestic routes. A cost-oriented jet-age tariff proposed by the airline was, with one exception, approved by the Civil Aeronautics Board. A Flying Tiger containerization program was accepted within the automotive industry, largest single user of airfreight, and a Flying Tiger subsidiary was chosen to initiate the concept.

Early in the year, a significant policy change was made by the Civil Aeronautics Board in another major case affecting the airline. For the first time, ruling in a case involving domestic all-cargo route applications, the Board stated that it would now consider such applications in hearings separate from cases involving passenger rights. This should both simplify and expedite route matters in cargo cases. The new ruling had long been sought by Flying Tiger and indeed was a major element in many of its regulatory issue applications.

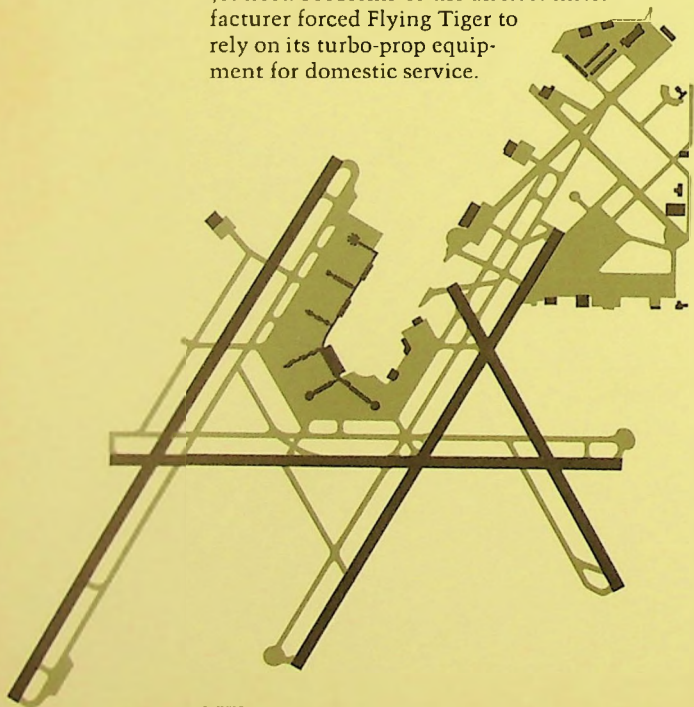
The airline's domestic system operated under a serious competitive disadvantage for nine months of the year, due primarily to a six-month delay in first deliveries of its new jet fleet. Problems of the aircraft manufacturer forced Flying Tiger to rely on its turbo-prop equipment for domestic service.

These aircraft, which fly 200 miles an hour slower than pure jet equipment, were not able to match the jet schedules of our major competitors.

The DC8-63F fleet reached full scheduled operation on domestic routes in October and first results were gratifying. Flying this new, highly competitive equipment, the airline was able to show a 25 per cent traffic gain in October over the same month last year. Throughout the balance of the year, payloads frequently exceeded 90 per cent of the airplane's total freight capacity. By contrast, earlier equipment, whether jet or turbo-prop, seldom has been able to exceed 70 per cent of theoretical payload capacity due to space limitations. The DC8-63F effectively overcomes this historic handicap.

For the first time in airfreight history, the CAB accepted almost in its entirety an airline's new concept for a rate structure specifically designed to meet the needs of shipper and carrier with new jet aircraft. A Flying Tiger proposal led to the first tariff based on actual cost studies and reflects realistically the revenue needs of the carrier to attain a profit. It is also beneficial to the volume shipper. New pricing structures emphasize containerized traffic and provide considerable economic incentives to shippers over prior tariffs. Only the Flying Tiger proposal for a new minimum rate level was held up pending further Board investigation.

