

Seventeenth ANNUAL REPORT 1956

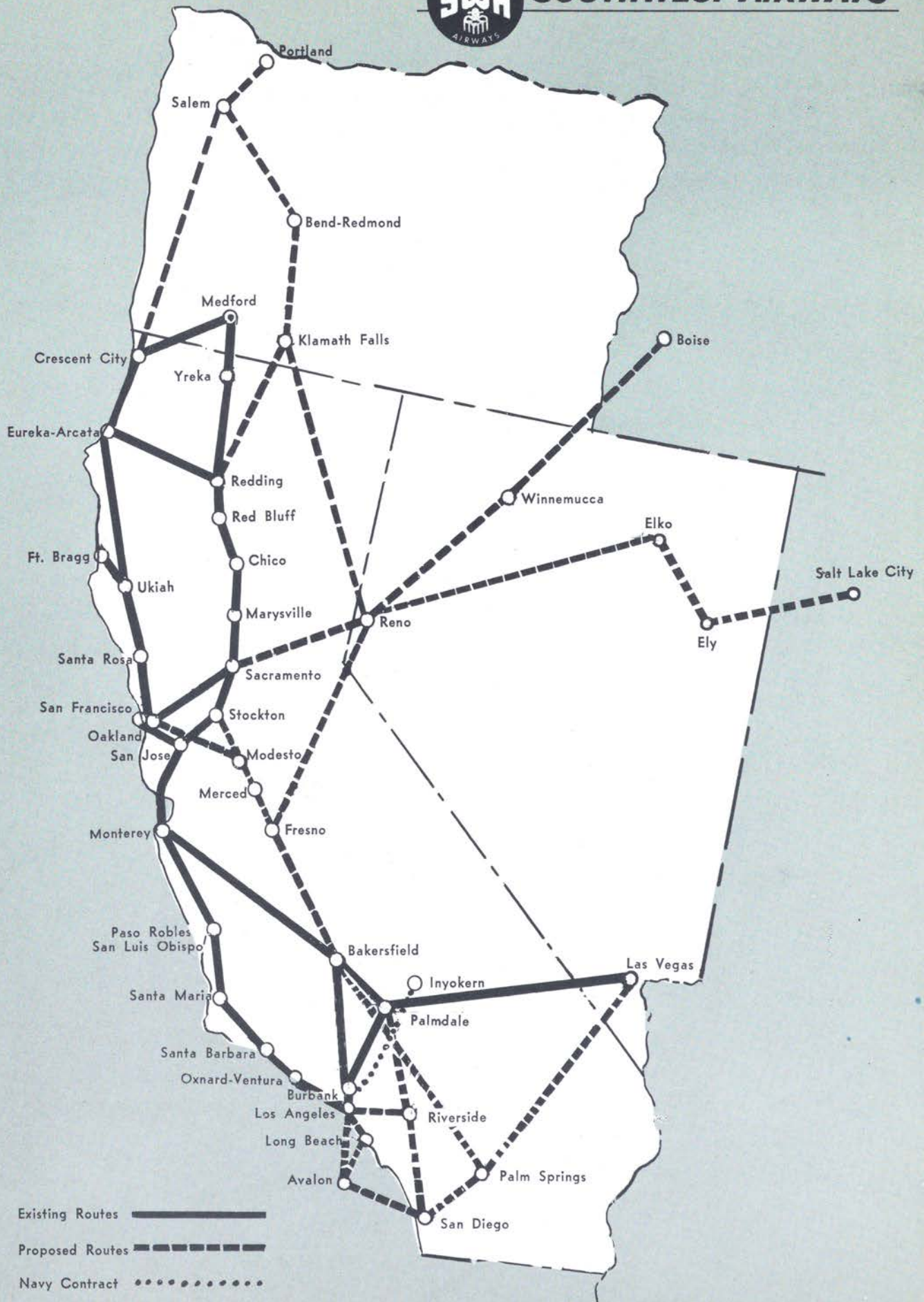


40-PASSENGER FAIRCHILD F-27 TURBO-JET

SOUTHWEST AIRWAYS



SOUTHWEST AIRWAYS



Existing Routes —————
Proposed Routes - - - - -
Navy Contract
.....



