ANNUAL REPORT 1977

NORTH CENTRAL AIRLINES

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7500 northliner drive, minneapolis, minnesota

board of directors

Hal N. Carr*
Chairman of the Board
North Central Airlines

Eric Bramley
Retired Editor
Aviation Daily
(aviation industry news service)

G. F. DeCoursin*
President
April Company
(manufacturer and distributor of seasoned food products)

Chan Gurney
Retired Member
Civil Aeronautics Board

John M. Lawrence III
Partner in law firm of
Lawrence, Thornton, Payne & Watson

Samuel H. Maslon*
Partner in law firm of
Maslon, Kaplan, Edelman, Borman, Brand & McNulty

Theodore R. Miles
President and Chief Executive Officer
Stange Co.
(manufacturer and distributor of food products)

Jay Phillips
Chairman of the Board
Ed. Phillips & Sons Co.
(wholesale beverage distributor)

Morton B. Phillips
Chairman of the Board
Westland Capital Corporation
(small business investment corporation)

Joseph E. Rapkin
Partner in law firm of
Foley & Lardner

Henry M. Ross
President
Ross Industries, Inc.
(machinery manufacturer)

Bernard Sweet*
President and Chief Executive Officer
North Central Airlines

Kenneth B. Willett*
Chairman of the Board
First Financial Savings and Loan Assn. of Stevens Point

*Executive Committee

management

- Hal N. Carr .... *Chairman of the Board*
- Bernard Sweet .... *President and Chief Executive Officer*
- John P. Dow .... *Vice President and Secretary*
- John W. Dregge .... *Vice President-Federal Affairs*
- Robert L. Gren .... *Vice President-Maintenance and Engineering*
- George J. Karnas .... *Vice President-Inflight Service*
- Daniel F. May .... *Vice President-Finance*
- Gowan J. Miller .... *Vice President-Industrial Relations*
- David E. Moran .... *Vice President-Traffic and Sales*
- T. M. Needham .... *Vice President-Ground Operations*
- J. F. Nixon .... *Vice President and Treasurer*
- G. F. Wallis .... *Vice President-Flight Operations*
- Charlotte G. Westberg .... *Staff Vice President*
- Joseph W. Ettel .... *Assistant Secretary*
- Raymond J. Rasenberger .... *Assistant Secretary*
- Ralph Strangis .... *Assistant Secretary*
- Walter E. Nielsen .... *Assistant Treasurer*
- Michael D. Meyer .... *Controller*

ANNUAL MEETING:
Wednesday, April 5, 1978
Wausau, Wisconsin

AUDITORS:
Alexander Grant & Company

REGISTRARS AND STOCK TRANSFER AGENTS:

Citibank, N.A.
New York, New York 10022

Northwestern National Bank
Minneapolis, Minnesota 55480

STOCK TRADING:

Common stock and warrants traded under symbol NCA

New York Stock Exchange

Midwest Stock Exchange

highlights

	1977	1976	Change
OPERATING REVENUES	$ 229,123,000	$ 191,148,000	19.9%
OPERATING PROFIT	$ 18,535,000	$ 14,689,000	26.2
NET EARNINGS	$ 13,696,000	$ 7,679,000	78.4
NET EARNINGS PER SHARE	$1.11	$.63	76.2
DIVIDENDS PER SHARE	$ .12	$.10	20.0
WORKING CAPITAL FROM OPERATIONS	$ 28,505,000	$ 21,217,000	34.3
RETAINED EARNINGS	$ 48,957,000	$ 36,740,000	33.3
STOCKHOLDERS' EQUITY	$ 69,280,000	$ 56,485,000	22.7
PASSENGERS	5,547,000	4,969,000	11.6
PASSENGER MILES	1,392,406,000	1,179,144,000	18.1
CARGO TON MILES	13,998,000	13,052,000	7.2

thirty years of service

McDonnell Douglas DC-9

Convair 580

Lockheed 10A
1948-1951

Douglas DC-3
1951-1969

Convair 340/440
1959-1969

North Central Airlines, a regional scheduled carrier linking intermediate-sized cities with major metropolitan areas, has completed thirty years of service. Its principal function is to provide safe, dependable air transportation.

Incorporated as Wisconsin Central Airlines in 1944, the company received its Federal operating certificate three years later. Scheduled service was inaugurated on February 24, 1948. When headquarters were moved to Minneapolis/St. Paul in 1952, the name was changed to North Central Airlines. Traffic grew steadily, setting a regional industry record by 1960 with one million passengers, and then doubling every six years to reach four million in 1972.

The company has operated profitably for 23 years since 1954, when present management was brought in. Its fleet of 53 jet-powered aircraft makes 650 departures a day over the 10,900-mile route system. Computerized reservations and ticketing provide efficient passenger handling.

Now in its thirty-first year, the airline serves 90 cities—in 14 states and two Canadian provinces—including Chicago, Detroit, Cleveland, New York, Boston, Toronto, Milwaukee, Winnipeg, Minneapolis/St. Paul, Omaha, Kansas City, and Denver.

North Central's 3,850 dedicated employees offer the traveling public the finest type of regional airline service.

to our stockholders, employees and friends:

Net earnings of $13,696,000 highlight North Central's many record accomplishments in 1977. The airline generated $229,123,000 in revenues, carried 5.5 million passengers 1.4 billion passenger miles, and flew 14 million cargo ton miles.

Bernard Sweet *Hal N. Carr*

Significant gains were attained in all areas. The $13.7-million net profit was 78 percent over the $7,679,000 for 1976, and 66 percent greater than the previous high of $8,250,000 in 1974. Revenues, which have increased in each of the 30 years since scheduled operations began, jumped 20 percent. Passenger boardings were up 12 percent, and passenger miles climbed 18 percent. Cargo ton miles were seven percent ahead of 1976.

Several factors contributed to these outstanding results. Traffic was stimulated by the national economic growth, new Detroit-Boston nonstops, improved scheduling, and the professional service provided by North Central's employees. Financially, the company benefited from fare increases, favorable provisions in the 1976 Tax Reform Act, retroactive mail pay, and disposition of equipment.

In the regional airline industry, North Central's consistent financial performance is unmatched. The company has operated profitably for 23 years since 1954, when present management was brought in, and leads the regional carriers with retained earnings of $48,957,000. This achievement has permitted annual cash dividends to be paid for six consecutive years. The Board of Directors recently increased the dividend 33 percent, and stockholders of record on February 16, 1978, received $.16 per share of common stock.

While revenues reached $229,123,000, operating expenses rose 19 percent to $210,588,000. The $18,535,000-operating profit was 26 percent higher than in 1976. Other expenses and other income, primarily interest, were down to $3,835,000. The $6,949,000 in interest expense, directly related to financing new jet aircraft, was partially reduced by a $2,705,000-gain on disposition of equipment and $409,000 of other income. Earnings before taxes reached $14,700,000.

Investment tax credits, available to the company because of equipment purchased in 1976 and 1977, offset the current Federal income tax liability, while state, local and deferred taxes amounted to $1,004,000. Total income taxes for 1976 were $3,040,000. With the 1977 net earnings of $13,696,000, earnings per share jumped to $1.11 from $.63 in 1976.

The record year boosted stockholders' equity 23 percent to $69,280,000 and raised book value per share to $5.62. Even with $24,978,000 in additional loans to finance new aircraft, the company's debt/equity ratio is 1.21 to 1—still one of the best in the entire airline industry.

Besides carrying record annual traffic of 5,547,065 passengers, new highs were set for a single month and day. The airline flew 538,618 passengers in August and 25,386 on December 23. Also, Chicago became the first city at which North Central boarded one million people in one year.

The company successfully introduced its Detroit-Boston service in 1977, with traffic and revenues ahead of projections.

The Civil Aeronautics Board recently announced that a tentative decision is to be drafted granting North Central permissive nonstop authority between Detroit and Atlanta. In another decision, the Board awarded the airline Cincinnati-Philadelphia nonstop service. The company plans to inaugurate flights on these two routes in the summer of 1978, and they should provide significant operating profits. In addition, North Central has been recommended for Detroit-Baltimore and Minneapolis/St. Paul, Milwaukee-Memphis.

Further expansion is being sought through other route applications involving 24,941 miles and 22 new cities, plus broad authority between numerous Caribbean destinations and U.S. points. The CAB may conclude some of these cases in 1978. North Central presently serves 90 cities in 14 states and two Canadian provinces on a 10,900-mile route system.

Five DC-9-50s were added to the airline's jet-powered fleet in 1977. Another seven will be received in 1978. The company has ordered three more for delivery in early 1979 and has an option on three for late that year. Three Convair 580 prop-jets were sold in 1977, and two others may be sold in the months ahead. By the end of 1978, North Central plans to have a 58-aircraft fleet—35 DC-9s and 23 Convair 580s.

As a corporate citizen, North Central is aware of its responsibilities to people and the environment. During 1977, the airline's Equal Employment Opportunity and Affirmative Action programs placed members of both sexes in virtually every job category and increased minority employment 16 percent. In addition, energy conservation efforts saved over four million gallons of aviation fuel while producing smoother, quieter flights.

North Central gratefully acknowledges the valuable contribution of H. P. Skoglund, a director since 1964. This prominent Twin Cities business and civic leader served the airline in that capacity until his death in November 1977.

For three decades, the company's greatest assets have been its dedicated employees and its loyal stockholders, customers and friends. Knowing this support will continue and encouraged by the prospect of new routes, North Central looks forward to substantial profits in 1978.