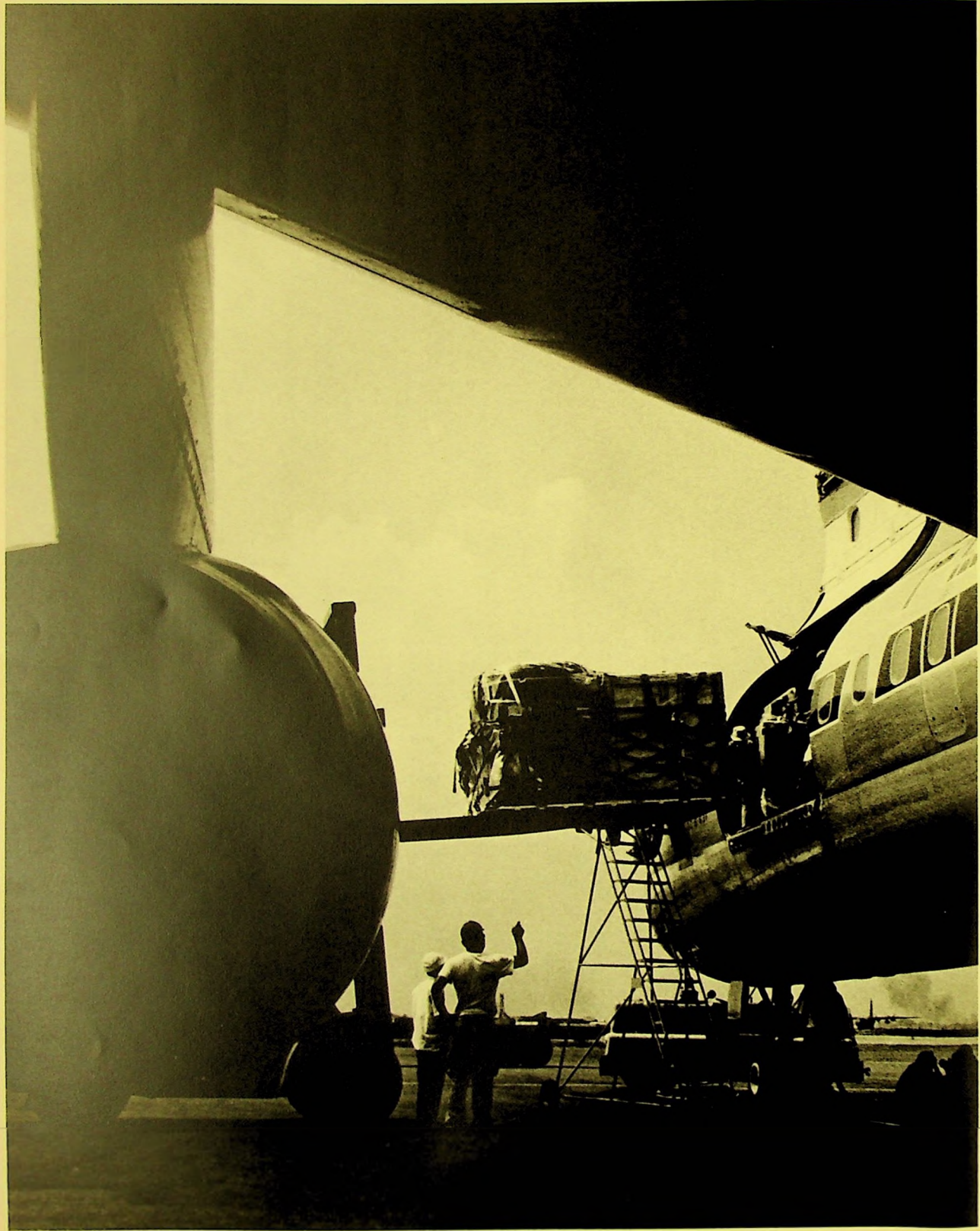
Containerization of airfreight was given major impetus when the Ford Motor Company, one of the nation's largest users of airfreight, signed a contract with Flying Tiger Air Services, a wholly owned subsidiary of the airline, for containerization of all Ford's airfreight out of the Detroit area. This again,



DETROIT

Maximum cargo capacity of 112,500 pounds may be placed aboard the DC8-63F in 45 minutes using Flying Tiger's fully automated cargo loading systems now in operation.





was a landmark accomplishment, representing the first time that a major shipper had committed to such a program. It should lead eventually to much greater containerization of airfreight by many volume shippers. Under the contract, Flying Tiger Air Services containerizes all Ford airfreight at Detroit, handles all shipping problems, and delivers the freight to Ford-designated air carriers. The benefits to Ford are reliance upon a single agency for airfreight handling, faster service to its production plants, and reduced transportation costs based on the volume and density rate advantages it gains.

Our new DC8-63F aircraft hold a considerable advantage over other jets in both weight and density capacities. Boeing 707s carry 13 pallets or a total weight of 95,000 pounds, compared to our aircraft's 18 pallets or 112,500 pounds.

