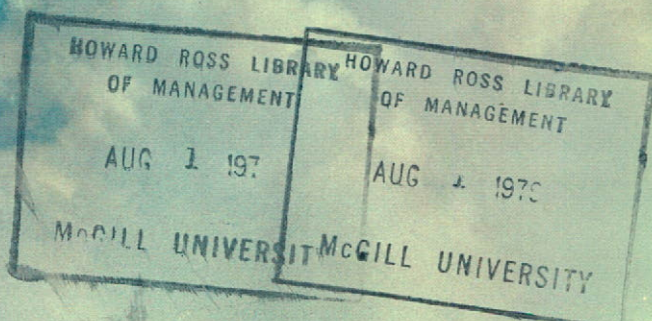


DELTA AIR LINES, INC. ANNUAL REPORT 1978



Description of Business

Delta Air Lines, Inc., is a certificated trunk air carrier providing scheduled air transportation for passengers and cargo over a network of routes covering approximately 38,000 miles. Delta's route structure connects the Northeast and Midwest with the Southern States from Texas to Florida; the Southeast to the Midwest, West, and California; and the East Coast to Florida. In addition, Delta operates international flights to Canada, Bermuda, the Bahamas, Venezuela, Puerto Rico and England. Service over nearly all of Delta's routes is highly competitive. As an air carrier, Delta is subject to federal regulation pursuant to the Federal Aviation Act of 1958, as amended, as well as other federal and state statutes.

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HIGHLIGHTS OF THE YEAR

The following comparative summary highlights the accomplishments of the past year in a number of major categories. Dollars are expressed in thousands, except per share figures.

| | <u>1978</u> | <u>1977</u> | <u>Per Cent Change</u> |
|------------------------------------|-------------|-------------|----------------------------|
| Operating Revenues..... | \$2,050,911 | \$1,719,645 | + 19% |
| Operating Expenses..... | \$1,845,816 | \$1,578,464 | + 17% |
| Net Income..... | \$131,127 | \$92,380 | + 42% |
| Earnings Per Share..... | \$6.60 | \$4.65 | + 42% |
| Revenue Passengers Enplaned..... | 33,007,670 | 28,811,966 | + 15% |
| Available Seat Miles (000)..... | 35,135,046 | 32,614,260 | + 8% |
| Revenue Passenger Miles (000)..... | 20,825,722 | 18,042,339 | + 15% |
| Passenger Load Factor..... | 59.27% | 55.32% | + 7% |

REPORT TO THE STOCKHOLDERS

It is our pleasure to report to you that fiscal 1978 was the most successful year in the history of Delta Air Lines. For the second consecutive year profits set a new record, reaching \$131.1 million, 42% above the \$92.4 million reported to you last year. Passenger revenue and total revenues also set new records of \$1.86 billion and \$2.05 billion, respectively, marking the first time in Delta's history that total revenues surpassed \$2 billion. We were privileged to serve over 33 million passengers and carry them a record 20.83 billion passenger miles, 15% more than in 1977.

Delta's achievements in the past year have been the subject of a number of awards.

Air Transport World magazine named Delta the "Airline of the Year" and *Dun's Review* selected Delta as "One of the Five Best Managed Companies in the Country." Such awards are a tribute to all the people who make up the Delta family, those whose hard work and dedication have been the foundation of Delta's success.

Air Transport World stated, "We, at least, are convinced that there really is a 'Delta Family' which includes all of the Delta people, and that this is a large part of the reason for the stability of the airline. Delta does well in good times and bad. It has truly been an airline for all seasons." To the more than 31,000 Delta Professionals, on behalf of our stockholders, we express thanks for a job well done.

In the past year, the Company's financial position was substantially strengthened. Total debt was reduced by \$88.1 million to \$177.1 million, equal to 24% of equity, one of the lowest debt-to-equity ratios in the airline industry. Expenditures for flight and ground equipment totaled \$231.7 million. Both the debt repayment and the capital expenditures were financed with internally generated funds. Delta's financial strength was exemplified by the renegotiation of the 1973 Bank Credit Agreement which was amended to provide a number



David C. Garrett, Jr., President and Chief Executive Officer, and W.T. Beebe, Chairman of the Board.

of changes favorable to the Company. These include reducing the interest rate to the prime rate, extending the agreement nine months to June 30, 1981, increasing the voluntary prepayment privileges, and eliminating a number of restrictive covenants.

Delta's competitive posture was further enhanced during the year as excellent progress was made in the continuing program to standardize and increase the efficiency of the aircraft fleet. Fourteen older aircraft were sold which resulted in an after-tax gain of 83¢ per share. The Company accepted delivery of 11 new aircraft including three L-1011's and eight B-727-200's.

The Company's already strong route system was further strengthened with the implementation of service on a number of new routes and by the award of other routes on which service will begin in the first half of fiscal 1979. On

April 30, 1978, the Company fulfilled one of its long-standing ambitions when nonstop service was begun between Atlanta and London. For the first time, travelers from the Southeastern U.S. will have the benefits of both nonstop flights to Europe and Delta's unique brand of customer service and convenience. To operate this milestone route, we have ordered two Lockheed L-1011-500's, the most technologically advanced aircraft available. These aircraft will be delivered in the summer of 1979. In the meantime, Delta is operating the route with two leased L-1011's. Customer response has been extremely gratifying, and, during the peak travel season, it has already begun to make a positive contribution to the Company's financial results.

In addition to Atlanta-London, service was begun earlier in the fiscal year on new routes between Atlanta, Tulsa and Denver; and between Memphis and Tampa. Service between Cleveland and Indianapolis was started on July 1, 1978. Service is scheduled to begin early in fiscal 1979 on new routes between Atlanta-Cleveland, Atlanta-Hartford/Springfield, Cincinnati-Cleveland, Louisville-Memphis and Las Vegas-Reno. The CAB has also given tentative approval for a realignment of Delta's route structure which will give the Company some new authority as well as increase our operating flexibility.

While fiscal 1978 was a banner year of new records and accomplishments, it has not been without some difficulties and setbacks. Inflation continues unchecked and in the past six months has accelerated. The much needed national energy program continues in limbo during Congressional debate. Interest rates have soared to their highest level since early 1975.

Our greatest concern has been in the area of regulation. While the Congress considers how much and in what form the airline industry should be regulated, the CAB has already undertaken the deregulation of the industry in a number of important areas. Route cases are being instituted at a record pace, and multiple

competitive permissive route awards are rapidly changing the structure of the air transportation network. The Board is in the process of implementing a policy that any "fit, willing, and able" carrier can be granted any route for which it applies without demonstrating that the route needs or can economically sustain such competitive service. The Company believes that this action by the Board is contrary to the requirements of the Federal Aviation Act, the legislation which created and defined the responsibilities of the CAB. As a result, Delta has filed suit in federal court to have this practice reviewed.

The CAB has moved vigorously in the area of fares. Much of the fare policy established in the comprehensive Domestic Passenger Fare Investigation Case, concluded by the CAB in 1975, has been abandoned in favor of a confusing array of rules and pronouncements. Almost any kind of discount fare is not only approved but encouraged. Nationwide discount fares allowing as much as a 50% reduction from the normal fare have been approved by the Board with no offsetting reductions in the cost of that service. As a result, the 6% average increase in normal fares which the Board allowed during the year to help offset mounting inflation, has disappeared, and the average passenger mile yield is now below what it was at this time last year.

Although the low fares have contributed to some degree to current passenger traffic growth, these low fares have had a disturbing effect on both the traveling public and the airlines. Since the end of last year, Delta has had to increase its reservations staff by more than 35%. This was necessary not only as a result of the growth in passengers, but also to answer the many questions of a confused public about the more than one hundred discount fares which the Board has allowed to be implemented. The Board has now permitted further reductions in fares by as much as 70% off the normal fare.

While the CAB has pursued its policies of free entry and low fares, it has maintained rigid control over increases in the normal fare. It continues to impose arbitrary and self-serving adjustments to the carriers' actual financial results, the effect of which is to deny carriers needed and justified fare increases.

The Board's current policies in the route and fare areas, while described by the Board as "deregulatory", in fact constitute some of the most forceful regulation that the industry has experienced. In areas other than routes and fares the CAB is increasing its regulation of the day-to-day conduct of the airline business.

Delta has long maintained its position that the nation's air transportation system is a vital national asset, more important than the narrow interest of one airline or one governmental agency. It is a delicately balanced structure which has been developed over many years. The Company believes that present regulatory and legislative efforts may erode the foundation of that structure. Rather than have the "Cannon/Kennedy Bill" passed by the Congress or have the CAB continue its present course, Delta believes that it would be more in the public interest to abolish the CAB entirely. It would be preferable to entrust the economic future of the air transportation system to a completely free market than have it regulated in chaotic fashion.

We are concerned about the coming year because of the uncertainty of the regulatory situation. We frankly do not know where the regulatory morass will lead, either at the CAB or in the Congress. The national economic picture appears to be reasonably good for the first half of the coming year although many of the same negative influences with which we have had to deal still confront us. These include mounting inflation, higher interest rates, and the lack of a sound national energy policy.

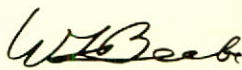
In spite of these negative influences, Delta's prospects for the coming year appear good. At the present time, advance traffic bookings are encouraging. Progress will continue to

be made in standardizing and increasing the efficiency of the aircraft fleet. We will continue our determined efforts to minimize the effects of inflation through gains in productivity without compromising service to our customers.

If we are to continue to be an industry leader in service to our customers and produce superior financial results, our team of Delta Professionals will again be tested, as they have been tested in the past by strengthened competition, unstable economic situations, energy crises, and mounting government regulation. We are confident that they will again measure up to the challenge and that Delta will continue its position as one of the finest airlines in the world.



