ANNUAL REPORT 1976

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

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

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

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)

H. P. Skoglund
Investments

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*

REGISTRARS AND STOCK TRANSFER AGENTS:
First National City Bank
New York, New York
Northwestern National Bank of Minneapolis
Minneapolis, Minnesota

STOCK TRADING:
Common stock and warrants traded under symbol NCA

New York Stock Exchange

Midwest Stock Exchange

ANNUAL MEETING:
First Wednesday in April
(April 6, 1977)
Wausau, Wisconsin

AUDITORS:
Alexander Grant & Company

highlights

	1976	1975	Change
OPERATING REVENUES	$ 191,108,000	$ 163,584,000	16.8%
OPERATING PROFIT	$ 14,028,000	$ 7,221,000	94.3
NET EARNINGS	$ 7,447,000	$ 5,224,000	42.6
NET EARNINGS PER SHARE	61¢	43¢	41.9
DIVIDENDS PER SHARE	10¢	10¢	—
WORKING CAPITAL FROM OPERATIONS	$ 19,026,000	$ 12,868,000	47.9
WORKING CAPITAL AT YEAR-END	$ 3,952,000	$ 1,803,000	119.2
RETAINED EARNINGS	$ 37,288,000	$ 31,039,000	20.1
STOCKHOLDERS' EQUITY	$ 57,033,000	$ 50,565,000	12.8
PASSENGERS	4,969,000	4,581,000	8.5
PASSENGER MILES	1,179,144,000	1,071,638,000	10.0
CARGO TON MILES	13,052,000	11,703,000	11.5

about north central

North Central Airlines is a regional scheduled carrier linking intermediate-sized cities with major metropolitan areas. 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 22 years since 1954, when present management was brought in. Its fleet of 54 jet-powered aircraft makes 640 departures a day over the 10,900-mile route system. Efficient passenger handling uses computerized reservations and automated ticketing.

Now in its thirtieth 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 3,600 dedicated employees offer the traveling public the finest type of regional airline service.

to our stockholders, employees and friends:

Excellent results were achieved by North Central in 1976. Net earnings totaled $7,447,000 – among the highest in the company's history – and showed a 43 percent increase over 1975. Records were set with revenues approaching $200 million, and nearly five million passengers carried.

North Central's earnings have averaged over $6 million for the last five years, and the airline has operated profitably for 22 years since 1954 when present management was brought in. This steady financial success has enabled the company to accumulate $37,288,000 in retained earnings – more than any other regional carrier.

After evaluating the airline's financial strength, the Board of Directors declared a cash dividend for the fifth consecutive year. Stockholders of record February 15, 1977, received 12 cents per share of common stock, 20 percent over 1976.

Traffic and fare increases in 1976 helped push revenues ahead 17 percent to $191,108,000. With operating expenses of $177,080,000, up 13 percent, operating profit virtually doubled to $14,028,000. Other expenses, primarily interest on loans to finance new aircraft, rose 56 percent to $3,641,000.

Equipment purchased during 1976 entitled North Central to an investment tax credit. Some of this was used to reduce current income taxes, and the balance will be available for 1977. With $2,940,000 of taxes payable in 1976, the resulting net earnings reached $7,447,000, or $.61 per share. A year earlier, the company had a net tax credit of $340,000 and earned $5,224,000, or $.43 per share.

Stockholders' equity jumped 13 percent to $57,033,000, boosting the book value per share to $4.68. After borrowing $32 million for flight equipment, the airline's debt/equity ratio of 1.35 to 1 is still one of the best in the industry.

Passenger traffic gained 8.5 percent in 1976 as North Central set records by carrying 4,969,000 people, 479,000 in August and over 21,500 on December 23. Passenger miles flown jumped 10 percent to 1.2 billion. Cargo ton miles, improving 12 percent, exceeded 13 million. North Central also achieved the best operating performance in its history. The airline completed 99.4 percent of the 29.4 million scheduled miles, and 86.6 percent of its 223,656 scheduled arrivals were on time.

The company was awarded a new Detroit-Boston nonstop route in 1976 by the Civil Aeronautics Board. Service was inaugurated January 3, 1977, with eight daily flights. Passenger and cargo traffic has been at a profitable level from the start. This segment is expected to produce a $3.2 million operating profit the first year.

North Central is continuing to pursue other route applications involving eight new cities and 8,629 miles. Proceedings are nearing completion in several cases, and CAB action should be forthcoming this year.

The airline serves 90 cities in 14 states and two Canadian provinces on its 10,900-mile route system.

Five new 125-passenger DC-9-50 fan jets featuring the wide-body look were received in 1976, and all are now in scheduled service. Three are being delivered in 1977. By the end of this year, North Central will have 29 DC-9s and 25 Convair 580s in its 54-aircraft fleet. In 1978, another DC-9-50 is available, and the company has an option to buy six more then.

To conserve natural resources, the airline is constantly modifying aircraft operating procedures to reduce fuel consumption. A recently-developed program is designed to save one million gallons of jet fuel in 1977. To protect the environment, North Central has implemented quieter take-off and descent procedures.

Through government-approved Affirmative Action and Equal Employment Opportunity plans, the company is making better use of human talents. Members of both sexes are working in virtually every job category, and more women are in management positions. The airline also conducts several personal development programs.

The company has again benefited from the support of its stockholders, dedicated employees, and loyal passengers and shippers. Their efforts and confidence have significantly contributed to the airline's success.

Prospects for the future are excellent. With new Boston traffic, and the national economy showing moderate growth, revenues should increase substantially.
By maintaining strict cost control and capitalizing on the very favorable terms of the 1976 Tax Reform Act, North Central expects to earn record profits in 1977.

Sincerely,

Hal N. Carr
Chairman of the Board

Bernard Sweet
President and
Chief Executive Officer

March 7, 1977

financial review

North Central dramatically improved its financial performance in 1976 as net earnings jumped 43 percent to $7,447,000. Revenues reached $191,108,000 to set an all-time record.

For the last five years, earnings have averaged over $6 million. The company has operated profitably for 22 years since 1954 when present management was brought in. North Central now has retained earnings of $37,288,000 – more than any other regional airline.

The $191 million in revenues represents a 17 percent gain from the $163,584,000 in 1975. Operating expenses, including depreciation and amortization of $9,676,000, rose 13 percent to $177,080,000 from $156,363,000.

By achieving an operating profit of $14,028,000, the company virtually doubled the $7,221,000 of the previous year. Financing for the purchase of six DC-9-50 jets raised other expenses (primarily interest) to $3,641,000 from $2,337,000. After income taxes of $2,940,000, the net earnings of $7,447,000, or $.61 per share, resulted. For 1975, a $340,000 tax credit was realized, and net earnings were $5,224,000, or $.43 per share.

With the purchase of new flight equipment in 1976, the company generated investment tax credits of $6,361,000. Of this amount, $2,638,000 reduced current and deferred income taxes, and $3,723,000 can be used to lower future taxes. The recent Tax Reform Act permits airlines to offset 100 percent of the tax liability in 1977 with available tax credits, instead of the 50 percent previously allowed.

The $37.3 million in retained earnings enabled North Central to finance the new DC-9s with favorable interest rates. Long-term debt was increased by $32 million to $86 million, including a loan guaranteed by the Federal Government which was placed with several financial institutions. The airline sold five Convair

580s—two for delivery in 1976 and three in 1977—and the proceeds are helping finance new aircraft.

Profitable operations for over two decades, with higher earnings in the last five years, have put the company in the strongest financial condition in its history. Considering these factors, the Board of Directors raised the annual cash dividend 20 percent to $.12, payable to stockholders of record February 15, 1977.

North Central is the only regional airline that has paid a cash dividend in each of the last five years.

Some 12,177,718 shares of common stock were outstanding at the end of 1976, and another 285,034 were in treasury stock. With stockholders' equity at a record $57,033,000, book value has reached $4.68 per share.

North Central is capitalizing on its expertise, equipment and facilities to derive income from activities other than airline service. This diversification generated $2,000,000 in revenues for 1976. The company leases computers and aircraft, sells computer and flight simulator time, and provides catering from the Flight Kitchen.

Trends in financial performance and traffic growth from 1972-1976 are summarized on Page 23. Quarterly statements of earnings for the last two years and stock quotations are carried on Page 21.

North Central is financially sound, and prospects for the future are particularly good. Traffic gains and fare increases should boost revenues. The new DC-9-50s offer operating economies, strict cost control will hold down expenses, and a substantial tax credit is available. With these favorable conditions, the company is anticipating record earnings for 1977.

