ANNUAL REPORT 1981

REPUBLIC AIRLINES

REPUBLIC AIRLINES, INC.
7500 Airline Drive • Minneapolis, Minnesota 55450 • 612-726-7411

Contents

About Republic

Republic Airlines, one of the nation's largest scheduled carriers, provides safe, dependable air transportation to the traveling and shipping public.

The company, originally called Wisconsin Central Airlines, inaugurated service on February 24, 1948. The name was changed to North Central in 1952. Southern Airways, which began scheduled flights in 1949, was merged into the company in 1979, and the airline then became "Republic." Hughes Airwest, another carrier with over 30 years of experience, was acquired October 1, 1980.

Republic serves 170 cities—more than any other airline in the country. It flies to most of the nation's metropolitan areas and many intermediate-sized cities. The route system extends from coast to coast, and from Canada to Mexico and the Cayman Islands in the Caribbean. (See map on center pages.)

Republic ranked sixth among U. S. airlines in passenger traffic, with 16.8 million passengers carried and 7.6 billion passenger miles flown in 1981. The company operates the seventh-largest commercial jet fleet in the world. Its 161 jet-powered aircraft—Boeing 727s, Douglas DC-9s and Convair 580s—make over 1,300 departures daily.

Republic's 14,000 dedicated employees offer the finest type of airline service.

ANNUAL MEETING
Wednesday, April 28, 1982

AUDITORS
Alexander Grant & Company

REGISTRARS &
STOCK TRANSFER AGENTS
Citibank, N.A.
New York, New York 10043

Northwestern National Bank
Minneapolis, Minnesota 55480

STOCK TRADING
Common stock (RAI)

New York Stock Exchange
Midwest Stock Exchange

To our stockholders, employees and friends:

In 1981, the airline industry was plagued by the lingering national recession, high interest rates, intense price competition, and the air traffic controllers strike. Although Republic experienced substantial growth, with total revenues increasing 58 percent to a record $1.45 billion, a net loss of $46 million was incurred.

Faced with the most difficult period in its history, the company is carrying out a comprehensive financial recovery program. The plan emphasizes four goals:

- Increase productivity by major changes in employee contract work rules.
- Lower costs through pay cuts, reduction in work force, and ongoing austerity programs.
- Increase aircraft utilization by improved flight scheduling and additional marketing of charters.
- Boost traffic with a national advertising campaign, aggressive sales activities, and competitive schedules and fares.

Substantial cost-cutting was undertaken by Republic when projected summer traffic did not materialize. Most employees accepted common stock in lieu of 15 percent of one month's pay, a postponement of scheduled wage increases, and a 10 percent cut in compensation for six months. Other expenses have been slashed through "Operation Self-Help," a program which implements employee suggestions.

The company reduced its work force by over 1,000 with terminations and furloughs, including 300 who took early retirement. Many people volunteered for unpaid leaves of absence, or worked overtime as needed for compensating time off. In February 1982, additional furloughs were announced. Also, the majority of employees agreed to a deferred compensation plan which postpones one month's pay until August 1983.

During 1981, the airline continued moderate expansion by adding Dallas/Fort Worth and Guadalajara, Mexico, to the system. Dallas/Fort Worth is on a new route linking Houston, Kansas City and Minneapolis/St.Paul. Guadalajara is served nonstop from Chicago. New nonstops were introduced out of major cities, such as Minneapolis/St. Paul, Detroit, Memphis, Kansas City, Phoenix, Las Vegas, and Seattle/Tacoma. Special events to promote these flights attracted tremendous public attention and considerable media coverage.

Service was suspended at many unprofitable points. However, Republic is working with the replacement carriers to provide convenient, long-haul connections so the communities will continue to receive good service.

Republic achieved an eight percent traffic increase last year—flying 7.6 billion passenger miles—while the 12 major airlines as a whole reported a decline of more than six percent. Cargo ton miles, showing even better progress, were up 11 percent. Over 16.8 million passengers were carried, down three percent. (Comparisons relate to 1980 combined statistics for Republic and Hughes Airwest, acquired in October 1980.)

This growth was possible because the airline added three new high-technology DC-9 Super 80 jets, seven Boeing 727s and three other DC-9s to its operation. Six excess planes were removed from service and sold. The airline now has a fleet of 161 aircraft.

Republic ranked among industry leaders by completing more than 99 percent of its scheduled miles. In addition, 81 percent of its 484,000 scheduled arrivals were on time.

Even with exceptional performance, traffic gains and cost cuts, the company could not overcome adverse market conditions and high interest rates. Revenues jumped 58 percent to the record $1.45 billion, partly due to results of a full year's integration of the former Hughes Airwest operation. Expenses reached $1.49 billion, and the net loss of $46.3 million, or $2.30 a share, was sustained. The annual cash dividend, which has been paid for nine consecutive years, was not declared in 1982.

Republic is in good position to make a steady financial recovery. The new advertising campaign is telling the nation "Nobody Serves Our Republic Like Republic." Special promotions—such as "The World's Biggest Airline Giveaway" and Chex cereal box advertising—are increasing the company's national exposure and identity. The airline's multi-hub route structure and convenient scheduling will produce continued growth, despite predatory pricing by other carriers.

Republic has the essential ingredients for success—a strong route system, an efficient fleet, and experienced people. The company is lean and well-prepared to take advantage of the increased demand for airline service which will accompany the national economic recovery.

Sincerely,

Hal N. Carr
Chairman of the Board

Daniel F. May
President and Chief Executive Officer

March 10, 1982

Financial Review

The year 1981 was one of substantial revenue gains and traffic growth, but resulted in a disappointing loss. The airline has, however, developed a fundamentally sound route system which will produce earnings when the goals of the company's financial recovery program are achieved.

Revenues increased 58 percent to $1,448,416,000 in 1981, up from $916,715,000 a year earlier. The increase is partly due to the impact of the Hughes Airwest acquisition in October 1980. Reported 1980 revenues include only three months of Airwest operations.

For 1981, revenues from the expanded system were augmented by an increase in available seat miles, slightly higher coach fares, and greater income per ticket as passengers flew farther on Republic. These factors were offset by uneconomic fare discounting Republic was forced to match, and business lost by the air traffic controllers strike. With the lingering recession, projected traffic did not materialize.

Operating expenses, including depreciation and amortization, also rose 58 percent to $1,431,960,000. This, too, reflects the Airwest acquisition. Schedules were changed to add economical long-haul flights and improve aircraft utilization. "Operation Self-Help", an austerity program begun in the fall, is implementing employees' cost-saving suggestions.

Operating profit increased to $16,456,000 in 1981 from $13,224,000 a year ago.

Other expenses, primarily interest of $108,362,000, were reduced by other income of $45,695,000, mainly from disposition of aircraft and sale of tax benefits. Total expenses were $1,494,685,000, and the company sustained a net loss of $46,269,000, or $2.30 per common share.

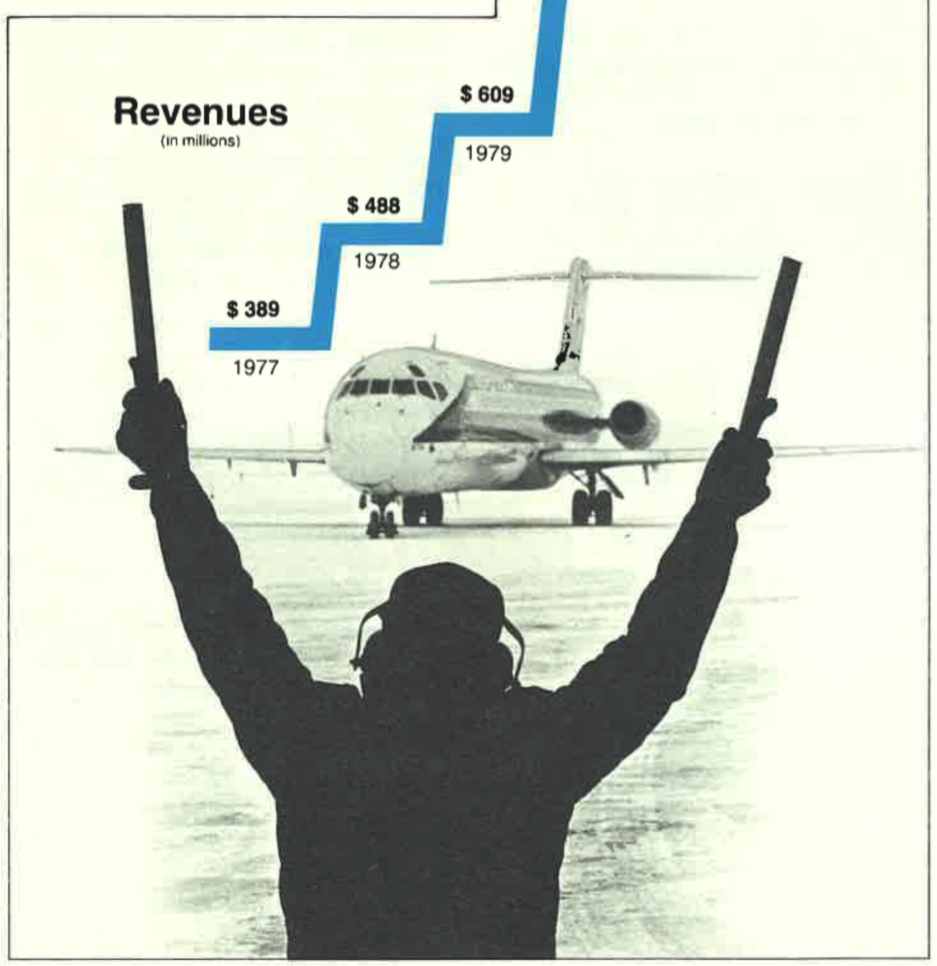
For 1980, revenues were $916,715,000, operating and other expenses totaled $941,377,000, and the net loss was $24,662,000, or $1.19 per share. Including Airwest operations for the first nine months of 1980, the pro forma combined results show revenues of $1,238,955,000, expenses of $1,285,006,000, and a net loss of $46,051,000, or $2.22 per share.

Largely responsible for the net losses and pressure on cash resources are industry fare-discounting and weak traffic—causing lower revenues than forecast—and the company's high debt position from aircraft acquisitions, with the resultant interest expense.

To help improve profitability and preserve cash in 1981, most employees accepted common stock in lieu of 15 percent of August pay, worth $4 million; a postponement of scheduled wage increases; and a 10 percent cut in compensation for six months which saves another $4 million monthly. The company reduced its work force by over 1,000, with terminations and furloughs, including 300 who accepted a special early retirement program. Many people volunteered unpaid leaves of absence, or worked overtime as needed for compensating time off. In February 1982, additional furloughs were announced. Also, a majority of employees agreed to a one-month pay deferral that will conserve $20 million until it is repaid in August 1983.

Productivity gains, through changes in contract work rules, will permit the airline to make greater use of its equipment and personnel. Pilots and flight attendants, for example, are being asked to fly more hours a month. Other groups are considering working additional hours and permitting more flexibility on scheduling of work hours.