DAVID C. GARRETT, JR.
*President and
Chief Executive Officer*



W.T. BEEBE
Chairman of the Board

August 29, 1978

EARNINGS AND DIVIDENDS

Fiscal 1978 earnings were \$131.1 million (\$6.60 per share), an increase of 42% over the 1977 earnings of \$92.4 million (\$4.65 per share). The following table compares operating results for fiscal 1978 and 1977.

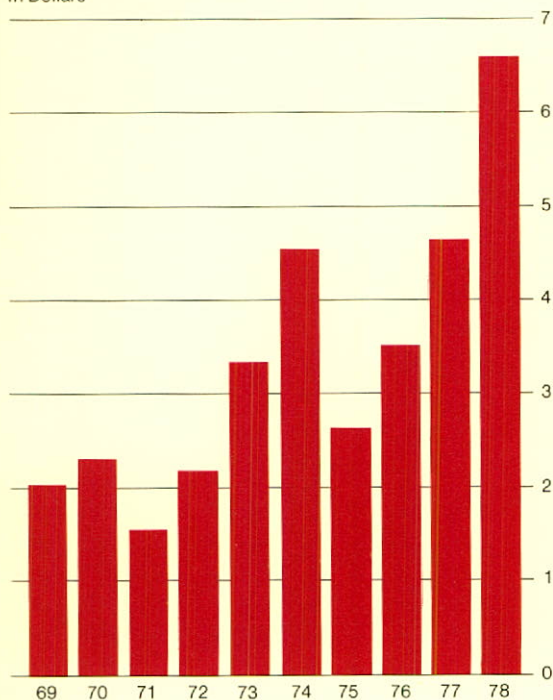
| | 1978 | 1977 | Per Cent Change |
|---|----------------|-----------|--------------------|
| | (In Thousands) | | |
| Operating Income. | \$205,095 | \$141,181 | + 45% |
| Other Expense (Income): | | | |
| Interest Expense. | 22,107 | 25,983 | - 15 |
| Less—Interest Capitalized on Advances for Equipment. | (4,794) | (2,922) | + 64 |
| | 17,313 | 23,061 | - 25 |
| Gain on Disposition of Aircraft. | (32,689) | (29,403) | + 11 |
| Realized/Unrealized Loss (Gain) on Foreign Currency Translation.. | 3,339 | (2,699) | - 224 |
| Miscellaneous Income, Net. | (7,640) | (4,825) | + 58 |
| | (19,677) | (13,866) | + 42 |
| Income Before Taxes. | 224,772 | 155,047 | + 45 |
| Provision for Income Taxes: | | | |
| Income Taxes Provided | 109,296 | 76,362 | + 43 |
| Less—Amortization of Investment Tax Credits. | (15,651) | (13,695) | + 14 |
| | 93,645 | 62,667 | + 49 |
| Net Income. | \$131,127 | \$ 92,380 | + 42% |
| Net Income Per Share. . . . | \$6.60 | \$4.65 | + 42% |

Operating income increased 45% to \$205.1 million on a 19% growth in operating revenue, and a 17% increase in operating expense. Net interest expense declined \$5.7 million or 25% as the average debt outstanding was reduced, and interest capitalized increased \$1.9 million as the result of higher average equipment purchase deposits.

Gains from the sale of aircraft totaled \$32.7 million, 83¢ per share after taxes, while fiscal 1977 results included gains from flight equipment sales of \$29.4 million, or 75¢ per share after taxes. Translation of foreign debt

Earnings per Share*

In Dollars



*These data reflect the operations of Delta Air Lines, Inc., and do not include the Northeast Airlines' system prior to August 1, 1972.

repayable in pounds sterling resulted in a loss in the current year of \$3.3 million or 9¢ per share after taxes compared to a gain of \$2.7 million, 7¢ per share after taxes, in fiscal 1977. Miscellaneous income increased \$2.8 million, principally from higher interest income.

Income taxes were provided on book income at a rate of approximately 49% in both fiscal years. The provisions were reduced by investment tax credit amortization of \$15.7 million in 1978 and \$13.7 million in 1977.

During the year, the Company reached agreement with the Internal Revenue Service providing for settlement of proposed income tax deficiencies for fiscal years 1966 through 1972. These taxes had been provided for in prior years.

Total dividend payments for the year amounted to \$14.9 million, 75¢ per share, a 7% increase over the \$13.9 million, 70¢ per share, paid last year.

At the July, 1978, meeting of the Board of Directors, the quarterly dividend was increased 25% to 25¢ per share. This was the second increase in the dividend rate in the last six months. Fiscal 1978 marked the 29th consecutive year in which Delta has made cash dividend payments.

OPERATING REVENUES

The following table compares operating revenues for fiscal 1978 and 1977 by major revenue category.

| | 1978 | 1977 | Per Cent Change |
|---------------------|-----------------------|--------------------|-----------------|
| | <i>(In Thousands)</i> | | |
| Scheduled Passenger | \$1,861,100 | \$1,575,642 | + 18.1% |
| Cargo..... | 153,233 | 114,800 | + 33.5 |
| Charter..... | 18,284 | 13,039 | + 40.2 |
| Other, Net..... | 18,294 | 16,164 | + 13.2 |
| Total..... | <u>\$2,050,911</u> | <u>\$1,719,645</u> | <u>+ 19.3%</u> |

Total operating revenues in 1978 increased by \$331.3 million to \$2.05 billion from the \$1.72 billion reported last year. Scheduled passenger revenues rose 18% or \$285.5 million to \$1.86 billion. Revenue passenger miles totaled 20.83 billion, a 15% gain over the previous year. In the last four months of fiscal 1978, revenue passenger miles grew 22% reflecting strong consumer confidence, a high level of economic activity, and the stimulation of low discount fares. During the year the CAB approved increases to the basic fare averaging 6%. Two-thirds of the increase was offset by the proliferation of deep discount fares in the last half of the year, and the average passenger mile yield for the year increased only 2% to 8.94¢. For the June, 1978 quarter, when the impact of the deep discount fares was strongest, the average yield was down 1% from the yield in the June, 1977 quarter.

Cargo revenues increased 33% to \$153.2 million, including a \$15.2 million adjustment in mail payments, of which \$12.3 million



was applicable to prior fiscal years. Cargo ton miles grew 8%, and the average yield increased 12%.

Charter revenues totaled \$18.3 million, a gain of 40%, which resulted from strengthened marketing programs aimed at developing charter operations.

Other net revenues increased by \$2.1 million, most of which related to the strong traffic growth in passengers and cargo.

| Revenue Statistics | 1978 | 1977 | Per Cent Change |
|---|-------------|-------------|------------------------|
| Revenue Passenger Miles (000) | 20,825,722 | 18,042,339 | + 15.4% |
| Revenue Passengers Enplaned. | 33,007,670 | 28,811,966 | + 14.6% |
| Cargo Ton Miles (000) | 298,246 | 277,498 | + 7.5% |
| Passenger Load Factor | 59.27% | 55.32% | + 7.1% |
| Passenger Mile Yield | 8.94¢ | 8.73¢ | + 2.4% |

OPERATING EXPENSES

The following table compares operating expenses for fiscal year 1978 with 1977 by major expense category.

| | 1978 | 1977 | Per Cent Change |
|---|--------------------|--------------------|-----------------|
| | (In Thousands) | | |
| Salaries and Related Costs..... | \$ 831,818 | \$ 706,770 | + 18% |
| Aircraft Fuel..... | 382,159 | 316,478 | + 21 |
| Aircraft Maintenance | | | |
| Materials and Repairs | 44,794 | 30,818 | + 45 |
| Aircraft Rentals..... | 6,295 | 5,248 | + 20 |
| Other Rentals..... | 32,629 | 30,887 | + 6 |
| Landing Fees..... | 38,354 | 35,941 | + 7 |
| Passenger Food and Related Supplies.... | 71,863 | 59,224 | + 21 |
| Agency Commissions.. | 64,800 | 52,846 | + 23 |
| Advertising..... | 28,835 | 23,461 | + 23 |
| Other Cash Costs..... | 176,114 | 150,751 | + 17 |
| Total Cash Costs..... | \$1,677,661 | \$1,412,424 | + 19% |
| Depreciation and Amortization..... | 168,155 | 166,040 | + 1 |
| Total Operating Expenses..... | <u>\$1,845,816</u> | <u>\$1,578,464</u> | <u>+ 17%</u> |

Total operating expenses increased \$267 million or 17% over last year. Significant increases in traffic and operating capacity, start-up of service on new routes, and continuing inflationary pressures affected practically all areas of expense.

Aircraft fuel and labor cost increases accounted for \$191 million or 71% of the total increase in operating expenses. Fuel consumption increased 8%, equal to the growth in available seat miles, and the price of fuel increased an average of 11% to 37.12¢ per gallon. Salaries and related costs were up 18% as the average level of employment rose 6%.

Aircraft maintenance materials and repairs expense increased 45% reflecting initial overhauls on a number of the newer aircraft during the year as well as an abnormally low level of expense in fiscal 1977. Aircraft rentals were up due to the leasing of two long-range L-1011's from TWA to allow the timely implementation of Atlanta-London service. Promotion of new routes and fares contributed to the 23% increase in advertising expenditures.

Passenger food and related supplies increased 21% due to passenger growth and price increases. Substantial increases in passenger revenues and continued growth in the number of passengers using travel agencies accounted for the 23% growth in agency commissions. Landing fees and other rentals increased 7% and 6%, respectively, generally keeping pace with capacity growth. Other cash costs increased 17% as the result of inflation, traffic growth, and the higher level of operations. Depreciation increased 1%.

| <u>Operating Statistics</u> | <u>1978</u> | <u>1977</u> | <u>Per Cent Change</u> |
|-----------------------------|-------------|-------------|------------------------|
| Revenue Plane | | | |
| Miles (000) | 240,234 | 227,171 | + 6% |
| Available Seat | | | |
| Miles (000) | 35,135,046 | 32,614,260 | + 8% |
| Available Ton | | | |
| Miles (000) | 4,743,778 | 4,478,038 | + 6% |
| Fuel Gallons | | | |
| Consumed (000) . . . | 1,029,597 | 949,369 | + 8% |
| Average Price per | | | |
| Fuel Gallon. | 37.12¢ | 33.34¢ | + 11% |
| Breakeven Load | | | |
| Factor. | 52.74% | 50.36% | + 5% |

CAPITALIZATION AND FINANCING

During fiscal 1978 no additional borrowing was required. However, to comply with the requirements of Financial Accounting Standards Board Statement No.13, the Company capitalized several new long-term leases totaling \$3.1 million. Internally generated funds of \$334.5 million were used primarily to purchase \$231.7 million of flight and ground equipment and to reduce long-term debt.