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 $27.5-million revenue gain for 1976 is attributable to several factors. The upturn in the economy stimulated traffic and raised passenger revenues by $11.4 million. To meet rising costs, the Civil Aeronautics Board granted fare increases worth $10.1 million. A revised formula for calculating public service revenues, paid to the company for providing air service to small communities, added $1.1 million. The balance of revenue growth came from cargo business, up 24 percent, and charter activity, which jumped 48 percent.

VARIANCE ANALYSIS

	Net Changes 1976-1975	Net Changes 1975-1974
NET EARNINGS		
1976	$ 7,400,000	
1975	5,200,000	$ 5,200,000
1974		8,200,000
Change in net earnings	$ 2,200,000	$ (3,000,000)
MAJOR FACTORS OF CHANGE:		
Operating revenues		
Passenger miles	$11,400,000	$ 1,400,000
Passenger fares	10,100,000	10,300,000
Public service revenues	1,100,000	100,000
Cargo and other revenues	4,900,000	300,000
Net revenue changes	27,500,000	12,100,000
Operating expenses		
Labor and employee benefits	10,200,000	7,700,000
Cost of aircraft fuel	3,400,000	9,200,000
Parts, supplies and services	2,300,000	1,700,000
Landing fees and rent	1,700,000	800,000
Passenger service and promotion	1,300,000	600,000
Mutual Aid payments	(1,100,000)	800,000
Other expenses	1,400,000	1,900,000
Depreciation	1,500,000	200,000
Net expense changes	20,700,000	22,900,000
Change in operating profit	6,800,000	(10,800,000)
Nonoperating income and expense		
Interest income and other	300,000	(700,000)
Interest expense	1,600,000	(700,000)
Income taxes	3,300,000	(7,800,000)
Net nonoperating changes	4,600,000	(7,800,000)
Change in net earnings	$ 2,200,000	$ (3,000,000)

Inflation escalated operating expenses although not quite as rapidly as in 1975. Total expenses rose $20.7 million, compared with $22.9 million the previous year.

Labor and employee benefits increased $10.2 million, or 15 percent, due mainly to higher wages and greater pension and insurance costs. The 3,600 people on the payroll represent a five percent gain over 1975.

Jet fuel costs were up another $3.4 million, after soaring $9.2 million the year before. Inflation also raised prices for landing fees, parts, services, and supplies. Mutual aid payments to other carriers dropped because 1976 was relatively free of strikes in the airline industry.

The climb in depreciation and interest is directly related to the acquisition of six new DC-9-50 jet aircraft.

Even after utilizing maximum allowable investment tax credits, the company incurred $3.3 million more income tax expense in 1976. This jump is due to increased earnings. In 1975, the company had a net tax credit.

The combined effect of all these factors was the substantial $2.2-million improvement in net earnings for 1976.

traffic growth and performance

Passenger traffic reached record levels in 1976. North Central carried nearly five million people, with almost a half-million in its busiest month, and established a new single-day high.

The airline boarded 4,969,264 passengers for the year, an 8.5 percent gain over the 4,580,521 in 1975. Each month's traffic bettered the corresponding period in any previous year. The 478,727 travelers carried in August and the 21,520 on December 23 broke company records. The airline flew 1.2 billion passenger miles in 1976, a 10 percent jump from the 1.1 billion the year before.

On July 2, the company reached another milestone by carrying its 50-millionth passenger since operations began on February 24, 1948. The event was marked with ceremonies at Grand Rapids.

Charter business increased 48 percent with relaxed government regulations and new reduced-rate night charters. The 74,257 passengers on 565 flights flew to such places as the Caribbean, Mexico and northern Canada. To accommodate 32,627 passengers at peak demand travel periods, the airline operated 1,012 extra sections of scheduled flights.

Cargo ton miles showed a substantial rise after a two-year decline. The 13,052,226 ton miles flown in 1976 reflect a 12 percent improvement from 11,703,151 a year earlier. Freight and express increased 10 percent, while mail was up 16 percent. The number of shipments climbed 24 percent to 553,974 from 448,449.

North Central proved the dependability of its service by completing 99.4 percent of the 29,392,907 scheduled miles— another record— and the company has averaged 99 percent over the last 19 years.

This high level of performance ranks near the top in the entire airline industry, despite the adverse weather conditions that plague North Central's operations for many months. The airline also reached a new high with 86.6 percent of its 223,656 scheduled arrivals on time.

Flight crews, ground personnel and maintenance all contribute to this outstanding performance. Pilots and Flight Control work closely with maintenance, station and passenger service people to insure the best operation possible when weather, air traffic control or other factors prevent routine flights. Rescheduling aircraft and crews, rerouting passengers and luggage, and communicating changes are among the activities to be handled.

SCEPTRE, a new computerized maintenance aid developed by company personnel, helped mechanics keep the fleet airworthy; only one-tenth of one percent of departures were cancelled for maintenance reasons, and 1.4 percent were delayed by mechanicals.

Competence and sound judgment are vital to the company's efforts to provide safe, dependable airline service. North Central is proud of its employees who consistently demonstrate their dedication.

Captain Bill Hannon (left) greets Jack Parker (right) and his family at Grand Rapids. Parker was the 50-millionth passenger to fly North Central since the airline began scheduled operations in 1948.

social action programs

By continuing to develop existing programs and enacting new ones, North Central again demonstrated that it cares about its employees, the cities it serves and the environment.

Working within Affirmative Action plans approved by the Federal Aviation Administration and the Office of Federal Contract Compliance, the company increased its minority employee population by nine percent in 1976, while total ranks grew five percent. Women hold 39 management positions, 22 percent over the previous year, and members of both sexes are now working in virtually every job category.

To insure that minorities and women are aware of the airline's long-standing policy of promotion from within, these people were given an opportunity to complete an "Individual Profile" summarizing education, training and work experience. When job openings occur, this data is compared with the qualifications needed, and personnel meeting them are referred to the particular department for consideration.

A booklet containing equal employment and affirmative action information was distributed to all employees. It describes the company policy and how it affects each person.

Recruiting is centered in communities the airline serves. Industrial Relations personnel have made appearances at high schools and colleges, and career counselors have toured North Central facilities to gain a better understanding of job requirements.

Conservation of natural resources and protection of the environment remain major corporate objectives. For several years, North Central has been implementing fuel-saving and noise-abatement measures.

By using its $1.8-million DC-9 digital flight simulator for pilot training, the company saved 600,000 gallons of jet fuel in 1976. Also, the U.S. Air Force, Federal Aviation Administration and another airline buy time on the simulator, keeping it busy over 13 hours a day.

For 1977, company pilots hope to save one million gallons of jet fuel. Flight Operations has prepared a new Fuel Management manual which emphasizes that minor adjustments in cruise speed, altitude, taxi time, fuel loads and flap settings have a cumulative effect on fuel consumption.

Revised noise-abatement take-off and descent procedures, which also save fuel, were recently implemented by member-carriers of the industry's Air Transport Association. North Central actively participated in the development of these techniques and others involving lower power and flap settings, which produce quieter flights with operational economies.

Flight Superintendent Mike Carew reviews weather conditions with pilots. From left are Captain Bill Banks, First Officer Joe Moore, Captain Chuck Timberg, First Officer Barbara Wiley.

The company has invested in aircraft deicing equipment offering more efficient use of petroleum-base fluids. To conserve heating oil, building thermostats are turned down to 60 degrees in off-hours. Since 1973, more discriminate use of lighting at the airline's headquarters has curtailed electricity requirements by three million watts yearly.

Over 146,500 pounds of used paper were salvaged for recycling in 1976. In less than three years, the company's "Waste Not" program has recovered 495,000 pounds of paper.

Demonstrating concern for its personnel, North Central is helping chemically dependent employees and family members through professional education and treatment under company-paid insurance. Reaction to the program is very favorable, and direct benefits have been far-reaching.

Active corporate and individual memberships are maintained in many civic and social development organizations. North Central people are involved in such groups as the National Urban League, National Alliance of Businessmen, Kiwanis, Lions, Better Business Bureau and the National Society of Consumer Affairs Professionals.

A new management development program was begun in 1976 to achieve better communications and more effective leadership. Group meetings were designed to build understanding between people and departments. Special training is also provided for newly-promoted supervisors. Future seminars will expand the initial series of lectures and workshops.