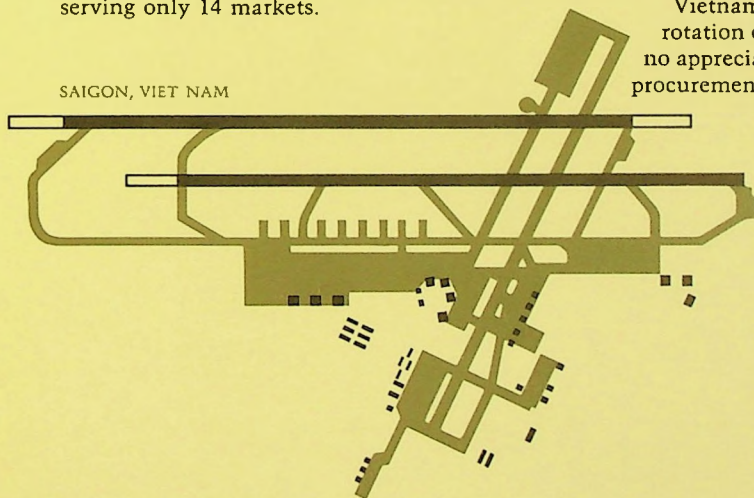
The policy declaration of CAB on hearing all-cargo route cases separately came in a board proceeding prior to a Flying Tiger application to expand its domestic service by adding approximately 20 additional terminals. It will be heard by the Board in 1969. If granted, this route expansion to 34 terminals would bring Flying Tiger into almost every major domestic market, greatly expanding its now-limited domestic route structure serving only 14 markets.

The decrease in Military Airlift Command (MAC) revenues in 1968 was the result of several significant factors. There was further reduction in MAC rates from the previous year, along with a reduction in the total awards made to commercial airlines. The most significant factor, however, was that CL-44 aircraft were priced out of military business. The unit cost (ton-mile) of operating the CL-44 is much greater than that of pure jets, and the CAB has accordingly placed a higher rate on this aircraft for military use.

A standard procedure of MAC is to award business to commercial carriers in direct relation to each carrier's participation in the Civil Reserve Air Fleet Program (CRAF). Flying Tiger ranks second of 20 airlines participating in CRAF. However, overriding this procedure is cost consideration. Although there was a heavy demand for airlift during the summer months of 1968, a significant amount would have been awarded to Flying Tiger, if our new, more economical jet aircraft had been available.

The new fleet makes Flying Tiger a much larger factor in the mobilization base index of CRAF, and the attractive unit cost of operating the DC8-63F presents an added incentive for MAC to contract with airlines flying it. Any withdrawal of forces in

Vietnam does not affect the normal rotation of men that must remain, and no appreciable reduction in total procurement is anticipated.



SAIGON, VIET NAM

Flying Tiger's all DC8-63F fleet represents a 60 per cent increase in available ton mile capacity at only a 30 per cent increase in costs, with significant effects upon future profit potential.

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Two major changes in our cargo terminal concept were introduced into the domestic system in 1968. One involved the actual facility for ground handling of airfreight and the other was a basic reorganization of terminal administration.

New, automated facilities specifically designed to our needs were completed at San Francisco, Los Angeles, Chicago and Newark. Constructed to specifications developed by Flying Tiger as a result of studies conducted over the past several years, these facilities represent the most advanced systems required to service efficiently our new fleet of DC8-63F aircraft. They provide for complete palletization of the aircraft, or for unusual freight load requirements. The system permits loading or unloading of a maximum 112,500-pound payload in 45 minutes.

Pallets are built up with freight within an airport terminal or turned over to shippers for loading at their own plants. Within the airport terminal, special racks may be used either to store freight for a future flight, or the pallets may be moved directly through the rack area onto track fingers leading out to the aircraft loading ramp. There the pallets move onto a mobile freight loading vehicle, which places it directly aboard the aircraft. All equipment is automated and requires only a controller for operation.

Terminal areas may include one or more stations, each under the supervision of a general terminal manager responsible for producing a profit. All sales and ground operation activities are now under his

control and he is charged specifically with sales productivity, efficiency in the pickup and delivery of freight, rapid loading and unloading of aircraft, and customer service.

Timely certification of our new DC8-63F simulator, along with the leasing of two of the new aircraft from another airline, allowed Flying Tiger to prevent effects of the six-month delay in delivery from becoming even more protracted.