Sincerely,

Hal N. Carr
Chairman of the Board

Bernard Sweet
President and Chief Executive Officer

March 6, 1978

New York City tours, available through North Central and travel agents, feature sightseeing, elegant dining and Broadway shows.

financial review

Record net earnings of $13,696,000 were achieved by North Central in 1977. This exceeded the previous high of $8,250,000 in 1974 by 66 percent, and was 78 percent ahead of the $7,679,000 for 1976. Revenues jumped 20 percent to a record $229,123,000.

North Central has now operated profitably for 23 years since 1954, when present management was brought in. The company has retained earnings of $48,957,000—highest among the regional airlines.

The $229 million in 1977 revenues surpassed the previous record of $191 million set a year earlier. Operating expenses, including depreciation and amortization of $14,590,000, were up 19 percent to $210,588,000 from $176,459,000. The operating profit increased 26 percent to $18,535,000 from the $14,689,000 in 1976.

Other expenses, primarily interest, dropped three percent to $3,835,000 from $3,970,000 in 1976. The $6,949,000 in interest expense, directly related to financing new jet aircraft, was partially reduced by a $2,705,000-gain on disposition of equipment and $409,000 of other income.

Under provisions of the 1976 Tax Reform Act, North Central is entitled to investment tax credits of $10,298,000 as a result of equipment purchased in 1976 and 1977. Most of these credits were used to offset 100 percent of the current Federal income tax liability. State, local and deferred taxes were $1,004,000. For 1976, total income taxes were $3,040,000.

The 1977 net earnings of $13.7 million, or $1.11 per share, are significantly better than the $7.7 million, or $.63 per share, the previous year. For the period 1973 through 1977, earnings have exceeded $5 million each year, and average annual earnings are $8.3 million.

Stockholders' equity climbed 23 percent to a record $69,280,000. With 12,328,158 shares of common stock outstanding, book value has increased to $5.62 per share, from $4.64 in 1976. The company's debt/equity ratio of 1.21 to 1 continues to be one of the best in the entire airline industry.

In January 1978, the Board of Directors declared an annual cash dividend. Stockholders of record February 16, 1978, were paid $.16 per share, up 33 percent from $.12 per share in 1977. North Central is the only regional carrier to have paid a cash dividend in each of the last six years.

Diversified activities in 1977 generated $4 million in revenues not related to airline service. This income was derived primarily from leasing aircraft and computers to other companies and from the sale of surplus time on North Central equipment.

A summary of trends in financial performance and traffic growth from 1973 through 1977 appears on Page 23. Supplemental stockholder information, including quarterly statements and stock quotations for the last two years, is carried on Page 21.

Planning ahead, the company arranged for equipment trust certificates to finance six DC-9-50 fan jets scheduled for delivery in 1978. The new DC-9-50s will increase capacity to accommodate anticipated traffic gains and make other jets available for possible route awards.

A new CAB policy permits known future costs to be used when calculating requested fare increases. This change will help the airline recover most costs as they occur, and minimize regulatory lag.

North Central's excellent financial condition strengthens its prospects for future development. New routes, fare adjustments, and traffic growth should boost revenues. With continuing cost control and the availability of investment tax credits, the company expects to attain a substantial profit in 1978.

A Colorado Summer tour offers a variety of leisure activities—from backpacking to authentic ranch vacations—and North Central can make all arrangements.

MAJOR FACTORS OF CHANGE IN REVENUES AND EXPENSES

The Variance Analysis table below summarizes the major changes in revenues and expenses which have occurred in the company's operation over the past two years.

The $38-million jump in revenues for 1977 was due largely to record traffic. Passenger revenues accounted for $29.5 million, which included $10 million from the new Detroit-Boston route and $5.1 million from fare increases. Cargo and other revenues rose $8.7 million. Of that amount, the company derived $2.6 million from higher mail pay rates, (of which $1.9 million relates to prior years), $2.5 million in new air freight business, $2 million in additional charter operations, and $1.6 million from miscellaneous activities.

VARIANCE ANALYSIS

	Net Changes	
	1977-1976	**1976-1975**
MAJOR FACTORS OF CHANGE:		
Operating revenues		
Passenger miles	$24,400,000	$11,400,000
Passenger fares	5,100,000	10,100,000
Public service revenues	(200,000)	1,100,000
Cargo and other revenues	8,700,000	4,900,000
Net revenue changes	38,000,000	27,500,000
Operating expenses		
Labor and employee benefits	14,300,000	10,200,000
Cost of aircraft fuel	7,700,000	3,400,000
Parts, supplies and services	2,800,000	2,300,000
Landing fees and rent	1,400,000	1,600,000
Passenger service and promotion	3,400,000	1,300,000
Mutual Aid payments	(100,000)	(1,100,000)
Other expenses	1,700,000	1,400,000
Depreciation	3,000,000	1,500,000
Net expense changes	34,200,000	20,600,000
Change in operating profit	3,800,000	6,900,000
Other expenses (income)		
Gain on disposition of equipment	2,500,000	200,000
Interest income and other	(100,000)	–
Interest expense	2,200,000	1,300,000
Income taxes	(2,000,000)	3,400,000
Net other changes	(2,200,000)	4,500,000
Change in net earnings	$ 6,000,000	$ 2,400,000

Operating expenses rose $34.2 million in 1977, compared with $20.6 million the previous year. The introduction of Detroit-Boston nonstop service, the acquisition of new aircraft, and the impact of inflation accounted for the rise in expenses.

Labor and employee benefits increased $14.3 million, or 18 percent, as total employment rose seven percent, and both pay scales and pension requirements were up. The company has 3,850 employees.

Aviation fuel expenses were boosted $7.7 million by rising prices and the increase in plane miles flown. Inflation affected landing fees and the cost of parts, services and supplies. The climb in depreciation and interest is directly related to the addition of new DC-9-50 jets.

Under other expenses (income), the sale of aircraft was the principal reason for the increase of $2.5 million in the gain on disposition of equipment. Interest expense, up $2.2 million, reflects the cost of financing new jets.

Terms of the 1976 Tax Reform Act permitted the company to offset the current Federal income tax liability with investment tax credits generated by the purchase of new equipment. This provision accounts for the $2-million decrease in income taxes, even though earnings before taxes rose significantly in 1977.

The combined effect of all these factors was the substantial $6-million improvement in net earnings.

Boston's "Freedom Trail" is one of the many historic attractions included in North Central's tours of New England.

Canadian Wilderness adventures highlight North Central's many fishing tours.

traffic growth and performance

Numerous passenger and cargo traffic records were set by North Central in 1977. Foremost were the 5.5 million passengers, 1.4 billion passenger miles and the 14 million cargo ton miles flown for the year.

These accomplishments are attributable to an improving national economy which stimulated business and leisure travel, greater capacity from new DC-9 fan jets, improved scheduling, and first-year business on the Detroit-Boston route.

Passenger traffic for 1977 was the best in North Central's history. Boardings increased 12 percent to 5,547,065. Passenger miles jumped 18 percent to 1.4 billion – about the same as taking each person in the cities of Boston, Detroit and Chicago on a 250-mile flight. In 1976, the airline carried 4,969,264 passengers and flew 1.2 billion passenger miles.

The company achieved its best single day and month with 25,386 passengers on December 23 and 538,618 in August. Chicago became the first city at which North Central boarded one million passengers in one year. The airline carried 122,709 Boston-Detroit passengers in 1977 – 12 percent more than estimated by the Civil Aeronautics Board. Of the 90 cities North Central serves, 47 produced traffic records in 1977.

For the first time in the company's history, over 100,000 passengers rode on charter flights in one year, a 47 percent gain compared with 1976. The airline operated 796 charters for 108,802 people. Although the DC-9-50s increased capacity on scheduled flights, 720 extra sections were needed during peak travel periods to accommodate 24,446 passengers.

Cargo ton miles – including freight, express and mail – improved seven percent in 1977, reaching 13,998,000, to set another company record. Freight and express climbed eight percent, while mail rose four percent. The 588,620 actual freight and express shipments were six percent ahead of 1976.

For the past 20 years, North Central has ranked among industry leaders in operating performance with a completion record averaging 99 percent. In 1977, North Central completed 99 percent of its 31.8 million scheduled miles. This dependability is particularly significant since North Central contends with more adverse weather for a longer period of time than any other U.S. carrier.

Concerted efforts by pilots, ground personnel and flight control people contribute to this high level of operating excellence. A comprehensive and progressive maintenance program also helps assure reliability. Of North Central's 220,000 departures in 1977, only one-tenth of one percent were cancelled for mechanical reasons, and 1.5 percent were delayed.

North Central's consistent traffic growth and outstanding operating performance attest to the efforts of the company's 3,850 employees. Their talents and dedication are the keys to providing safe, dependable air transportation.

Capt. Charles Clawson follows the company's noise abatement procedures for making a landing approach over a densely-populated area.

environmental and social action programs

Through its environmental and social action programs, North Central is using natural resources efficiently, developing employee potential, and increasing customer satisfaction.

Three enterprising energy programs in 1977 enabled the airline to conserve over four million gallons of vital aviation fuel worth $1.6 million. With these well developed plans, the company was able to maintain its full service commitment to the 90 cities on its system.

Following the company's fuel management procedures, North Central pilots make adjustments in fuel loads, taxi routes, flap settings, cruise speed, and altitude of the aircraft. The cumulative result was a 2.2-million gallon reduction in fuel consumption for 1977.

By conducting pilot training and proficiency checks in its $2-million DC-9 digital flight simulator, the company conserved another two million gallons of fuel – enough to add one DC-9 jet to North Central's schedule for 346 days.