Cooperation of this kind, coupled with temporary relief provided by pay concessions, is most important to recovery. When fully implemented, these programs should produce an estimated $75 million annual reduction in projected operating costs. Furthermore, the company would be in a position to retain its unique multi-hub route system and withstand the pressures of competition until the national economy improves and the demand for airline service increases.



Highlights

	1981	1980	1979
OPERATING REVENUES	$ 1,448,416,000	$ 916,715,000	$ 609,230,000
OPERATING PROFIT	$ 16,456,000	$ 13,224,000	$ 28,053,000
NET EARNINGS (LOSS)	$ (46,269,000)	$ (24,662,000)	$ 13,061,000
NET EARNINGS (LOSS)PER COMMON SHARE-Primary	$ (2.30)	$ (1.19)	$ .70
CASH FLOW FROM OPERATIONS	$ 16,807,000	$ 14,840,000	$ 41,717,000
RETAINED EARNINGS	$ 14,125,000	$ 64,830,000	$ 93,634,000
STOCKHOLDERS' EQUITY	$ 72,348,000	$ 117,627,000	$ 145,514,000
PASSENGERS	16,841,000	13,220,000	12,156,000
PASSENGER MILES	7,641,170,000	4,760,341,000	3,846,805,000
CARGO TON MILES	51,159,000	37,113,000	32,324,000

Major Factors of Change

Under Operating Revenues, Passenger Revenues reflect the Airwest purchase. Revenues from passenger miles also rose because the average trip on Republic increased to 454 miles in 1981 from 360 in 1980. However, price competition and longer trip length reduced yield per passenger mile.

Public Service Revenues, paid for service to unprofitable smaller cities, increased with the Airwest acquisition and higher rates—partially offset by suspension of service to some communities. Public Service Revenues will decline in 1982.

Concerning Operating Expenses, these items were similarly influenced by the addition of Airwest, plus purchases of new jets. Salaries and Employee Benefits—totaling 37 percent of operating costs—rose, but some relief came in late 1981 from pay reductions, early retirements and terminations. Aircraft Fuel was affected by greater consumption, plus average price increases of 14 cents per gallon in 1981 and 31 cents in 1980.

Operating Profit was up because revenues early in the year outpaced costs. By late summer, the weakening economy and fare discounting reversed the favorable trend, and an operating loss resulted for the fourth quarter. Expected pay reductions, furloughs, and productivity improvements could significantly temper the rise in operating costs for 1982.

Other Expenses-net for both periods include interest expense, tied to the prime rate—offset by other income from disposition of equipment. For 1981, other income also includes sale of tax benefits on new aircraft, made possible by new Federal legislation.

Liquidity and Capital Resources

The company's acquisition costs for new aircraft were $140 million in 1981 and $119 million in 1980. Financing for those jets was accomplished through leases, long-term bank debt, and equipment trust certificates.

Republic currently has contractual commitments for 11 DC-9-80 aircraft on order. Cash deposits of $26,643,000 have been advanced against the $237 million purchase price of these aircraft. As a result of its financial condition and the amended covenants of the Revolving Credit Agreement, the company is unable to take delivery of these aircraft as originally scheduled. Republic is presently negotiating with McDonnell Douglas Corporation to defer delivery of the 11 DC-9-80 aircraft to 1983 and 1984.

Although the Super 80s in service are very efficient and performing well on Republic's system, McDonnell Douglas has been asked to find other buyers for the remaining 11 aircraft scheduled for delivery in 1981 and 1982. The ultimate gain or loss on disposal of the DC-9-80s is subject to several factors, including final terms of the continuing negotiations with McDonnell Douglas. While the company cannot estimate ultimate gain or loss resulting from this situation and no provision is made in 1981 financial statements, management does not expect a loss to result from resolution of the purchase agreement.

MAJOR FACTORS OF CHANGE
(Thousands of dollars)

	Increases (Decreases)			
	1981 to 1980		1980 to 1979	
Operating revenues		Percent		Percent
Passenger:				
Passenger miles	$495,600	60	$146,900	28
Passenger fares	(11,300)	(1)	153,000	29
	484,300	59	299,900	57
Public service	17,700	79	(4,000)	(15)
Cargo and other	29,700	45	11,600	21
Net revenue changes	531,700	58	307,500	50
Operating expenses				
Salaries and employee benefits	187,000	55	100,100	42
Aircraft fuel	145,600	56	131,600	102
Other	195,900	65	90,600	43
Net expense changes	528,500	58	322,300	55
Changes in operating profit	3,200	24	(14,800)	(53)
Other expenses—net	22,800	57	23,100	138
Income taxes	2,000	103	(200)	(11)
Changes in net results	$(21,600)		$(37,700)	

Financial review

(continued)

Employee terminations and furloughs, pay cuts and deferrals, and contract work rule changes now under negotiation should enable the company to operate on a positive cash basis—despite the depressed traffic level and rampant fare discounting. Depreciation and amortization are sufficient to cover 1982 bank debt retirement, capital expenditures, and other fund requirements. Additional outside funding, however, may be required if adverse economic conditions persist. The company is actively seeking commitments from lenders to refinance certain aircraft and ground equipment or to provide standby financing.

Some aircraft in scheduled operation are available for sale, if reasonable prices can be obtained. Present market conditions are poor, but when sales can be arranged, proceeds will be used to increase working capital or reduce debt.

At year end, total long-term debt and obligations under capital leases were $756,058,000. This includes $404,500,000 outstanding against a Revolving Credit Agreement with a group of 12 banks. All available funds are currently outstanding under this agreement.

As a result of the company's present financial situation, the banks have imposed restrictive covenants limiting additional debt, capital expenditures, payment of dividends, investments in subsidiaries, and interest on subordinated debt.

Under an agreement, the company deferred the dividend due in January 1982 on the preferred stock in its subsidiary, Republic Airlines West. This stock is held by McDonnell Douglas.

Management believes that satisfactory agreements with the banks and McDonnell Douglas can be negotiated. This—together with improved flight scheduling, aggressive advertising, innovative promotions, and increased employee productivity—will enable the company to continue in the normal course of business.

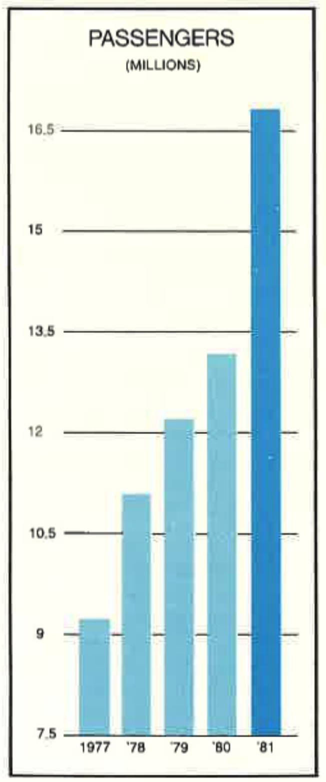
Further reporting of the company's operation begins on page 6. Five-year financial and traffic data is summarized on page 5, while supplemental stockholder information, including quarterly statements and the effects of changing prices, can be found on pages 22-24.

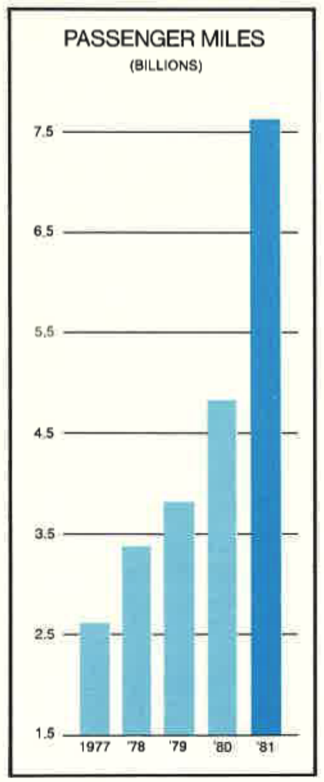
The year 1981 has been extremely difficult for the airline industry, because of the national recession, weak traffic, intense price competition, and high interest rates. To meet these challenges, the company is carrying out a comprehensive financial recovery program which emphasizes four goals:

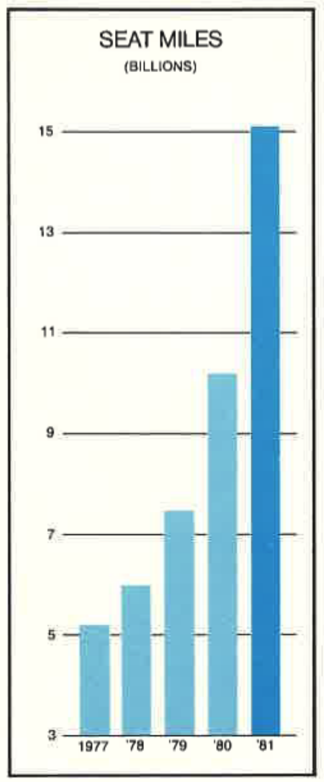
1. Increase productivity by changes in contract work rules.
2. Lower costs through reductions in force, temporary pay cuts, and austerity programs.
3. Increase aircraft utilization by improved flight scheduling and charter marketing.
4. Boost traffic with national advertising, aggressive sales activities, and competitive fares and schedules.

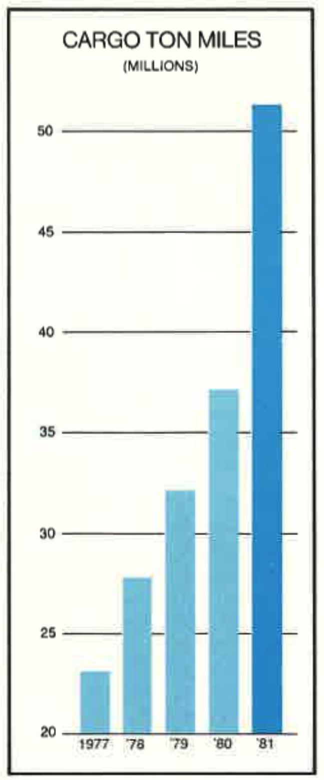
Republic employees are contributing to the recovery with realistic attitudes toward the lower wages and higher productivity of new carriers. This effort—combined with aggressive marketing strategy, an efficient fleet of aircraft, and a strong route system—will improve Republic's potential for future profitability.