North Central is constantly seeking new and improved ways to be a sensitive employer and responsible corporate citizen.

new facilities and services

The introduction of DC-9-50 fan jets on April 25, 1976, marked another major step in North Central's continuing flight equipment modernization program.

Passengers found a completely new decor with a wide-body look, featuring enclosed overhead compartments for carry-on items, more legroom, dramatic cabin lighting, and a coordinated aqua, blue and gold color scheme.

The first three 125-passenger jets initially served 19 cities on the airline's system. Later in the year, two more DC-9-50s were delivered, and flights started on January 3, 1977. The five new aircraft reduce operating cost per seat mile, and also permit the company to substantially upgrade service by using 100-passenger DC-9-30 jets to replace Convair 580 prop-jets at 26 cities.

North Central has 54 aircraft in its fleet, including 26 DC-9s and 28 Convair 580s. Three additional DC-9-50 jets will be received in 1977, replacing three Convairs sold for delivery this spring. In 1978, the DC-9-50 leased to another carrier will be returned, and the company has an option to purchase six more that year.

Many of the company's facilities throughout the system were improved during 1976. At Detroit Metropolitan Airport, passenger comfort and convenience were greatly enhanced by major remodeling and expansion. North Central now has three new jetways, a larger passenger service counter, and seven spacious, fully-carpeted gate areas to accommodate more travelers. Operations and administrative offices were renovated, and a commissary was added.

In Milwaukee, walking distance to the gate area is being cut in half with construction of a pedestrian overpass. In addition, the expansion program includes new and larger passenger service counters, another jet bridge, and improved air freight and office areas.

Gate and counter facilities were remodeled at Minot, Sioux City, Columbus and Traverse City. New counters were installed at Boston, LaCrosse and Saginaw/Bay City/Midland. Airport terminal construction was completed at Sault Ste. Marie, Iron Mountain/Kingsford, and is planned for Rhinelander/Land O'Lakes. Thunder Bay is considering enlarging its passenger area.

Greater identity for North Central skycaps at Chicago was achieved with new blue uniforms, highlighted by easily-recognized blue and green hats. A suit is worn by men, while women have slacks with matching jacket, vest and complementary blouse. Each skycap has a portable paging receiver for direct inter-terminal communication.

Passengers are now receiving faster ticketing service and fare quotes. Over 85 percent of this activity is handled automatically by the computerized "Quick Ticket."

Flight Attendant Carolyn Anderson puts carry-on items in the enclosed overhead compartment, one of the convenience features on the new DC-9-50 fan jet.

Any passenger with advance reservations can have a machine-printed ticket in ten seconds.

Priority air express service, introduced by North Central in 1976, enables shippers to send goods on a specific flight of their choosing. For "VIP" (Very Important Package) pickup and delivery of small packages, a new toll-free phone number is now available.

Detroit now has spacious, fully-carpeted gate areas. In the foreground are Passenger Service Agents Preston Bilberry and Karl Mercer.

social action programs

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North Central is constantly seeking new and improved ways to be a sensitive employer and responsible corporate citizen.

Through ESCORT, the airline's $8-million electronic reservations and communications system, preparation of complicated travel itineraries was simplified by an improved display of flight schedules for reservationists.

At the Milwaukee airport, a new "Mini-Computer" is serving as an information center for North Central passengers. The TV-like console gives travelers access to ESCORT's weather and flight arrival data for Milwaukee.

A Fuel Inventory Management System, designed for ESCORT, was developed to monitor the use of jet fuel—which costs about $77,000 a day. The data aids analysis of aircraft and schedule characteristics that produce higher than normal fuel consumption. Also, availability of fuel at North Central cities is quickly determined so refueling stops can be planned efficiently.

A unique deicing system conceived by company personnel is being field-tested in Grand Rapids. From hydrants connected to a 2,000-gallon supply tank in the terminal, an electrically-heated and pumped solution is sprayed on aircraft by one agent working from a lift basket he alone controls. Compared with other methods, this approach costs less initially, is more reliable, saves fluid and reduces man-hours. The airline has purchased deicing vehicles at Minneapolis/St. Paul and converted other units at Detroit, Milwaukee and Chicago.

Working with manufacturers, North Central modified the autopilot system on all DC-9-30s to match that on the DC-9-50. Also, new computerized equipment was acquired for testing overhauled autopilots. In addition, installation of improved solid-state electronic distance measuring equipment for navigation has been completed on the entire DC-9 fleet.

Maintenance economies were realized with the expansion of SCEPTRE, the company-developed computer system with corporate information as its base. Hundreds of thousands of supplies and aircraft parts were cataloged into SCEPTRE so ordering from inventory can now be accomplished with a computer entry. SCEPTRE also provides real-time data on components and parts, maintenance forecasts, work completed, aircraft flying times, and pilot reports on aircraft.

Maintenance information, which is continually updated, can be displayed on TV-style receivers or hard-copy printers. A mechanic, inspector, pilot, flight superintendent, or engineer can extract aircraft information from SCEPTRE at any of 150 locations—line maintenance bases, overhaul shops, stock rooms, and station operations offices.

In 1976, the company initiated a program to issue an Individual Benefit Statement to each employee annually. The Industrial Relations Department produces the statement from personnel data within SCEPTRE. The system allows continuous updating of employee information.

To feature the nation's Bicentennial, favorite dishes of "Great Colonial Inns" were offered on selected flights. Recipes came from restaurants dating back 200 years or more.

Employees helped reduce costs and increase efficiency through the company's incentive suggestion program. Cash awards totaling $4,200 were made to 72 people for ideas implemented during 1976.

In its efforts to provide quality service to passengers and shippers, North Central constantly strives to improve every phase of its operation.

Agent Darlene Lalich assists a passenger in using the flight information "Mini-Computer" at Milwaukee.

National advertising by IBM featured SCEPTRE, the company's computerized maintenance program. This photo of Supervisor Jim Jilek was in the ad.

route development

Boston is the newest city on North Central's system. Nonstop Detroit-Boston service was inaugurated January 3, 1977, and the airline is operating eight daily flights with 100-passenger DC-9 fan jets.

The Detroit-Boston route was authorized by the Civil Aeronautics Board in a decision issued October 4. The 632-mile segment is the most significant addition since Milwaukee-New York nonstops began in 1970. The CAB estimates that the company will carry 110,000 Boston passengers the first year, and realize an operating profit of $3.2 million.

All eight flights originate or terminate in cities west and north of Detroit. Passengers from Lansing, Grand Rapids, Saginaw/Bay City/Midland, Alpena, Escanaba, Marquette, South Bend, Green Bay/Clintonville, and Chicago can fly to Boston without changing planes. Thirty other Upper Midwest cities have convenient Boston connections on North Central.

Including Boston, North Central serves 90 cities in 14 states and two Canadian provinces on its 10,900-mile route system.

CHICAGO-NEW ORLEANS NONSTOP

In March 1976, a Civil Aeronautics Board administrative law judge selected North Central to provide new Chicago-New Orleans nonstops. In October, the Board instituted a discretionary review without oral argument. The CAB order issued February 11, 1977, favored another carrier, and North Central is appealing that decision.

The company is proposing six daily nonstops, with each flight originating or terminating in cities north of Chicago. Eight would have direct service to New Orleans, and 31 would have single-carrier connecting flights. North Central would carry 115,000 Chicago-New Orleans passengers and earn a $2.2-million operating profit the first year. The 837-mile route is nearly 100 miles longer than any segment now flown by the airline.

DETROIT-BALTIMORE NONSTOP

The State of Maryland and North Central have jointly asked the CAB for a Show Cause order permitting an early introduction of Detroit-Baltimore nonstops by the airline. The petition, filed in February 1977, noted that the Board first cited the need for service 17 years ago. Since then, traffic has increased, and only one nonstop operates in each direction. The parties requested an expedited hearing as an alternative to the Show Cause order.

North Central is proposing four flights daily with DC-9 fan jets. The airline estimates it would carry more than 70,000 passengers on the 409-mile route and earn a $1.2-million operating profit the first year. Ten Midwest cities would receive single-plane service, and over 25 others would have convenient, single-carrier connections.

MIDWEST-ATLANTA

North Central is asking for Detroit-Atlanta and Cincinnati-Atlanta nonstops. The two routes, totaling 968 miles, would generate $20 million in revenues and produce a $5.8-million operating profit. In January, 1977, the law judge issued an initial decision recommending another carrier for both routes. North Central will appeal the matter to the Board.