Some 200,000 gallons were saved through procedures based on the computerized Fuel Inventory Management System (FIMS) introduced two years ago. In 1977, FIMS was programmed to provide real-time data which permits better use of aircraft auxiliary power units, lower takeoff weights through fuel load control, and identification of engines with high "burn" rates.

Multiple benefits are derived from aircraft noise-abatement procedures for takeoff and descent. Minimum power and flap settings produce a smoother ride for passengers, quieter flights over densely-populated neighborhoods, and greater fuel efficiency. Noise is also suppressed by preferential runway selection, which means final landing approaches are made over least-populated areas when weather conditions permit.

New equipment for deicing aircraft with hot water has reduced the use of petroleum-based fluids. Six stations now have this company-designed equipment.

During 1977, employees at the airline's headquarters collected 128,000 pounds of used office paper which was suitable for recycling. Since the "Waste Not" theme was adopted four years ago, North Central has recovered 623,000 pounds of paper and "saved" an estimated 5,300 trees.

Investing in human resources is one of the company's prime concerns. The Affirmative Action program resulted in a 16 percent increase in minority employment. The total workforce grew seven percent. Minorities were recruited at 30 colleges and trade schools.

Members of both sexes are now employed in virtually every job classification. Women are in pilot, mechanic and sales positions, while men are working as flight attendants, reservationists, and clerks.

The Federal Aviation Administration conducted an on-site inspection at Detroit this past year and found North Central in compliance with Affirmative Action program standards. The FAA considered the company's female and minority representation, employee morale, and community involvement.

Flight attendant training, which includes first aid, was credited with saving a passenger's life in 1977. While in flight, Attendant Anne Odenwald successfully used the prescribed Heimlich Maneuver when a passenger was choking on food.

Conscientious concern for the traveling public has produced outstanding results for North Central and the air transportation industry. American consumers gave airlines the highest rating among 21 industries evaluated in a 1977 survey for *U.S. News & World Report.*

The public considered value received, concern for health and safety, and information to customers about products and services. In the aviation industry, North Central consistently ranks among those airlines which have the fewest consumer complaints filed with the Civil Aeronautics Board.

Preserving the environment, developing human resources, and serving the traveling public are essential elements of North Central's daily operation. The company continually seeks to fulfill its responsibilities as a corporate citizen.

new facilities and services

Accelerating its flight equipment program, North Central added five new DC-9-50 fan jets in 1977 which improved service to 17 communities. Twin-engine jets accounted for 80 percent of the 2.9 billion seat miles flown by the airline in 1977.

The new DC-9s carry 130 passengers. Interiors feature the wide-body look with enclosed overhead luggage compartments, and comfortable two and three-abreast seating. Corporate colors, aqua and royal blue, dominate the cabin decor.

North Central's 53-aircraft fleet of 28 DC-9s and 25 Convair 580 prop-jets is being expanded again in 1978. Seven DC-9-50 jets are to be delivered during the year. The company has ordered another three due in early 1979, and has an option on three more. These airplanes will accommodate anticipated growth and help reduce operating cost per seat mile. Three 48-passenger Convair 580s were sold in 1977, and several more may be disposed of in the months ahead. By the end of 1978, the fleet will have grown to 58 aircraft—35 DC-9s and 23 Convair 580s.

To improve the convenience, comfort and appearance of ground facilities, the airline is remodeling passenger service areas throughout the system. In 1977, carpeting, seating and accessories were standardized in boarding lounges at the terminals in Denver, Omaha, Chicago, Cleveland, Columbus, Dayton, and Cincinnati. New passenger service counters have been completed at the Omaha, Milwaukee and Grand Rapids airports. A new downtown office was opened in Boston, and the Chicago City Ticket Office was redecorated.

Civic and community cooperation has led to improvements in airport facilities at many North Central cities. The new terminal at Iron Mountain/Kingsford has a spacious lobby and boarding area, new passenger service counters, administrative offices, drive-in air freight, and a convenient baggage claim arrangement.

New terminals are being built at Hibbing/Chisholm and Huron. An enlarged ramp at Alpena has aided aircraft operations, and the runway extension at Kalamazoo/Battle Creek permitted introduction of DC-9 jet service. Airport security was simplified at terminals in Duluth/Superior, Green Bay/Clintonville and Grand Rapids with the installation of luggage X-ray equipment.

Jet bridges were installed at Boston, Detroit, and Grand Rapids. At Cleveland, construction is nearly finished on new airport passenger service counters, baggage claim space and offices.

Substantial construction took place in 1977 at the Milwaukee terminal. A new main entrance, escalator, and second-level corridor shorten the distance to newly-decorated boarding lounges. The addition of a jet bridge was also a major improvement. By enlarging the passenger service counter, more check-in locations are now available. The air freight and office areas were also remodeled.

Flight Attendants (from left) Carole Darin, Terry Hogan and Audrey Burton model the versatile new uniform ensemble.

Inside the company's DC-9 digital flight simulator, Captains William Hunchis (left) and Len Dolny discuss new VITAL IV visual equipment. It displays airport runways, taxiways and surrounding terrain in daylight, twilight and night settings.

Another "new look" in 1977 was the change in attire of flight attendants and station personnel. A new wardrobe of beige and brown apparel gives flight attendants a distinctive appearance and a variety of coordinated ensembles. Station agents at larger cities are wearing blue slacks and light blue shirts. Navy blazers and blue slacks are worn by all senior agents and by the agents and managers at smaller stations.

Faster and more efficient reservations service has resulted from refinements to ESCORT, the airline's electronic reservations and communications system. (ESCORT is a major user of the company's $13-million data processing facility.) North Central led the industry by developing a computer program to handle travel agent and commercial account transactions in 50 percent less time. Also, computerized flight information was doubled so that immediate confirmation of space can be given on connecting flights to any North American city with scheduled airline service.

In another new application, ESCORT compiles real-time information on passenger boardings and the amount of mail, freight and baggage carried on each flight segment. Station personnel now plan flight loads with greater accuracy. Also, this daily operations data establishes a statistical base for company-wide use.

North Central has over 700 TV-like display units and printers linked to ESCORT—up from 380 in 1970. A new Computer Network department was created to manage this extensive communications system.

In the area of flight crew training, North Central became the first airline to install new McDonnell Douglas VITAL IV visual equipment on its DC-9 digital flight simulator. This unit displays airport runways, taxiways and surrounding terrain in restricted daylight, twilight and nighttime settings. (Previously, only nighttime environment was depicted.) Its 11,000 colored lights and 450 geometric surface planes are computer-generated to create all the visual sensations of natural flight. Fog, haze, rain and other weather can also be produced.

The company's pilots "fly" over 2,200 hours annually on this simulator for DC-9 proficiency checks and training. Surplus time on the $2-million cockpit module is sold to outside organizations, such as the Federal Aviation Administration, the U.S. Air Force, and other airlines. For 1977, this amounted to 1,000 hours.

The addition of new shop equipment is cutting costs and time required for aircraft maintenance and parts fabrication. Overall, maintenance department personnel reduced expenses for special parts fabrication in 1977 by an average of 45 percent.

During 1977, several new functions were added to SCEPTRE, the company-developed computer system for corporate data. Clerical personnel and agents throughout the company now order office and ticket supplies by simple computer entries, and vendor addresses are available for correspondence and equipment orders. Aircraft parts routing and aircraft cleaning schedules have been included. SCEPTRE stores real-time and historical information on hundreds of thousands of aircraft parts, and these records can be retrieved through 350 receivers at stations and maintenance bases.

By prudent investments in more efficient equipment and by implementing innovative programs, North Central is providing greater reliability and service to the traveling public.

New uniforms for Ground Operations personnel are worn by Rochester Station Agent Leroy Johnson (left) and Manager Vernon Beyer.

North Central's Milwaukee airport facility features an enlarged passenger service counter, a new main entrance, escalator, and newly-decorated boarding lounges.

route development

New Detroit-Atlanta and Cincinnati-Philadelphia nonstop service by North Central is planned for the summer of 1978. These routes, which add two cities and 1,102 miles to the company's system, resulted from Civil Aeronautics Board action in February 1978.

Early that month, the CAB directed its staff to prepare a tentative decision granting the airline permissive nonstop authority on the 595-mile Detroit-Atlanta route, and an order is due in April. Later, the Board awarded the 507-mile Cincinnati-Philadelphia route to North Central.

DC-9 fan jets would be used on both segments. These flights will provide new, direct or single-carrier connecting service to the south and east for numerous cities in the Dakotas, Minnesota, Wisconsin, Michigan and Canada.

In January 1977, the airline inaugurated Detroit-Boston nonstop service. The company carried more than half the passengers in the market, and exceeded first-year traffic and revenue projections.

Permanent certification was granted to North Central on the Winnipeg-Duluth/Superior segment which the airline has served since 1974. In the same order, the company received permissive authority for Milwaukee-Winnipeg service.

The CAB is processing many of the airline's pending route applications. Final decisions are imminent on Minneapolis/St. Paul, Milwaukee-Memphis and Detroit-Baltimore. In both cases, the law judges recommended North Central. These routes involve two new cities and 1,664 miles. Another eight cases could be resolved later this year or in 1979.

This increased activity reflects North Central's aggressive route development program and the Board's recent efforts to stimulate competition. The company filed ten new applications with the CAB during 1977, and already this year has asked to be considered in the Florida-Atlanta Nonstop Case. These routes could add 18,354 miles and 20 new cities to the airline's system. Also, the company requested broad authority from various North Central cities to the Caribbean area.

The airline's applications are summarized below.