Five years of growth









Five-year summary

OPERATIONS
(in thousands except per share amounts)

	1981	1980	1979	1978	1977
OPERATING REVENUES					
Passenger	$1,311,951	$827,678	$527,792	$408,243	$317,469
Public service	40,058	22,354	26,362	16,523	18,299
Other	96,407	66,683	55,076	62,799	52,866
	1,448,416	916,715	609,230	487,565	388,634
OPERATING EXPENSES	1,431,960	903,491	581,177	444,756	360,839
OPERATING PROFIT	16,456	13,224	28,053	42,809	27,795
OTHER EXPENSES (INCOME)					
Interest expense—net	108,362	48,341	20,122	16,673	11,476
Other income—net	(45,695)	(8,515)	(3,380)	(3,899)	(9,604)
	62,667	39,826	16,742	12,774	1,872
EARNINGS (LOSS) BEFORE INCOME TAXES	(46,211)	(26,602)	11,311	30,035	25,923
Income taxes (credit)	58	(1,940)	(1,750)	5,464	2,885
NET EARNINGS (LOSS)	$ (46,269)	$(24,662)	$ 13,061	$ 24,571	$ 23,038
NET EARNINGS (LOSS) PER COMMON SHARE					
Primary	$(2.30)	$(1.19)	$ .70	$1.42	$1.38
Fully diluted	$(2.30)	$(1.19)	$ .68	$1.31	$1.23

OTHER FINANCIAL DATA
(in thousands except per share amounts)

	1981	1980	1979	1978	1977
Current assets	$ 263,296	$ 249,010	$144,691	$107,764	$ 89,088
Property and equipment—net	$ 882,196	$ 778,375	$399,632	$314,054	$235,671
Total assets	$1,154,567	$1,036,226	$549,381	$428,424	$330,336
Total long-term debt and capital lease obligations	$ 722,434	$ 652,257	$263,035	$196,637	$142,648
Redeemable preferred stock of subsidiary	$ 28,000	$ —	$ —	$ —	$ —
Retained earnings	$ 14,125	$ 64,830	$ 93,634	$ 83,050	$ 60,493
Stockholders' equity	$ 72,348	$ 117,627	$145,514	$113,288	$ 89,266
Common shares outstanding	22,061	20,951	20,620	16,348	15,982
Book value per share of common stock	$3.28	$5.61	$7.06	$6.93	$5.59
Cash dividends per share of common stock	$ .10	$ .20	$ .20	$ .16	$ .12

STATISTICS

	1981	1980	1979	1978	1977
Passengers	16,841,000	13,220,000	12,156,000	11,143,000	9,180,000
Passenger miles (000)	7,641,000	4,760,000	3,847,000	3,364,000	2,584,000
Available seat miles (000)	15,119,000	10,185,000	7,479,000	6,010,000	5,152,000
Passenger load factor	50.5%	46.7%	51.4%	56.0%	50.2%
Cargo ton miles	51,159,000	37,113,000	32,324,000	28,062,000	23,346,000
Revenue plane miles	144,539,000	101,531,000	80,915,000	70,850,000	61,981,000
Number of employees	14,378	14,709	8,982	7,676	6,772

Many flights were added at Memphis and other major hubs in 1981.

Building the system

Republic's route system underwent a dynamic transition during 1981. The airline responded to market opportunities, increased competition, intense price-cutting, complications from the air traffic controllers strike, and a weakening economy.

The company's basic strategy centers on developing "hubs" at carefully selected major cities. This allows passengers from medium-sized cities to travel easily to central locations, then remain on board—or connect with a convenient Republic flight—to their final destinations. Republic's system is unique—presently it has six hubs, while other major carriers have two or three.

During 1981, Guadalajara, Mexico, and Dallas/Fort Worth joined the system. A new international route, which starts in Minneapolis/St.Paul, operates nonstop from Chicago to Guadalajara, then on to Puerto Vallarta. Dallas/Fort Worth has nonstops to Houston (Hobby) and to Kansas City, with through-plane service to the Twin Cities.

Major routes were also inaugurated linking Minneapolis/St. Paul with other important markets: Seattle/Tacoma and Portland; Salt Lake City, Reno and Oakland; plus Phoenix and Orange County/Santa Ana/Anaheim.

In Detroit, nonstop flights were added to Memphis. New Detroit-Phoenix service was introduced, via Kansas City. At the Memphis hub, nonstops serve Nashville, Houston Hobby and Denver. Atlanta-Miami nonstops were also inaugurated in 1981.

The Orlando hub gained nonstops to New Orleans, which continue to Houston Hobby. Phoenix received nonstop service to Kansas City and the Twin Cities.

In 1982, nonstops connected Cleveland with Milwaukee and with Baltimore; Des Moines to Las Vegas; and Bismarck/Mandan to the Twin Cities.

Inadequate traffic levels and flight schedule restrictions resulting from the air traffic controllers strike caused service to be suspended at 27 stations serving 34 cities. Republic worked closely with civic leaders to secure replacement by regional (commuter) carriers and is assisting them during the transition. The company also contracts with some of these airlines to provide ramp, counter and gate space; ticketing and ground service; as well as reservations capabilities.

The success of Republic's route system can be seen in the year's traffic results. While total traffic on the 12 major airlines as a group declined by over six percent in 1981, only Republic and one other airline recorded a gain.

Republic flew 7.6 billion revenue passenger miles and carried 16.8 million passengers in 1981. Passenger miles jumped 61 percent, and passenger boardings were ahead 27 percent. A new monthly record was set in March when 1,520,052 passengers chose Republic. The airline logged 51.2 million cargo ton miles, a 38 percent gain.

Using more comparable 1980 pro forma combined statistics of Republic and Hughes Airwest (which was acquired in October 1980), passenger miles increased 8 per cent from the combined 7.1 billion in 1980, while boardings declined 3 percent from 17.4 million. Cargo ton miles were up 11 percent from 46.2 million in 1980.

Supplementing scheduled service, Republic transported over 72,000 passengers on 371 charter trips. The VIP small parcel express grew in popularity as 187,000 "Very Important Packages" were handled.

Republic's operating performance record for 1981 was one of the highest in the airline industry—with 99.2 percent of the company's 144.7 million scheduled miles being flown. In addition, an on-time performance of 80.7 percent was achieved. Of the airline's 483,944 scheduled arrivals, 390,640 were routine.

Contributing to this outstanding operation was the airline's exacting and progressive maintenance program. In 1981, only two-tenths of one percent of Republic's departures were cancelled for maintenance reasons, and 1.7 percent were delayed by mechanicals.

The air traffic controllers strike which began in August 1981 adversely affected all airlines. The Federal Aviation Administration immediately imposed severe reductions at 22 major airports across the country, of which Republic serves 20. Operations have been particularly restricted at Detroit, Chicago and Atlanta. The airline is still not being permitted to offer its pre-strike level of peak-hour service at these hubs.

While FAA-imposed restrictions continue, Republic has been able to fly about 90 percent of its pre-strike schedule because its operations are spread over a multi-hub route network. The air traffic control system is gradually being restored to previous levels, and service to these important cities is being returned as soon as possible.

After 18 months of preparation, ESCORT—Republic's computerized reservations and telecommunications system—was switched over to a new, highly-efficient IBM 3081 computer. The change was scheduled to coincide with the expiration of a contract for these services in the western area. This simplifies training, operating procedures, equipment maintenance, and personnel assignments. The single computer system is now being used for all reservations, ticketing, message switching, and flight operations functions.

Over 2.5 million messages are processed daily by ESCORT, a 40 percent increase from 1980. More than 4,000 computer sets, 800 message printers, and 250 ticket printers connect all Republic locations into one of the country's most sophisticated airline reservations networks.

New devices were installed in a central reservations office so persons with speech or hearing difficulties can "converse" with the airline. At special centers, these people use compatible machines to relay typed messages by dialing a toll-free 800 number into Republic's reservations office.

ESCORT was expanded to allow others—principally the regional carriers replacing Republic at smaller locations—to utilize the reservations system. This "co-hosting" technique permits these airlines to conveniently handle their own reservations and book passengers on long-haul Republic flights at connecting points. To make its schedule information more accessible to 4,000 travel agents, Republic itself became a co-host in Apollo, another carrier's system.

Since the airline industry was deregulated in 1978, any carrier can enter any market at any time. This condition has resulted in a proliferation of new airlines and a highly-competitive battle for passengers, which requires flexible, sophisticated market planning.

Republic has retained an aviation consulting firm to assist in evaluating marketing plans. A customized computer program assesses potential costs, revenues, traffic and yields on proposed new routes. This data will help determine the most efficient flight schedules for the company's aircraft.

During 1981, new and expanded facilities were completed around the system. Additional jet bridges expedited passenger boarding. Ticket counters, gate lobbies, operations, and baggage claim areas were improved at such cities as Minneapolis/St. Paul, Detroit, Chicago, Memphis, St. Louis and Spokane. New air freight facilities were opened at Detroit, Birmingham, San Diego, Saginaw/Bay City/Midland, Sarasota/Bradenton, and Wausau/Stevens Point.

Maintenance areas were enlarged in Detroit, Chicago and Milwaukee. Major maintenance projects are scheduled for completion in 1982 at Minneapolis/St. Paul and Atlanta.

New airport terminal buildings—mostly financed by local bond issues—were opened in Orlando, Gulfport/Biloxi, Brainerd, Eau Claire, Redding/Red Bluff and Kalispell. Extensive improvements are underway at Houston Hobby, Milwaukee, Boise and Tucson. In 1982, Republic will have its own gate and operations facilities at New York LaGuardia.

Many of these terminals are especially important to the development of the airline's multi-hub system. Republic is unique because it brings passengers to major hub cities from over 100 medium-sized communities.

The airline is well prepared to aggressively pursue new opportunities and handle increased traffic as the nation's economy recovers.

Personal attention is an important part of the outstanding service Republic provides.

Building the fleet

A significant addition to Republic's fleet of 161 jet-powered aircraft came in July with the introduction of the highly sophisticated McDonnell Douglas DC-9 Super 80. Three of these aircraft—the quietest, most fuel-efficient jet available today—were delivered in 1981.

The Super 80s have surpassed expectations. The advanced technology built into this aircraft, particularly the engine and wing designs, contributes to its fuel savings of 20-40 percent over aircraft of comparable size. Seat-mile costs are lower than projected, performance has been superior, and utilization is high.

The DC-9-80 is also a "good neighbor," reducing the high-decibel area around noise-sensitive airports to one-fifth the size affected by similar aircraft. Quiet equipment and operational noise abatement techniques are becoming essential to remain competitive in markets such as Boston, Washington (D.C.) National Airport, Sarasota/Bradenton, Orange County/ Santa Ana/Anaheim and Burbank.

Recognizing Republic's efforts to limit noise, the National Organization to Insure a Sound-Controlled Environment (N.O.I.S.E.) presented its 1981 "Award of Merit" to the company. The citation is given each year to acknowledge "distinguished achievement" in the reduction of aircraft noise in communities throughout the country.

Thirteen aircraft were added to Republic's operation in 1981: the three Super 80s, a new DC-9-50, five new Boeing 727s, and the three 727s which had been leased to foreign airlines. One of the returned 727s was traded for two DC-9-30s and cash. Another 727, a DC-9-10, and four Convair 580s were removed from service and sold. With 161 aircraft—16 727s, 129 DC-9s and 16 Convair 580s—Republic has the seventh-largest commercial jet fleet in the world.

Jet fuel remained plentiful during 1981, and prices rose a relatively modest 16 percent to an average of $1.04 per gallon. Forecasts for 1982 indicate those trends should continue, principally because Federal decontrol of domestic crude oil and relaxed export restrictions have led to an oversupply of crude oil in the world market. Since Republic uses over one million gallons of fuel every day, conservation plans still command top priority.