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

Hearings were held in October 1976, and an initial decision is pending. North Central 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. Benefiting a potential 71,000 passengers the first year, North Central would realize a $1-million operating profit.

MILWAUKEE-DENVER ONE-STOP

North Central is asking for single-plane authority between Milwaukee and Denver, via Minneapolis/St. Paul or Madison. Passengers are now required to change planes in the Twin Cities. The CAB denied the company's 1976 request for expedited hearings on nonstop service. The Madison-Denver segment would add 828 new route miles.

OMAHA-DALLAS/FT. WORTH, KANSAS CITY-DALLAS/FT. WORTH NONSTOPS

In February 1976, the company applied for two new nonstops to Dallas/Ft. Worth from Omaha and Kansas City (1,043 miles). By adding these segments, single-carrier service would be provided through Kansas City or Omaha from 19 cities in Iowa, Nebraska, Minnesota and the Dakotas. The CAB law judge has recommended another carrier on the Kansas City route, and Board action is pending on the Omaha case.

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 available 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)

COLUMBUS, DAYTON, CINCINNATI-PHILADELPHIA NONSTOPS

The company is awaiting the CAB administrative law judge's initial decision based on hearings held in October 1976. As part of the Ohio/Indiana Points Nonstop Service Investigation, North Central asked to serve Philadelphia from Columbus, Dayton and Cincinnati. (1,389 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)

DETROIT-MONTREAL, VIA TORONTO

This authority was requested under an amendment to the 1966 Bilateral Air Transport Agreement between the United States and Canada, and a hearing is expected in 1977. North Central could also offer single-plane service from Minneapolis/St. Paul and Milwaukee to Montreal. The amendment authorizes Detroit-Montreal flights by a U.S. carrier after 1978. (315 miles)

MILWAUKEE, DULUTH/SUPERIOR-WINNIPEG NONSTOPS

North Central is seeking permanent authority to Winnipeg, with certain restrictions lifted from its temporary certificate. If approved, the airline could fly nonstop from Duluth/Superior and Milwaukee. In addition, one-stop service could be offered from the Twin Cities, Chicago and several other points with no change of planes. Hearings are scheduled for March 15.

SUMMARY

Pending applications would add eight new cities and 8,629 miles to North Central's route system.

the future

North Central sees real opportunities for further growth and development in 1977—its 30th year of scheduled operation. The three most significant factors affecting the future will be route development, the national economy and regulatory reform.

New Detroit-Boston nonstops began January 3, 1977. These have been operating profitably since service was inaugurated, and traffic should increase in the coming months. This route is expected to generate $10 million in revenues and produce an operating profit of $3.2 million the first year.

Boston is an international gateway to Europe. It is a good business market and also offers attractions for the lucrative, leisure-travel field. The company's passenger traffic is now 27 percent pleasure-oriented, and efforts are being made to boost that share while still attaining growth in business travel.

The airline also feels it has an excellent chance of being awarded other routes now under consideration by the Civil Aeronautics Board.

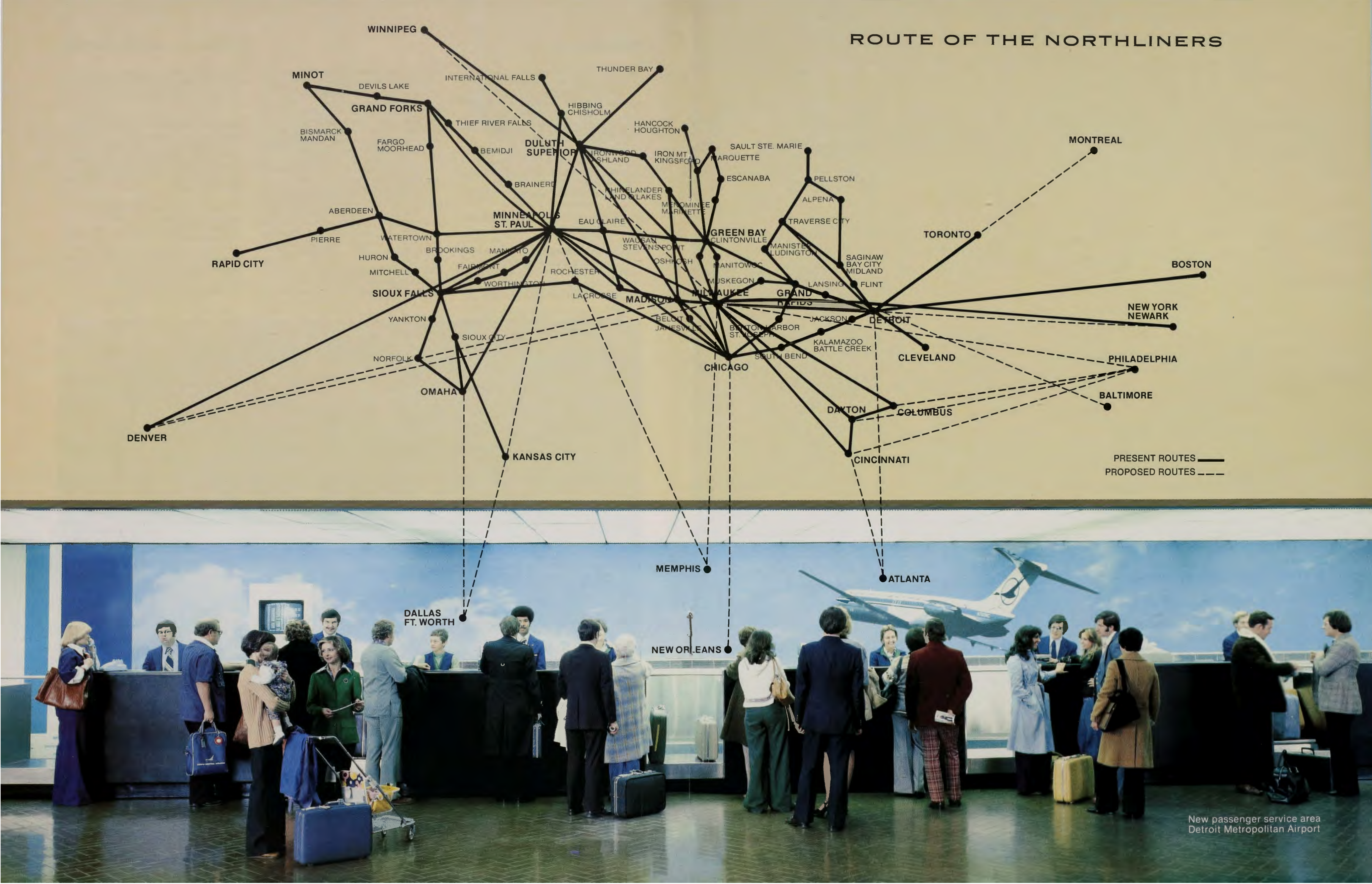
According to most leading indicators, the national economy should have moderate growth in 1977. On that assumption, and adding traffic from new routes, North Central anticipates passenger and cargo gains of approximately eight percent. Any fare increases will be closely tied to rising costs—particularly fuel and wages.

Two labor contracts are to be negotiated in 1977, and the four others extend into the next year or beyond. The company has never had a work stoppage, and expects to reach equitable agreements with all unions.

While Congress is considering some degree of regulatory reform in the airline industry, the end result cannot be predicted. The company favors more flexibility in setting fares and expedited procedures for granting routes.

The success of any company ultimately hinges on its ability to maintain strict cost control and achieve maximum productivity. North Central will continue to meet these requirements, while providing safe, dependable airline service. The company forecasts a substantial profit again in 1977.

North Central flights to Boston-Logan International Airport arrive at the North Terminal (center), and passengers use the left concourse. Service began January 3, 1977. The city of Boston is in the background.