On June 30, 1978, the 1973 Bank Credit Agreement was amended to provide a number of changes favorable to the Company. The new terms include a nine-month extension of the agreement to June 30, 1981, reduction of the interest rate to the prime rate, and a change in the provision for voluntary prepayment to allow prepayment of up to eight quarters. In addition, a number of restrictive covenants were either lessened or eliminated.

Total debt at June 30, 1978, was \$177.1 million, including current maturities, a

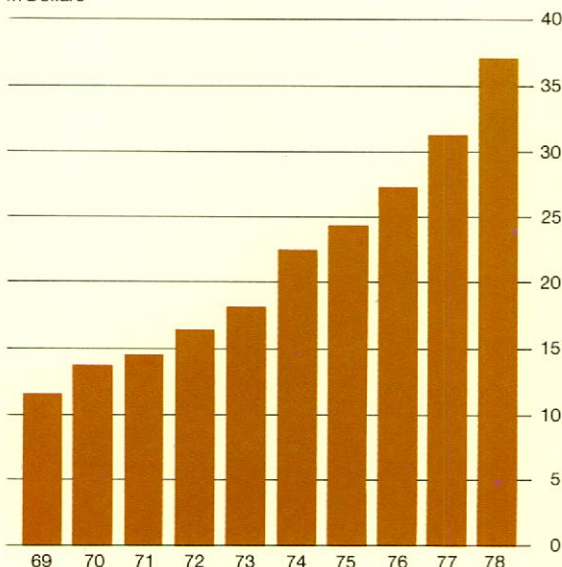
decrease of \$88.1 million from the previous year. The year-end balance was 24% of equity. At June 30, 1978, the Company had voluntarily prepaid the next six quarterly installments totaling \$66 million and \$11.3 million of the final payment due June 30, 1981, under the 1973 Bank Credit Agreement. Also, \$2 million of the 6½% Convertible Subordinated Debentures had been acquired for future sinking fund requirements. At June 30, 1978, the Company had forward exchange contracts for the purchase of pounds sterling to cover a portion of scheduled fiscal 1979 principal and interest payments on the Lazard debt.

Outstanding purchase commitments at year-end for aircraft and related spares will require future expenditures of approximately \$607 million during fiscal years 1979 through 1982. Mandatory debt repayments due in fiscal 1979 total \$9.7 million.

Total stockholder equity at June 30, 1978, was \$736.8 million or \$37.06 per share, 19% over the \$31.22 per share last year.

Stockholder Equity per Share*

In Dollars



*These data reflect the operations of Delta Air Lines, Inc., and do not include the Northeast Airlines' system prior to August 1, 1972.

FLIGHT EQUIPMENT AND PURCHASE COMMITMENTS

During the past fiscal year Delta accepted delivery of three Lockheed L-1011 aircraft and eight advanced model Boeing B-727-200 aircraft. Two long-range L-1011's were leased from Trans World Airlines for an 18-month period. These two aircraft will be used primarily on the Atlanta-London route until Delta receives its two long-range L-1011-500's which are scheduled for delivery in May and September, 1979. The fleet was reduced by the sale of five DC-9-32's, four B-727-100's and five DC-8-51's. At June 30, 1978, Delta operated the following aircraft fleet:

| Type of Aircraft | Seats | Owned | Leased | Total |
|------------------|---------|------------|----------|------------|
| L-1011-1. | 264/293 | 24 | | 24 |
| L-1011-100. | 253 | | 2 | 2 |
| DC-8-61. | 199 | 13 | | 13 |
| DC-8-51. | 143/153 | 10 | | 10 |
| B-727-200. | 137 | 89 | 7 | 96 |
| DC-9-32. | 88 | 51 | | 51 |
| Total. | | <u>187</u> | <u>9</u> | <u>196</u> |

At the end of the fiscal year, arrangements had been finalized for the sale of three additional DC-9-32 aircraft, two scheduled for delivery in December, 1978 and one in March, 1979.

At June 30, 1978, Delta had purchase commitments for 28 Boeing B-727-200 aircraft, 14 of which were confirmed for delivery between August, 1978 and June, 1979. Subsequent to the end of the year, an additional four B-727-200's were confirmed for delivery in the December, 1979 quarter. The Company has the right to confirm delivery dates for the remaining ten aircraft at specified intervals to August, 1979. These aircraft are tentatively scheduled for delivery in the June and December quarters of 1980. The Company also has outstanding commitments to purchase six Lockheed L-1011-1 and five L-1011-500 aircraft. Four of the L-1011-1 aircraft are confirmed for delivery between February, 1979 and January, 1980. The remaining two are cancellable to February, 1979 and are



tentatively scheduled for delivery in May and December, 1980. Two of the L-1011-500 aircraft are confirmed for delivery in May and September, 1979, and three are cancellable at specified intervals to November, 1979. These three aircraft, which Delta has the option to convert to L-1011-1's, are tentatively scheduled for delivery in the December quarter of 1981.

PERSONNEL

At June 30, 1978, the team of full-time Delta Professionals numbered 31,195 (an average of 29,857 during the year), compared to the June 30, 1977, total of 28,527 (an average of 28,234 during the year). Direct salaries totaled \$676.9 million, a 17% increase over last year, and related fringe benefits increased 22% to \$154.9 million. Expenditures for salaries and fringe benefits equalled 41¢ of each revenue dollar, the same as fiscal years 1976 and 1977.

During the year Mr. David C. Garrett, Jr., Delta's President, was elected to the additional post of Chief Executive Officer. Mr. W. T. Beebe, Delta's Board Chairman and formerly Chief Executive Officer, will reach his normal retirement age in only two years, and he and the Board of Directors concluded that it was of prime importance that an orderly transition of duties be initiated. Mr. Richard S. Maurer was promoted to the newly created position of Vice Chairman of the Board and Secretary.

Other officer promotions during the year included Mr. James W. Callison to Senior Vice President-General Counsel and Mr. Frank Rox to Senior Vice President-Flight Operations. Mr. Hoyt T. Fincher was named Senior Vice President-Technical Operations. Mr. Robert Oppenlander, whose responsibilities remain unchanged, was named Senior Vice President-Finance. Mr. Sidney F. Davis was promoted to Vice President-Assistant General Counsel and Assistant Secretary; Mr. John Hume to Vice President-Personnel; Mr. Russell H. Heil to Vice President-Personnel Administration; Mr. M. O. Galloway was named Vice President-Finance; Mr. R. Anthony McKinnon was promoted to Assistant Vice President-Marketing Administration; Mr. M. E. Dullum to Assistant Vice President-Government Affairs; Mr. R. Lamar Durrett to Assistant Vice President-Facilities; and Mr. Robert H. Cowart to Assistant Vice President-Consumer Affairs. Elevated to the position of Treasurer was Mr. Frank S. Chew, and Mr. Julius P. Gwin was elected to the position of Comptroller.

In August, 1978, Mr. George E. Shedd, Assistant Vice President-Public Relations, suffered a fatal heart attack. Mr. Shedd's outstanding career spanned more than 37 years of dedicated service to Delta.

FACILITIES

During the past year, the Company completed and occupied a 135,000 square foot office building at the Hartsfield Atlanta International Airport. The new facility houses the Atlanta Reservations office as well as some Personnel, Marketing, and Finance staff functions.

Terminal facilities were completed and occupied in Tulsa, Denver and London to support route awards to those new cities. A new customs facility was constructed in Atlanta for the convenience of Delta's London passengers. Other new or expanded facilities were occupied



or begun in Cleveland; Baltimore; Phoenix; Orlando; Columbus, Ohio; and LaGuardia airport in New York. Numerous expansions of reservation facilities were started throughout the Delta system.

Excellent progress on Atlanta's new terminal facility was made during the year. Upon completion, currently scheduled for early 1981, the facility will be the largest passenger terminal in the nation. Excluding tenant improvements, it will cost approximately \$240 million, some portion of which will be provided from the Airport and Airway Trust Fund which was created by the 8% airline ticket tax. Delta's share of the project cost, including leasehold improvements, is currently estimated at \$80 million.

REGULATORY MATTERS

The Regulatory Environment

The regulatory reform movement in Congress continues. The Senate has passed the "Cannon/Kennedy Bill" to which Delta remains opposed because of the Company's belief that it would lead to deterioration of airline service and to more, not less regulation. While Delta's financial strength and outstanding corps of dedicated employees mean that the Company would likely do well under any regime, passage of the Cannon/Kennedy Bill by the entire Congress could unnecessarily harm the national air route system. Rather than see this bill passed, Delta would prefer to see the CAB abolished entirely. On the House side of Congress, a more modest bill is under consideration, which may be considered by the full House near the end of this term.

In the meantime, unprecedented and drastic changes in the regulatory environment are taking place under the leadership of Chairman Kahn of the Civil Aeronautics Board. While Delta favors some of the programs, e.g., certain of the proposals to expedite the administrative process, a number of the Board's policies and decisions, in Delta's view, are contrary to the Federal Aviation Act. This is particularly true of the Board's apparent intention to eliminate the service obligations of virtually all airline certificates, converting them to "permissive" licenses, and the Board's related program, dependent on the "permissive" award approach, of licensing multiple carriers in all markets, large or small, and of doing so at a rapid pace. This seems to be an attempt by the Board to move at an accelerated rate to an "open entry and exit" policy under the existing statute, without awaiting a declaration by Congress as to the direction in which Congress desires the CAB to move. Delta has sought Federal Court review of this aspect of CAB activity.