A new computerized program was introduced in 1981 to help monitor and interpret fuel supply and consumption data. The system discloses total fuel inventory at any given moment, amount allocated to each Republic fuel station, the portion used of the daily allotment, and how much money has been spent for fuel during the current month.

In the day-to-day operation, the shortest route to a destination is selected from pre-determined flight plans. Pilots choose the optimum altitude and most economical speeds for the best Specific Fuel Consumption (SFC)—the fuel required to fly an aircraft one nautical mile. Engines on the DC-9-50s and -30s are being modified to produce better SFC, increased thrust, and improved aircraft payload.

Several other new techniques are holding down costs. At a number of airports, for example, pilots use engine reverse thrust to "power back" the aircraft from the loading gate. Otherwise, personnel and expensive ground equipment are required to push back the plane.

A more comprehensive fleet maintenance program has been implemented to schedule aircraft inspections and overhauls at the most efficient intervals. This speeds up maintenance processes, helps increase aircraft utilization, and aids inventory control.

Nearly all of the DC-9s now have the wide-body look with enclosed overhead luggage racks. The aqua, blue and white corporate design is being applied to aircraft as maintenance schedules permit. Most planes will have the new color scheme by early summer.

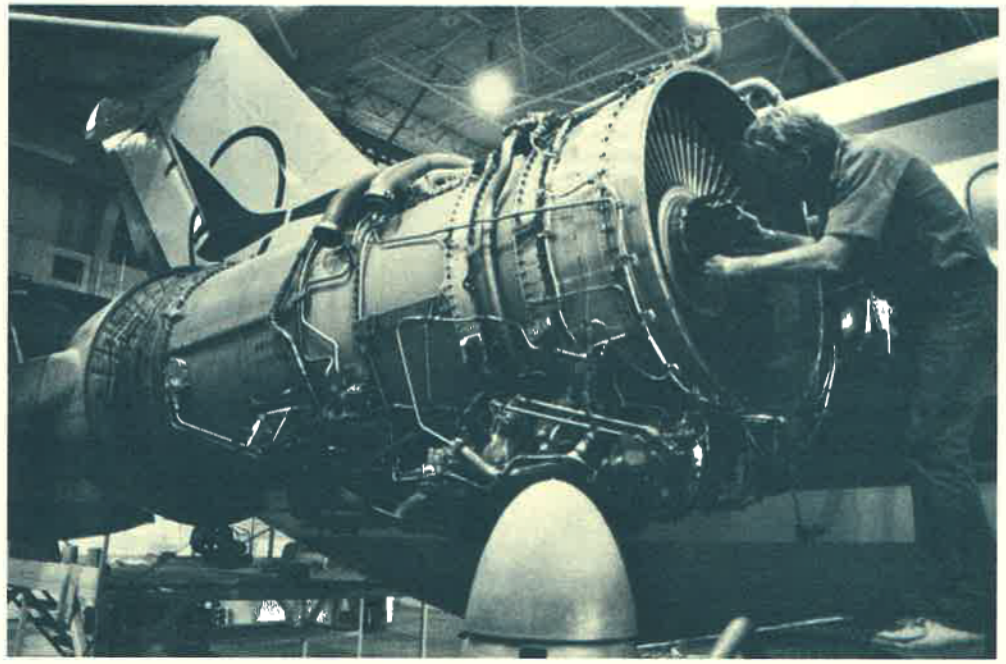
This October, Republic begins operating a new state-of-the-art DC-9-80 flight simulator at the company's flight crew training center in Atlanta. The device provides advanced simulation with effective, Federally-approved procedures and virtually eliminates the use of aircraft and costly jet fuel. Because only one other simulator of this type is operational, several airlines which fly DC-9-80s are expected to purchase training time. Excellent support equipment and facilities are also available at the center.

Airfone, a new telephone service which enables passengers in the sky to call people on the ground, is being introduced in the fall of 1982. The cordless telephone instrument accepts major credit cards and can be used at the passenger's seat.

Republic's comprehensive fleet development program matches appropriate aircraft with the changing route structure—while permitting the most economical, competitive operation. This approach provides for passenger comfort and convenience, holds down operating expenses, and allows the company to earn a reasonable return on this major investment.

Republic's 161 aircraft form the seventh-largest commercial jet fleet in the world.

Skilled pilots, using noise abatement techniques, helped Republic achieve recognition as a "good neighbor".



Exacting and progressive maintenance programs keep Republic's fleet operating efficiently.

Building the image

An aggressive new advertising campaign, using the theme "Nobody Serves Our Republic Like Republic," is creating a national identity for the airline. It emphasizes Republic's name, informs customers about the magnitude of the route system, and builds awareness.

The program was launched in January 1982, with the airline's first national television commercials. The theme is being supported by local radio, newspaper, magazine, and billboard advertising which stresses Republic's quality service, competitive fares, and trans-continental route system—with convenient flights to both major and medium-sized cities.

The campaign was conceived and implemented by Campbell-Mithun, the company's new advertising agency, appointed in December 1981.

Sales promotion and advertising programs for 1981 highlighted new service, improved schedules and special fares, while furthering the corporate marketing effort. Over 4,500 localized newspaper ads, 50 different TV commercials, 300 radio spots, 500 billboard messages, and 60 magazine ads were run.

During the first weeks of the air traffic controllers strike, special radio and newspaper advertising told the traveling public that the airline was still flying most of its schedule. Republic pilots and other spokesmen—interviewed extensively by news media across the country—reassured the public about the safety and efficiency of the air traffic control system.

To attract repeat business, the "Frequent Flyer" program received special attention. Regular customers are given travel incentives and other bonuses for taking at least nine Republic flights during 1982. Frequent Flyers may also use the six new "Republic Executive Suites." These are attractive and comfortable rooms where passengers can work, relax, or meet with business associates at the airport. Suites are located in Minneapolis/St. Paul, Chicago, Milwaukee, Detroit, Atlanta and Orlando terminals.

"Business Coach" service was expanded to all Boeing 727s and DC-9 Super 80s. A separate compartment in the front of the aircraft offers wide, two-abreast seating and extra leg room. The quiet, relaxed atmosphere is comparable to First Class service offered by other carriers, but at a greatly reduced price.

A spectacular, fun-filled promotional effort, "The World's Biggest Airline Giveaway," added a festive mood to the inaugural of Twin Cities-Seattle/Tacoma nonstop service. Thousands of people responded, and unprecedented newspaper and television coverage resulted. Nearly 4,000 contestants were packed and ready to travel when they came to the Minneapolis/St. Paul airport last April hoping to win one of 200 free tickets. Some 2,000 gathered at the Seattle/Tacoma airport the same day for a similar contest.

"Giveaway" promotions were also staged in Memphis, Salt Lake City, Reno, Oakland, New Orleans, Dallas/Fort Worth, Houston, Kansas City, and Phoenix, drawing crowds of up to 6,000 people. Many winners purchased tickets for traveling companions. The popular program is continuing in selected cities.

The newest promotion is a nationwide cooperative effort with the Ralston-Purina Company. A free flight is being offered to each child who sends in five box tops and is accompanied by a fare-paying adult. Ads appeared in early 1982 on 20 million cereal boxes and in 34 million Sunday newspapers. The program is achieving high visibility and generating immediate results.

Nearly 120,000 sales calls were made on travel agencies and key commercial accounts during 1981. Pilots and flight attendants, in uniform, and customer service personnel brought a new feature to this program. They volunteered to make sales calls on their own time, answering questions about Republic's service and its route system.

The company's aggressive new advertising campaign emphasizes Republic's name and the magnitude of its route system.

Over 3,400 visitors received guided tours of the airline's facilities throughout the system. Another 11,300 guests attended public functions held in the company's headquarters.

Good employees build Republic's image by providing outstanding service. The company's 14,000 people are highly skilled, and virtually all have extensive experience in the airline industry. Affirmative action plans and equal employment opportunity programs, reviewed and approved by the Federal government, are followed in the hiring process.

An award-winning training program, called "Courtesy is the Key," was developed to enhance the skills of customer service employees. New and distinctive uniforms were designed for passenger agents, station agents, and customer service managers to project a professional image for these public contact personnel.

Employee communication is important to Republic. Each year, company officers visit every location and meet with employees. "Direct Approach," a toll-free telephone system, provided over 1,200 confidential answers to questions and comments from employees. The airline disseminates information through its company newspaper, "Republic People," and a weekly bulletin, "Extra Section." Timely messages are sent via ESCORT.

Republic's image is built on the service provided by individual employees, as well as an integrated corporate communications program. Republic must be visible in today's highly-competitive, deregulated environment. The ambitious marketing program now underway will increase the airline's national identity and lead Republic to an established position of leadership in the marketplace.

Thousands of contestants entered "The World's Biggest Airline Giveaway" promotions at cities across the nation. Fare-paying passengers traveled with nearly all winners.

The future

The essential ingredients for success—a strong route structure, an efficient fleet and experienced personnel—are all present at Republic.

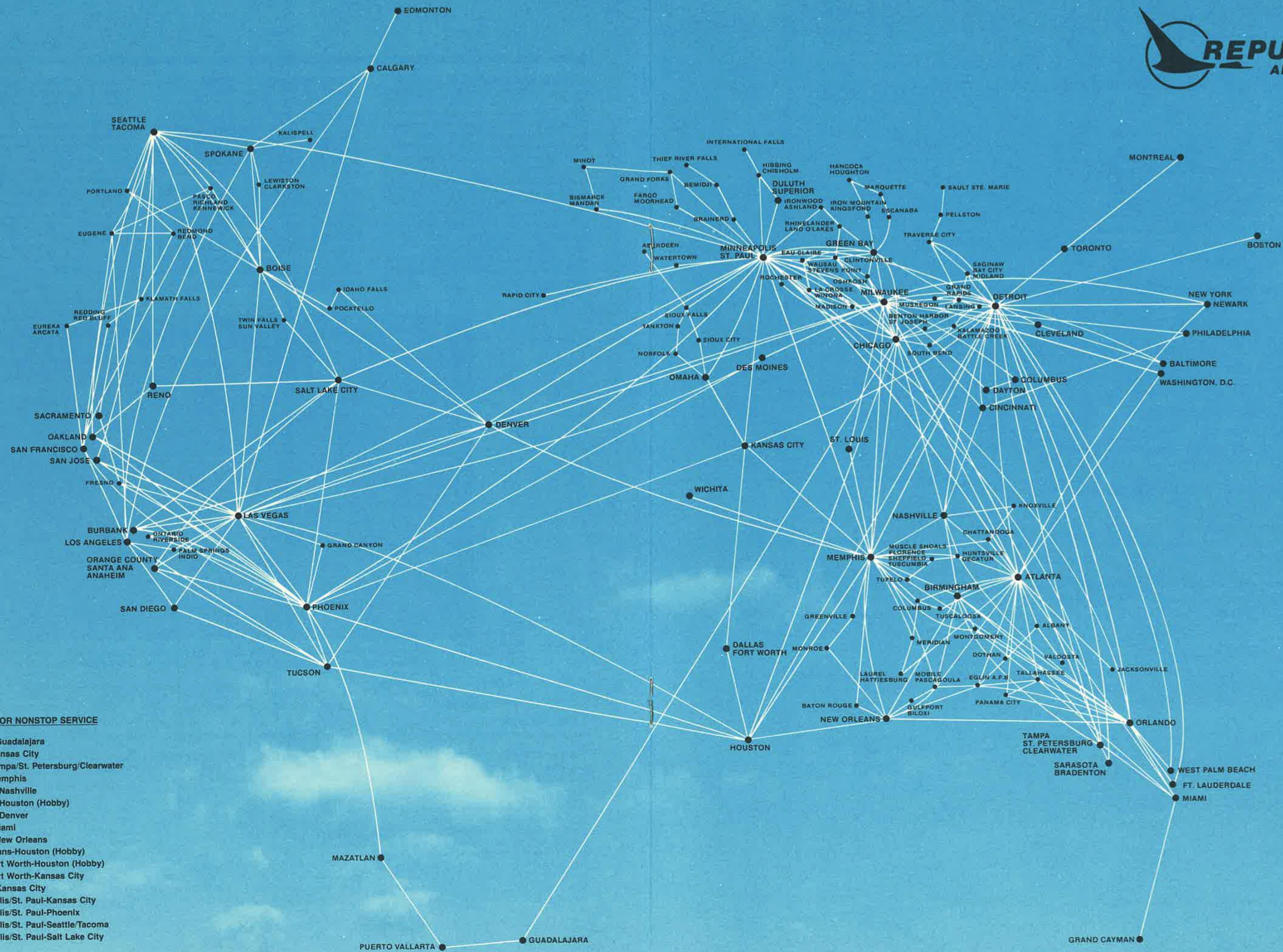
The airline's comprehensive financial recovery program will increase productivity, lower operating costs, expand aircraft utilization and boost traffic. The plan is already producing results. In early 1982, the average length of a flight was up 17 percent to 340 miles, and the average passenger trip had risen 10 percent to 489 miles.