New passenger service area
Detroit Metropolitan Airport

NORTH CENTRAL AIRLINES, INC.

balance sheet

	December 31	
	1976	1975
ASSETS		
CURRENT ASSETS		
Cash (note B)	$ 9,034,000	$ 3,555,000
Accounts receivable, less allowances	19,045,000	19,277,000
Flight equipment parts and supplies (notes A and B)	5,500,000	4,791,000
Prepaid expenses and other (note A)	8,433,000	7,610,000
	42,012,000	35,233,000
PROPERTY AND EQUIPMENT — at cost (notes A, B and E)		
Flight equipment	153,815,000	104,192,000
Ground property and equipment	19,258,000	17,648,000
Improvements to leased property	5,388,000	5,145,000
	178,461,000	126,985,000
Less accumulated depreciation	51,440,000	44,005,000
	127,021,000	82,980,000
Advance payments on equipment	4,919,000	11,154,000
	131,940,000	94,134,000
DEFERRED CHARGES AND OTHER ASSETS		
Unamortized development and preoperating costs (note A)	1,585,000	1,473,000
Rentals and other (notes A, C and D)	2,136,000	3,303,000
	3,721,000	4,776,000
	$177,673,000	$134,143,000
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES		
Current maturities of long-term debt (note B)	$ 9,068,000	$ 7,581,000
Trade accounts payable	7,825,000	5,472,000
Interline payables and tickets outstanding (note A)	10,039,000	9,370,000
Accrued compensation and other expenses	10,850,000	10,754,000
Income taxes (notes A and J)	278,000	253,000
	38,060,000	33,430,000
LONG-TERM OBLIGATIONS		
Long-term debt — less current maturities (note B)	76,976,000	45,909,000
Deferred income taxes (notes A and J)	4,705,000	3,939,000
Other	899,000	300,000
	82,580,000	50,148,000
COMMITMENTS AND CONTINGENCY (notes D, E and F)	—	—
STOCKHOLDERS' EQUITY (notes B and G)		
Common stock — authorized 16,000,000 shares of $.20 par value	2,493,000	2,493,000
Additional paid-in capital	18,056,000	18,032,000
Retained earnings	37,288,000	31,039,000
Treasury stock — at cost	(804,000)	(999,000)
	57,033,000	50,565,000
	$177,673,000	$134,143,000

The accompanying notes are an integral part of this statement.

statement of earnings

	Years ended December 31	
	1976	1975
OPERATING REVENUES		
Passenger (note A)	$157,159,000	$135,664,000
Freight and express	11,200,000	8,531,000
Public service revenues (note H)	13,296,000	12,225,000
Mail (notes A and F)	2,347,000	1,996,000
Non-scheduled service and other	7,106,000	5,168,000
	191,108,000	163,584,000
OPERATING EXPENSES		
Flying operations	57,363,000	50,342,000
Maintenance	27,392,000	24,330,000
Aircraft and traffic servicing	43,893,000	38,481,000
Passenger service	10,979,000	9,873,000
Promotion and sales	17,178,000	14,933,000
General and administrative	9,638,000	8,322,000
Other transport-related expenses	961,000	1,910,000
Depreciation and amortization (note A)	9,676,000	8,172,000
	177,080,000	156,363,000
Operating profit	14,028,000	7,221,000
OTHER EXPENSES (INCOME)		
Interest expense	5,174,000	3,611,000
Less interest capitalized (note A)	843,000	757,000
	4,331,000	2,854,000
Interest income and other — net	(690,000)	(517,000)
	3,641,000	2,337,000
Earnings before income taxes	10,387,000	4,884,000
INCOME TAXES (notes A and J)		
Current	2,169,000	172,000
Deferred	771,000	(512,000)
	2,940,000	(340,000)
NET EARNINGS	$ 7,447,000	$ 5,224,000
NET EARNINGS PER SHARE (note K)	$ .61	$ .43

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 1976	1975
SOURCES		
From operations		
Net earnings	$ 7,447,000	$ 5,224,000
Charges (credits) to earnings not using (providing) working capital		
Depreciation and amortization	9,676,000	8,172,000
Deferred income taxes	766,000	(928,000)
Other	1,137,000	400,000
Working capital provided from operations	19,026,000	12,868,000
Proceeds in excess of gain from property and equipment dispositions	1,675,000	51,000
Increase in long-term debt	41,102,000	34,531,000
Reduction of rentals and other	1,488,000	1,138,000
	63,291,000	48,588,000
APPLICATIONS		
Additions to property and equipment	49,283,000	28,051,000
Reduction of long-term debt	10,035,000	21,255,000
Payment of cash dividend	1,198,000	1,229,000
Additions to deferred charges	626,000	527,000
Purchase of treasury stock	—	582,000
	61,142,000	51,644,000
INCREASE (DECREASE) IN WORKING CAPITAL	2,149,000	(3,056,000)
Working capital at beginning of year	1,803,000	4,859,000
Working capital at end of year	$ 3,952,000	$ 1,803,000

NET CHANGE IN WORKING CAPITAL ELEMENTS	1976	1975
Increase (decrease) in current assets		
Cash and short-term investments	$ 5,479,000	$ (11,250,000)
Accounts receivable	(232,000)	4,513,000
Flight equipment parts and supplies	709,000	768,000
Prepaid expenses and other	823,000	2,580,000
Net change in current assets	6,779,000	(3,389,000)
Increase (decrease) in current liabilities		
Current maturities of long-term debt	1,487,000	(819,000)
Trade accounts payable	2,353,000	(1,116,000)
Interline payables and tickets outstanding	669,000	1,180,000
Accrued compensation and other expenses	96,000	2,601,000
Income taxes	25,000	(2,179,000)
Net change in current liabilities	4,630,000	(333,000)
INCREASE (DECREASE) IN WORKING CAPITAL	$ 2,149,000	$ (3,056,000)

The accompanying notes are an integral part of this statement.

statement of changes in stockholders' equity

Years ended December 31, 1976 and 1975

	Common Stock		Additional Paid-In Capital	Retained Earnings (note B)	Treasury Stock	
	Shares Issued	Amount			Shares Held	Amount
Balance at January 1, 1975	12,462,752	$2,493,000	$18,032,000	$27,044,000	150,900	$417,000
Cash dividend (note G)	—	—	—	(1,229,000)	—	—
Purchase of treasury stock	—	—	—	—	213,900	582,000
Net earnings for the year	—	—	—	5,224,000	—	—
Balance at December 31, 1975	12,462,752	2,493,000	18,032,000	31,039,000	364,800	999,000
Cash dividend (note G)	—	—	—	(1,198,000)	—	—
Disposition of treasury stock	—	—	24,000	—	(79,766)	(195,000)
Net earnings for the year	—	—	—	7,447,000	—	—
Balance at December 31, 1976	12,462,752	$2,493,000	$18,056,000	$37,288,000	285,034	$804,000

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, 1976 and 1975, 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, 1976 and 1975, 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.

Alexander Grant & Company

Minneapolis, Minnesota
February 11, 1977

notes to financial statements

December 31, 1976 and 1975

Note A—Summary of Significant Accounting Policies—The company 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 ($873,000 in 1976 and $675,000 in 1975) 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 ($3,890,000 in 1976 and $3,010,000 in 1975). 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 $461,000 in 1976 and $317,000 in 1975. For income tax reporting purposes, interest is expensed in the current period.

Capitalized Leases: The company capitalizes, for both financial reporting and tax purposes, leased facilities where the terms of the lease result in the creation of a material equity in the property accruing to the company. In November 1976 the Financial Accounting Standards Board issued its Statement No. 13 entitled "Accounting for Leases" which establishes new standards of financial accounting and reporting for leases to be effective for years ending after December 31, 1976. While this statement is not effective for 1976, management is currently examining its lease obligations to determine what effect, if any, this statement might have on future financial statements of the company.

Depreciation: Depreciation is provided for in amounts sufficient to relate the cost of depreciable assets to operations over their estimated service lives on a straight line basis for financial reporting purposes. The straight line method of depreciation is also followed for substantially all assets for tax reporting purposes, but accelerated methods are used for selected assets acquired in 1976. Flight equipment is being depreciated to 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 from five to eight 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 carryover periods. The company recognizes deferred income taxes resulting from differences in financial and income tax reporting (note J).

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

	1976	1975
Quarterly installment notes (a)	$12,096,000	$19,014,000
Quarterly installment notes (b)	41,000,000	28,700,000
Quarterly installment notes (c)	27,212,000	—
Total due banks and insurance companies (d)	80,308,000	47,714,000
Lease obligation (e)	3,636,000	4,418,000
Subordinated convertible debentures (f)	690,000	690,000
Semi-annual subordinated notes (g)	—	300,000
Sundry	1,410,000	368,000
Total long-term debt	86,044,000	53,490,000
Less current maturities (h)	9,068,000	7,581,000
	$76,976,000	$45,909,000

(a) Payable in quarterly installments of $1,296,000 plus interest during January and April and $1,728,000 plus interest during July and October through 1978; interest at 7%. Two equipment manufacturers have guaranteed certain series of these notes totaling $3,980,000.