As the Board takes an increasingly superficial approach to the processing of route applications under this new policy, and toward tariff

filings, the attention of the Board's staff is being redirected to other areas, where the CAB is regulating *more*, not less. Most of this type of regulation (e.g., a proposed requirement to report the number of lavatories per seat on aircraft, detailed prescriptions as to how a carrier is to accommodate non-smokers and smokers, and requirements for posting virtually useless fare summaries) directly interferes with the day-to-day conduct of airline business, in contrast to the developmental nature of route regulation. Passage of the Cannon/Kennedy Bill by Congress would add impetus to this trend of *increased* regulation.

Although the regulatory environment under the present CAB administration is highly volatile and unpredictable, Delta is continuing a program of route development and expansion, involving the following matters of major interest:

Route Developments

During the past several months, Delta has been awarded the following new nonstop routes:

| | |
|----------------------------------|------------------------|
| Atlanta-London | Reno-Las Vegas |
| Atlanta-Hartford/ Springfield | Atlanta-Cleveland |
| Louisville-Memphis | Cincinnati-Cleveland |
| | Indianapolis-Cleveland |

In addition, Delta received "fillup" or local traffic rights between San Francisco-Los Angeles and Houston-New Orleans on flights operated to the Caribbean. The Atlanta-London service was inaugurated April 30, 1978; Indianapolis-Cleveland service started July 1, 1978; and the other new services will be inaugurated in the near future.

Delta has applications pending before the CAB in various procedural stages, for nonstop authority in a number of additional markets.

The CAB issued an order in April, 1978, proposing the consolidation, realignment and simplification of Delta's domestic route authorities which—if finalized—would remove or modify many of the conditions and restrictions on Delta's operating authority. This in turn would provide the Company with more scheduling flexibility and enhanced opportunities for efficient routing of aircraft. Delta has urged the

Board to finalize the realignment as promptly as possible.

Competitive rights have recently been granted other carriers in the following Delta-served markets:

| | |
|--------------------|------------------|
| Atlanta-Charleston | Atlanta-Columbia |
| Atlanta-Cincinnati | Atlanta-Detroit |
| Dallas/Ft.Worth- | Atlanta-Savannah |
| Las Vegas | |

Competitive authority is sought by other carriers in a number of additional Delta markets, some of which are now being processed by the CAB and others of which are awaiting consideration.

Route Suspensions

Delta remains suspended at Havana, Cuba, at a number of points in New England currently served by other carriers, and has suspended all service at Montego Bay, Jamaica. Delta's Brunswick, Georgia, authority, which had been under suspension, was recently transformed to permissive authority.

Fare and Rate Matters

While the CAB has approved certain increases (as discussed elsewhere in this report) in standard fares during the past year, it has also encouraged and approved the filing of a plethora of discount fares. In addition, the Board has decided to modify its fare-setting standards and policies as established in the *Domestic Passenger Fare Investigation*, by providing for "no suspend zones" which would permit carriers to lower standard fares by as much as 70%. The Board will also permit carrier management some small degree (not more than 10%) of upward flexibility to increase basic fares under tight conditions and in selected markets.

Those provisions of the Federal Aviation Act regulating the carriage of property in air transportation were drastically altered in November of 1977, essentially "deregulating" the air freight and express industry. Specifically, the law was changed to permit all "fit, willing and able" carriers who had operated all-cargo air services at any time during 1977 to receive

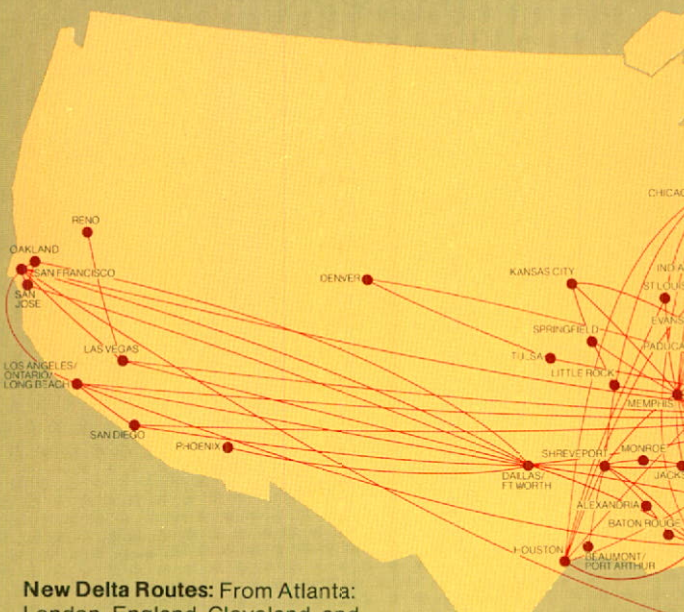
"grandfather" certificates authorizing the carriage of property between any or all pairs of points in the continental United States. After one year following the law's enactment, any applicant which meets the fitness test can receive similar authority. In addition, the law was changed so as to remove the CAB's jurisdiction over most aspects of property rate and tariff matters, which essentially mooted the rate-making conclusions which had been established in the *Domestic Air Freight Rate Investigation*, finalized in the latter part of 1977 shortly before the law was changed.

Charter and Tour Services

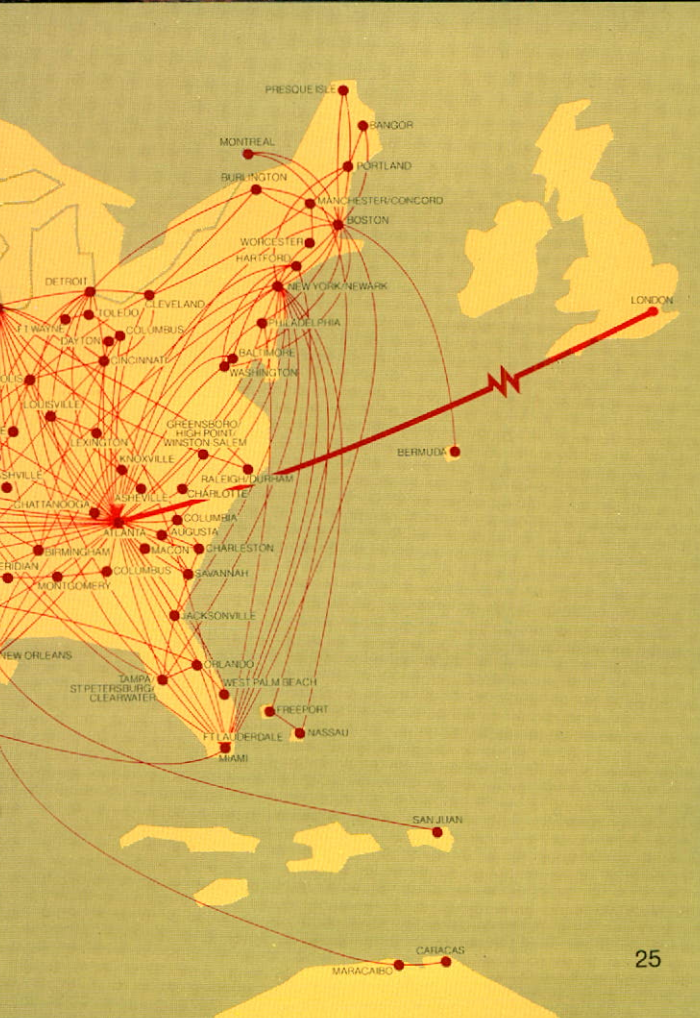
The last year has produced a continuation of the CAB's drive to liberalize charter rules and remove distinctions between individually ticketed services and charter services. In its most recent action, the Board has created a new charter mode, the "Public Charter," which will replace all existing charter forms (with the exception of Single Entity and Affinity Charters), and which allows charter air transportation to be sold to individual members of the general public on a one-way basis through tour operators.



Delta Air Lines System Route Map



New Delta Routes: From Atlanta: London, England, Cleveland, and nonstop Hartford/Springfield; Indianapolis/Cincinnati-Cleveland, Louisville-Memphis, Las Vegas-Reno; and (on "fillup" basis) San Francisco-Los Angeles and Houston-New Orleans on Caribbean route.



Balance Sheets

June 30, 1978 and 1977

| ASSETS | 1978 | 1977 |
|---|-----------------------------|--------------------|
| | (In Thousands) | |
| CURRENT ASSETS: | | |
| Cash. | \$ 7,347 | \$ 26,209 |
| Short-term cash investments, at cost. | <u>116,764</u> | <u>26,103</u> |
| | 124,111 | 52,312 |
| Accounts receivable, net. . . . | 181,019 | 144,592 |
| Maintenance and operating supplies, at average cost. . . | 12,892 | 12,567 |
| Prepaid expenses, etc. | <u>7,108</u> | <u>7,269</u> |
| Total current assets. | <u>325,130</u> | <u>216,740</u> |
| PROPERTY AND EQUIPMENT (Notes 2 and 4): | | |
| | <u>Flight Equipment</u> | <u>Other</u> |
| Cost— | | |
| 1978 | \$1,862,231 | \$282,149 |
| 1977 | <u>1,720,843</u> | <u>256,949</u> |
| | | 1,977,792 |
| Accumulated depreciation— | | |
| 1978 | 755,747 | 148,081 |
| 1977 | <u>630,260</u> | <u>133,470</u> |
| | 1,240,552 | 1,214,062 |
| Advance payments for new equipment (Note 2). | <u>71,983</u> | <u>45,084</u> |
| | <u>1,312,535</u> | <u>1,259,146</u> |
| OTHER ASSETS: | | |
| Long-term receivables and prepayments, etc. | 7,250 | 4,539 |
| Nonoperating flight equipment held for sale. . . . | 955 | 11,394 |
| Preoperating expenses— London service. | <u>813</u> | <u>—</u> |
| | <u>9,018</u> | <u>15,933</u> |
| | <u>\$1,646,683</u> | <u>\$1,491,819</u> |

**LIABILITIES AND
STOCKHOLDER EQUITY****1978****1977***(In Thousands)***CURRENT LIABILITIES:**

Current maturities of long-

term debt. \$ **9,731** \$ 27,628

Accounts payable and accrued

liabilities. **166,966** 139,834

Air traffic liability.