SOUTHWEST AIRWAYS COMPANY

General Offices:
San Francisco International Airport
San Francisco, California

OFFICERS

John H. Connelly *President and General Manager*
 T. R. Mitchell *Executive Vice-President*
 *Alwin W. Johnson *Vice-President and Treasurer*
 E. Roger Dahl (Elected Sept. 1957) . . . *Treasurer*
 R. E. Costello *Vice-President—Traffic and Sales*
 Max A. King *Vice-President—Public Relations*
 Walter Roche *Secretary*
 Floyd Hendrickson *Assistant Secretary*

BOARD OF DIRECTORS

Leland Hayward, *Chairman*

Bert Allenberg	*Alwin W. Johnson
John H. Connelly	T. R. Mitchell
R. E. Costello (Elected June 1957)	Daniel O'Shea
Floyd Hendrickson	Walter Roche

William B. Smullin

AUDITORS

PRICE WATERHOUSE & CO.
120 Montgomery Street, San Francisco, California

REGISTRAR

Bank of America
300 Montgomery Street
San Francisco

TRANSFER AGENT

Crocker-Anglo National Bank
1 Montgomery Street
San Francisco

*Resigned 12/31/56



SOUTHWEST AIRWAYS

A DECADE OF PROGRESS

FINANCIAL

	Total Revenues	Operating Expenses	Non-Operating Income (Expense)	Net Profit or (Loss) After Taxes
1947	\$2,214,961	\$2,172,077	\$ (37,403)	\$ 5,481
1948	2,363,753	2,283,989	(15,602)	28,062
1949	2,398,580	2,263,878	(481)	81,143
1950	2,213,745	1,968,883	(16,856)	135,473
1951	2,390,964	2,352,265	56,932	73,231
1952	2,883,069	2,740,413	(3,942)	86,714
1953	3,271,655	3,401,012	(14,596)	(90,812)
1954	3,455,519	3,185,691	(39,089)	126,739
1955	4,228,022	4,056,575	16,855	115,518
1956	5,225,736	5,154,251	(48,230)	5,010*



OPERATIONS AND TRAFFIC

	Revenue Miles Flown	Number of Passengers Carried			Seat Miles—Schedule Service		
		Scheduled Service	Charter Etc.	Total	Available	Sold	Load Factor or % Sold
1947	1,854,117	83,994	1,082	85,076	38,627,001	15,160,237	39.25%
1948	2,363,827	97,424	530	97,424	49,356,216	17,783,649	36.03
1949	2,419,695	114,573	1,345	115,918	50,399,055	20,947,484	41.56
1950	2,375,224	118,860	3,111	121,971	48,546,414	22,236,008	45.80
1951	2,526,630	135,158	2,663	137,821	51,216,039	26,332,303	51.41
1952	2,716,503	164,281	776	165,057	56,621,670	31,133,636	54.99
1953	2,845,172	178,817	9,549	188,366	63,007,173	34,763,675	55.16
1954	2,563,039	180,715	23,099	203,814	57,528,963	34,842,303	60.56
1955	3,316,457	236,083	32,535	268,618	79,005,186	47,131,928	59.66
1956	4,048,797	259,522	29,718	289,240	107,084,154	55,917,208	52.22

* See President's report opposite page, 5th paragraph, regarding temporary rates



PRESIDENT'S REPORT

TO OUR STOCKHOLDERS, EMPLOYEES AND CUSTOMERS

Although Southwest Airways Company began operations in 1939 and inaugurated its initial airline activity as a scheduled freight air carrier for the U. S. Army 16 years ago (1941), it was not until 1946 that the Company was certificated as a scheduled passenger airline by the Civil Aeronautics Board. The statistical record of these past 10 years as a certificated air carrier is reflected on the page opposite to this letter so that the Company's 659 stockholders, 460 employees, its customers, suppliers, and friends may study the past decade, note the trends, and view the future. We trust that these figures are presented clearly and briefly to enable quick interpretation.