MINNEAPOLIS/ST. PAUL-MEMPHIS, MILWAUKEE-MEMPHIS NONSTOPS

An administrative law judge chose North Central for both routes, and a final CAB decision is expected this spring. The airline is proposing the first direct service between Minneapolis/St. Paul and Memphis, a 699-mile route. Initially, flights would stop at Milwaukee and go nonstop the 556 miles to Memphis. As traffic increases, Twin Cities-Memphis nonstops would be operated. Serving a potential 71,000 passengers the first year, North Central would realize a $1-million operating profit.

DETROIT-BALTIMORE NONSTOP

In February 1978, a CAB law judge chose North Central for the route, and a final decision is anticipated soon. The State of Maryland and North Central had jointly asked the CAB to permit the early introduction of Detroit-Baltimore nonstops by the airline. North Central is proposing four flights daily with DC-9 fan jets. The airline estimates it would carry 77,000 passengers on the 409-mile route and earn a $1.2-million operating profit the first year. Eleven Midwest cities would receive single-plane service, and 37 others would have convenient, single-carrier connections.

CHICAGO MIDWAY LOW-FARE PROCEEDING

The CAB expedited proceedings in this case, and a hearing has been held. A final decision is expected by the fall of 1978. North Central is requesting authority for low-fare, high-frequency nonstops between Chicago Midway Airport and the following cities: Cleveland, Detroit, Kansas City, Minneapolis/St. Paul, Pittsburgh and St. Louis. The company proposes up to 26 daily flights in each market, using DC-9 jets with 139-passenger seating. (1,594 miles)

BISMARCK/MANDAN-FARGO/MOORHEAD-TWIN CITIES-CHICAGO

Hearings have been held on North Central's request to remove certain operating restrictions from its certificate to permit improved service to Chicago from Bismarck/Mandan and Fargo/Moorhead. Single-plane service could then be offered from Bismarck/Mandan, via Fargo/Moorhead and the Twin Cities, to Chicago; and one-stop service from Fargo/Moorhead. In addition, Fargo/Moorhead-Twin Cities nonstops would be operated. (410 miles)

MINNEAPOLIS/ST. PAUL-SAN DIEGO, LAS VEGAS, PHOENIX NONSTOPS

CAB hearings are set for June 1978. North Central is proposing daily nonstops between Minneapolis/ St. Paul and San Diego, Las Vegas and Phoenix. These three routes are among the largest in the nation without competitive service. (4,108 miles)

ATLANTA-FLORIDA NONSTOP SERVICE

In February 1978, the airline asked to be considered for nonstop service from Atlanta to Tallahassee, Daytona Beach, and Sarasota/Bradenton. These routes, involving 1,034 miles, are part of the Florida-Atlanta Competitive Nonstop Service Case. Board hearings are scheduled for July 1978.

CHICAGO-SYRACUSE/ALBANY-BOSTON

The Board has agreed to hear North Central's proposal to operate six daily flights with DC-9 jets between Chicago and Boston – one round trip via Syracuse, one round trip via Albany, and one round trip serving both stops. Chicago-Syracuse/Albany and Boston-Syracuse/Albany are presently monopoly routes – each served by a different carrier. This case involves two of the largest monopoly markets remaining in the United States. A potential 156,000 passengers would benefit from the new service, and the airline would realize a first-year operating profit of $2.1 million. (1,858 miles)

TWIN CITIES-HOUSTON NONSTOP, TWIN CITIES-DALLAS/FT. WORTH-HOUSTON

Board hearings in this case are planned for 1978. North Central is proposing new Twin Cities-Houston and Twin Cities-Dallas/Ft. Worth nonstops, supplemented by one-stop Twin Cities-Houston service, via Dallas/Fort Worth. Only one carrier presently offers nonstop service between Minneapolis/St. Paul and these two Texas markets. (2,110 miles)

DETROIT-MONTREAL, VIA TORONTO

This authority was requested under an amendment to the 1966 Bilateral Air Transport Agreement between the United States and Canada. The amendment authorizes Detroit-Montreal flights by a U.S. carrier after 1978. A hearing is expected this year. North Central could also offer single-plane service from Minneapolis/St. Paul and Milwaukee to Montreal. (315 miles)

DENVER-SAGINAW/BAY CITY/MIDLAND, DENVER-FLINT NONSTOPS

In February 1977, the airline requested nonstop authority from Denver to Saginaw/Bay City/Midland and from Denver to Flint. Another carrier began service on these routes under an exemption certificate approved by the Board in July 1977. North Central's application is awaiting CAB action. (2,222 miles)

OMAHA-DALLAS/FT. WORTH NONSTOP

The company is proposing to extend its Twin Cities-Omaha flights to Dallas/Ft. Worth. Nine communities north and east of Minneapolis/St. Paul would receive single-plane service to Dallas/Ft. Worth for the first time. Board action on consolidation is pending. (583 miles)

MILWAUKEE, MADISON-DENVER NONSTOPS

In June 1977, the CAB authorized North Central to provide single-plane service between Milwaukee and Denver, via Minneapolis/St. Paul, but did not act on the application for nonstop flights. The airline is also waiting for a Board decision on its request for Madison-Denver nonstops. (1,747 miles)

WISCONSIN, MICHIGAN, OHIO-FLORIDA POINTS

In February 1977, the company asked to serve Tampa/St. Petersburg/Clearwater and Orlando from Milwaukee, via Detroit. Nonstop authority was also requested to the same Florida destinations from Dayton, via Cincinnati. (3,469 miles)

MILWAUKEE, CLEVELAND-ATLANTIC CITY NONSTOPS

Board action is pending on the airline's application, filed in February 1977, to serve Atlantic City from Milwaukee and from Cleveland. The two nonstop segments would add 1,140 miles to the company's route system.

MILWAUKEE-PHILADELPHIA NONSTOP

New nonstop service has been proposed providing single-plane service for 10 Minnesota and Wisconsin communities. Although two other carriers are certificated, only one nonstop is presently operated in each direction. (690 miles)

MICHIGAN POINTS-DETROIT-NEW YORK

This application would enable North Central to provide new, single-plane service through Detroit to New York City from ten Michigan cities. (501 miles)

TWIN CITIES-KANSAS CITY NONSTOP

This application would permit North Central to operate nonstop flights, in addition to the present two-stop service. (394 miles)

CARIBBEAN AREA SERVICE INVESTIGATION

The company has applied for nonstop service from 11 U.S. cities to numerous locations in the Caribbean. A CAB prehearing conference is expected in 1978. Originating points in the U.S. would be Boston, New York, Baltimore, Atlanta, Detroit, Cleveland, Cincinnati, Chicago, Milwaukee and Minneapolis/St. Paul. Some of the Caribbean destinations include cities in the Bahamas, Barbados, Cuba, Dominican Republic, Haiti, Jamaica, Puerto Rico, Virgin Islands, the Antilles, Trinidad and Tobago.

SUMMARY

North Central route applications total 24,941 miles and would add 22 new cities to the system. In addition, the company has requested service to Caribbean points.

North Central brings snow and skiers together with a variety of tour packages in Colorado and the Upper Midwest.

the future

Having just completed the most profitable year in its history, North Central looks forward to excellent results in 1978. Expansion from route awards is expected this year. The airline will also benefit from continued traffic growth and more realistic fare increases.

Service on the new Detroit-Atlanta and Cincinnati-Philadelphia routes is planned for this summer, and the additional traffic should improve operating profits. These two segments will add 1,102 miles to the airline's system. Also, North Central has been recommended for Detroit-Baltimore and Minneapolis/St. Paul, Milwaukee-Memphis nonstops. Final decisions are due soon. Eight other applications may be resolved later in the year.

Passenger and cargo traffic is already ahead of 1977's record pace, and this growth should continue. To meet greater demand on existing routes and operate new service, North Central is acquiring seven DC-9-50 fan jets in 1978.

Under a new CAB policy, known future costs can be included when calculating requested fare increases. This change will minimize regulatory lag and allow the company to recover most costs as they occur.

Some type of Federal legislation affecting the airline industry is likely to be passed by Congress during 1978. The company, with its financial strength, will be able to adapt to reasonable new regulations. However, North Central believes no new laws are necessary. The CAB's current efforts to increase competition and encourage innovative fares indicate that changes can be accomplished under the present Federal Aviation Act.

For the year ahead, the company is projecting significant revenue gains because it has the capacity and ability to capitalize on the many growth opportunities. With continued cost control, 1978 should be highly profitable for North Central.