These improvements, which come from additional long-haul flights, lower costs per seat mile and significantly enhance earnings potential. By increasing service on routes of 500-1,500 miles, Republic is linking major metropolitan centers and offering convenient connections for air travelers from intermediate-sized cities.

In 1982, more flights will be offered in major markets as Federal government restrictions are relaxed. This strategy will enable Republic to achieve maximum benefit from its fleet and aggressively challenge its competitors.

The airline is lean and well-prepared to meet the increased demand for air transportation as the national economy recovers. Republic's 14,000 employees are determined to provide high-quality service and to help the company emerge from this difficult period as a solid and profitable carrier.

REPUBLIC AIRLINES



NEW MAJOR NONSTOP SERVICE

Chicago-Guadalajara
Detroit-Kansas City
Detroit-Tampa/St. Petersburg/Clearwater
Detroit-Memphis
Memphis-Nashville
Memphis-Houston (Hobby)
Memphis-Denver
Atlanta-Miami
Orlando-New Orleans
New Orleans-Houston (Hobby)
Dallas/Fort Worth-Houston (Hobby)
Dallas/Fort Worth-Kansas City
Phoenix-Kansas City
Minneapolis/St. Paul-Kansas City
Minneapolis/St. Paul-Phoenix
Minneapolis/St. Paul-Seattle/Tacoma
Minneapolis/St. Paul-Salt Lake City

REPUBLIC AIRLINES, INC.

Consolidated balance sheets

(in thousands)	December 31 1981	December 31 1980
ASSETS		
CURRENT ASSETS		
Cash and short-term investments	$ 43,542	$ 50,145
Accounts receivable, less allowances	143,718	119,873
Flight equipment parts and supplies	47,764	43,262
Prepaid expenses and other	28,272	35,730
	263,296	249,010
PROPERTY AND EQUIPMENT – at cost		
Flight equipment	765,152	666,672
Ground property and equipment	96,811	88,540
	861,963	755,212
Less accumulated depreciation	198,967	159,742
	662,996	595,470
Advance deposits on equipment	67,490	60,135
	730,486	655,605
PROPERTY AND EQUIPMENT UNDER CAPITAL LEASES		
Flight equipment	159,671	134,499
Ground property and equipment	12,960	9,455
	172,631	143,954
Less accumulated amortization	20,921	21,184
	151,710	122,770
DEFERRED CHARGES AND OTHER ASSETS	9,075	8,841
	$1,154,567	$1,036,226
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES		
Current maturities of long-term debt	$ 28,181	$ 15,121
Current obligations under capital leases	5,443	6,238
Notes payable	28,100	2,748
Accounts payable	56,301	55,687
Interline payables and tickets outstanding	84,387	70,198
Accrued compensation and employee benefits	48,156	45,678
Accrued interest	31,662	24,662
Other accrued expenses	47,859	42,875
	330,089	263,207
LONG-TERM OBLIGATIONS		
Long-term debt – less current maturities	565,469	519,583
Noncurrent obligations under capital leases	156,965	132,674
Deferred income taxes and other	1,696	3,135
	724,130	655,392
COMMITMENTS AND CONTINGENCIES (Notes B, F and G)	–	–
REDEEMABLE PREFERRED STOCK OF SUBSIDIARY	28,000	–
STOCKHOLDERS' EQUITY		
Common stock – authorized 30,000,000 shares of $.20 par value	4,412	4,190
Additional paid-in capital	53,811	48,607
Retained earnings	14,125	64,830
	72,348	117,627
	$1,154,567	$1,036,226

The accompanying notes are an integral part of these statements.

Consolidated statements of operations

(in thousands except per share amounts)	Year ended December 31 1981	1980	1979
OPERATING REVENUES			
Passenger	$1,311,951	$827,678	$527,792
Freight and mail	64,604	50,585	41,510
Public service	40,058	22,354	26,362
Non-scheduled service and other	31,803	16,098	13,566
	1,448,416	916,715	609,230
OPERATING EXPENSES			
Salaries and benefits	528,004	340,981	240,906
Aircraft fuel	406,495	260,946	129,312
Maintenance materials and repairs	57,705	39,637	25,790
Food service	31,252	18,077	11,195
Rentals and landing fees	68,725	41,380	29,813
Agency commissions	78,280	38,435	21,494
Depreciation and amortization	63,728	40,310	29,440
Other	197,771	123,725	93,227
	1,431,960	903,491	581,177
Operating profit	16,456	13,224	28,053
OTHER EXPENSES (INCOME)			
Interest expense	122,181	57,767	26,497
Less interest capitalized	13,819	9,426	6,375
	108,362	48,341	20,122
Sale of tax benefits	(28,930)	–	–
Gain on disposition of equipment	(13,369)	(4,112)	(2,002)
Interest income and other – net	(3,396)	(4,403)	(1,378)
	62,667	39,826	16,742
Earnings (loss) before income taxes	(46,211)	(26,602)	11,311
INCOME TAXES			
Income taxes (credit)	58	(1,940)	(1,750)
NET EARNINGS (LOSS)	$ (46,269)	$ (24,662)	$ 13,061
NET EARNINGS (LOSS) PER COMMON SHARE			
Primary	$ (2.30)	$ (1.19)	$ .70
Fully diluted	$ (2.30)	$ (1.19)	$ .68

The accompanying notes are an integral part of these statements.

Consolidated statements of changes in financial position

(in thousands)

SOURCES AND APPLICATIONS OF WORKING CAPITAL

	Year ended December 31		
	1981	1980	1979
SOURCES			
From operations			
Net earnings (loss)	$(46,269)	$(24,662)	$ 13,061
Charges (credits) to operations not using (providing) working capital			
Depreciation and amortization	63,728	40,310	29,440
Deferred income taxes and other	(652)	(808)	(784)
Working capital provided from operations	16,807	14,840	41,717
Net book value of equipment dispositions	30,423	23,656	2,159
Increase in long-term obligations	144,775	421,475	187,797
Issuance of redeemable preferred stock of subsidiary	28,000	–	–
Issuance of common stock	4,267	–	–
Conversion of debentures to common stock	–	–	7,864
Options and warrants exercised	1,159	602	13,490
Disposition of treasury stock	–	7,207	–
Other	1,670	1,878	328
	227,101	469,658	253,355
APPLICATIONS			
Acquisition of Hughes Airwest			
Increase in long-term obligations	–	(38,500)	–
Property and equipment acquired	–	240,542	–
Long-term liabilities assumed	–	(141,223)	–
	–	60,819	–
Additions to property and equipment	195,318	202,696	116,857
Reduction of long-term obligations	74,598	211,929	113,449
Conversion of debentures to common stock	–	–	7,864
Payment of cash dividends	4,436	4,142	2,477
Acquisition of treasury stock	–	6,892	–
Additions to deferred charges and other assets	5,345	5,838	1,340
	279,697	492,316	241,987
INCREASE (DECREASE) IN WORKING CAPITAL	(52,596)	(22,658)	11,368
Working capital (deficit) at beginning of year	(14,197)	8,461	(2,907)
Working capital (deficit) at end of year	$(66,793)	$(14,197)	$ 8,461

NET CHANGE IN WORKING CAPITAL ELEMENTS

	1981	1980	1979
Cash and short-term investments	$ (6,603)	$ 36,967	$(20,221)
Accounts receivable	23,845	35,053	38,588
Flight equipment parts and supplies	4,502	12,491	14,548
Prepaid expenses and other	(7,458)	19,808	4,012
Current maturities of long-term debt and capital lease obligations	(12,265)	(3,140)	5,938
Notes and accounts payable	(25,966)	(18,252)	(14,452)
Interline payables and tickets outstanding	(14,189)	(32,280)	(10,121)
Accrued compensation and other expenses	(14,462)	(73,305)	(6,924)
INCREASE (DECREASE) IN WORKING CAPITAL	$(52,596)	$(22,658)	$ 11,368

The accompanying notes are an integral part of these statements.

Consolidated statements of changes in stockholders' equity

Years ended December 31, 1979, 1980 and 1981
(in thousands)

	Common Stock		Additional Paid-In Capital	Retained Earnings	Treasury Stock	
	Shares Issued	Amount			Shares Held	Amount
Balance at January 1, 1979	16,483	$3,297	$27,321	$83,050	135	$ 380
Cash dividend	–	–	–	(2,477)	–	–
Exercise of stock options and warrants	2,650	530	13,248	–	–	–
Conversion of debentures	1,621	324	7,540	–	–	–
Net earnings for 1979	–	–	–	13,061	–	–
Balance at December 31, 1979	20,754	4,151	48,109	93,634	135	380
Cash dividend	–	–	–	(4,142)	–	–
Exercise of stock options and warrants	197	39	563	–	–	–
Acquisition of treasury stock	–	–	–	–	1,060	6,892
Disposition of treasury stock	–	–	(65)	–	(1,195)	(7,272)
Net loss for 1980	–	–	–	(24,662)	–	–
Balance at December 31, 1980	20,951	4,190	48,607	64,830	–	–
Cash dividends:						
Redeemable preferred stock	–	–	–	(2,336)	–	–
Common stock	–	–	–	(2,100)	–	–
Issuance of common stock	709	142	4,125	–	–	–
Exercise of stock options and warrants	401	80	1,079	–	–	–
Net loss for 1981	–	–	–	(46,269)	–	–
Balance at December 31, 1981	22,061	$4,412	$53,811	$14,125	–	$ –

The accompanying notes are an integral part of these statements.