(b) The company has established credit agreements with banks for loan commitments in the amount of $58,000,000. At December 31, 1976 the company had borrowed $41,000,000 under the agreement with interest only payable quarterly during 1977; principle is payable in quarterly installments of $2,000,000 plus interest during 1978 and 1979 and $1,389,000 plus interest quarterly from February 1980 through May 1984; interest varies from ¼ to ½% above the banks' prime rate; effective interest rate at December 31, 1976 was 6½% (7½% at December 31, 1975). The agreement requires a loan commitment fee of ½% per year on the unused portion.

(c) 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 banks' prime interest rate; effective rate at December 31, 1976 was 7½%. The notes are guaranteed by the Department of Transportation as to 90% of the unpaid principal and 100% of the unpaid interest.

(d) Total due banks and insurance companies is collateralized by substantially all flight equipment and spare parts owned by the company. Among the loan covenants 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 G). The obligations are being accrued as additional interest expense through 1979.

The company was required to maintain average compensating balances of approximately $3,500,000 and $2,900,000 during 1976 and 1975, respectively, related to borrowing arrangements. The arrangements principally require the payment of interest at ½% over prime rate on the average compensating balance shortfalls. Interest paid on shortfalls was approximately $175,000 in 1976 and $100,000 in 1975. At December 31, 1976 and 1975 the required compensating balances (adjusted for float) were approximately $2,500,000 and $3,500,000, respectively.

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

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

(g) Debt was retired in March 1976. Stock purchase warrants issued in connection with this debt enable the holders to purchase a total of 200,000 common shares through October 31, 1979 (note G).

(h) Current maturities of all long-term debt due in each of the next five years following December 31, 1976 are as follows:

1977	$ 9,068,000
1978	18,660,000
1979	11,401,000
1980	8,801,000
1981	8,245,000
	$56,175,000

At December 31, 1976, $4,500,000 of unused lines of credit were available for short-term borrowing from several banks principally at their prime lending rate.

Note C—Lessor Leasing Activities—Investments in leased equipment accounted for under the finance method, including residual values, totaled $958,000 and $1,338,000 at December 31, 1976 and 1975, respectively.

In 1975 the company leased equipment which they capitalized at a cost of approximately $4,700,000 (note B[e]). This equipment was subleased and rentals are accounted for under the operating method.

In 1976 the company purchased an aircraft and spare engine at a cost of approximately $8,900,000. This equipment has been leased to another carrier and rentals are accounted for under the operating method.

Note D — Lease Obligations — Total rent expense, including landing fees, was $15,389,000 in 1976 and $13,642,000 in 1975, including rentals under "financing leases" (as defined by the Securities and Exchange Commission) of $6,193,000 in 1976, $6,421,000 in 1975.

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. These leases expire over varying periods, and future annual lease commitments are not determinable due to the usage and adjustment factors.

At December 31, 1976, the company's minimum rental commitments, including rental prepayment requirements, under non-cancellable leases with initial or remaining terms of more than one year are as follows (in thousands of dollars):

Period	DC-9-30 Aircraft	Computer Equipment	Facilities	Other	Total
1977	$2,088	$1,569	$1,634	$24	$5,315
1978	2,088	1,398	1,634	—	5,120
1979	2,088	1,023	1,634	—	4,745
1980	2,088	—	1,634	—	3,722
1981	1,467	—	1,634	—	3,101
1982-1986	490	—	8,170	—	8,660
1987-1991	—	—	7,963	—	7,963
1992-1996	—	—	7,290	—	7,290
1997-2001	—	—	817	—	817

Because DC-9-30 leases are related to the prevailing prime interest rate, the actual rent expense exceeded the minimum by $140,000 in 1976 and $344,000 in 1975. Nearly all leases contain renewal or extension options which are to be negotiated within specified periods prior to the expiration of the leases.

The present value of the noncapitalized financing leases and the related interest rates at December 31 are (in thousands of dollars):

	Interest Rate	1976	1975
Five DC-9-30 aircraft	6½%	$ 8,612	$10,113
Nine CV-580 aircraft	5¾%	—	434
Computer equipment	8½%	3,317	4,220
Facilities	4½%	15,427	15,942
Other	6¾%	24	467
		$27,380	$31,176

The impact on net earnings by capitalization of such leases would have been immaterial. The company, regulated by the CAB, is unable to determine what impact the above capitalization might have on the rate base and any consequent rate adjustments.

Note E — Commitments — At December 31, 1976, the company has purchase commitments on three new DC-9-50 aircraft for which it has advanced $4,735,000 and capitalized interest of $31,000. An additional $19,363,000 will be expended by the company in fulfilling these commitments. The purchase agreement calls for delivery of these aircraft during the fourth quarter of 1977, although earlier deliveries may be arranged depending upon the operating needs of the company.

The company has advanced $150,000 on a purchase commitment, which contains an option to cancel prior to September 1977, for three additional DC-9-50 aircraft. If the option to cancel is not exercised, an additional $23,527,000 would be expended prior to delivery of the three aircraft in the fourth quarter of 1978.

Subsequent to year end, the company advanced another $150,000 on a purchase commitment, which contains an option to cancel prior to March 1977, for three additional DC-9-50 aircraft. If the option to cancel is not exercised, an additional $26,140,000 would be expended prior to delivery of the three aircraft in the second quarter of 1978.

During 1976, the company entered into a contract for the sale of five CV-580 aircraft. Pursuant to the terms of the agreement, two aircraft were delivered in 1976 and three are scheduled for delivery in 1977. The total selling price is $3,975,000, which approximates the company's undepreciated cost of these aircraft.

Purchase commitments for various other equipment total $382,000, for which $87,000 has been advanced.

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 — Contingency — The company, as well as all other scheduled domestic air carriers, is a party to the Domestic Service Mail Rates Investigation by the CAB. Mail revenues received by the company for the period March 28, 1973 through December 31, 1976 are subject to retroactive determination upon the conclusion of the investigation. An Administrative Law Judge has rendered an initial decision in this proceeding which, if made final by the CAB, would result in approximately $2,800,000 of additional mail revenue being recognized by the company for the period from 1973 through 1976. However, the initial decision has been appealed by the United States Postal Service and is being reviewed by the CAB. Therefore, determination of the final rate is not possible at the present time and no provision for any adjustment has been recorded.

Note G — Common Stock — At December 31, 1976, 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.

notes to financial statements

December 31, 1976 and 1975 (continued)

Options Outstanding		Option Price and Fair Market Value at Date of Grant				
			December 31, 1976		December 31, 1975	
Year Granted	Year Exercisable	Per Share	Shares	Amount	Shares	Amount
1971	1971	$3.1875	—	$ —	36,100	$115,069
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	123,550	372,135
1975	1979	2.50	95,000	237,500	95,000	237,500
1976	1979	3.875	36,100	139,888	—	—
			131,100	377,388	95,000	237,500
			218,550	$634,454	218,550	$609,635

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, 1976.

At December 31, 1976 and 1975 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 B(d) and (g). All warrants enable the holder to purchase common stock at $5.50 per share and must be exercised by October 31, 1979.

During January 1977, the Board of Directors declared a $.12 per share dividend payable on March 1, 1977 to shareholders of record on February 15, 1977. The company paid cash dividends of $.10 per share to its shareholders during the first quarter of 1976 and 1975.

Note H — 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 I — Pension Costs — Total pension expense was $5,282,000 for 1976 and $4,489,000 for 1975. At January 1, 1976, the latest actuarial valuation date, the total market value of fund assets exceeded the actuarially computed value of vested benefits for all plans by $885,000.

The Pension Reform Act of 1974 is not expected to have a significant effect on the company's pension expense, funding or unfunded vested benefits.