ROUTE OF THE NORTHLINERS

NORTH CENTRAL AIRLINES, INC.

balance sheet

ASSETS	December 31 1977	1976 restated (note B)
CURRENT ASSETS		
Cash (note C)	$ 12,243,000	$ 9,034,000
Accounts receivable, less allowances	25,696,000	19,045,000
Flight equipment parts and supplies (notes A and C)	6,233,000	5,500,000
Prepaid expenses and other (note A)	7,570,000	7,275,000
	51,742,000	40,854,000
PROPERTY AND EQUIPMENT – at cost (notes A, C, D and E)		
Flight equipment	185,307,000	165,066,000
Ground property and equipment	30,914,000	27,006,000
Improvements to leased property	6,052,000	5,388,000
	222,273,000	197,460,000
Less accumulated depreciation and amortization	75,835,000	64,969,000
	146,438,000	132,491,000
Advance payments on equipment	12,413,000	4,919,000
	158,851,000	137,410,000
DEFERRED CHARGES AND OTHER ASSETS		
Unamortized development costs (note A)	1,876,000	1,585,000
Rentals and other (notes A and D)	1,982,000	1,581,000
	3,858,000	3,166,000
	$214,451,000	$181,430,000

LIABILITIES AND STOCKHOLDERS' EQUITY	1977	1976
CURRENT LIABILITIES		
Current maturities of long-term debt (note C)	$ 20,410,000	$ 10,282,000
Accounts payable	10,028,000	7,825,000
Interline payables and tickets outstanding (note A)	12,198,000	10,039,000
Accrued compensation and other expenses	13,249,000	10,850,000
Income taxes (notes A and J)	441,000	278,000
	56,326,000	39,274,000
LONG-TERM OBLIGATIONS		
Long-term debt – less current maturities (note C)	83,635,000	80,067,000
Deferred income taxes (notes A and J)	4,816,000	4,705,000
Other	394,000	899,000
	88,845,000	85,671,000
COMMITMENTS (notes D and E)	–	–
STOCKHOLDERS' EQUITY (notes C and F)		
Common stock – authorized 16,000,000 shares of $.20 par value	2,493,000	2,493,000
Additional paid-in capital	18,210,000	18,056,000
Retained earnings	48,957,000	36,740,000
Treasury stock – at cost	(380,000)	(804,000)
	69,280,000	56,485,000
	$214,451,000	$181,430,000

The accompanying notes are an integral part of this statement.

statement of earnings

	Years ended December 31 1977	1976 restated (note B)
OPERATING REVENUES		
Passenger (note A)	$186,641,000	$157,159,000
Freight and express	13,680,000	11,200,000
Public service revenues (note G)	13,079,000	13,296,000
Mail (notes A and H)	4,932,000	2,347,000
Non-scheduled service and other	10,791,000	7,146,000
	229,123,000	191,148,000
OPERATING EXPENSES		
Flying operations	68,348,000	55,970,000
Maintenance	29,337,000	27,321,000
Aircraft and traffic servicing	50,978,000	43,603,000
Passenger service	14,605,000	10,979,000
Promotion and sales	20,999,000	16,428,000
General and administrative	10,801,000	9,562,000
Other transport-related expenses	930,000	961,000
Depreciation and amortization (note A)	14,590,000	11,635,000
	210,588,000	176,459,000
Operating profit	18,535,000	14,689,000
OTHER EXPENSES (INCOME)		
Interest expense	7,781,000	5,503,000
Less interest capitalized (note A)	832,000	843,000
	6,949,000	4,660,000
Interest income and other – net	(409,000)	(501,000)
Gain on disposition of equipment	(2,705,000)	(189,000)
	3,835,000	3,970,000
Earnings before income taxes	14,700,000	10,719,000
INCOME TAXES (notes A and J)		
Current	745,000	2,169,000
Deferred	259,000	871,000
	1,004,000	3,040,000
NET EARNINGS	$ 13,696,000	$ 7,679,000
NET EARNINGS PER SHARE (note K)	$1.11	$ .63

The accompanying notes are an integral part of this statement.

statement of changes in financial position

SOURCES AND APPLICATIONS OF WORKING CAPITAL	Years ended December 31 1977	1976 restated (note B)
SOURCES		
From operations		
Net earnings	$13,696,000	$ 7,679,000
Charges to earnings not using working capital		
Depreciation and amortization	14,590,000	11,635,000
Deferred income taxes	111,000	766,000
Other	108,000	1,137,000
Working capital provided from operations	28,505,000	21,217,000
Proceeds in excess of gain from property and equipment dispositions	3,003,000	1,675,000
Increase in long-term debt	24,978,000	41,102,000
Reduction of rentals and other	578,000	447,000
	57,064,000	64,441,000
APPLICATIONS		
Additions to property and equipment	39,100,000	49,283,000
Reduction of long-term debt	21,410,000	11,160,000
Payment of cash dividend	1,479,000	1,198,000
Additions to deferred charges	1,239,000	626,000
	63,228,000	62,267,000
INCREASE (DECREASE) IN WORKING CAPITAL	(6,164,000)	2,174,000
Working capital (deficit) at beginning of year	1,580,000	(594,000)
Working capital (deficit) at end of year	$ (4,584,000)	$ 1,580,000

NET CHANGE IN WORKING CAPITAL ELEMENTS	1977	1976
Increase (decrease) in current assets		
Cash	$ 3,209,000	$ 5,479,000
Accounts receivable	6,651,000	(232,000)
Flight equipment parts and supplies	733,000	709,000
Prepaid expenses and other	295,000	723,000
Net change in current assets	10,888,000	6,679,000
Increase in current liabilities		
Current maturities of long-term debt	10,128,000	1,362,000
Accounts payable	2,203,000	2,353,000
Interline payables and tickets outstanding	2,159,000	669,000
Accrued compensation and other expenses	2,399,000	96,000
Income taxes	163,000	25,000
Net change in current liabilities	17,052,000	4,505,000
INCREASE (DECREASE) IN WORKING CAPITAL	$ (6,164,000)	$ 2,174,000

The accompanying notes are an integral part of this statement.

statement of changes in stockholders' equity

Years ended December 31, 1977 and 1976

	Common Stock		Additional Paid-In Capital	Retained Earnings (note B)	Treasury Stock	
	Shares Issued	Amount			Shares Held	Amount
Balance at January 1, 1976 as originally reported	12,462,752	$2,493,000	$18,032,000	$31,039,000	364,800	$999,000
Effect of change in accounting for leases (note B)	–	–	–	(780,000)	–	–
Balance at January 1, 1976 as restated	12,462,752	2,493,000	18,032,000	30,259,000	364,800	999,000
Cash dividend (note F)	–	–	–	(1,198,000)	–	–
Disposition of treasury stock	–	–	24,000	–	(79,766)	(195,000)
Net earnings for the year 1976	–	–	–	7,679,000	–	–
Balance at December 31, 1976	12,462,752	2,493,000	18,056,000	36,740,000	285,034	804,000
Cash dividend (note F)	–	–	–	(1,479,000)	–	–
Disposition of treasury stock	–	–	154,000	–	(150,440)	(424,000)
Net earnings for the year 1977	–	–	–	13,696,000	–	–
Balance at December 31, 1977	12,462,752	$2,493,000	$18,210,000	$48,957,000	134,594	$380,000

The accompanying notes are an integral part of this statement.

auditors' report

Alexander Grant
& COMPANY
CERTIFIED PUBLIC ACCOUNTANTS

INTERNATIONAL FIRM
ALEXANDER GRANT TANSLEY WITT

Stockholders and Board of Directors
North Central Airlines, Inc.

We have examined the balance sheet of North Central Airlines, Inc. (a Wisconsin corporation) as of December 31, 1977 and 1976, and the related statements of earnings, changes in stockholders' equity and changes in financial position for the years then ended. Our examination was made in accordance with generally accepted auditing standards and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the financial statements referred to above present fairly the financial position of North Central Airlines, Inc., at December 31, 1977 and 1976, and the results of its operations and changes in its financial position for the years then ended, in conformity with generally accepted accounting principles applied on a consistent basis after restatement for the change, with which we concur, in the method of accounting for lease agreements as described in note B to the financial statements.

Alexander Grant & Company

Minneapolis, Minnesota
February 13, 1978

notes to financial statements

December 31, 1977 and 1976

Note A — Summary of Significant Accounting Policies — The company, as a regional airline providing scheduled service for passengers, mail and property, is regulated by the Civil Aeronautics Board (CAB) and uses the Uniform System of Accounts and Reports for Certified Air Carriers as required by the CAB. The significant policies consistently followed by the company are:

Flight Equipment Parts and Supplies: These are priced at average cost. An allowance for obsolescence ($999,000 in 1977 and $873,000 in 1976) is provided for repairable parts by allocating their cost over the life of the related aircraft.

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 ($4,530,000 in 1977 and $3,890,000 in 1976). Actual overhaul costs are charged to expense as incurred.

Capitalized Interest: To properly reflect their total cost, major additions to flight equipment, ground facilities and expenditures for deferred charges include capitalized interest based on the weighted average interest rate of debt outstanding. Capitalization of interest ceases when projects become operational. The capitalized interest is amortized over the useful lives of the related assets for financial reporting purposes. If capitalized interest had been expensed as incurred for financial reporting purposes, net earnings would have been reduced by approximately $565,000 in 1977 and $461,000 in 1976. For income tax reporting purposes, interest is expensed in the current period.

Capitalized Leases: The company accounts for leased property in accordance with Financial Accounting Standards Board Statement No. 13. Accordingly, certain leases are capital leases for financial reporting while others are treated as operating leases. Previously only leases which resulted in the creation of a material equity in the leased property accruing to the company were capitalized (notes B and D).

Depreciation: Depreciation is provided in amounts sufficient to relate the cost of depreciable assets to operations over their estimated service lives on a straight line basis for financial and tax reporting purposes. Flight equipment is being depreciated to estimated residual values (15% of cost): Convair 580 based on a common retirement date of June 1979 and DC-9 based on 15-year lives.

Deferred Charges: Expenditures for route development are deferred and amortized over the life of temporary certificates, or five years for permanent certificates. Major computer software development is deferred and amortized over a five-year period. Certain of these expenditures are expensed when incurred for tax reporting purposes.

Passenger Revenues: Passenger revenue is recognized when the transportation service is provided. Unused ticket sales are included as a current liability.

Pension Costs: The company has pension plans for substantially all of its employees, and funds its current expense of normal costs and amortization of prior service costs over 40 years. Pension funding is determined under the unit credit and aggregate frozen liability methods (note I).