The training function was particularly critical during the year as pilots, crews, maintenance and administrative personnel operated schedules with older equipment and trained for the new jets at the same time. The transition was made under less than ideal conditions, yet the loss of productive flying time was held to a minimum by the skill and hard work of men and women throughout the airline.

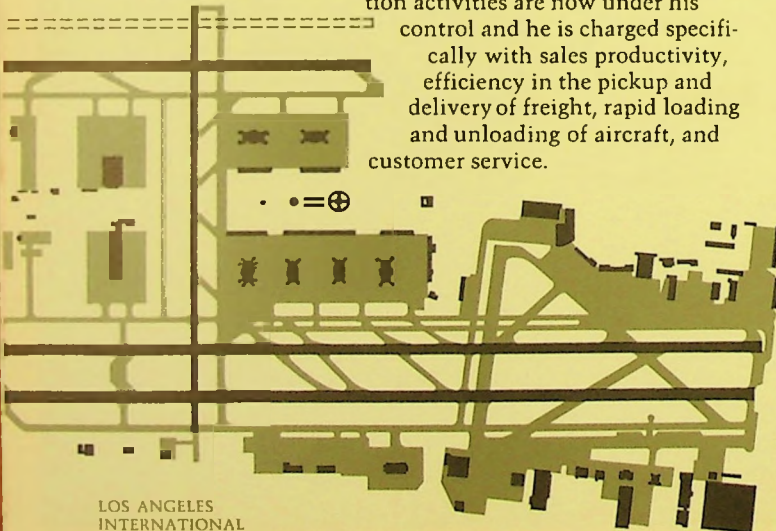
Passenger evacuation tests and proving flights for the new planes were performed very quickly as the aircraft were received. The results were expressed in our placing the first five new DC8-63Fs in operations within a five week period.

Our new operations control computer was installed by mid-year and the entire Crew Control Management function is now programmed in and completely operational. The computer is also performing flight planning functions for the new fleet of aircraft. Computer control of both these functions will effect much greater efficiency and economy throughout the system.

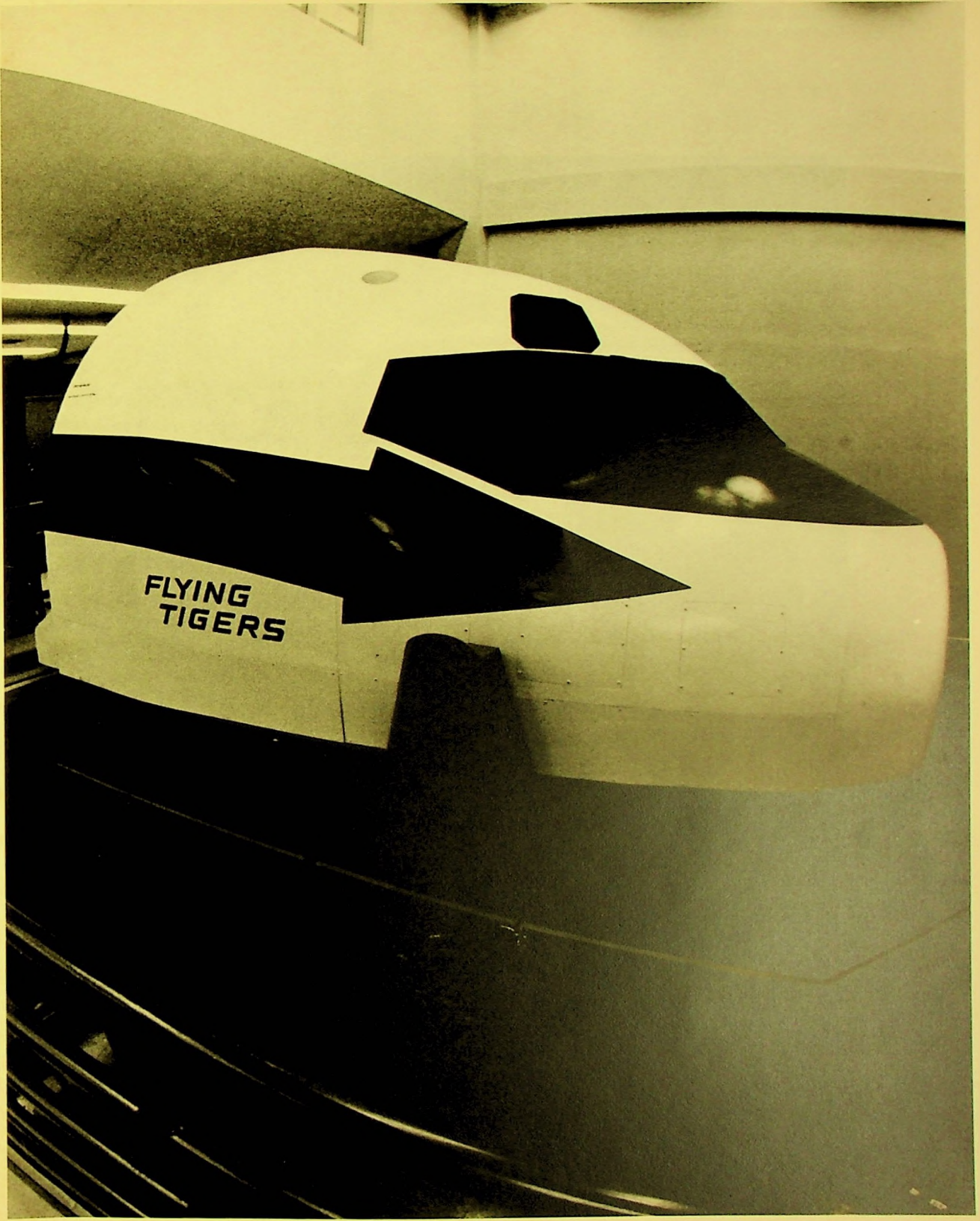
Other logistics management problems are being phased into computer operations and in time a major part of maintenance, training, and personnel administration will be carried out in this manner.