Note J — Income Taxes — Income tax expense for the years ended December 31 consists of the following:

	1976	1975
Current income taxes		
Federal	$3,489,000	$1,675,000
Investment tax credit used in current year	(1,757,000)	(811,000)
Investment tax credit carried back to prior year	—	(918,000)
	1,732,000	(54,000)
State and local	437,000	226,000
	2,169,000	172,000
Deferred Income taxes		
Federal	1,471,000	418,000
Investment tax credit	(881,000)	(1,013,000)
	590,000	(595,000)
State and local	181,000	83,000
	771,000	(512,000)
	$2,940,000	$ (340,000)

Income taxes of $2,940,000 in 1976 and $(340,000) in 1975 (effective rates of 28.3% and (7.0%) 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:

	1976	1975
Computed "expected" tax expense	$4,986,000	$2,344,000
Increase (decrease) in income taxes		
Investment tax credit utilized	(2,638,000)	(2,742,000)
State and local income taxes net of federal income tax benefit	470,000	161,000
Other	122,000	(103,000)
	$2,940,000	$ (340,000)

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

	1976	1975
Increase (decrease) in deferred income tax expense		
Capitalized interest	$ 324,000	$ 403,000
Lessor leasing activities	473,000	311,000
Depreciation	690,000	136,000
Pension	—	(306,000)
Training and development	70,000	(147,000)
Investment tax credit	(881,000)	(1,013,000)
Other	95,000	104,000
	$ 771,000	$ (512,000)

For federal income tax reporting purposes, investment tax credits of $5,617,000 are available to offset future income taxes payable through 1983. Of this amount $1,894,000 has been recognized for financial reporting purposes as an offset to deferred income taxes payable through December 31, 1976.

During the fourth quarter of 1975 the company generated more investment tax credits than were anticipated earlier in the year. Part of the additional credits were generated by establishing an employee stock ownership plan. The company received an additional investment tax credit of approximately $580,000 in 1976 and $250,000 in 1975 by contributing the same amount to the plan.

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 will allow 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 (12,164,423 in 1976 and 12,212,427 in 1975). 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, 1976 and 1975.

Note L — Selected Quarterly Financial Data (unaudited) — The unaudited quarterly results of operations for each of the four quarters ended in 1976 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)

	1976 Three Months Ended				1975 Three Months Ended			
	December 31	September 30	June 30	March 31	December 31	September 30	June 30	March 31
OPERATING REVENUES								
Passenger	$41,229	$43,369	$38,677	$33,884	$35,587	$38,487	$33,066	$28,524
Public service revenues	3,151	3,415	3,410	3,320	3,334	3,358	2,782	2,751
Other	5,990	4,753	4,988	4,922	4,769	3,862	3,381	3,683
	50,370	51,537	47,075	42,126	43,690	45,707	39,229	34,958
OPERATING EXPENSES								
Flying operations and maintenance	22,287	21,464	20,817	20,187	19,698	19,119	18,294	17,561
Other operating expenses	21,744	21,032	20,323	19,550	20,414	19,115	17,228	16,762
Depreciation and amortization	2,615	2,548	2,377	2,136	2,074	2,148	1,967	1,983
	46,646	45,044	43,517	41,873	42,186	40,382	37,489	36,306
OPERATING PROFIT (LOSS)	3,724	6,493	3,558	253	1,504	5,325	1,740	(1,348)
OTHER EXPENSES — net	1,077	932	1,006	626	719	695	471	452
EARNINGS (LOSS) BEFORE TAXES	2,647	5,561	2,552	(373)	785	4,630	1,269	(1,800)
Income taxes (credit)	702	1,628	701	(91)	(1,089)	939	490	(680)
NET EARNINGS (LOSS)	$ 1,945	$ 3,933	$ 1,851	$ (282)	$ 1,874	$ 3,691	$ 779	$ (1,120)
NET EARNINGS (LOSS) PER SHARE	$.16	$.32	$.15	$(.02)	$.16	$.30	$.06	$(.09)
DIVIDENDS PER SHARE	—	—	—	$ .10	—	—	—	$ .10

STOCKHOLDER 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.

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.

GENERAL DESCRIPTION OF THE IMPACT OF INFLATION (unaudited)

The impact of inflation on the company's operating expenses has been generally greater than the corresponding change in the general price level, particularly in the areas of fuel and labor costs. However, the company has historically been able to compensate for cost increases by increased fares and improved operating efficiencies in amounts sufficient to maintain profitable operations. The company, regulated by the CAB, is unable to determine what fare and rate increases might be approved in the future to keep pace with rising costs.

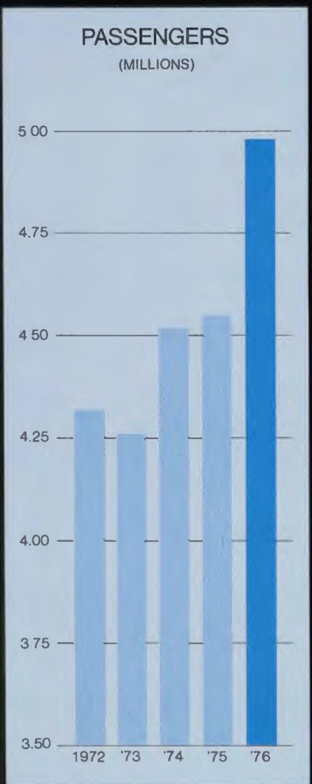
Although the cumulative impact of inflation over a number of years has resulted in higher costs for replacement of existing flight equipment and property, such inflationary increases have partially been offset by technological improvements and design changes which often result in increasing the productivity of the newer asset additions.

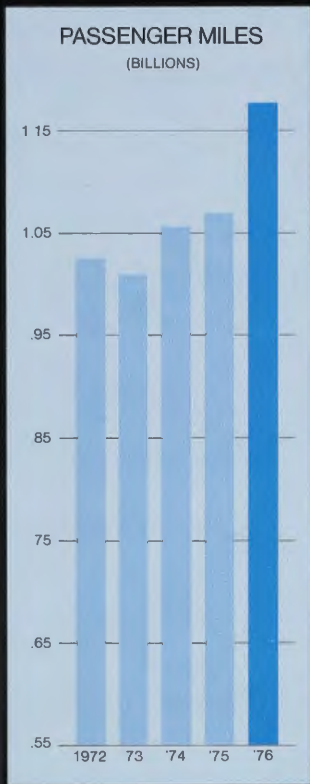
The company's annual report on Form 10-K (a copy of which is available on request) contains additional quantitative information with respect to the estimated replacement cost of inventories and flight equipment and property at December 31, 1976, and the related estimated effect of such replacement costs on depreciation expense for the year then ended.

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.

	1976		1975	
	High	Low	High	Low
1st Quarter	4	2⅜	3⅜	2⅜
2nd Quarter	3¾	3⅛	3¼	2⅝
3rd Quarter	4⅛	3⅛	3	2½
4th Quarter	4	3¼	2⅝	2¼


PASSENGERS
(MILLIONS)
5 00
4.75
4 50
4.25
4.00
3 75
3.50
1972
'73
'74
'75
'76


PASSENGER MILES
(BILLIONS)
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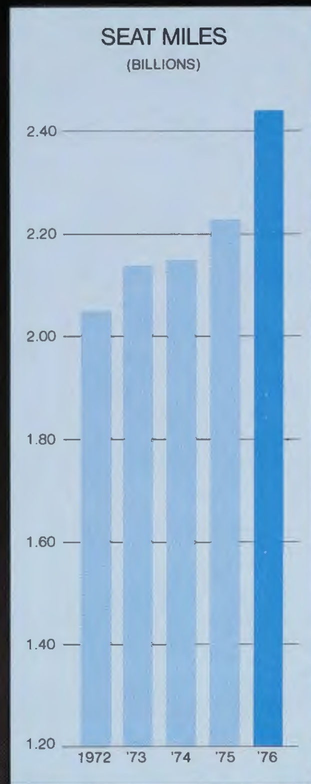
1.05
.95
85
75
.65
.55
1972
73
'74
'75
'76


SEAT MILES
(BILLIONS)
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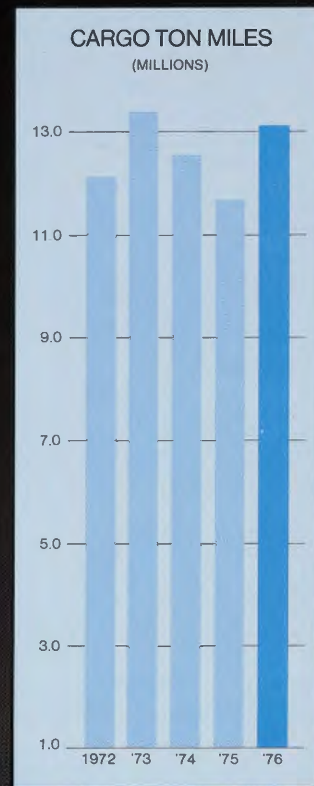
2.20
2.00
1.80
1.60
1.40
1.20
1972
'73
'74
'75
'76