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 on tax returns are offset against deferred income taxes to the extent they are applicable to 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 J).

Note B — Change in Method of Accounting for Lease Agreements — The Financial Accounting Standards Board, in Statement No. 13, has issued new criteria for accounting for lease agreements. During December 1977 the company has applied the new lease accounting criteria to their lease agreements and in accordance with Statement No. 13 restated the financial statements and data presented to reflect the prescribed accounting methods. The restatement results from capitalizing certain leases for financial reporting purposes which were previously accounted for under the operating method. The impact on earnings was immaterial for all years presented and therefore reconciliations of previously reported earnings are not presented (note D).

Note C — Long-term Debt — Long-term debt at December 31 consists of the following:

	1977	1976 restated
Quarterly installment notes (a)	$ 64,000,000	$41,000,000
Quarterly installment notes (b)	25,434,000	27,212,000
Quarterly installment notes (c)	5,298,000	12,096,000
Total due banks and insurance companies (d)	94,732,000	80,308,000
Lease obligation (e)	2,772,000	3,636,000
Lease obligation (f)	2,029,000	3,092,000
Lease obligation (g)	1,309,000	1,212,000
Subordinated convertible debentures (h)	690,000	690,000
Sundry	2,513,000	1,411,000
Total long-term debt	104,045,000	90,349,000
Less current maturities (i)	20,410,000	10,282,000
	$ 83,635,000	$80,067,000

(a) Payable in quarterly installments, plus interest, of $2,041,000 during 1978 and 1979, $2,435,000 from February 1980 through May 1984 and $1,921,000 in August and November 1984; interest at ½% above the bank's prime rate; effective interest rate at December 31, 1977 was 8¼% (6½% at December 31, 1976). Through June 1979 the company pays additional interest on 5% of the average quarterly borrowing at the prime rate plus ½%. In January 1978, the credit agreement was increased to a total of $72,000,000.

(b) Payable in quarterly installments of approximately $1,062,000, including interest, during the period April 1, 1977 to October 1, 1986 with interest at 8⅞% on the major portion of this debt; interest on the balance of the debt at ¾% above the bank's prime interest rate; effective rate at December 31, 1977 was 8½% (7½% at December 31, 1976). The notes are guaranteed by the Department of Transportation as to 90% of the unpaid principal and 100% of the unpaid interest.

(c) Payable in quarterly installments, plus interest, of $1,135,000 during January and April and $1,514,000 during July and October 1978; interest at 7%. Two equipment manufacturers have guaranteed certain series of these notes totaling $1,743,000.

(d) Total due banks and insurance companies is collateralized by substantially all flight equipment and spare parts owned by the company. Among the loan convenants are restrictions on dividend payments, capital expenditures, lease obligations, investments, guarantees, additional borrowings and requirements related to minimum working capital and net worth. The company has a commitment to retire 259,511 warrants at $1.50 per warrant within 30 days after the expiration date of October 31, 1979 for any of these warrants not then exercised. These warrants were issued to loan holders in consideration of deferring certain debt repayments (note F). The obligations are being accrued as additional interest expense through 1979.

The company was required to maintain average compensating balances of approximately $3,400,000 and $3,500,000 during 1977 and 1976, respectively, related to borrowing arrangements. The two major

arrangements require the payment of interest at ½% over prime rate on the average compensating balance shortfalls. Interest paid on shortfalls was approximately $5,000 in 1977 and $175,000 in 1976. At December 31, 1977 and 1976 the required compensating balances (adjusted for float) were approximately $3,700,000 and $2,500,000, respectively.

(e) Lease obligation payable in monthly installments of $99,000 including interest at 10% through July 1980 (note D).

(f) Lease obligation payable in monthly installments of $102,000 including interest at 6¼% through September 1979 (note D).

(g) Lease obligation payable representing the present value of the guaranteed residual values to be paid at the expiration of the lease terms during 1978 and 1979 (note D).

(h) Convertible into common shares at $8.55 a share to maturity, June 1, 1978; interest payable each June and December at 5½%.

(i) Current maturities of all long-term debt due in each of the next five years following December 31, 1977 are as follows:

1978	$20,410,000
1979	12,970,000
1980	13,355,000
1981	12,800,000
1982	12,950,000
	$72,485,000

At December 31, 1977, $5,000,000 of unused lines of credit were available for short-term borrowing from several banks; all but one at their prime lending rate.

Note D — Lessee Leasing — The following is a description and financial summary of the company's lessee leasing activities:

Operating Leases: The company has lease commitments for various airport facilities based upon usage and landings, 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. The company leases its main operating base facilities and various hangars from municipal authorities for varying terms with renewal options.

The leases for five DC-9-30 aircraft are related to the prevailing prime interest rate. The actual rent expense exceeded the minimum shown below by $87,000 in 1977 and $140,000 in 1976.

At December 31, 1977, the company's minimum rental commitments, including rental prepayment requirements, under non-cancellable operating leases with initial or remaining terms of more than one year are as follows (in thousands of dollars):

Period	Facilities	DC-9-30 Aircraft	Total
1978	$ 1,805	$2,088	$ 3,893
1979	1,634	2,088	3,722
1980	1,634	2,088	3,722
1981	1,634	1,467	3,101
1982	1,634	490	2,124
1983-2002	22,606	–	22,606
	$30,947	$8,221	$39,168

Total rent expense, including landing fees, was $14,186,000 in 1977 and $12,809,000 (as restated) in 1976.

Capitalized Leases: The company leases nine CV-580 aircraft and various ground property and equipment which are capitalized for financial reporting purposes. An agreement to acquire these aircraft and certain of the ground property and equipment for $6,600,000 in 1978 was completed subsequent to year end.

The following is an analysis of leased property under capital leases included in property and equipment at December 31:

	1977	1976
Flight equipment	$11,250,000	$11,250,000
Ground property and equipment	12,449,000	12,449,000
	23,699,000	23,699,000
Less accumulated amortization	16,437,000	14,058,000
	$ 7,262,000	$ 9,641,000

At December 31 minimum lease payments under capital leases and the present value of the net minimum lease payments are as follows:

	Flight Equipment	Ground Property and Equipment
1978	$ 1,200,000	$ 2,415,000
1979	150,000	2,109,000
1980	–	792,000
Total minimum lease payments	1,350,000	5,316,000
Less amount representing interest	41,000	515,000
Present value of net minimum lease payments	$ 1,309,000	$ 4,801,000

Note E — Commitments — The company has purchase commitments on nine new DC-9-50 aircraft for which it has advanced $11,981,000 and capitalized interest of $432,000. An additional $73,229,000 will be expended by the company in fulfilling these commitments. The purchase agreement calls for delivery of six aircraft during 1978 and three in 1979. The company has arrangements to sell $45,000,000 of 9% Equipment Trust Certificates collateralized by the aircraft to be delivered in 1978.

In January 1978, the company advanced $150,000 on a purchase commitment, which contains an option to cancel prior to September 1978, for three additional DC-9-50 aircraft. If the option to cancel is not exercised, an additional $30,890,000 would be expended prior to delivery of the three aircraft in the fourth quarter of 1979.

Under provisions of the Mutual Aid Agreement, the company would pay struck carriers who are a party to this agreement. The company would receive such payments in the event of a strike by its employees.

Note F — Common Stock — At December 31, 1977, 87,450 shares of unissued common stock are reserved for officers and key employees, under a qualified plan adopted in 1965. An additional 200,000 shares are reserved under a plan adopted in 1975. When options are exercised, the excess of the option price over par value of the shares is credited to additional paid-in capital. The company makes no charges to income in connection with the shares issued under the stock option plan.

Options Outstanding		Option Price and Fair Market Value at Date of Grant				
			December 31, 1977		December 31, 1976	
Year Granted	Year Exercisable	Per Share	Shares	Amount	Shares	Amount
1973	1973	$4.25	7,500	$ 31,875	7,500	$ 31,875
1974	1974	3.375	8,525	28,772	8,525	28,772
1974	1974	2.75	23,925	65,794	23,925	65,794
1974	1975	2.75	45,000	123,750	45,000	123,750
1974	1977	2.75	2,500	6,875	2,500	6,875
			87,450	257,066	87,450	257,066
1975	1979	2.50	95,000	237,500	95,000	237,500
1976	1979	3.875	36,100	139,888	36,100	139,888
			131,100	377,388	131,100	377,388
			218,550	$634,454	218,550	$634,454

notes to financial statements

December 31, 1977 and 1976 (continued)

All options granted expire five years after date of granting. There were 68,900 shares under the 1975 plan available for granting at December 31, 1977.

At December 31, 1977 and 1976 there were outstanding warrants to purchase 2,649,061 shares of common stock. These warrants resulted from public offerings prior to 1973 and from financial transactions as discussed in note C(d). All warrants enable the holder to purchase common stock at $5.50 per share and must be exercised by October 31, 1979.

During January 1978, the Board of Directors declared a $.16 per share dividend payable on March 1, 1978 to shareholders of record on February 16, 1978. The company paid cash dividends of $.12 and $.10 per share to its shareholders during the first quarter of 1977 and 1976 respectively.

Note G — Public Service Revenues — As a local service carrier, the company receives public service revenues for serving small and intermediate size communities which do not generate sufficient traffic to fully support profitable air service. The amount of such payments is determined by the CAB on the basis of its evaluation of the amount of revenue needed to meet operating expenses and provide a reasonable return on investment with respect to eligible routes. The amount so determined is reduced by a portion of the company's earnings on routes not eligible for public service revenue, when these earnings exceed the prescribed maximum return on investment as set by the CAB. The CAB adopted Class Rate VIII effective as of July 1, 1976. It provides for semiannual review of the company's public service revenue rate and has no specified expiration date.