Effects of an all DC8-63F fleet will be felt in every phase of our training and maintenance programs. The complexity of training procedures in the past for pilots, crews, maintenance, and loading personnel operating various aircraft types has been frequently both time consuming and costly. Flying Tiger Line's new fleet of DC8-63F aircraft will eliminate these inefficiencies and allow a greater emphasis on productive flying operations in the years ahead.

Transition to an all DC8-63F fleet will result in economies throughout Flying Tiger operations, including appreciable savings in training air and ground crews.



**FLYING
TIGERS**



Balance Sheets

December 31, 1968 and 1967

ASSETS	1968	1967
CURRENT ASSETS (including prepaid engine overhaul cost):		
Cash	\$ 2,572,366	\$ 12,683,091
Receivables, less reserves—		
Freight customers	3,974,559	4,433,736
Charters, service sales and other	10,690,553	10,607,034
Federal income tax refund (Note 5)	3,337,000	—
Materials and supplies, at average cost	4,744,405	4,668,237
Equipment under sales contract (Note 2)	6,725,000	—
Prepaid insurance, rents, etc.	2,702,207	2,574,796
Prepaid engine overhaul cost	7,335,469	2,237,855
Total current assets	\$ 42,081,559	\$ 37,204,749
TEMPORARY CASH INVESTMENTS, restricted to disbursement for equipment acquisition	\$ —	\$ 46,630,000
PROPERTY AND EQUIPMENT, at cost (Notes 1 and 3):		
Aircraft, engines and other flight equipment	\$ 96,964,938	\$ 76,715,211
Other equipment	4,056,879	3,316,144
Buildings and leasehold improvements	7,660,365	6,387,706
	\$108,682,182	\$ 86,419,061
Less— Reserves for depreciation and amortization	11,105,256	35,383,874
	\$ 97,576,926	\$ 51,035,187
Aircraft in nontransport use, net of reserves (Note 2)	18,803,431	1,127,840
Deposits on aircraft, engines, etc.	10,939,848	22,401,821
	\$127,320,205	\$ 74,564,848
OTHER ASSETS AND DEFERRED CHARGES:		
Unamortized debt expenses	\$ 1,467,806	\$ 1,166,961
Long-term lease receivables, less unearned income of \$3,341,712 (Note 2)	8,955,673	—
Long-term deposits, etc.	2,994,032	1,218,026
Training costs applicable to aircraft, being amortized	5,152,366	3,003,475
	\$ 18,569,877	\$ 5,388,462
	\$187,971,641	\$163,788,059