CARGO TON MILES
(MILLIONS)
13.0
11.0
9.0
7.0
5.0
3.0
1.0
1972
'73
'74
'75
'76

five-year summary

EARNINGS

	1976	1975	1974	1973	1972
OPERATING REVENUES					
Passenger	$157,159,000	$135,664,000	$124,007,000	$104,279,000	$ 99,260,000
Public service revenues	13,296,000	12,225,000	12,126,000	9,631,000	9,090,000
Other	20,653,000	15,695,000	15,357,000	14,073,000	12,903,000
	191,108,000	163,584,000	151,490,000	127,983,000	121,253,000
OPERATING EXPENSES					
Flying operations and maintenance	84,755,000	74,672,000	59,060,000	48,480,000	46,732,000
Other operating expenses	82,649,000	73,519,000	66,419,000	60,152,000	55,176,000
Depreciation and amortization	9,676,000	8,172,000	8,017,000	7,350,000	6,990,000
	177,080,000	156,363,000	133,496,000	115,982,000	108,898,000
OPERATING PROFIT	14,028,000	7,221,000	17,994,000	12,001,000	12,355,000
OTHER EXPENSES (INCOME)					
Interest expense	5,174,000	3,611,000	3,868,000	3,623,000	3,229,000
Capitalized interest	(843,000)	(757,000)	(341,000)	(142,000)	(14,000)
Interest income and other—net	(690,000)	(517,000)	(1,229,000)	(690,000)	(256,000)
	3,641,000	2,337,000	2,298,000	2,791,000	2,959,000
EARNINGS BEFORE TAXES	10,387,000	4,884,000	15,696,000	9,210,000	9,396,000
Income taxes	2,940,000	(340,000)	7,492,000	2,763,000	2,903,000
EARNINGS BEFORE EXTRAORDINARY GAIN	7,447,000	5,224,000	8,204,000	6,447,000	6,493,000
Extraordinary gain on disposition of equipment (net of income taxes)	—	—	—	—	1,043,000
NET EARNINGS	$ 7,447,000	$ 5,224,000	$ 8,204,000	$ 6,447,000	$ 7,536,000
NET EARNINGS PER SHARE	$ .61	$.43	$.66	$.52	$.60
DIVIDENDS PER SHARE	$ .10	$.10	$.10	$.05	—

BALANCE SHEET ITEMS

	1976	1975	1974	1973	1972
Current assets	$ 42,012,000	$ 35,233,000	$ 38,622,000	$ 34,164,000	$ 33,806,000
Working capital from operations	$ 19,026,000	$ 12,868,000	$ 18,784,000	$ 14,176,000	$ 14,263,000
Working capital at year-end	$ 3,952,000	$ 1,803,000	$ 4,859,000	$ 4,654,000	$ 5,439,000
Property and equipment—net	$131,940,000	$ 94,134,000	$ 73,892,000	$ 76,324,000	$ 59,143,000
Total long-term debt	$ 76,976,000	$ 45,909,000	$ 32,633,000	$ 42,172,000	$ 36,327,000
Retained earnings	$ 37,288,000	$ 31,039,000	$ 27,044,000	$ 20,086,000	$ 14,262,000
Stockholders' equity	$ 57,033,000	$ 50,565,000	$ 47,152,000	$ 40,611,000	$ 34,787,000
Shares outstanding	12,178,000	12,098,000	12,312,000	12,463,000	12,463,000
Book value per share	$4.68	$4.18	$3.83	$3.26	$2.79

STATISTICS

	1976	1975	1974	1973	1972
Passengers	4,969,000	4,581,000	4,546,000	4,263,000	4,319,000
Passenger miles (000)	1,179,000	1,072,000	1,061,000	1,012,000	1,029,000
Available seat miles (000)	2,444,000	2,235,000	2,151,000	2,139,000	2,048,000
Passenger load factor	48.2%	48.0%	49.3%	47.3%	50.3%
Cargo ton miles	13,052,000	11,703,000	12,585,000	13,394,000	12,181,000
Revenue plane miles	30,810,000	29,748,000	29,055,000	29,422,000	29,200,000
Number of employees	3,600	3,410	3,360	3,250	3,120

communications

An aggressive advertising and promotion effort introduced North Central's new Detroit-Boston nonstop service.

Millions of potential air travelers were told of the airline's jet schedules, inflight service, two and three-abreast seating, and other benefits supporting the theme, "You never had it so good."

The message was carried in full-color newspaper, magazine and billboard ads, TV/radio commercials, personal sales calls, direct mail pieces, colorful printed material, and news releases plus promotional flights and audio-visual presentations. The campaign, centered in Detroit and Boston, covered 24 cities.

News releases and promotional items were distributed system-wide to inform the general public in other cities and company employees.

To stimulate recreational air travel, skiing dominated fall and winter advertising in 1976. Primary emphasis was placed on North Central's Denver service—including a new interline connection from Buffalo via the Twin Cities and special tour packages in the Colorado Rockies. Ski areas served by the airline in the Upper Midwest and Canada were also promoted.

The "Ski Tips" booklet and eight-minute movie, offering advice from professional skier Jake Hoeschler, have both received extensive distribution. Nearly three million people have seen the film on TV or in person since the movie was produced, and 50,000 copies of the booklet were printed for the 1976-77 season. Sales personnel appeared before numerous ski and travel groups in prime markets.

New films were prepared on fishing in the northern lake country. Several vacation packages were arranged with tour operators, and ads encouraged fishermen to fly to their favorite spots.

As a test program, the company developed a "City Profile" manual for Milwaukee travel agents. A variety of information on New York City was assembled in one book, providing easy references to assist the tourist or business traveler. The approach was well received and is being expanded to other markets.

A major campaign announced the inauguration of North Central's new 125-passenger DC-9-50 jets in April 1976. Newspaper, TV and radio ads, brochures, familiarization flights, and news releases publicized the new aircraft.

The company's business progress was reported to the news media through 50 general and special releases. Financial, passenger and cargo statistics are given out monthly. North Central was the subject of feature stories in *Barron's, The Wall Street Journal* and several other major newspapers, plus *Better Investing, Commercial West,* and *Corporate Report* magazines. Company officers are also making presentations to members of the investment community in selected cities each month.

The 1975 Annual Report, North Central's principal communication with stockholders and potential investors, received a Merit Award from *Financial World* magazine for the fourth consecutive year. Quarterly reports provide interim financial information and update company operations.

Company sales people made over 25,000 personal calls on travel agencies and businesses with frequent air travelers. They were also active as participants or guest speakers at 1,500 civic, industry and special-interest functions.

The airline's tour program attracted over 5,700 visitors to the General Office and Main Operations Base. Events held in the employee cafeteria, most of them catered by the Flight Kitchen, gave an additional 15,500 a look at North Central's headquarters. Civic and business leaders from various cities on the system are periodically flown to Minneapolis/St. Paul to tour the company's facilities and discuss air service to their communities.

Employees receive company news from *The Northliner* newspaper, another award-winning publication, a weekly report called "The Message," periodic memos, bulletin boards, and "instantly" through ESCORT, the airline's communications system. Company officers are continuing their yearly visitation program of informal meetings with employees at each station.

Aboard the aircraft, the *Northliner Magazine* entertains and informs passengers. Each issue carries a story about the airline and corporate advertising. The magazine has recently been expanded to 48 pages and is being published bimonthly in 1977, rather than quarterly.

Again the company wishes to acknowledge the promotional contributions of its many friends and associates whose efforts provide immeasurable benefits to North Central Airlines.

Jim Palm, regional traffic and sales manager, presents North Central's new "City Profile" manual to a travel agent.

North Central Airlines 8 nonstop jets between Detroit and Boston

(with direct or connecting service to over 40 other cities)

Call your travel agent or North Central Airlines

In Boston, we're located in the North Terminal with DELTA, TWA and UNITED.

Detroit to Boston		Boston to Detroit	
Lv. 8:05 a.m.	Ar. 9:37 a.m.	Lv. 7:50 a.m.	Ar. 9:35 a.m.
2:20 p.m.	3:52 p.m.	10:25 a.m.	12:10 p.m.
5:15 p.m.	6:47 p.m.	4:35 p.m.	6:20 p.m.
8:30 p.m.	10:02 p.m.	7:30 p.m.	9:15 p.m.

NORTH CENTRAL AIRLINES

NORTH CENTRAL AIRLINES, INC.
7500 NORTHLINER DRIVE • MINNEAPOLIS, MINNESOTA 55450