Note H — Mail Revenue — In December of 1977 the CAB issued an order establishing new temporary mail rates in connection with its Domestic Service Mail Rates Investigation. As a result of this order the company has recognized $2,733,000 of additional revenue in 1977. Approximately $1,932,000 of this retroactive amount applies to the period March 28, 1973 through December 31, 1976. The company anticipates the final rates will approximate the temporary rates.

Note I — Pension Costs — Total pension expense was $6,346,000 for 1977 and $5,282,000 for 1976. At January 1, 1977, the latest actuarial valuation date, the total market value of fund assets exceeded the actuarially computed value of vested benefits by $4,270,000 for all plans.

Note J — Income Taxes — Income tax expense for the years ended December 31 (1976 — as restated) consists of the following:

	1977	1976
Current income taxes		
Federal	$6,065,000	$3,489,000
Investment tax credit used in current year	(6,065,000)	(1,757,000)
	–	1,732,000
State and local	745,000	437,000
	745,000	2,169,000
Deferred income taxes		
Federal	1,046,000	1,631,000
Investment tax credit	(898,000)	(961,000)
	148,000	670,000
State and local	111,000	201,000
	259,000	871,000
	$1,004,000	$3,040,000

Income taxes of $1,040,000 in 1977 and $3,040,000 in 1976 (effective rates of 6.8% and 28.4% respectively) are less than those expected to result by application of the federal income tax rate of 48% to income before taxes. The reasons for these differences are:

	1977	1976
Computed "expected" tax expense	$7,056,000	$5,145,000
Increase (decrease) in income taxes		
Investment tax credit utilized	(6,963,000)	(2,718,000)
State and local income taxes net of federal income tax benefit	856,000	485,000
Other	55,000	128,000
	$1,004,000	$3,040,000

Deferred income taxes arise from timing differences between financial and tax reporting. The tax effects of these differences follow:

Increase (decrease) in deferred income tax expense	1977	1976
Capitalized interest	$ 328,000	$ 324,000
Lessor leasing activities	278,000	473,000
Depreciation	(80,000)	690,000
Capitalized leases	195,000	180,000
Training and development	237,000	70,000
Investment tax credit	(898,000)	(961,000)
Other	199,000	95,000
	$ 259,000	$ 871,000

For federal income tax reporting purposes, investment tax credits of $3,482,000 are available to offset future income taxes payable through 1984. Of this amount $2,792,000 has been recognized for financial reporting purposes as an offset to deferred income taxes payable through December 31, 1977.

During the fourth quarter of 1976, the Tax Reform Act of 1976 was enacted into law. The amount of investment credit that could previously be claimed was limited to approximately 50% of the company's tax liability through 1976. Beginning in 1977, a special provision under the new law permits the company to offset their federal tax liability by the following approximate percentages (subject to the availability of sufficient investment tax credits):

Year	Maximum Percentage
1977	100%
1978	100
1979	90
1980	80
1981	70
1982	60
1983 (and later years)	50

The Internal Revenue Service has examined and cleared the company's federal tax returns through December 31, 1974.

Note K — Net Earnings Per Share — Net earnings per share is based on the weighted average number of shares outstanding for the year (12,328,158 in 1977 and 12,164,423 in 1976). Conversion of debentures into common stock, exercise of stock options and warrants to purchase stock would not result in material dilution of net earnings per share for the years ended December 31, 1977 and 1976.

Note L — Selected Financial Data (unaudited) — The unaudited quarterly results of operations for each of the four quarters ended in 1977 and 1976 and the unaudited asset replacement cost information are presented on page 21 of this annual report and are incorporated by reference into this note.

supplemental stockholder information

Quarterly Statement of Earnings

(unaudited — in thousands of dollars)

	1977 Three Months Ended*				1976 Three Months Ended*			
	December 31	September 30	June 30	March 31	December 31	September 30	June 30	March 31
OPERATING REVENUES								
Passenger	$48,319	$51,970	$45,926	$40,426	$41,229	$43,369	$38,677	$33,884
Public service revenues	3,358	3,356	3,231	3,134	3,151	3,415	3,410	3,320
Other	10,250	6,607	6,302	6,244	6,000	4,763	4,998	4,932
	61,927	61,933	55,459	49,804	50,380	51,547	47,085	42,136
OPERATING EXPENSES								
Flying operations and maintenance	25,752	25,432	23,684	22,817	21,921	21,098	20,451	19,821
Other operating expenses	26,733	25,424	23,825	22,331	21,465	20,753	20,044	19,271
Depreciation and amortization	3,838	3,832	3,595	3,325	3,104	3,037	2,867	2,627
	56,323	54,688	51,104	48,473	46,490	44,888	43,362	41,719
OPERATING PROFIT	5,604	7,245	4,355	1,331	3,890	6,659	3,723	417
OTHER EXPENSES (INCOME)—net	1,986	1,721	1,401	(1,273)	1,159	1,014	1,088	709
EARNINGS (LOSS) BEFORE INCOME TAXES	3,618	5,524	2,954	2,604	2,731	5,645	2,635	(292)
Income taxes	297	337	189	181	727	1,653	726	(66)
NET EARNINGS (LOSS)	$ 3,321	$ 5,187	$ 2,765	$ 2,423	$ 2,004	$ 3,992	$ 1,909	$ (226)
NET EARNINGS (LOSS) PER SHARE	$.27	$.42	$.22	$.20	$.16	$.33	$.16	$(.02)
DIVIDENDS PER SHARE	–	–	–	$.12	–	–	–	$ .10

*All of the quarters for 1976 and the first three quarters of 1977 have been restated for the change in accounting for lease agreements in accordance with Financial Accounting Standards Board Statement No. 13 (note B).

STOCKHOLDER'S DISCLOSURE OF OWNERSHIP

The company is required by §245.16 of the Civil Aeronautics Board Economic Regulations to include in its annual report to stockholders the following notice:

(1) Any person who either owns, as of December 31, of the year preceding issuance of such annual report, or subsequently acquires, beneficially or as trustee, more than 5 percent, in the aggregate, of any class of the capital stock or capital of the air carrier, shall file with the Board a report containing the information required by §245.12, on or before April 1, as to the capital stock or capital owned as of December 31, of the preceding year, and in the case of stock subsequently acquired, a report under §245.13, within 10 days after such acquisition or ownership;

(2) any bank or broker covered by (1), to the extent that it holds shares as trustee on the last day of any quarter of a calendar year, shall file with the Board, within 30 days after the end of the quarter, a report in accordance with the provisions of §245.14; and

(3) any person required to report under this subpart who grants a security interest in more than 5 percent of any class of the capital stock or capital of the air carrier shall within 30 days after granting such security interest file with the Board a report containing the information required in §245.15. The notice shall also state that any stockholder who believes that he may be required to file such a report may obtain further information by writing to the Director, Bureau of Operating Rights, Civil Aeronautics Board, Washington, D.C. 20428.

LABOR AGREEMENTS

Among the agreements the airline has with six labor unions, two are to be negotiated in 1978 and four expire in 1979. The company expects to reach equitable agreements with these unions.

FORM 10-K REPORT

For the Form 10-K report to the Securities and Exchange Commission, write to Mr. John P. Dow, Secretary, North Central Airlines, 7500 Northliner Drive, Minneapolis, MN 55450.

STOCK MARKET QUOTATIONS

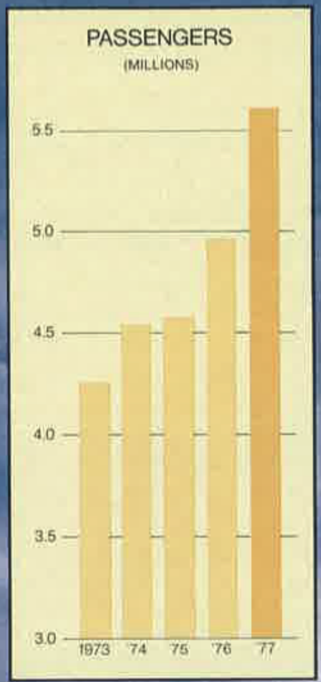
The following tabulation sets forth the price range for the company's common stock which is traded on the New York Stock Exchange and the Midwest Stock Exchange.