LIABILITIES AND STOCKHOLDERS' EQUITY

	1968	1967
CURRENT LIABILITIES :		
Notes payable to banks	\$ 4,000,000	\$ —
Current installments of long-term debt	11,131,444	7,053,521
Accounts payable and accrued liabilities	12,081,510	9,923,161
Accrued Federal income taxes	—	549,000
Total current liabilities	\$ 27,212,954	\$ 17,525,682
LONG-TERM DEBT (See Summaries) (Note 3)	\$102,536,685	\$ 79,966,506
DEFERRED CREDITS :		
Deferred Federal income taxes (Note 5)	\$ 15,075,748	\$ 16,806,236
Overhaul liability—leased aircraft and engines	1,453,003	2,122,676
	\$ 16,528,751	\$ 18,928,912
STOCKHOLDERS' EQUITY (Note 3) :		
Common shares—\$1 par value—		
Authorized, 10,000,000 shares		
Outstanding, 4,540,638 shares (1968) and		
4,538,138 shares (1967)	\$ 4,540,638	\$ 4,538,138
Additional paid-in capital	17,184,091	17,136,441
Retained earnings (Note 4)	19,968,522	25,692,380
	\$ 41,693,251	\$ 47,366,959
	\$187,971,641	\$163,788,059

The accompanying notes and summaries of long-term debt are an integral part of these balance sheets.

Statements of Income

For the Years Ended December 31, 1968 and 1967

	1968	1967
OPERATING REVENUES:		
Scheduled freight operations	\$21,430,134	\$21,689,211
Military Airlift Command	43,255,211	53,413,028
Charters, service sales, etc.	12,013,327	11,929,255
	\$76,698,672	\$87,031,494
OPERATING EXPENSES:		
Flying operations	\$32,681,344	\$31,173,364
Ground operations	11,066,509	10,549,561
Maintenance	16,670,663	19,021,222
Sales, advertising and publicity	2,959,112	2,861,996
General and administrative	3,904,519	4,027,215
Depreciation and amortization (straight line)	6,722,385	7,118,426
	\$74,004,532	\$74,751,784
Operating income	\$ 2,694,140	\$12,279,710
OTHER (INCOME) EXPENSE:		
Interest expense	\$ 3,086,519	\$ 1,775,305
Miscellaneous (net)	(499,547)	(896,973)
	\$ 2,586,972	\$ 878,332
Net income before provision for Federal income taxes and extraordinary item	\$ 107,168	\$11,401,378
PROVISION FOR FEDERAL INCOME TAXES (Note 5)	13,000	3,815,000
NET INCOME BEFORE EXTRAORDINARY ITEM	\$ 94,168	\$ 7,586,378
EXTRAORDINARY ITEM:		
Provision for losses on fleet disposition, less applicable deferred income tax effect of \$5,069,446 in 1968 and \$294,000 in 1967 (Note 2)	(5,364,212)	(801,350)
NET INCOME (LOSS)	\$ (5,270,044)	\$ 6,785,028
PER SHARE OF COMMON STOCK, reflecting conversion of debentures in 1967:		
Net income before extraordinary item	\$.02	\$ 1.67
Extraordinary item	(1.18)	(.17)
NET INCOME (LOSS)	\$ (1.16)	\$ 1.50
<i>The accompanying notes are an integral part of these statements.</i>		

Statements of Stockholders' Equity
 For the Years Ended December 31, 1968 and 1967

	1968				1967
	\$1 Par Common Stock	Additional Paid-in Capital	Retained Earnings	Total	Total
BALANCE, Beginning of Year	\$4,538,138	\$17,136,441	\$25,692,380	\$47,366,959	\$40,482,363
ADD—					
Net income (loss) for year	—	—	(5,270,044)	(5,270,044)	6,785,028
Conversion of debentures	—	—	—	—	500,000
Issuance of shares under stock options	2,500	47,650	—	50,150	53,382
	\$4,540,638	\$17,184,091	\$20,422,336	\$42,147,065	\$47,820,773
DEDUCT—					
Cash dividends on common stock— \$.10 a share	—	—	453,814	453,814	453,814
BALANCE, End of Year (Note 4)	\$4,540,638	\$17,184,091	\$19,968,522	\$41,693,251	\$47,366,959

The accompanying notes are an integral part of these statements.