129,607 90,351

Accrued income taxes.

66,490 14,662

Total current liabilities. . . .

372,794 272,475

LONG-TERM DEBT (Note 3). . .

167,331 237,497**DEFERRED CREDITS:**

Deferred income taxes.

296,239 288,783

Unamortized investment tax

credits.

68,094 66,697

Other.

5,426 5,784**369,759** 361,264**COMMITMENTS AND****CONTINGENCIES (Notes 2,
4, and 7)****STOCKHOLDER EQUITY (Note 6):**

Common stock, par value

\$3.00 per share—Authorized

25,000,000 shares;

Outstanding 19,880,577

shares.

59,642 59,642

Common stock purchase

warrants.

— 6,750

Additional paid-in capital. . . .

80,088 73,338

Retained earnings (of which

\$335,580,000 is restricted

at June 30, 1978 as to the

payment of cash dividends

under debt agreements). . . .

597,069 480,853**736,799** 620,583**\$1,646,683** **\$1,491,819***The accompanying notes are an integral part of these balance sheets.*

Statements of Income

For the years ended June 30, 1978 and 1977

| | <u>1978</u> | <u>1977</u> |
|--|-----------------------|------------------|
| | <i>(In Thousands)</i> | |
| OPERATING REVENUES: | | |
| Passenger. | \$1,861,100 | \$1,575,642 |
| Cargo. | 153,233 | 114,800 |
| Other, net. | <u>36,578</u> | <u>29,203</u> |
| Total operating revenues. . . | <u>2,050,911</u> | <u>1,719,645</u> |
| OPERATING EXPENSES: | | |
| Salaries and related costs. . . | 831,818 | 706,770 |
| Aircraft fuel. | 382,159 | 316,478 |
| Aircraft maintenance materials and repairs. | 44,794 | 30,818 |
| Rentals and landing fees. . . . | 77,278 | 72,076 |
| Passenger service. | 83,286 | 68,276 |
| Agency commissions. | 64,800 | 52,846 |
| Other cash costs. | 193,526 | 165,160 |
| Depreciation and amortization. . | <u>168,155</u> | <u>166,040</u> |
| Total operating expenses. . . | <u>1,845,816</u> | <u>1,578,464</u> |
| OPERATING INCOME. | <u>205,095</u> | <u>141,181</u> |
| OTHER EXPENSE (INCOME): | | |
| Interest expense. | 22,107 | 25,983 |
| Less—Interest capitalized on advances for equipment. . . . | <u>4,794</u> | <u>2,922</u> |
| | 17,313 | 23,061 |
| Gain on disposition of aircraft. . | (32,689) | (29,403) |
| Realized and unrealized loss (gain) on foreign currency translation. | 3,339 | (2,699) |
| Miscellaneous income, net. . . . | <u>(7,640)</u> | <u>(4,825)</u> |
| | <u>(19,677)</u> | <u>(13,866)</u> |
| INCOME BEFORE INCOME TAXES. | <u>224,772</u> | <u>155,047</u> |
| PROVISION FOR INCOME TAXES (Note 5): | | |
| Income taxes provided. | 109,296 | 76,362 |
| Less—Amortization of investment tax credits. | <u>(15,651)</u> | <u>(13,695)</u> |
| | <u>93,645</u> | <u>62,667</u> |
| NET INCOME. | <u>\$ 131,127</u> | <u>\$ 92,380</u> |
| NET INCOME PER COMMON SHARE. | <u>\$6.60</u> | <u>\$4.65</u> |

The accompanying notes are an integral part of these statements.

Statements of Retained Earnings

For the years ended June 30, 1978 and 1977

| | <u>1978</u> | <u>1977</u> |
|--|-----------------------|------------------|
| | <i>(In Thousands)</i> | |
| BALANCE AT BEGINNING OF YEAR. | \$480,853 | \$402,389 |
| Add (Deduct): | | |
| Net income. | 131,127 | 92,380 |
| Cash dividends—\$.75 per share in 1978 and \$.70 per share in 1977. | <u>(14,911)</u> | <u>(13,916)</u> |
| BALANCE AT END OF YEAR (restricted as indicated on balance sheet). | <u>\$597,069</u> | <u>\$480,853</u> |

Statements of Additional Paid-in Capital

For the years ended June 30, 1978 and 1977

| | <u>1978</u> | <u>1977</u> |
|--|-----------------------|-----------------|
| | <i>(In Thousands)</i> | |
| BALANCE AT BEGINNING OF YEAR. | \$73,338 | \$73,331 |
| Transfer of amount assigned to common stock purchase warrants resulting from the expiration of unexercised warrants (Note 6). | 6,750 | — |
| Income tax reduction to Company resulting from sales by employees of common shares issued under stock option plan. | <u>—</u> | <u>7</u> |
| BALANCE AT END OF YEAR... | <u>\$80,088</u> | <u>\$73,338</u> |

The accompanying notes are an integral part of these statements.

Statements of Changes in Financial Position

For the years ended June 30, 1978 and 1977

| | 1978 | 1977 |
|--|-----------------------|-------------|
| | <i>(In Thousands)</i> | |
| FUNDS PROVIDED BY: | | |
| Net income. | \$131,127 | \$ 92,380 |
| Add (deduct) items not affecting working capital— | | |
| Depreciation and amortization. | 168,194 | 166,238 |
| Deferred income taxes. | 23,703 | 15,119 |
| Unrealized loss (gain) on translation of long-term portion of debt payable in sterling | 3,517 | (1,819) |
| Investment tax credits, net. | 2,550 | 37,743 |
| Other. | (333) | 886 |
| Total from operations. | 328,758 | 310,547 |
| Long-term financing— | | |
| Capitalized leases. | 3,109 | 932 |
| Other. | — | 1,087 |
| Disposition of property and equipment (book value). | 20,612 | 44,093 |
| Other. | 1,438 | 580 |
| | 353,917 | 357,239 |
| FUNDS USED FOR: | | |
| Property and equipment additions— | | |
| Flight equipment and advances. | 200,820 | 228,189 |
| Ground property and equipment. | 30,837 | 20,790 |
| | 231,657 | 248,979 |
| Reduction of long-term debt, net of unrealized foreign currency gains | 76,792 | 113,671 |
| Prior years' income taxes. | 17,400 | — |
| Cash dividends. | 14,911 | 13,916 |
| Increase in long-term notes receivable. | 2,671 | — |
| Preoperating expenses. | 913 | — |
| Other. | 1,502 | 1,529 |
| | 345,846 | 378,095 |
| INCREASE (DECREASE) IN WORKING CAPITAL. | \$ 8,071 | \$ (20,856) |
| CHANGES IN WORKING CAPITAL COMPONENTS: | | |
| Increase (decrease) in— | | |
| Cash and short-term investments. | \$ 71,799 | \$ (30,596) |
| Accounts receivable, net. | 36,427 | 18,364 |
| Other current assets. | 164 | (1,481) |
| Decrease (increase) in— | | |
| Current maturities of long-term debt. | 17,897 | 23,826 |
| Accounts payable and accrued liabilities. | (27,132) | (11,581) |
| Air traffic liability. | (39,256) | (13,495) |
| Accrued income taxes. | (51,828) | (5,893) |
| | \$ 8,071 | \$ (20,856) |

The accompanying notes are an integral part of these statements.

Notes to Financial Statements

June 30, 1978 and 1977

1. SUMMARY OF ACCOUNTING POLICIES:

Passenger Revenue—Passenger ticket sales are recorded as revenue when the transportation is used. The value of unused tickets is included in current liabilities in the financial statements.

Depreciation—Substantially all of the Company's flight equipment is being depreciated on a straight-line basis to residual values (10% of cost) over a 10-year period from dates placed in service. Ground property and equipment is depreciated on a straight-line basis over its estimated service life (various lives ranging from three to 30 years).

Maintenance and Repairs—All maintenance and repair costs, including engine and airframe overhauls, are charged to maintenance expense when incurred. Major replacements and betterments are capitalized.

Preoperating Expenses—When major new routes or new types of aircraft are introduced, leasing, training and other major costs incurred are deferred and then amortized on a straight-line basis generally over a period of two years or less. Preoperating expenses related to the new Atlanta-London route are being amortized over a 17-month period which began in May, 1978.

Interest Capitalized—Interest on advances for new equipment is capitalized based on the Company's current interest rate on long-term debt in order to properly reflect the total cost of acquiring such equipment. Capitalization of interest ceases when the equipment is placed in service. Assuming all interest had been charged to expense as incurred, net income would have been lower by approximately \$595,000 in 1978 and higher by approximately \$1,118,000 in 1977.

Foreign Currency Transactions—Realized and unrealized foreign exchange adjustments are included in income on a current basis.

Retirement Plans—All of the Company's permanent employees are covered under its noncontributory trustee plans providing for retirement, disability and survivor benefits. The total expense under these plans amounted to approximately \$61,364,000 in 1978 and \$52,324,000 in 1977. The Company's policy is to fund each year's accrued costs under the plans, which costs include amortization of prior service costs (\$47,924,000 at June 30, 1977) over varying periods up to thirty years. As of June 30, 1977 (date of the most recent actuarial study), the actuarially computed present value of vested benefits under the retirement plans exceeded the assets of those plans by approximately \$10,776,000.