At present your company is operating a fleet of 7 Martin 44-passenger aircraft; 11 DC-3 28-passenger aircraft; and 1 Lockheed 8-place charter plane. On February 15, 1957, an order was placed with Fairchild Engine & Airplane Company for three F-27 turbo-prop jet 40-passenger aircraft. Spare Rolls Royce Dart turbo-prop jet engines are also on order directly from Rolls Royce. Delivery of this equipment is due September 1958, and necessitated the negotiation of a \$2,600,000 loan with the Bank of America, San Francisco, California.

Labor relations with our employees is on a pleasant, sound basis. Wages are comparable to the top scale of the industry and production efficiency is the highest.

On January 19, 1956, service was inaugurated over the new San Francisco-Los Angeles segment via San Jose and Bakersfield. Since that date this route has steadily developed and at present is one of the strongest segments of your company's system with a passenger load factor of 61.1% for the second quarter of 1957. Offsetting this splendid gain was the substantial diversion of traffic attendant to the Civil Aeronautics Board decision, by a 2 to 2 vote, granting Santa Barbara and Monterey, United Air Lines service in competition with Southwest. This decision necessitates a substantial increase in Southwest's subsidy as your company is now splitting the traffic with United Air Lines between these points and the principal terminals, Los Angeles and San Francisco, and, also, of course, splitting at many other points heretofore jointly served by both companies and now connected by both to Santa Barbara and Monterey.

As your company has been on a temporary mail rate since January 9, 1956, and as it has been the policy of the Civil Aeronautics Board to grant a carrier on a temporary rate a subsidy rate calculated to cover *only* the Carrier's break-even need without

regard to profit, it is expected that the temporary rate as established may be increased to include a profit element when the final rate is resolved by the Board. We anticipate the final rate will be determined late in 1957 or early in 1958, and, of course, be retroactive to January 9, 1956.

The year of 1956 was a period of intensive route development which culminated in the 1957 award by the Civil Aeronautics Board of certification to Las Vegas, Nevada, via two routings; the 500 mile route, San Francisco-Las Vegas via San Jose and Bakersfield; and the densely-traveled 293 mile route, Burbank-Las Vegas. Service over these route segments will be inaugurated in October 1957.

During 1957, hearings before an Examiner of the Civil Aeronautics Board were held on the Company's application to extend service North to Portland and East to Reno, Salt Lake City, and Boise. This case may be decided early in 1958. Your company's investment in route development should result in a larger, stronger company in the years ahead.

You, no doubt recall that at the Annual Stockholders Meeting of June 4, 1956, the issue of changing the Company's name to PACIFIC AIRLINES, was approved. The delay in effectuating the name change is attributable to the requirement of obtaining Civil Aeronautics Board approval. For this purpose a hearing was held July 23, 1957, before an Examiner of the Civil Aeronautics Board, and a decision should be forthcoming within the next six months.

You will be pleased to know that Congress has again, as it did in the permanent certificate legislation last year, expressed its understanding of the importance of developing the local airlines by the passage of two important bills which were proposed by the local carriers: (1) in September 1957, the President signed a bill which provides that the Government will guarantee private loans for flight equipment; (2) A bill permitting airlines to issue equipment trust certificates, a privilege heretofore granted only to railroads. These two bills are designed to ease the problem of financing badly needed replacements for obsolete DC-3 aircraft so that local carriers may efficiently and more profitably serve their rapidly expanding markets.

Respectfully submitted,



B A L A N C E S H E E T

ASSETS

December 31
1956 1955

Current Assets:

Cash	\$ 114,011	\$ 188,004
Accounts receivable:		
U. S. Government—mail, passengers and other	689,596	188,796
Traffic and agents	286,157	247,845
Insurance claims receivable		178,758
Miscellaneous, less allowance for possible losses in collection (1956—\$2,692; 1955—\$467)	26,041	28,757
Employees	4,834	3,143
Inventories of materials and supplies and motor fuel, at approximate cost, not in excess of market	206,945	184,123
Prepaid expenses	119,873	68,800
	<u>\$ 1,447,457</u>	<u>\$ 1,088,226</u>