Auditors' Report

Alexander Grant
& COMPANY
CERTIFIED PUBLIC ACCOUNTANTS

MEMBER FIRM
GRANT THORNTON INTERNATIONAL

Stockholders and Board of Directors
Republic Airlines, Inc.

We have examined the consolidated balance sheets of Republic Airlines, Inc. (a Wisconsin corporation), and its subsidiary as of December 31, 1981 and 1980, and the consolidated statements of operations, changes in stockholders' equity and changes in financial position for the years ended December 31, 1981, 1980 and 1979. 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.

The accompanying consolidated financial statements have been prepared on a going concern basis, which contemplates the realization of assets and the satisfaction of liabilities in the normal course of business but, as discussed in Note B, certain eventualities could cause the company to be unable to continue in business. Also, as discussed in Note G, an additional uncertainty has arisen because the company has been unable to meet the delivery terms of its aircraft purchase commitments and is negotiating a revision of such commitments. The consolidated financial statements do not include any adjustments relating to losses which may be incurred as a result of these purchase commitments or to the realization of the carrying value of assets or the amount and classification of liabilities that might be necessary should the company be unable to continue in the normal course of business.

In our opinion, subject to the effects on the 1981 consolidated financial statements of such adjustments, if any, as might have been required had the outcome of the uncertainties referred to in the preceding paragraph been known, the consolidated financial statements referred to above present fairly the financial position of Republic Airlines, Inc.,and its subsidiary at December 31, 1981 and 1980, and the results of their operations and changes in their financial position for the years ended December 31, 1981, 1980 and 1979, in conformity with generally accepted accounting principles applied on a consistent basis.

Minneapolis, Minnesota
February 26, 1982

Alexander Grant & Company

Notes to financial statements

December 31, 1981, 1980 and 1979

Note A - Summary of Significant Accounting Policies

1. *Principles of Consolidation:* The consolidated financial statements include the accounts of Republic Airlines West, Inc., a subsidiary. (See note D for information concerning the acquisition of Hughes Air Corp. d/b/a Hughes Airwest). All significant intercompany transactions have been eliminated. Certain accounts in the 1979 and 1980 consolidated financial statements have been reclassified to conform with the 1981 presentation.

2. *Flight Equipment Parts and Supplies:* Spare parts and supplies are priced at average cost. An allowance for obsolescence ($7,155,000 at December 31, 1981 and $6,038,000 at December 31, 1980) is provided for repairable parts by allocating their cost over the life of the related aircraft.

3. *Prepaid Expenses - Engine Overhaul:* The company reclassifies to a current prepaid expense the estimated portion of the purchase price of flight equipment attributable to its overhaul expected to be consumed within the next twelve months ($21,099,000 at December 31, 1981 and $19,045,000 at December 31, 1980). Actual overhaul costs are charged to expense as incurred.

4. *Capitalized Interest:* To properly reflect their total cost, major additions to flight equipment and ground facilities include capitalized interest based on the interest rate of the related debt outstanding. The capitalized interest is amortized over the useful lives of the related assets for financial reporting purposes. For income tax reporting purposes, interest is expensed as incurred.

5. *Property, Equipment and Depreciation:* Owned property and equipment are stated at cost. Property and equipment acquired under capital leases are stated at the lower of the present value of minimum lease payments or fair market value at the inception of the lease. Depreciation and amortization of property and equipment are provided on a straight line basis over estimated useful lives of 7-20 years for flight equipment and 3-10 years for other property and equipment.

6. *Deferred Charges:* Significant costs, such as traffic promotion related to the inauguration of service over major new routes, and personnel training relating to the introduction of new types of aircraft are deferred and amortized over periods of up to five years.

7. *Passenger Revenues:* Passenger revenue is recognized when the transportation service is provided. Tickets sold but unused are included as a current liability.

8. *Pension Costs:* The company has pension plans covering all employee groups, and funds its current expense of normal costs. Prior service costs are amortized over varying periods up to 40 years. Pension funding is determined under the unit credit, aggregate frozen liability, and individual entry age normal methods.

9. *Income Taxes:* The company uses the flow-through method of accounting for investment tax credit which reduces income tax expense when the related liability is reduced. Investment credits not applied currently are offset against deferred income taxes to the extent they are applicable to previously deferred taxes becoming payable in the carry-over periods. The company recognizes deferred income taxes resulting from differences in financial and income tax reporting.

Note B - Eventualities Affecting Going Concern - The consolidated financial statements of the company have been prepared on a going concern basis, which contemplates the realization of assets and the satisfaction of liabilities and commitments in the normal course of business. The company's financial condition, operating results, inability to meet its existing debt covenants without amendments to its loan agreements, inability to meet the delivery terms of its aircraft purchase commitments, along with other factors may eventually result in the company being unable to continue in the normal course of business; however, the consolidated financial statements do not include any adjustments relating to the realization of the carrying value of assets, the amount and classification of liabilities or losses on aircraft purchase commitments that might be necessary should the company be unable to continue in the normal course of business.

The company's continuation as a going concern is principally dependent upon its ability to:

(a) continue to reach agreement with the parties to the Revolving Credit Agreement which will satisfactorily modify certain restrictive covenants [Note E(e)],

(b) successfully conclude negotiations of the terms of Purchase Agreements for DC-9-80 aircraft (Note G),

(c) generate sufficient cash flow to meet obligations on a timely basis, and

(d) ultimately attain successful operations.

The company's management believes that satisfactory agreements with the banks and McDonnell Douglas Corporation can be negotiated, and along with improved scheduling, higher levels of advertising and promotion and additional contract concessions from its organized employees, this will enable the company to continue in the normal course of business.

Note C - Significant Transactions - During the fourth quarter of 1981, as allowed by the leasing provisions of the Economic Tax Recovery Act of 1981, the company entered into sale-leaseback transactions for income tax purposes involving certain 1981 equipment additions. As a result of these transactions, the company has recognized income of $28,930,000. Provisions of these transactions include, among other things, indemnification of the tax benefit amount to the buyer, under certain circumstances.

Note D - Acquisition of Hughes Airwest - On October 1, 1980, the company acquired from Summa Corporation and the Estate of Howard R. Hughes, Jr. all of the outstanding stock of Hughes Airwest. The total purchase price for all the stock was $38,500,000 consisting of $24,000,000 cash and $14,500,000 of the company's 13% convertible subordinated debentures. Hughes Airwest was a regional airline operating primarily in the western portions of the United States. The name of the acquired company was changed to Republic Airlines West, Inc. and continues its operation using the name "Republic Airlines."

The fair value of the net assets acquired exceeded the $38,500,000 purchase price by $44,028,000. This amount has been allocated primarily to flight equipment as a reduction in fair value.

Results of Republic Airlines West, Inc. operations since the acquisition date are included in the consolidated statements of operations. The following data presents on a pro forma basis the combined results of operations as if the acquisition of Hughes Airwest had been effected on January 1, 1979. Pro forma adjustments have been made to record interest on the funds borrowed and assumed to acquire Hughes Airwest, depreciation on the increased values of operating property and equipment, maintenance expense on the direct expense method rather than the accrual method for Hughes Airwest, and income tax adjustments based on pro forma operations (in thousands except per share amounts).

	Year ended December 31 (unaudited) 1980	1979
Operating revenues	$1,238,955	$920,946
Net loss	$ (46,051)	$(14,262)
Net loss per share	$(2.22)	$(.81)

Note E - Long-term Debt - Long-term debt at December 31 consists of the following (in thousands):

	1981	1980
Revolving credit agreement (a)	$404,500	$397,500
Installment notes (b)	121,235	71,925
Equipment Trust Certificates (c):		
due May 1, 1993	37,500	42,000
due July 1, 1998	8,821	-
Subordinated debentures (d):		
13% due November 15, 1992	14,500	14,500
6¾% due December 15, 1982	1,303	1,646
Sundry	5,791	7,133
Total long-term debt (e)	593,650	534,704
Less current maturities (f)	28,181	15,121
	$565,469	$519,583

(a) During 1981 the company borrowed an additional $51,000,000, principally to finance the purchase price of three new B727-200 aircraft. In September, 1981, the Revolving Credit Agreement was amended to provide that maximum borrowings would not exceed $436,500,000. In the fourth quarter of 1981, $18,900,000 of the proceeds from the sale of tax benefits (Note C) were applied to reduce this indebtedness. These payments, along with additional payments throughout the year required as a result of the sale of aircraft, reduced the balance to $404,500,000 at December 31, 1981. This amount will be retired in quarterly installments through 1989 and no further borrowings are permitted under the agreement. Principal payments of approximately $9,044,000 in 1982 and $54,545,000 each year through 1988, with final payments totaling $68,186,000 in 1989, are required. Interest is to be paid quarterly to each participating bank at ½% over the Citibank, N.A. alternative rate. Effective rate at December 31, 1981 was 16¼%.

(b) Consists of various installment notes with final maturity dates from 1986 through 1996 at interest rates ranging from 8% (for notes guaranteed by the Federal Aviation Administration) to 19¼%. The aggregate installment payments in 1982 will be approximately $27,566,000 including interest.

(c) The Equipment Trust Certificates due in May 1993 require semi-annual sinking fund payments of $2,250,000 in 1982, $1,575,000 from 1983 through 1992 and $1,500,000 at maturity plus interest at 9%. The company may make semi-annual optional sinking fund payments beginning in May 1983 up to $1,575,000 and may pay off the remaining balance in full on or after May 1, 1988 at a premium.

In 1981, the company issued $9,081,000 of Equipment Trust Certificates due July 1, 1998. Semi-annual sinking fund payments of approximately $259,000 are required plus interest at rates ranging from ½ to 1½% over the Citibank, N.A. alternative rate. Effective rate at December 31, 1981 was 16¼%. The company may pay off the remaining balance in full at any time.

(d) On October 1, 1980, the company issued $14,500,000 of 13% convertible subordinated debentures due November 15, 1992 as partial payment for the acquisition of the stock of Hughes Airwest. Interest payments are due semi-annually. Debenture holders may convert the principal to common stock of the company at $15.00 per share. Prior to November 15, 1992, debentures are redeemable beginning on November 16, 1985 at a premium. Sinking fund payments of $1,450,000 are due annually beginning November 15, 1983.

As a result of the acquisition of Hughes Airwest, the company assumed $1,927,000 of 6¾% subordinated debentures due December 15, 1982. Interest is payable semi-annually.