Income Taxes—Total income taxes are provided by applying the applicable tax rates to book income before income taxes. Deferred income taxes are provided for all significant items (principally depreciation and other property items) where there is a timing difference in recording such items for financial reporting purposes and for income tax purposes. Investment tax credits are amortized (as a reduction of the provision for income taxes) over seven years. (See Note 5).

Earnings Per Share—Net income per common share is computed based on the weighted average number of outstanding shares during the year (19,880,577 shares in 1978 and 1977). Outstanding stock options and warrants (see Note 6) in 1978 and 1977, had no material dilutive effect on net income per common share during the periods.

2. AIRCRAFT PURCHASE AND SALE COMMITMENTS:

At June 30, 1978, the Company had outstanding purchase commitments for the acquisition of 28 Boeing B-727-200 aircraft, six Lockheed L-1011-1 and five L-1011-500 aircraft, including related spare engines, which will require future expenditures of approximately \$607,000,000 during fiscal years 1979 through 1982. The delivery of the last 14 Boeing B-727-200 aircraft can be confirmed by the Company at specified interim dates to August, 1979. Subsequent to June 30, 1978, the Company confirmed delivery of four of the Boeing B-727-200 aircraft. The last two Lockheed L-1011-1 aircraft are cancelable by specified interim dates to February 28, 1979, and the last three Lockheed L-1011-500's are cancelable by specified interim dates to November 1, 1979.

The Company has entered into agreements to sell three Douglas DC-9-32 aircraft, which agreements provide for delivery of the aircraft during fiscal 1979.

3. LONG-TERM DEBT:

At June 30, 1978 and 1977, the Company's long-term debt (including current maturities) was as follows:

| | 1978 | 1977 |
|--|-----------------------|------------------|
| | <i>(In Thousands)</i> | |
| a) Due Lazard Brothers & Co., Limited, under 5½%, 6% and 7½% unsecured notes, repayable in pounds sterling in semiannual installments to 1986 (\$7,246,000 payable in fiscal 1979). | | |
| At original exchange rates. | \$ 60,790 | \$ 69,993 |
| Less unrealized gain on— | | |
| Current maturities. | (1,957) | (2,420) |
| Long-term portion. | <u>(10,021)</u> | <u>(15,572)</u> |
| At current exchange rates. | 48,812 | 52,001 |
| b) Due banks under 1973 unsecured credit agreement, (as amended in 1978), repayable in quarterly installments of \$11,000,000 with the remaining \$46,700,000 balance payable on June 30, 1981. The interest rate is equal to the prime rate (\$77,300,000 voluntarily prepaid at June 30, 1978, without penalty). | 101,653 | 168,000 |
| c) Convertible Subordinated Debentures, 6½%, maturing August 1, 1986, with annual sinking fund redemptions of \$1,100,000. The remaining obligations at June 30, 1978 and 1977, are after deducting \$2,020,000 and \$2,200,000 of debentures, respectively, acquired for future sinking fund requirements (Note 6). | 17,780 | 18,700 |
| d) Due an insurance company under a 9¾% unsecured note. | — | 17,500 |
| e) Other notes, with various interest rates and maturity dates (\$1,964,000 payable in fiscal 1979). | 4,745 | 7,992 |
| f) Capitalized leases (Note 4) (\$521,000 payable in fiscal 1979). | <u>4,072</u> | <u>932</u> |
| Total. | 177,062 | 265,125 |
| Less—Current maturities. | <u>(9,731)</u> | <u>(27,628)</u> |
| | <u>\$167,331</u> | <u>\$237,497</u> |

In the opinion of management, funds provided from operations will sufficiently cover future expenditures for aircraft (see Note 2) and scheduled debt maturities. At June 30, 1978, the aggregate annual maturities of long-term debt for the next five fiscal years were as follows:

| | <u>Amount</u> |
|------------|-----------------------|
| | <i>(In Thousands)</i> |
| 1979. | \$ 9,731 |
| 1980. | 31,259 |
| 1981. | 89,277 |
| 1982. | 9,605 |
| 1983. | <u>9,658</u> |

In addition to restrictions on cash dividends as indicated on the balance sheet, the Company's debt agreements include requirements for maintenance of working capital (as defined) and limitations on indebtedness, leases and other obligations. In connection with the 1973 bank credit agreement, the Company has informally agreed to maintain on deposit with the lending banks average balances (including normal working balances) equal to 15% (reduced to 10% effective June 30, 1978) of the average daily outstanding borrowings, with the average balances and borrowings being computed over the term of the agreement. There are no legal restrictions on the Company's use of these funds.

4. LEASE OBLIGATIONS:

At June 30, 1978, the Company leased seven Boeing B-727 and two Lockheed L-1011-100 aircraft and certain airport terminal and maintenance facilities, ticket offices, etc., under long-term agreements. Rental expense was \$38,924,000 in 1978 and \$36,135,000 in 1977, including rentals under noncapitalized capital leases (pre-1977 leases) of \$5,519,000 in 1978 and 1977.

At June 30, 1978, the Company's minimum rental commitments under noncapitalized capital leases and noncancelable operating leases with initial or remaining terms of more than one year were as follows:

| Payable for Fiscal Year | Noncap- italized Capital Leases | Operating Leases | | Total |
|----------------------------|--|------------------|-----------------|------------------|
| | | Municipal | Other | |
| | | (In Thousands) | | |
| 1979 | \$ 5,470 | \$ 19,110 | \$11,940 | \$ 36,520 |
| 1980 | 5,380 | 18,620 | 5,320 | 29,320 |
| 1981 | 5,370 | 17,300 | 2,660 | 25,330 |
| 1982 | 3,690 | 16,300 | 2,260 | 22,250 |
| 1983 | 880 | 15,680 | 1,950 | 18,510 |
| After 1983 | <u>1,780</u> | <u>220,230</u> | <u>16,160</u> | <u>238,170</u> |
| | <u>\$22,570</u> | <u>\$307,240</u> | <u>\$40,290</u> | <u>\$370,100</u> |

The estimated present value (based on a weighted average interest rate in 1978 of 6.0%, with such interest rates used ranging from 5.1% to 8.5%) of the minimum rental commitments under noncapitalized capital leases (pre-1977 leases) was as follows at June 30, 1978 and 1977:

| Applicable to | 1978 | 1977 |
|--------------------------|-----------------------|-----------------|
| | <i>(In Thousands)</i> | |
| Aircraft leases. | \$16,290 | \$18,970 |
| Other leases. | 2,960 | 3,350 |
| | <u>\$19,250</u> | <u>\$22,320</u> |

Assuming all noncapitalized capital leases were capitalized and amortized, the effect on the 1978 and 1977 financial statements would not have been significant. In fiscal 1978 and 1977, the Company capitalized all new leases defined as capital leases under Financial Accounting Standards Board Statement No. 13. The effect on the 1978 and 1977 financial statements of capitalizing and amortizing these leases is not significant.

The Company is participating in a major expansion of terminal facilities at Hartsfield Atlanta International Airport. Total project cost (excluding tenant improvements) is presently estimated at approximately \$240,000,000. The Company's share of this project cost, plus estimated leasehold improvements, is approximately \$80,000,000. The Company's annual rentals beginning in 1981 (the planned first year of operation) and other costs associated with the new facility are presently estimated at \$20,000,000.

5. INCOME TAXES:

The provision for income taxes in 1978 and 1977 consisted of:

| | 1978 | 1977 |
|---|-----------------------|-----------------|
| | <i>(In Thousands)</i> | |
| Current taxes..... | \$ 67,392 | \$ 9,805 |
| Deferred taxes..... | 23,703 | 15,119 |
| Investment tax credits..... | <u>18,201</u> | <u>51,438</u> |
| Income taxes provided..... | 109,296 | 76,362 |
| Less—Amortization of investment tax credits..... | <u>(15,651)</u> | <u>(13,695)</u> |
| | <u>\$ 93,645</u> | <u>\$62,667</u> |

Total income taxes provided were approximately 49% of 1978 and 1977 book income before income taxes, representing taxes provided at the 48% Federal statutory rate plus state income taxes. As of June 30, 1978, all available investment tax credits have been utilized to reduce Federal income taxes payable.

The provision for deferred income taxes resulted from the tax effect of the following timing differences:

| | <u>1978</u> | <u>1977</u> |
|--|-----------------------|-----------------|
| | <i>(In Thousands)</i> | |
| Depreciation and other property items. | \$22,210 | \$14,124 |
| Other, net. | <u>1,493</u> | <u>995</u> |
| | <u>\$23,703</u> | <u>\$15,119</u> |

In June, 1978, the Company reached agreement with the Internal Revenue Service providing for settlement of proposed income tax deficiencies for fiscal years 1966 through 1972. These taxes had been provided for in prior years. In the opinion of management, adequate provisions have been made for income taxes for fiscal years 1973 through 1978.

6. COMMON STOCK:

At June 30, 1978, the Company had 71,120 common shares reserved for conversion (at \$250 per share) of the Convertible Subordinated Debentures. Warrants for the purchase of 500,000 shares of the Company's common stock at \$48 per share expired unexercised on May 1, 1978.

Under the Company's Qualified Stock Option Plan, the remaining outstanding options for 1,250 shares at \$51.75 per share expired unexercised in May, 1978. These options were outstanding and exercisable at June 30, 1977.

7. CONTINGENCIES:

The Company is a defendant in certain legal actions relating to environmental problems (primarily noise), employee benefit plans, alleged employee discrimination and other matters. Given the unsettled status of the law in many of the areas involved, the outcome of these actions is difficult to predict. In the present opinion of management and its legal counsel, however, the disposition of these matters will not have a material adverse effect on the Company's financial condition or significantly interfere with its operations.