Statements of Funds

For the Years Ended December 31, 1968 and 1967

	1968	1967
WORKING CAPITAL AT BEGINNING OF YEAR	\$ 19,679,067	\$19,570,874
SOURCE OF FUNDS:		
Net income before extraordinary item	\$ 94,168	\$ 7,586,378
Add (Deduct)—		
Depreciation and amortization provisions	6,718,090	7,752,526
Deferred tax provision (Note 5)	3,350,000	1,754,000
Gain on retirement of property and equipment	(116,503)	(170,244)
Extraordinary item (portion reducing funds)	(473,955)	—
Total funds from operations	\$ 9,571,800	\$16,922,660
Proceeds from issue of 1967 Equipment Trust Certificates	51,000,000	—
Proceeds from issue of 1968 Equipment Trust Certificates	19,000,000	—
Proceeds from Equipment Purchase Notes	13,379,646	—
Proceeds from common stock issued upon exercise of restricted stock options	50,150	53,382
Proceeds from retirement of property and equipment	1,235,839	323,339
Deposits on equipment refunded or refundable in one year	2,974,416	—
All other (net)	314,830	610,587
	\$ 97,526,681	\$17,909,968
APPLICATION OF FUNDS:		
Payment on long-term debt	\$ 7,985,576	\$ 7,737,212
Increase in current portion of long-term debt	4,077,923	118,984
Deferred debt expense	341,889	1,174,298
Deferred training costs applicable to aircraft	4,812,815	121,395
Cash deposits on equipment	166,228	5,541,967
Purchase of property and equipment, net of cash deposits applied	84,498,898	2,654,105
Cash dividends on common shares	453,814	453,814
	\$102,337,143	\$17,801,775
WORKING CAPITAL AT END OF YEAR	\$ 14,868,605	\$19,679,067

The accompanying notes are an integral part of these statements.

Summaries of Long-Term Debt

December 31, 1968 and 1967

	1968	1967
1959 Equipment Trust Certificates—		
Series A—5½%, due 1969-1970	\$ 3,600,711	\$ 8,589,257
Series B—5½%, due 1969	—	791,864
1964 Equipment Trust Certificates—		
Series A—5½%, due 1969-1970	2,568,633	2,921,098
5½% Promissory Note, due 1969-1970 (Note 3)	986,797	1,106,685
1965 Equipment Trust Certificates (variable interest rate, currently 8%)—		
Series A—due 1969-1971	3,875,000	5,250,000
Series B—due 1971-1974	6,340,000	6,340,000
1967 Equipment Trust Certificates—		
Series A—6.6%, due 1969-1980	51,000,000	46,630,000
6¾% Subordinated Equipment Purchase Notes, due 1974-1979	6,611,658	—
1968 Equipment Trust Certificates—		
Series A—6%, due 1969-1975	8,000,000	—
Series B—7%, due 1975-1979	8,000,000	—
Series C—6¾%, due 1979-1981	3,000,000	—
7% Promissory Note, due 1969-1988 (Note 3)	3,931,859	4,000,000
Aircraft Purchase Notes, at prime interest rate plus ½ per cent, due 1970	6,478,316	—
Equipment Purchase Notes, including accrued interest at prime rate plus ½ per cent, due upon delivery of equipment	9,952,830	12,068,798
	\$114,345,804	\$87,697,702
Less: Cost of \$690,000 principal amount of 1967 Equipment Trust Certificates held in Treasury	677,675	677,675
	\$113,668,129	\$87,020,027
Less: Current maturities	11,131,444	7,053,521
	\$102,536,685	\$79,966,506

The accompanying notes are an integral part of these summaries.

(1) LEASE AND PURCHASE COMMITMENTS —

At December 31, 1968, the Company had long-term leases on real property, aircraft, engines, and equipment for which annual rentals will be approximately \$3,921,000 in 1969, and total rentals will aggregate approximately \$16,300,000 for the minimum lease periods. The minimum lease periods range from one year on aircraft to 30 years on real property. There are renewal and purchase options on the aircraft and engines.

The Company has entered into purchase agreements to acquire nine additional DC8-63F aircraft, engines, etc., with deliveries scheduled in 1969 for an aggregate cost of approximately \$99,000,000, net of applicable deposits. Of this cost, approximately \$19,000,000 will be paid from the balance of the proceeds of the 1968 Equipment Trust Certificates issuable in 1969. It is anticipated that seven of the aircraft will be obtained under long-term leases.

(2) FLEET DISPOSITION —

Aircraft in nontransport use includes aircraft being retired from the operating fleet for which reserves have been provided to reduce them to estimated salvage value. In addition, training and preoperating costs applicable to these aircraft types have been written off. Two of the aircraft were under long-term lease at December 31, 1968. Another aircraft, previously held under long-term lease, was acquired for resale under a contract calling for delivery in 1969.