Insurance Claims Receivable

\$ 751,078

Property and Equipment, at cost

Flight equipment—pledged under note payable	\$ 3,736,446	\$ 2,442,432
Ground and other equipment	561,455	300,304
	<u>\$ 4,297,901</u>	<u>\$ 2,742,736</u>
Less—Accumulated depreciation	1,765,020	1,461,432
	<u>\$ 2,532,881</u>	<u>\$ 1,281,304</u>
Construction in progress	81,080	24,260
	<u>\$ 2,613,961</u>	<u>\$ 1,305,564</u>

Investments in Stocks of Service Organizations, at cost

\$ 4,321 \$ 4,321

Deferred Charges:

Extension and development expense	\$ 34,230	\$ 15,814
Other	164,795	25,041
	<u>\$ 199,025</u>	<u>\$ 40,855</u>
	<u>\$ 4,264,764</u>	<u>\$ 3,190,044</u>

LIABILITIES

December 31
1956 1955

Current Liabilities:

Notes payable to bank, including current instalments on long-term debt	\$ 335,210	\$ 132,000
Accounts payable	1,029,379	597,777
Taxes collected or withheld from others	79,985	69,674
Accrued expenses	134,545	79,854
Transportation sold, not yet used or refunded	28,876	22,678
Federal taxes on income (estimated)	53,821	72,658
	<u>\$ 1,661,816</u>	<u>\$ 974,641</u>

Long-Term Debt:

Notes payable to bank — secured by chattel mortgage on flight equipment (Note A):		
4% notes maturing in monthly instalments to December 15, 1960	\$ 857,000	\$ 434,000
Conditional sales contracts, payable through 1958	3,187	8,397
	<u>\$ 860,187</u>	<u>\$ 442,397</u>

Provision For Federal Income Taxes of Future Years

\$ 136,456 \$ 171,711

Capital Stock and Surplus:

Common stock:		
Authorized, 10,000,000 shares of 50c par value per share		
Issued, 671,410 shares	\$ 335,705	\$ 335,705
Paid-in surplus	246,324	246,324
Earnings retained for use in the business, per accompanying statement (Note A)	1,024,276	1,019,266
	<u>\$ 1,606,305</u>	<u>\$ 1,601,295</u>
	<u>\$ 4,264,764</u>	<u>\$ 3,190,044</u>



STATEMENT OF EARNINGS

Year Ended December 31
1956 1955

Operating revenues:		
Passenger	\$ 3,129,855	\$ 2,781,027
Mail	102,496	74,259
Charter and contract operations	224,101	293,683
Express, freight and excess baggage	95,855	94,851
Other	21,417	19,390
	<u>\$ 3,573,724</u>	<u>\$ 3,263,210</u>
Federal subsidy (Note B)	1,652,012	964,812
	<u>\$ 5,225,736</u>	<u>\$ 4,228,022</u>
Operating expenses:		
Flying operations	\$ 1,583,351	\$ 1,287,113
Flight equipment maintenance	847,228	554,057
Depreciation on flight equipment	264,646	184,450
	<u>\$ 2,695,225</u>	<u>\$ 2,025,620</u>
Ground operations	\$ 753,179	\$ 641,880
Ground and indirect maintenance	309,442	291,425
Passenger service	211,185	177,120
Traffic and sales	546,390	446,009
Advertising and publicity	193,828	107,615
General and administrative	400,023	314,456
Depreciation on ground equipment	44,979	52,450
	<u>\$ 2,459,026</u>	<u>\$ 2,030,955</u>
	<u>\$ 5,154,251</u>	<u>\$ 4,056,575</u>
Operating income	<u>\$ 71,485</u>	<u>\$ 171,447</u>
Other (income) and expenses:		
Interest	\$ 45,902	\$ 27,786
Extension and development	7,243	21,058
Net (gain) or loss on disposition of assets	(2,497)	621
Other, net	(2,418)	(14,395)
	<u>\$ 48,230</u>	<u>\$ 35,070</u>
	<u>\$ 23,255</u>	<u>\$ 136,377</u>
Estimated federal income taxes	18,245	65,784
Net earnings before extraordinary credit	<u>\$ 5,010</u>	<u>\$ 70,593</u>
Extraordinary item:		
Excess of insurance recoverable over carrying value of replacement parts, etc. destroyed by fire, less estimated federal income taxes \$7,000		44,925
Net earnings for year	<u>\$ 5,010*</u>	<u>\$ 115,518</u>
Earnings retained for use in the business:		
Balance, beginning of year	1,019,266	745,246
Excess of insurance recoverable over net book value of equipment destroyed by fire, less provision for federal income taxes of future years		158,502
Balance, end of year	<u>\$ 1,024,276</u>	<u>\$ 1,019,266</u>

* See 5th paragraph of President's report on page 3

PRICE WATERHOUSE & CO.