8. QUARTERLY FINANCIAL DATA (Unaudited):

| | Three Months Ended | | | |
|---|---------------------------------|-----------------|----------------|----------------|
| | Sept.30 | Dec.31 | Mar.31 | June 30 |
| | (In millions, except per share) | | | |
| <i>Fiscal 1978</i> | | | | |
| Operating revenues. . . | <u>\$465.1</u> | <u>\$508.6</u> | <u>\$518.7</u> | <u>\$558.5</u> |
| Operating income. . . . | <u>\$ 34.1</u> | <u>\$ 59.0</u> | <u>\$ 42.1</u> | <u>\$ 69.9</u> |
| Net income. | <u>\$ 27.1</u> | <u>\$ 33.5*</u> | <u>\$ 27.4</u> | <u>\$ 43.1</u> |
| Net income per share. | <u>\$ 1.36</u> | <u>\$ 1.68</u> | <u>\$ 1.38</u> | <u>\$ 2.18</u> |
| Net income includes after-tax gain on sales of aircraft of. . . | <u>\$ 7.9</u> | <u>\$ 3.1</u> | <u>\$ 2.6</u> | <u>\$ 3.1</u> |
| *Includes after-tax income of \$7.7 million or 39¢ per share from increases in temporary mail rates retroactive to 1973. | | | | |
| <i>Fiscal 1977</i> | | | | |
| Operating revenues. . . | <u>\$402.8</u> | <u>\$420.1</u> | <u>\$440.3</u> | <u>\$456.4</u> |
| Operating income. . . . | <u>\$ 26.6</u> | <u>\$ 32.2</u> | <u>\$ 31.9</u> | <u>\$ 50.5</u> |
| Net income. | <u>\$ 17.9</u> | <u>\$ 18.5</u> | <u>\$ 22.2</u> | <u>\$ 33.8</u> |
| Net income per share. | <u>\$.90</u> | <u>\$.93</u> | <u>\$ 1.12</u> | <u>\$ 1.70</u> |
| Net income includes after-tax gain on sales of aircraft of. . . | <u>\$ 2.5</u> | <u>\$ 1.9</u> | <u>\$ 5.0</u> | <u>\$ 5.5</u> |

9. PROPERTY AND EQUIPMENT

REPLACEMENT COST (Unaudited):

For operating expenses such as salaries and wages, fuel, supplies, etc., the Company's financial statements generally reflect current prices. However, the Company's substantial investment in productive capacity (flight equipment and ground property and equipment) and the related depreciation expense are based on historical cost. Although a major portion of the Company's aircraft seat capacity has been purchased in recent years, the financial statements do not reflect the higher current replacement cost of the Company's entire productive capacity resulting from the cumulative impact of inflation. Further, the Civil Aeronautics Board presently makes no allowance for these higher replacement costs in determining airline fares and rates.

As required by the Securities and Exchange Commission, the Company's 1978 Form 10-K Annual Report (copy of which is available on request) contains unaudited data on the approximate replacement cost of the Company's property and equipment as of June 30, 1978 and 1977, and the approximate effect which replacement cost might have on depreciation expense for fiscal 1978 and 1977.

Auditors' Report

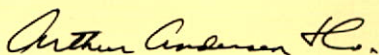
ARTHUR ANDERSEN & CO.

ATLANTA, GEORGIA

To the Stockholders and the Board of
Directors of Delta Air Lines, Inc.:

We have examined the balance sheets of DELTA AIR LINES, INC. (a Delaware corporation) as of June 30, 1978 and 1977, and the related statements of income, retained earnings, additional paid-in capital and changes in financial position for the years then ended. Our examinations were made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the financial statements referred to above present fairly the financial position of Delta Air Lines, Inc. as of June 30, 1978 and 1977, and the results of its operations and the changes in its financial position for the years then ended, in conformity with generally accepted accounting principles applied on a consistent basis.



Atlanta, Georgia,
August 18, 1978.

Summary of Operations

For the years ended June 30
(Dollars expressed in thousands except per share figures)

| | <u>1978</u> |
|---|------------------|
| Operating revenues: | |
| Passenger. | \$ 1,861,100 |
| Cargo. | 153,233 |
| Other, net. | <u>36,578</u> |
| Total operating revenues. | 2,050,911 |
| Operating expenses. | <u>1,845,816</u> |
| Operating income. | \$ 205,095 |
| Interest expense, etc., net*. | 9,673 |
| Gain on disposition of aircraft. | 32,689 |
| Realized and unrealized loss (gain) on foreign currency translation. | <u>3,339</u> |
| Income before income taxes. | \$ 224,772 |
| Income taxes. | <u>93,645</u> |
| Net income. | \$ 131,127 |
| Net income per share. | \$6.60 |
| Dividends paid. | \$14,911 |
| Dividends paid per share. | \$.75 |
| *Has been reduced by interest capitalized of. | \$4,794 |

Other Financial and Statistical Data

| | |
|---|------------|
| Long-term debt. | \$ 167,331 |
| Stockholder equity. | \$ 736,799 |
| Stockholder equity per share. | \$37.06 |
| Shares of common stock outstanding. | 19,880,577 |
| Revenue passengers enplaned. | 33,007,670 |
| Available seat miles (000). | 35,135,046 |
| Revenue passenger miles (000). | 20,825,722 |
| Passenger load factor. | 59.27% |
| Break-even load factor. | 52.74% |
| Available ton miles (000). | 4,743,778 |
| Revenue ton miles (000). | 2,426,265 |
| Passenger revenue per passenger mile. | 8.94¢ |
| Operating expenses per available seat mile. | 5.25¢ |
| Operating expenses per available ton mile. | 38.91¢ |

| <u>1977</u> | <u>1976</u> | <u>1975</u> | <u>1974</u> |
|------------------|------------------|------------------|------------------|
| \$1,575,642 | \$1,406,417 | \$1,271,720 | \$1,124,759 |
| 114,800 | 100,626 | 85,388 | 86,685 |
| <u>29,203</u> | <u>21,899</u> | <u>19,922</u> | <u>15,683</u> |
| 1,719,645 | 1,528,942 | 1,377,030 | 1,227,127 |
| <u>1,578,464</u> | <u>1,411,333</u> | <u>1,282,000</u> | <u>1,070,043</u> |
| \$ 141,181 | \$ 117,609 | \$ 95,030 | \$ 157,084 |
| 18,236 | 29,103 | 28,984 | 14,377 |
| 29,403 | 7,680 | 7,944 | 18,607 |
| <u>(2,699)</u> | <u>(13,357)</u> | <u>(5,855)</u> | <u>—</u> |
| \$ 155,047 | \$ 109,543 | \$ 79,845 | \$ 161,314 |
| <u>62,667</u> | <u>39,336</u> | <u>27,965</u> | <u>70,665</u> |
| \$ 92,380 | \$ 70,207 | \$ 51,880 | \$ 90,649 |
| \$4.65 | \$3.53 | \$2.61 | \$4.56 |
| \$13,916 | \$11,928 | \$11,928 | \$11,926 |
| \$.70 | \$.60 | \$.60 | \$.60 |
| \$2,922 | \$3,247 | \$6,099 | \$10,810 |
| \$ 237,497 | \$ 350,968 | \$ 390,437 | \$ 345,119 |
| \$ 620,583 | \$ 542,112 | \$ 483,833 | \$ 443,826 |
| \$31.22 | \$27.27 | \$24.34 | \$22.33 |
| 19,880,577 | 19,880,577 | 19,880,577 | 19,879,377 |
| 28,811,966 | 27,996,665 | 25,831,631 | 25,565,208 |
| 32,614,260 | 30,389,761 | 29,497,234 | 28,417,679 |
| 18,042,339 | 17,621,247 | 15,916,860 | 15,445,891 |
| 55.32% | 57.98% | 53.96% | 54.35% |
| 50.36% | 53.14% | 49.93% | 46.76% |
| 4,478,038 | 4,145,183 | 4,030,116 | 3,847,226 |
| 2,113,798 | 2,034,848 | 1,822,574 | 1,800,400 |
| 8.73¢ | 7.98¢ | 7.99¢ | 7.28¢ |
| 4.84¢ | 4.64¢ | 4.35¢ | 3.77¢ |
| 35.25¢ | 34.05¢ | 31.81¢ | 27.81¢ |

Management's Analysis and Discussion of Summary of Operations

A comparison of the results of operations for fiscal years 1978 and 1977 can be found in previous sections of this report. The following is a comparison of the results of 1977 and 1976.

Fiscal 1977 earnings of \$92.4 million were 32% above the \$70.2 million earned in 1976. Total operating revenues were \$1.72 billion, an increase of 12% over 1976. Passenger revenue rose 12% on a 2% growth in revenue passenger miles and a 9% increase in the passenger mile yield. Cargo revenue was up 14% reflecting the general growth in the economy during fiscal 1977 and a 6% increase in the average yield. Charter revenues increased 137% as the Company transferred six DC-8-51 aircraft from scheduled service to full-time charter operations to take advantage of liberalized charter regulations.

Operating expenses increased \$167.1 million or 12% over fiscal 1976. Operating capacity grew 7% to 32.61 billion available seat miles. Increases in salaries and related costs and aircraft fuel expenses accounted for \$124.3 million of the \$150 million increase in cash costs. The average level of employment rose 2%. The average price per gallon of fuel was 33.34¢, up 11%, while the total fuel consumed increased 4%. Depreciation expense was 12% higher in fiscal 1977 than 1976 due to the introduction of new aircraft and the acquisition of 11 aircraft previously leased.

Lower interest rates and a reduced level of borrowing resulted in a 25% decline in interest expense. Interest capitalized was down 10%. The sale of aircraft resulted in a gain of \$29.4 million, 75¢ per share after taxes, in fiscal 1977 compared to a gain of \$7.7 million, 20¢ per share after taxes, in fiscal 1976. Gain on foreign currency translation totaled \$2.7 million in 1977 and \$13.4 million in 1976.