(3) CAPITAL STOCK AND LONG-TERM DEBT —

At December 31, 1968, there were 241,100 shares of common stock reserved for issuance under the Qualified Stock Option Plan, of which options to officers and key employees for purchase of 212,000 shares of common stock were granted at prices ranging from \$20.06 to \$39.00 per share (exercisable in 1969-1973). Subsequent to December 31, 1968, the Company issued stock purchase warrants for 25,000 shares of common stock, exercisable from 1969 to 1979, initially at \$28.75 per share increasing to \$31.33 per share in 1975.

The 5½ per cent Promissory Note is secured by

the Company's equity of redemption in certain aircraft, and the 7 per cent Promissory Note is secured by general office and maintenance facilities and assignment of ground lease.

Subsequent to December 31, 1968, the Company entered into loan agreements providing for the issuance of \$25 million principal amount of 5¾ per cent subordinated notes, due 1979-1989. The notes are convertible into common stock at \$32.50 per share through 1989. The net proceeds will be added to the Company's working capital.

(4) RESTRICTIONS UNDER DEBT AGREEMENTS —

The equipment trust agreements and other debt agreements include restrictive provisions as to cash dividends on common shares, working capital, borrowing, capital expenditures, etc. Under the most restrictive provisions, cash dividends are limited to \$500,000 for 1969.

The loan agreements related to the 5¾ per cent subordinated notes limit the payment of cash dividends for years subsequent to December 31, 1968 to an aggregate of \$1,000,000 plus net income.

(5) FEDERAL INCOME TAXES —

Federal income taxes deferred through additional depreciation and other additional deductions for tax purposes have been credited to a reserve, which the Company intends to restore to income as such deferred taxes become payable. Such additional deductions in 1968 will result in a claim for refund for prior years' taxes paid in the amount of \$3,337,000, including the \$2,061,000 current provision in 1967. The provisions have been reduced by \$37,000 and \$1,734,000 investment tax credit in 1968 and 1967, respectively.

(6) PENSION PLANS —

The Company maintains pension plans for substantially all employees. The total pension plan expense for the year ended December 31, 1968 was \$1,096,921, of which \$206,069 was applicable to the unfunded liability for past service benefits which is being amortized over 20 years. Pension costs are funded as accrued. At December 31, 1968, the actuarially computed vested benefits exceeded pension funds by approximately \$1,297,700.

Arthur Andersen & Co.
Los Angeles, California

To the Stockholders,
The Flying Tiger Line Inc.:

We have examined the balance sheets of THE FLYING TIGER LINE INC. [a Delaware corporation] as of December 31, 1968 and 1967, and the related statements of income, stockholders' equity, and funds for the years then ended. Our examinations were made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the financial statements referred to above present fairly the financial position of The Flying Tiger Line Inc. as of December 31, 1968 and 1967, and the results of its operations and the source and application of funds for the years then ended, in conformity with generally accepted accounting principles applied on a consistent basis during the periods.

Los Angeles, California
March 19, 1969

Arthur Andersen & Co.

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Laurence C. Craigie...Lockheed Aircraft Corporation, Burbank
J. Howard Edgerton.....Chairman of the Board of
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Myer Feldman.....Ginsburg & Feldman, Washington, D.C.
Charles Luckman...Charles Luckman Associates, Los Angeles
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Robert W. Prescott.....President
Houston Rehrig.....President, Rehrig-Pacific Co., Los Angeles
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Farmers Insurance Group, Los Angeles

TRANSFER AGENTS

The Chase Manhattan Bank
1 Chase Manhattan Plaza,
New York, N.Y. 10015

Bank of America, Corporate Agency Division
111 West Seventh Street,
Los Angeles, California 90014

REGISTRARS

The Bank of New York
48 Wall Street, New York, N.Y. 10015

Union Bank
8th and Hill Streets,
Los Angeles, California 90054

AUDITORS

Arthur Andersen & Co.
1320 West Third Street
Los Angeles, California 90017

OFFICERS OF THE COMPANY

Wayne M. Hoffman.....Chairman of the Board
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Anna Chennault.....Vice President Int'l Affairs
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Myer Feldman.....Asst. Secretary

J. W. Rosenthal.....Asst. Secretary

GENERAL COUNSEL

Ginsburg & Feldman
1700 Pennsylvania Avenue, N.W.
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EXECUTIVE OFFICES

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FLYING TIGER LINE

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