(e) Substantially all the flight equipment and spare parts owned by the company are pledged as collateral against the above debt. Among the original loan covenants in the Revolving Credit Agreement are requirements for the maintenance of debt to equity ratios, restrictions on dividend payments and capital expenditures, and coverage of fixed charges. As a result of continuing losses in 1981, these covenants were amended to permit the company to remain in compliance. Effective December 31, 1981, the company and the banks have further agreed to modify the convenants to provide, for the period December 31, 1981 through June 30, 1982, minimum stockholders' equity and minimum cash and short-term investment provisions based on an operating plan which was prepared by the company. The modified restrictive provisions do not allow payment of dividends or any payments on the 13% Subordinated Debentures until after June 30, 1982. It will be necessary for the company to reach further satisfactory agreement with the lenders for modifications to the original restrictive convenants which otherwise will be reinstated effective July 1, 1982.

The company is required to maintain average compensating balances ranging from 5% to 10% of the monthly average loan outstanding or commitment and is required to pay interest on any compensating balance short-fall at ½% over the Citibank, N.A. alternative rate. During 1981 the company was required to maintain average compensating balances (adjusted for float) of $37,100,000. At December 31, 1981, the required compensating balances (adjusted for float) were approximately $40,191,000.

(f) Current maturities of all long-term debt due in each of the next five years following December 31, 1981 are as follows (in thousands):

1982	$28,181
1983	72,912
1984	74,869
1985	75,964
1986	72,482

Note F - Leases - The company has lease commitments for flight equipment, various airport facilities, its main operating facilities, its maintenance and training facilities, and other property and equipment. The lease commitments for various airport facilities are based upon usage and landings and are subject to adjustment depending upon the needs of the airport operating authority. The annual lease commitments are not determinable due to the usage and adjustment factors.

During 1981, the company took delivery of one DC-9-80 and two DC-9-30 aircraft under capital lease agreements. The debt obligations relating to the capitalization of these leases were $28,084,000 at December 31, 1981. The aggregate payments in 1982 will be approximately $4,601,000 including interest at rates ranging from 12¾% to 14½%.

In 1980, the company took delivery of five DC-9-50 aircraft under capital lease agreements. The debt obligations relating to the capitalization of these leases were $55,748,000 at December 31, 1981. The obligations are payable in semi-annual installments of approximately $3,062,000 through January 1, 1987 and $3,607,000 thereafter through January 1, 1999 including interest at 9½%.

The company has other capital lease agreements for aircraft acquired before 1980. The debt obligations relating to the capitalization of these leases was $67,180,000 at December 31, 1981. The aggregate payments in 1982 will be approximately $8,784,000 including interest at rates ranging from 8¼% to 12½%.

In addition, the company has various types of ground property equipment under capital lease agreements. The debt obligations relating to the capitalization of these leases were $11,396,000 at December 31, 1981. The aggregate payments in 1982 will be approximately $2,093,000 including interest at a weighted average rate of 13½%.

At December 31, 1981, future minimum rental payments under capital leases and noncancellable operating leases with initial or remaining terms of more than one year are as follows (in thousands):

Period	Operating Leases	Capital Leases
1982	$ 22,373	$ 21,602
1983	20,750	22,450
1984	19,032	21,816
1985	18,869	21,493
1986	18,002	20,879
Thereafter	267,072	211,600
Total minimum capital lease payments	$366,098	319,840
Less amounts representing interest		157,432
Present value of future minimum capital lease payments		$162,408

Note G - Commitments - At January 1, 1981, the company had purchase commitments on fourteen DC-9-80 aircraft with McDonnell Douglas Corporation ("MDC"), scheduled for delivery during 1981 and 1982. During 1981, three of these aircraft were delivered to the company and four additional aircraft were completed and were available for delivery. In early 1982, three additional aircraft were completed and are available for delivery. The remaining four aircraft are scheduled for delivery during the balance of 1982. As a result of its financial condition and the amended covenants of the Revolving Credit Agreement, the company is unable to take delivery of these aircraft as originally scheduled.

In January 1982, MDC sold two of the available aircraft to a third party with the consent of the company. Concurrently, the company and MDC agreed that two replacement aircraft would be scheduled for delivery at a later date.

The company has advanced pre-delivery deposits of $26,643,000 in cash and $28,100,000 in notes and has capitalized interest of $12,075,000 in connection with the purchase commitments on the remaining eleven DC-9-80 aircraft. If all eleven aircraft were purchased according to the original delivery terms, a balance of approximately $210,000,000 would be due prior to and at delivery to retire the pre-delivery notes and fulfill the commitments. These prices may be increased by standard escalation clauses during the period of construction. After the aircraft are tendered for delivery, the company may also incur additional interest and storage costs.

The company is presently negotiating with MDC to defer delivery of all eleven DC-9-80 aircraft to 1983 and 1984. The aircraft already tendered for delivery according to the original schedule are currently being offered for sale by MDC and have been placed in storage. The remaining aircraft which presently are scheduled for delivery later in 1982 will also be offered for sale.

The outcome of these negotiations including the company's ultimate gain or loss on the disposal of these aircraft, is not presently determinable. No provision for any loss that may result from these purchase commitments has been recorded in the consolidated financial statements. However, management believes that the negotiations with MDC will be satisfactorily concluded and that no material losses will be incurred by the company.

The company has advanced $672,000 on two jet engines. An additional $2,686,000 will be expended prior to delivery in 1982.

Note H - Income Taxes - Income tax expense for the years ended December 31, is as follows (in thousands):

	1981	1980	1979
Current income taxes			
Federal	$ 1,206	$ –	$ 2,471
Investment tax credit	567	200	(2,090)
	1,773	200	381
State and local	(110)	(60)	325
	1,663	140	706
Deferred income taxes			
Federal	(2,978)	(6,384)	3,153
Investment tax credit	1,683	4,929	(6,005)
	(1,295)	(1,455)	(2,852)
State and local	(310)	(625)	396
	(1,605)	(2,080)	(2,456)
	$ 58	$ (1,940)	$ (1,750)

Differences between income tax expense and amounts derived by applying the statutory federal income tax rate of 46% to income before income taxes are as follows (in thousands):

	1981	1980	1979
Income tax expense (credit) at statutory federal income tax rates	$(21,257)	$(12,237)	$ 5,203
Investment tax credit	2,250	5,129	(8,095)
Employee Stock Ownership Plan	2,346	1,027	715
State and local taxes net of federal income tax benefit	(420)	(685)	389
Non-taxable permanent differences	3,099	–	–
Tax effect of net operating loss carryforward not recognized	12,731	5,021	–
Other	1,309	(195)	38
	$ 58	$ (1,940)	$(1,750)

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

	1981	1980	1979
Capitalized interest	$(2,372)	$(2,899)	$ 2,953
Investment tax credit	1,683	4,929	(6,005)
Group insurance	–	–	(290)
Capitalized leases	–	–	(472)
Training and development	(316)	(685)	498
Depreciation	(843)	(3,794)	754
Other	243	369	106
	$(1,605)	$(2,080)	$(2,456)

For Federal income tax reporting purposes, the company and its subsidiary file separate tax returns. Republic Airlines, Inc. has, as of December 31, 1981, a net operating loss carryover of approximately $94,411,000 available to offset future taxable income. Approximately $37,216,000 expires in 1995 and $57,195,000 in 1996. Investment tax credits of $33,927,000 are available to offset future income taxes payable and expire as follows: $10,928,000 in 1994; $17,120,000 in 1995; and $5,879,000 in 1996.

Republic Airlines West, Inc. has, as of December 31, 1981, a net operating loss carryover of approximately $53,623,000 available to offset future taxable income. Approximately $10,492,000 expires in 1994, $37,192,000 in 1995 and $5,939,000 in 1996. Investment tax credits of $8,194,000 are available to offset future income taxes payable and expire as follows: $937,000 in 1993; $5,226,000 in 1994; $402,000 in 1995; and $1,629,000 in 1996.

For financial reporting purposes, the company and its subsidiary calculate income taxes on a consolidated basis. On this basis, there are approximately $38,500,000 of net operating loss carryovers available to offset future consolidated taxable income and consolidated investment tax credit carryovers of approximately $35,000,000 are available to offset future consolidated tax provisions. Any utilization of the pre-aquisition net operating losses or investment credits of Republic Airlines West, Inc. will be recorded as adjustments of the purchase transaction.

Under the Revenue Act of 1978 and existing law, a special provision allows the company to offset its federal tax liability by the following approximate percentages (subject to the availability of sufficient investment tax credits): 1979–90%; 1980 and 1981 –80%; 1982 (and later years) – 90%.

The Internal Revenue Service has examined and cleared the company's federal tax returns through December 31, 1976. Federal income tax returns of the company through December 31, 1979 are currently being examined. Several adjustments have been proposed, mainly dealing with the timing of tax deductions, and provision has been made for adjustments which may result.

Note I - Retirement Plans - The company has retirement plans covering all employee groups. Pension expense for 1981, 1980 and 1979 was $35,842,000, $20,424,000 and $14,978,000, respectively. The company makes annual contributions to the plans equal to the amounts accrued for pension expense. Changes during 1980 in the actuarial assumptions used in computing pension costs had the effect of reducing the net loss by approximately $3,864,000 or $.19 per share. Plan improvements during 1981 had the effect of increasing the present value of plan benefits approximately $16,253,000 and increasing the net loss approximately $910,000 or $.04 per share. Plan amendments during 1981 not reflected in the acturial valuation at January 1, 1981 will increase the present value of plan benefits approximately $31,000,000 and impact the pension expense in future years. The accumulated plan benefits and plan net assets for the company's defined benefit plans are as follows (in thousands):

	January 1	
	1981	1980
Actuarial present value of accumulated plan benefits		
Vested	$191,580	$148,488
Nonvested	39,342	32,076
	$230,922	$180,564
Net assets available for benefits	$232,057	$171,061

The weighted average assumed rate of return used in determining the above actuarial present value of accumulated plan benefits was 7½% for both 1981 and 1980.

Note J - Net Earnings (Loss) Per Common Share - Primary and fully diluted loss per common share for 1981 and 1980 was based on the weighted average number of common shares outstanding of 21,385,451 and 20,722,638, respectively. The 1981 net loss was increased by preferred dividend requirements of $2,942,000 prior to computing the per common share amount.

Primary earnings per common share for 1979 is based on the weighted average number of common and common equivalent shares outstanding (18,561,082). Common equivalent shares result from the assumed exercise of stock options and warrants using the "treasury stock" method.

If the debentures converted into common stock during 1979 were assumed converted at the beginning of the period, primary earnings per common and common equivalent share would have been $.67, or a decrease of $.03 per share.

Notes to financial statements

December 31, 1981, 1980 and 1979 (continued)

Fully-diluted earnings per common share for 1979 is based on the assumed issuance of additional common shares (932,131) relating to the conversion of the debentures, and related interest (net of income tax effect) was added to income for purposes of the calculation.

Note K - Redeemable Preferred Stock of Subsidiary - The company's subsidiary, Republic Airlines West, Inc., has authorized 500,000 shares of $100 par value Cumulative Preferred Stock. In February, 1981, the subsidiary issued 280,000 shares in a private placement with McDonnell Douglas in connection with related aircraft acquisition and financing transactions. Principal terms of the cumulative preferred stock include:

Dividends: Annual cumulative dividends are payable quarterly at an annual rate of 13% through 1987, 16% from 1987 to 1990, 18% from 1990 to 1993, and 20% thereafter.