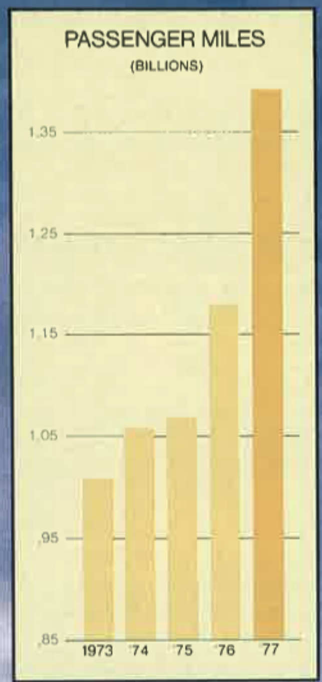
	1977		1976	
	High	Low	High	Low
1st Quarter	4⅛	3⅝	4	2⅜
2nd Quarter	4½	3⅝	3¾	3⅛
3rd Quarter	4½	3⅞	4⅛	3⅛
4th Quarter	5	3⅞	4	3¼

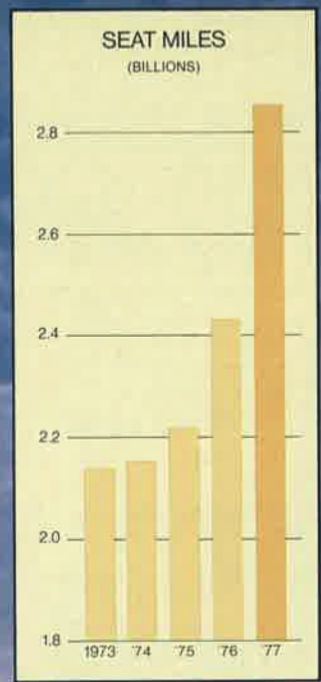
ASSET REPLACEMENT COST (unaudited)

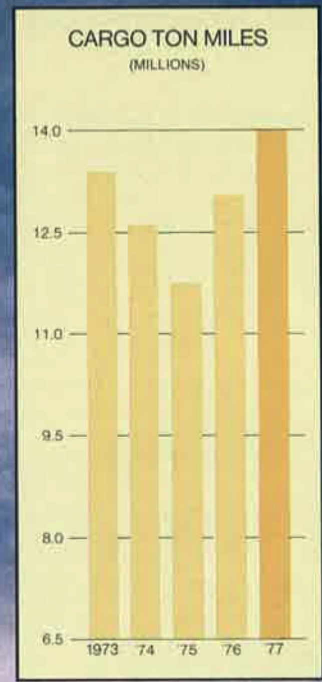
Replacing productive capacity of the airline with assets having equivalent capacity has generally required greater capital investment than was required to purchase the assets being replaced. The additional capital investment principally reflects the cumulative impact of inflation during the relatively long lives of the assets (10 to 15 years in the case of flight equipment).

The company's annual report on Form 10-K contains (1) additional quantitative information with respect to the estimated replacement cost of flight equipment parts and supplies and of property and equipment on December 31, 1977 and 1976, and (2) the related estimated effect of such replacement costs on depreciation expense.









Cosmopolitan Toronto is a popular destination for vacationers who take advantage of North Central tour packages.

five-year summary

EARNINGS*

	1977	1976	1975	1974	1973
OPERATING REVENUES					
Passenger	$186,641,000	$157,159,000	$135,664,000	$124,007,000	$104,279,000
Public service revenues	13,079,000	13,296,000	12,225,000	12,126,000	9,631,000
Other	29,403,000	20,693,000	15,735,000	15,397,000	14,113,000
	229,123,000	191,148,000	163,624,000	151,530,000	128,023,000
OPERATING EXPENSES					
Flying operations and maintenance	97,685,000	83,291,000	73,358,000	57,544,000	46,965,000
Other operating expenses	98,313,000	81,533,000	72,402,000	65,304,000	59,036,000
Depreciation and amortization	14,590,000	11,635,000	10,131,000	9,975,000	9,309,000
	210,588,000	176,459,000	155,891,000	132,823,000	115,310,000
OPERATING PROFIT	18,535,000	14,689,000	7,733,000	18,707,000	12,713,000
OTHER EXPENSES (INCOME)					
Interest expense	7,781,000	5,503,000	4,084,000	4,515,000	4,431,000
Capitalized interest	(832,000)	(843,000)	(757,000)	(341,000)	(142,000)
Interest income and other–net	(409,000)	(501,000)	(540,000)	(1,213,000)	(639,000)
(Gain) loss on disposition of equipment	(2,705,000)	(189,000)	23,000	(16,000)	(51,000)
	3,835,000	3,970,000	2,810,000	2,945,000	3,599,000
EARNINGS BEFORE INCOME TAXES	14,700,000	10,719,000	4,923,000	15,762,000	9,114,000
Income taxes	1,004,000	3,040,000	(328,000)	7,512,000	2,734,000
NET EARNINGS	$ 13,696,000	$ 7,679,000	$ 5,251,000	$ 8,250,000	$ 6,380,000
NET EARNINGS PER SHARE	$1.11	$.63	$.43	$.67	$.51
DIVIDENDS PER SHARE	$ .12	$.10	$.10	$.10	$.05

BALANCE SHEET ITEMS*

	1977	1976	1975	1974	1973
Current assets	$ 51,742,000	$ 40,854,000	$ 34,178,000	$ 38,758,000	$ 34,281,000
Working capital from operations	$ 28,505,000	$ 21,217,000	$ 14,854,000	$ 20,788,000	$ 16,068,000
Property and equipment–net	$158,851,000	$137,410,000	$101,563,000	$ 83,279,000	$ 87,670,000
Total long-term debt	$ 83,635,000	$ 80,067,000	$ 50,124,000	$ 38,194,000	$ 50,154,000
Retained earnings	$ 48,957,000	$ 36,740,000	$ 30,259,000	$ 26,236,000	$ 19,233,000
Stockholders' equity	$ 69,280,000	$ 56,485,000	$ 49,785,000	$ 46,344,000	$ 39,757,000
Shares outstanding	12,328,000	12,178,000	12,098,000	12,312,000	12,463,000
Book value per share	$5.62	$4.64	$4.12	$3.76	$3.19

*The years 1973 through 1976 have been restated for the change in accounting for lease agreements in accordance with Financial Accounting Standards Board Statement No. 13 (note B).

STATISTICS

	1977	1976	1975	1974	1973
Passengers	5,547,000	4,969,000	4,581,000	4,546,000	4,263,000
Passenger miles (000)	1,392,000	1,179,000	1,072,000	1,061,000	1,012,000
Available seat miles (000)	2,861,000	2,444,000	2,235,000	2,151,000	2,139,000
Passenger load factor	48.7%	48.2%	48.0%	49.3%	47.3%
Cargo ton miles	13,998,000	13,052,000	11,703,000	12,585,000	13,394,000
Revenue plane miles	33,343,000	30,810,000	29,748,000	29,055,000	29,422,000
Number of employees	3,850	3,600	3,410	3,360	3,250

Each year, over 23,000 people visit North Central Airlines' General Office and Main Operations Base at Minneapolis/St. Paul.

communications

A new "Summer Sun Times" advertising and sales program is luring leisure travelers to North Central's destinations. Vacationers are invited to tour historical New England via Boston, visit foreign-yet-near Toronto, explore Denver and the Rockies, fish in the Canadian Wilderness, and enjoy exciting New York City.

Brochures, movies and advertisements are telling about special tours and activities in these markets. All materials show that North Central or any travel agent can make complete arrangements.

The summer program is patterned after the highly successful winter promotion that has been in effect for several years. For the 1977-78 ski season, the company produced a new series of TV commercials, a movie entitled "Skiing—Colorado Style", and print ads noting "there's more to Colorado than just skiing". The airline's sales staff again participated in winter sports shows and distributed brochures describing North Central's tour packages and special fares.

To assist travel agents, the company prepared a Denver and Colorado Profile manual containing all the information needed for vacation arrangements. This sales aid, similar to that designed earlier for New York City, is being expanded to include year-round data.

The airline also worked with resorts in the Ironwood/Ashland area to promote skiing. Jointly published brochures extolled the winter wonders of Michigan's Upper Peninsula and North Central's reduced fares from Minneapolis/St. Paul.

For the first time, North Central publicized snowmobiling. In cooperation with a major manufacturer, special package tours were arranged to the "Great American Snowplaces" near Brainerd, Rhinelander and Traverse City. Each location has marked trails, and visitors can rent snowmobiles and suitable clothing.

An extensive and comprehensive advertising campaign introduced the airline's new Detroit-Boston nonstop flights. From December 1976 through March 1977, the quality of North Central's service was highlighted. This message appeared in full-color newspaper, magazine and billboard ads, TV/radio commercials, colorful mail pieces and news releases. Personal sales calls, promotional flights and audio-visual presentations were made. The initial campaign—centered in Detroit and Boston—covered 24 cities. It was followed by a series of ads emphasizing scheduled departure times and convenient direct or connecting flights to destinations west and north of Detroit.

Other major nonstop routes were promoted in Denver, Omaha, Minneapolis/St. Paul and Milwaukee. For intermediate-sized cities, ads pointed out the financial advantage of new "joint fares"—available to passengers who travel with North Central and a connecting airline.

Through 34 news releases to the media in 1977, the general public received timely information about the airline and its service. Monthly statistics were issued on financial and traffic progress; corporate officers held quarterly meetings with the investment community.

For five consecutive years, North Central's annual report has received a citation from *Financial World* magazine. The 1976 edition of this stockholder publication was chosen for a Merit Award. The company also distributes quarterly statements that summarize financial performance and major developments.

Sales personnel made 25,000 calls on travel agencies and corporate traffic offices in 1977 to emphasize the airline's service and encourage suggestions for improvements. Employees participated in 1,800 civic, industry and community functions. In May 1977, North Central hosted the quarterly meeting of the Association of Local Transport Airlines.

The company cafeteria was the site of public events attended by 16,000 persons. A new display area near the cafeteria entrance shows the airline's route system and offers promotional literature to these visitors. Another 7,000 people, including business and civic leaders from various communities, were given guided tours of the company's Twin Cities headquarters.

The Northliner newspaper, a perennial award-winner, is produced monthly for employees. Each issue contains information about the company, its people, and the aviation industry. Supplements to this publication are news briefs in the weekly *Message*, posted bulletins, and communiques sent via ESCORT, the company's electronic communications system.

Now in its tenth year, the *Northliner Magazine* continues to provide quality inflight reading material for passengers. The bimonthly publication carries stories about the company—and people, places and events of general interest.

Throughout North Central's system, many friends of the airline help promote its service. Their generous support is greatly appreciated.

N O R T H   C E N T R A L   A I R L I N E S,   I N C.
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