Income taxes were provided on book income at the rate of approximately 49% in both years. The amortization of investment tax credits reduced those provisions by \$13.7 million in 1977 and \$14.6 million in 1976.



Board of Directors

| | |
|--|---|
| R.W. ALLEN ³ | <i>Senior Vice President—Personnel</i> |
| W.T. BEEBE ³ | <i>Chairman of the Board</i> |
| B.W. BIEDENHARN ³ | <i>Chairman of the Board and Director, Ouachita Coca-Cola Bottling Co. and Biedenharn Realty Co., Inc. President and Director, Ouachita Candy Co. Monroe, Louisiana</i> |
| R.W. COURTS ^{2, 4} | <i>Director and Chairman of the Executive Committee, Atlantic Realty Co., Atlanta, Georgia</i> |
| C.H. DOLSON ³ | <i>Chairman of the Executive Committee</i> |
| R.W. FREEMAN ^{2, 4} | <i>Chairman of the Compensation and Finance Committees; Chairman of the Board and Director, Louisiana Coca-Cola Bottling Co., Ltd. New Orleans, Louisiana</i> |
| DAVID C. GARRETT, JR. ³ | <i>President and Chief Executive Officer</i> |
| EDWARD H. GERRY ⁴ | <i>Partner of Gerry Brothers & Co., Investment Management, New York, New York</i> |
| JESSE HILL, JR. ¹ | <i>President, Chief Executive Officer and Director, Atlanta Life Insurance Company, Atlanta, Georgia</i> |
| JOHN R. LONGMIRE ¹ | <i>Partner of investment banking firm of I. M. Simon & Co., St. Louis, Missouri</i> |
| R.S. MAURER ³ | <i>Vice Chairman of the Board and Secretary</i> |
| BILL MICHAELS ¹ | <i>Chairman of the Audit Committee; Chairman of the Board, Chief Executive Officer and Director, Storer Broadcasting Co., Miami, Florida</i> |
| T.M. MILLER ^{2, 4} | <i>Retired Senior Vice President—Marketing</i> |
| ROBERT OPPENLANDER ³ | <i>Senior Vice President—Finance</i> |
| STUART W. PATTON ¹ | <i>Member of law firm of Patton, Kanner, Segal, Zeller, King & Middelthon and Director of Storer Broadcasting Co., Miami, Florida</i> |
| CARLETON PUTNAM ¹ | <i>Private Investments</i> |
| GEORGE M. SNELLINGS, JR. ^{2, 4} | <i>Member of law firm of Snellings, Beard, Sartor, Inabnett & Trascher, Monroe, Louisiana</i> |

¹ Audit Committee

² Compensation Committee

³ Executive Committee

⁴ Finance Committee

Officers**EXECUTIVE**

| | |
|-----------------------|---|
| W.T. BEEBE | <i>Chairman of the Board</i> |
| DAVID C. GARRETT, JR. | <i>President and Chief Executive Officer</i> |
| R.S. MAURER | <i>Vice Chairman of the Board and Secretary</i> |

CORPORATE AFFAIRS

| | |
|------------------|--|
| MORRIS SHIPLEY | <i>Vice President—Government Affairs</i> |
| ROBERT H. COWART | <i>Asst. Vice President—Consumer Affairs</i> |
| M.E. DULLUM | <i>Asst. Vice President—Government Affairs</i> |
| C.G. SWEAZEA | <i>Asst. Vice President—Public Affairs</i> |
| IKE LASSETER | <i>Asst. Secretary</i> |

FINANCE

| | |
|--------------------|---|
| ROBERT OPPENLANDER | <i>Senior Vice President—Finance</i> |
| W.A. ATCHISON | <i>Vice President—Computer Services</i> |
| J.D. DUNN | <i>Vice President—Purchasing</i> |
| M.O. GALLOWAY | <i>Vice President—Finance</i> |
| REX A. McCLELLAND | <i>Vice President—Properties</i> |
| JULIUS P. GWIN | <i>Comptroller</i> |
| FRANK S. CHEW | <i>Treasurer</i> |
| HUGH H. SAXON | <i>Asst. Treasurer</i> |
| AUDLY TOLLER, JR. | <i>Asst. Treasurer</i> |

FLIGHT OPERATIONS

| | |
|---------------|--|
| FRANK F. ROX | <i>Senior Vice President—Flight Operations</i> |
| C.A. SMITH | <i>Vice President—Flight Operations</i> |
| JACK S. KING | <i>Asst. Vice President—Flight Control</i> |
| L.G. RODEFELD | <i>Asst. Vice President—Communications</i> |

LEGAL

| | |
|-----------------|---|
| J.W. CALLISON | <i>Senior Vice President—General Counsel</i> |
| SIDNEY F. DAVIS | <i>Vice President—Assistant General Counsel and Assistant Secretary</i> |
| E.A. THOMPSON | <i>Asst. Vice President—Economic Research</i> |

MARKETING

| | |
|-------------------|--|
| J.A. COOPER | <i>Senior Vice President—Marketing</i> |
| R.L. GIBSON | <i>Vice President—Traffic</i> |
| CHARLES P. KNECHT | <i>Vice President—Marketing</i> |
| J.T. MAPLES | <i>Asst. Vice President—Marketing Planning</i> |
| R.A. McKINNON | <i>Asst. Vice President—Marketing Administration</i> |
| HENRY ROSS | <i>Asst. Vice President—Sales Promotion</i> |

PASSENGER SERVICE

| | |
|------------------|--|
| HOLLIS L. HARRIS | <i>Senior Vice President—Passenger Service</i> |
| E.L. HAMNER | <i>Vice President—Stations</i> |
| FOY PHILLIPS | <i>Vice President—Passenger Service</i> |
| JEANETTE EASLEY | <i>Asst. Vice President—Passenger Service</i> |
| C.A. THOMPSON | <i>Asst. Vice President—Stations</i> |

PERSONNEL

| | |
|-------------------|--|
| R.W. ALLEN | <i>Senior Vice President—Personnel</i> |
| RUSSELL H. HEIL | <i>Vice President—Personnel Administration</i> |
| JOHN HUME | <i>Vice President—Personnel</i> |
| J.A. YORK | <i>Vice President—Employee Benefits</i> |
| H.M. JOHNSON | <i>Asst. Vice President—Employment</i> |
| EUGENE H. STEWART | <i>Asst. Vice President—Corporate Security</i> |

TECHNICAL OPERATIONS

| | |
|------------------|---|
| HOYT T. FINCHER | <i>Senior Vice President—Technical Operations</i> |
| D.P. HETTERMANN | <i>Vice President—Technical Operations</i> |
| J.K. BURNETTE | <i>Asst. Vice President—Quality Control</i> |
| JOHN P. DAVIS | <i>Asst. Vice President—Maintenance</i> |
| R. LAMAR DURRETT | <i>Asst. Vice President—Facilities</i> |
| A.C. FORD | <i>Asst. Vice President—Long Range Planning</i> |
| C.J. MAY | <i>Asst. Vice President—Engineering</i> |
| W.L. MILLER | <i>Asst. Vice President—Material Services</i> |

Transfer Agent and Registrar

The Citizens and Southern National Bank
99 Annex
Atlanta, Georgia 30399

Auditors

Arthur Andersen & Co.
25 Park Place, N.E.
Atlanta, Georgia 30303

Annual Meeting

October 26, 1978, Monroe, Louisiana

Common Stock

Listed on the New York Stock Exchange

Market Prices and Dividends

| <i>Fiscal Year 1978</i> | <i>Market Price Range of Common Stock on New York Stock Exchange</i> | | <i>Cash Dividends Paid Per Share</i> |
|-------------------------|--|------------------|--|
| <i>Quarter Ended:</i> | <i>High</i> | <i>Low</i> | |
| September 30. | 36 $\frac{7}{8}$ | 32 $\frac{1}{2}$ | \$.175 |
| December 31. | 40 $\frac{1}{8}$ | 32 $\frac{3}{8}$ | .175 |
| March 31. | 40 $\frac{3}{4}$ | 36 $\frac{3}{4}$ | .20 |
| June 30. | 49 $\frac{5}{8}$ | 38 $\frac{7}{8}$ | .20 |
| <i>Fiscal Year 1977</i> | | | |
| <i>Quarter Ended:</i> | | | |
| September 30. | 44 $\frac{1}{2}$ | 36 $\frac{1}{4}$ | \$.175 |
| December 31. | 41 | 34 $\frac{1}{2}$ | .175 |
| March 31. | 39 $\frac{1}{4}$ | 30 | .175 |
| June 30. | 38 | 30 | .175 |

Availability of Form 10-K

The Company will supply, upon written request and without charge, a copy of the Company's annual report for the fiscal year 1978 on Form 10-K to any person beneficially owning or owning of record any of the common stock of the Company on September 5, 1978. Requests for the report should be directed to R.S. Maurer, Secretary, Delta Air Lines, Inc., Hartsfield Atlanta International Airport, Atlanta, Ga. 30320.

Notice to the Stockholders of Delta Air Lines, Inc.

Part 245 of the Economic Regulations of the Civil Aeronautics Board provides that: (1) any person who either owns, as of December 31st of the year preceding issuance of this annual report, or subsequently acquires, beneficially or as trustee, more than 5%, in the aggregate, of any class of the capital stock or capital of Delta Air Lines, Inc., shall file with the Board a report containing the information required by Sec. 245.12 of Subpart 245, 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 the stock subsequently acquired, a report under Sec. 245.13, within 10 days after such acquisition, unless such person has otherwise filed with the Board a report covering 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 Section 245.14; and (3) any person required to report under this subpart who grants a security interest in more than 5% of any class of the capital stock or capital of Delta Air Lines, Inc. shall within 30 days after granting such security interest file with the Board a report containing the information required in Section 245.15. 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.

**Delta Air Lines, Inc.
General Offices,
Hartsfield Atlanta International Airport
Atlanta, Georgia 30320**