Optional Call: Callable at any time, at $100 per share plus all unpaid dividends.

Preference: Upon liquidation $100 per share plus unpaid dividends before any distribution to the parent company.

Sinking Fund Redemption: Quarterly redemption of 2½% of the outstanding shares at a price of $100 per share plus dividends unpaid to the redemption date, begins on April 30, 1987, and is calculated to retire all preferred shares by April 30, 1997.

Mandatory Purchase: In case of default, including failure to pay dividends, the shareholder can require the parent company to purchase all or any portion outstanding at $100 per share plus all unpaid dividends. Because an agreement was reached with the preferred stock shareholder, nonpayment of the January 31, 1982 dividend did not constitute a default. In addition, the shareholder may require the parent company to purchase 17,500 shares quarterly beginning May, 1983.

Supplemental stockholder information

STOCKHOLDER'S DISCLOSURE OF OWNERSHIP

The Civil Aeronautics Board requires that any person who owns as of December 31 of any year or who subsequently acquires ownership, either beneficially or as trustee, of more than 5%, in the aggregate, of the company's common stock shall file with the Board, within the time limits prescribed, a report containing the information required by Section 245.13 of Economic Regulations of the Civil Aeronautics Board, unless such person has previously filed such a report. Any shareholder who believes that he may be required to file such a report may obtain further information by writing to the Director, Bureau of Pricing and Domestic Aviation, Civil Aeronautics Board, Washington, D.C. 20428.

FORM 10-K REPORT

For the Form 10-K report to the Securities and Exchange Commission, write to Mr. A. L. Maxson, Senior Vice President-Finance, Republic Airlines, Inc., 7500 Airline Drive, Minneapolis, MN. 55450.

LABOR AGREEMENTS

Among the agreements the airline has with six labor unions, one is currently under negotiation, three are amendable in 1982, and two are amendable in 1983. The company expects to reach equitable agreements with these unions.

COMMON STOCK INFORMATION

The following tabulation sets forth the price range for the company's common stock which is traded on the New York Stock Exchange and the Midwest Stock Exchange.

	1981		1980	
	High	Low	High	Low
1st Quarter	8¼	5¾	8	5½
2nd Quarter	11⅝	7⅝	6⅜	5¾
3rd Quarter	9⅝	5⅛	9	5¾
4th Quarter	5⅜	3⅞	8⅛	5¼

The company paid cash dividends on common stock of $.10 per share to its stockholders during the first quarter of 1981 and $.20 per share during the first quarter of 1980. Under the restrictive convenants contained in the Revolving Credit Agreement dated October 1, 1980, as presently amended, the company cannot declare cash dividends or acquire its own capital stock. At February 26, 1982, the company had 39,202 holders of common stock.

QUARTERLY STATEMENTS OF OPERATIONS

(unaudited - in thousands except per share amounts)

	1981 Three Months Ended				1980 Three Months Ended			
	December 31	September 30	June 30	March 31	December 31*	September 30	June 30	March 31
Operating Revenues	$355,156	$368,224	$373,936	$351,100	$336,773	$212,635	$197,507	$169,800
Operating Expenses	363,191	365,526	357,171	346,072	321,168	204,372	198,429	179,522
Operating Profit (Loss)	(8,035)	2,698	16,765	5,028	15,605	8,263	(922)	(9,722)
Net Earnings (Loss)	(7,759)	(18,445)	(4,879)	(15,186)	111	(2,336)	(8,676)	(13,761)
Net Earnings (Loss) Per Common Share	(.39)	(.90)	(.27)	(.73)	.01	(.11)	(.43)	(.67)

*Operations for the quarter ended December 31, 1980 and all periods thereafter include the operations of Republic Airlines West, Inc., a consolidated subsidiary acquired on October 1, 1980.

Supplemental stockholder information

(continued)

CONSOLIDATED STATEMENT OF OPERATIONS —ADJUSTED FOR CHANGING PRICES

Year ended December 31, 1981 (in thousands—unaudited)

	As Reported in the Primary Statements	Adjusted for General Inflation	Adjusted for Changes In Specific Prices (Current Cost)
Total operating revenues	$1,448,416	$1,448,416	$1,448,416
Depreciation and amortization expense	63,728	77,029	113,004
Other operating expenses	1,368,232	1,371,655	1,371,655
Other expenses—net	76,036	76,036	76,036
Gain on disposition of equipment	(13,369)	(7,510)	(8,347)
Provision for income taxes	58	58	58
	1,494,685	1,517,268	1,552,406
Loss from operations	$ (46,269)	$ (68,852)	$ (103,990)
Gain from decline in purchasing power of net amounts owed		$ 68,584	$ 68,584
Increase in specific prices (current cost) of inventory and property and equipment held during the year*			$ 308,088
Effect of increase of general price level			182,761
Excess of increase in specific prices over increase in the general price level			$ 125,327

*At December 31, 1981, current cost of inventory was $54,853,000, and the current cost of property and equipment, net of accumulated depreciation and amortization, was $1,611,311,000.

FIVE-YEAR COMPARISON OF SELECTED SUPPLEMENTARY FINANCIAL DATA —ADJUSTED FOR EFFECTS OF CHANGING PRICES

(In average 1981 constant dollars, in thousands except per share and price index amounts—unaudited)

	Year ended December 31				
	1981	1980	1979	1978	1977
Total operating revenues—at historical costs	$1,448,416	$ 916,715	$609,230	$487,565	$388,634
Total operating revenues—in average 1981 dollars	$1,448,416	$1,011,804	$763,359	$679,697	$583,272
Historical cost information—adjusted for general inflation					
Net loss from operations	$ (68,852)	$ (44,721)	$ (215)	–	–
Net loss from operations per common share	$ (3.36)	$ (2.16)	$ (.01)	–	–
Equity in net assets at year-end	$ 332,984	$ 282,037	$263,411	–	–
Current cost information					
Net loss from operations	$ (103,990)	$ (58,219)	$ (7,694)	–	–
Net loss from operations per common share	$ (5.00)	$ (2.81)	$ (.38)	–	–
Excess of increase in specific prices over increase in the general price level	$ 125,327	$ 90,916	$ 22,830	–	–
Equity in net assets at year-end	$ 864,578	$ 715,940	$393,489	–	–
Gain from decline in purchasing power of net amounts owed	$ 68,584	$ 61,908	$ 41,926	–	–
Cash dividends declared per common share—historical	$ .10	$ .20	$ .20	$ .16	$ .12
Cash dividends declared per common share—in average 1981 dollars	$ .10	$ .22	$ .25	$ .22	$ .18
Market price per common share at year-end—historical	$ 4.13	$ 6.00	$ 6.00	$ 7.13	$ 5.00
Market price per common share at year-end—in average 1981 dollars	$ 3.99	$ 6.62	$ 7.52	$ 9.93	$ 7.50
Average consumer price index	272.4	246.8	217.4	195.4	181.5

NOTE: Certain data for years prior to 1979 have been omitted as permitted by FASB No. 33.

Supplemental stockholder information

(continued)

EFFECTS OF CHANGING PRICES (unaudited)

Basis of preparation of 1981 supplemental data

As required by Financial Accounting Standards Board (FASB) Statement No. 33, "Financial Reporting and Changing Prices," the company has provided supplemental information concerning the effects of changing prices on its financial statements. The disclosures are intended to address two different aspects of an inflationary environment: (1) the effect of a rise in the general price level on the exchange value or purchasing power of the dollar (called "general inflation") and (2) the specific price changes in the individual resources used by the company.

The supplemental information on changing prices does not reflect a comprehensive application of either type of inflation accounting. During the experimental period, the FASB decided to focus on those items most affected by changing prices, that is: (1) the effect of both general inflation and specific price changes on inventories and property and equipment and the related impact on earnings or loss, and (2) the effect of general inflation on monetary assets and liabilities.

Loss from operations

The net loss as reported in the primary statements represents the amount reported on the historical cost basis of accounting. Net loss adjusted for general inflation represents the historical amounts of revenues and expenses stated in dollars of the same (constant) general purchasing power, as measured by the average level of the Consumer Price Index (CPI) for 1981. Under this measurement method, historical amounts of depreciation expense, gain on equipment dispositions, and spare parts inventory are adjusted to reflect the change in the level of the CPI since the date the properties were acquired.

Current cost accounting attempts to deal with a different issue than earnings or loss adjusted for general inflation. The specific prices of the company's goods and services have risen at a different rate than the general inflation rate as measured by the CPI. The net loss adjusted for changes in specific prices (current cost) measures spare parts inventory, property and equipment, and gain from disposition of equipment at current cost (rather than historical cost) at the balance sheet date.

Income taxes

The provision for income taxes included in the supplemental statement of operations is the same as reported in the primary financial statements. Present tax laws do not allow deductions for higher depreciation adjustments for the effects of inflation. Thus, taxes are levied on the company at rates which, in real terms, exceed established statutory rates. During periods of persistent inflation and rapidly increasing prices, such a tax policy effectively results in a tax on shareholders' investment in the company.

Purchasing power gain from holding net monetary liabilities during the year

When prices are increasing, the holding of monetary assets (e.g., cash and receivables) results in a loss of general purchasing power. Similarly, liabilities are associated with a gain of general purchasing power because the amount of money required to settle the liabilities represents dollars of diminished purchasing power. The net gain in purchasing power is shown separately in the accompanying supplemental data. The amount has been calculated based on the company's average net monetary liabilities for the year multiplied by the change in the CPI for the year. Such amount does not represent funds available for distribution to shareholders.

Current cost measurements

Current cost calculations involve a substantial number of judgments as well as use of various estimating techniques that have been employed to limit the cost of accumulating the data. The data reported should not be thought of as precise measurements of the assets and expenses involved, but instead represent reasonable approximations of the price changes that have occurred in the business environment in which the company operates.

Current cost asset amounts were derived principally through a reference guide to current selling prices supplied by the Air Transport Association. Current cost depreciation is based on the average current cost of property and equipment during the year. Depreciation expense was computed by applying the ratio of historical depreciation expense to average historical asset cost to the average current cost of these assets. The result should be approximately the same as would be calculated using the depreciation methods used in preparing the primary financial statements.

Current cost does not purport to represent the amount at which the assets could be sold.

Increases in current cost adjusted for general inflation

Under current cost accounting, increases in specific prices (current cost) of spare parts inventory and property and equipment held during the year are not included in the loss from operations but are presented separately. The current cost increase is reduced by the effect of general inflation measured by applying the annual rate of change in the CPI to the average current cost balance of spare parts inventory and property and equipment.

Five-year comparison of selected financial data

As described above, the determination of net assets reflects a partial application of the two inflation accounting methods. Other assets, consisting primarily of deferred charges, have not been adjusted for general inflation, nor specific price changes. In addition, noncurrent payables have not been converted to reflect specific price changes (i.e., changes in interest rates).

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