120 MONTGOMERY STREET
SAN FRANCISCO 4
August 5 1957



SOUTHWEST AIRWAYS

To the Board of Directors of
Southwest Airways Company

In our opinion, the accompanying statements, together with the notes thereto, present fairly the financial position of Southwest Airways Company as of December 31 1956 and the results of its operations for the year then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year. Our examination of such financial statements 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. Certain receivables from the United States Government selected for test were not confirmed by direct correspondence, but we satisfied ourselves by other auditing procedures as to these items.

Price Waterhouse & Co.

NOTES TO FINANCIAL STATEMENTS

December 31, 1956

NOTE A:

Notes payable at December 31, 1956 comprised the following:

Unsecured 4½% loans, paid in August 1957	\$ 150,000
Secured 4% loans under loan agreement dated January 3, 1956	1,037,000
Conditional sales contract	8,397
	<u>\$1,195,397</u>

On May 1, 1957, the 1956 loan agreement was superseded by a new agreement and the balance of \$962,000 owing at that date was converted to the following secured loans:

5½% loan payable in monthly instalments of \$15,000 to June 15, 1958	\$ 412,000
5½% loan payable in monthly instalments of \$30,000 from June 15, 1958 to June 15, 1963. Under the loan agreement the Company may borrow from time to time on or before September 30, 1958, an additional \$2,050,000	550,000
	<u>\$ 962,000</u>

An additional \$145,787 has been borrowed since May 1, 1957 under the 1957 loan agreement.

Under the terms of the 1957 loan agreement, the Company has agreed that it (1) will not, without the prior written consent of the bank, pay any dividends in cash or purchase, redeem or otherwise acquire for value any of its outstanding shares, and (2) beginning January 1, 1958 will maintain current assets at least equal to current liabilities and beginning July 1, 1959 will maintain current assets in excess of current lia-

bilities by at least \$100,000; for the purpose of these computations current instalments of the loan are to be excluded from current liabilities.

NOTE B:

On July 26, 1957 the Civil Aeronautics Board increased the temporary rate of pay which the Company is to receive for transportation of mail on and after January 9, 1956. As a result the Company received on August 5, 1957 \$357,342 of additional pay of which \$228,570 applied to the period prior to January 1, 1957 and has been included in the accompanying financial statements. The temporary rate as established may be more or less than the final rate which will be eventually established by the Board.

NOTE C:

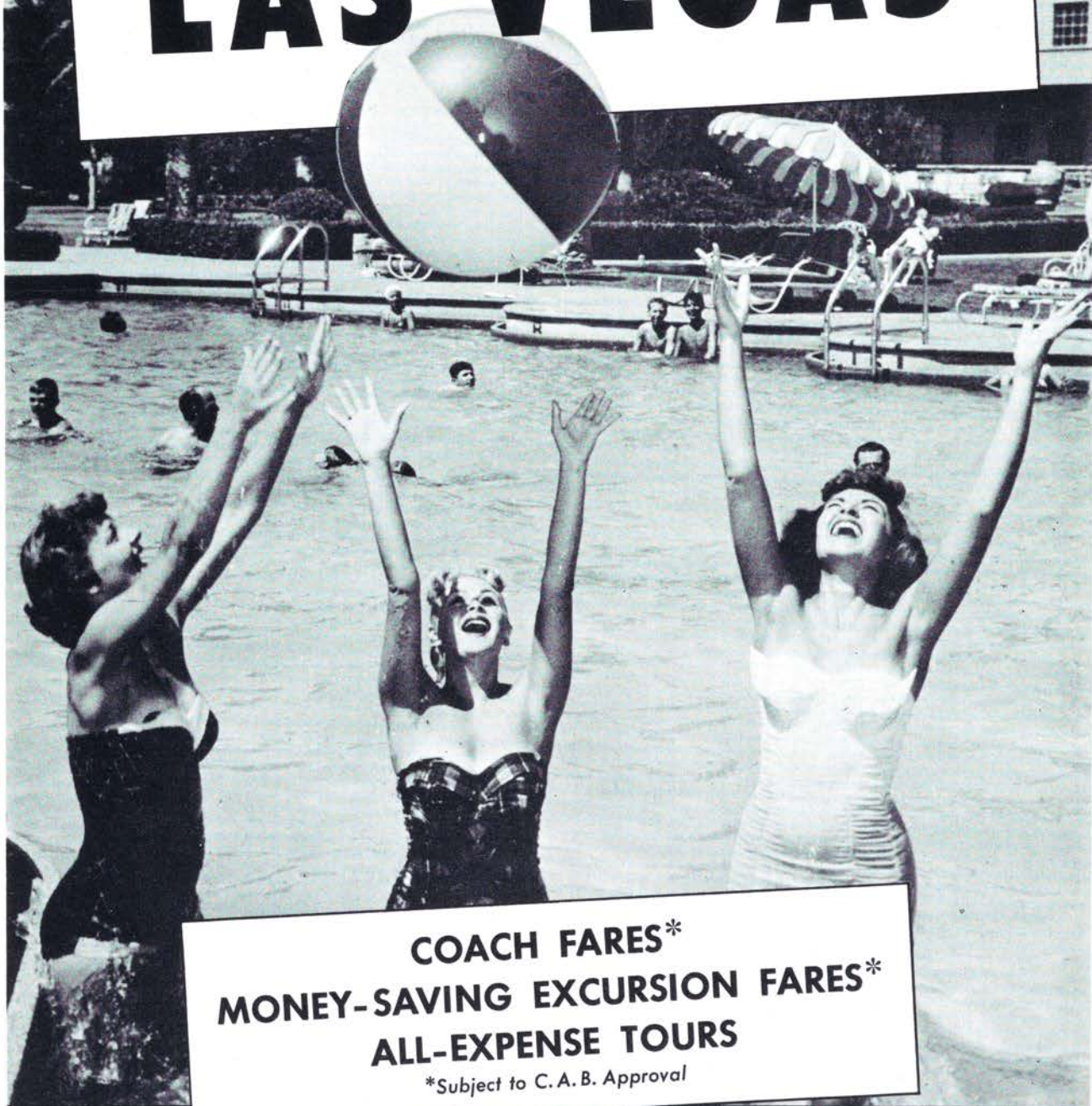
The Company has contracted for the purchase of three Fairchild F-27 aircraft for delivery during June and July 1958. The cost of the aircraft together with spare parts will be approximately \$1,790,000 on which an advance payment of \$90,000 was made in May 1957. An additional payment of \$150,000 will be required in 1957 and the balance will be payable in 1958.

The Company also has contracted to purchase from Rolls-Royce Limited four spare engines for Fairchild F-27 aircraft for delivery during February and March 1958; cost will be approximately £66,500 sterling. An advance payment of approximately \$56,000 was made in July 1957 and the balance, approximately \$130,000 at current rates of exchange, will be payable upon delivery.

NOTE D:

In 1956, the Company agreed with the Air Line Pilots Association to create a retirement plan for pilots effective as of April 1, 1956. The plan is to be insured and based on data furnished by an insurance company, the past-service costs of the plan are estimated to be approximately \$190,000. As at December 31, 1956 provision of \$21,525, not deductible for tax purposes in 1956, had been made in the accounts with respect to pension liability; this amount represents the current service cost for the period from April 1 to December 31, 1956 plus the portion of estimated past-service liability applicable to this period on a ten-year payment basis.

NEW! service to **LAS VEGAS**



COACH FARES*
MONEY-SAVING EXCURSION FARES*
ALL-EXPENSE TOURS

**Subject to C. A. B. Approval*



SOUTHWEST AIRWAYS

The **PACIFIC AIR LINE**



44-PASSENGER MARTINLINER

