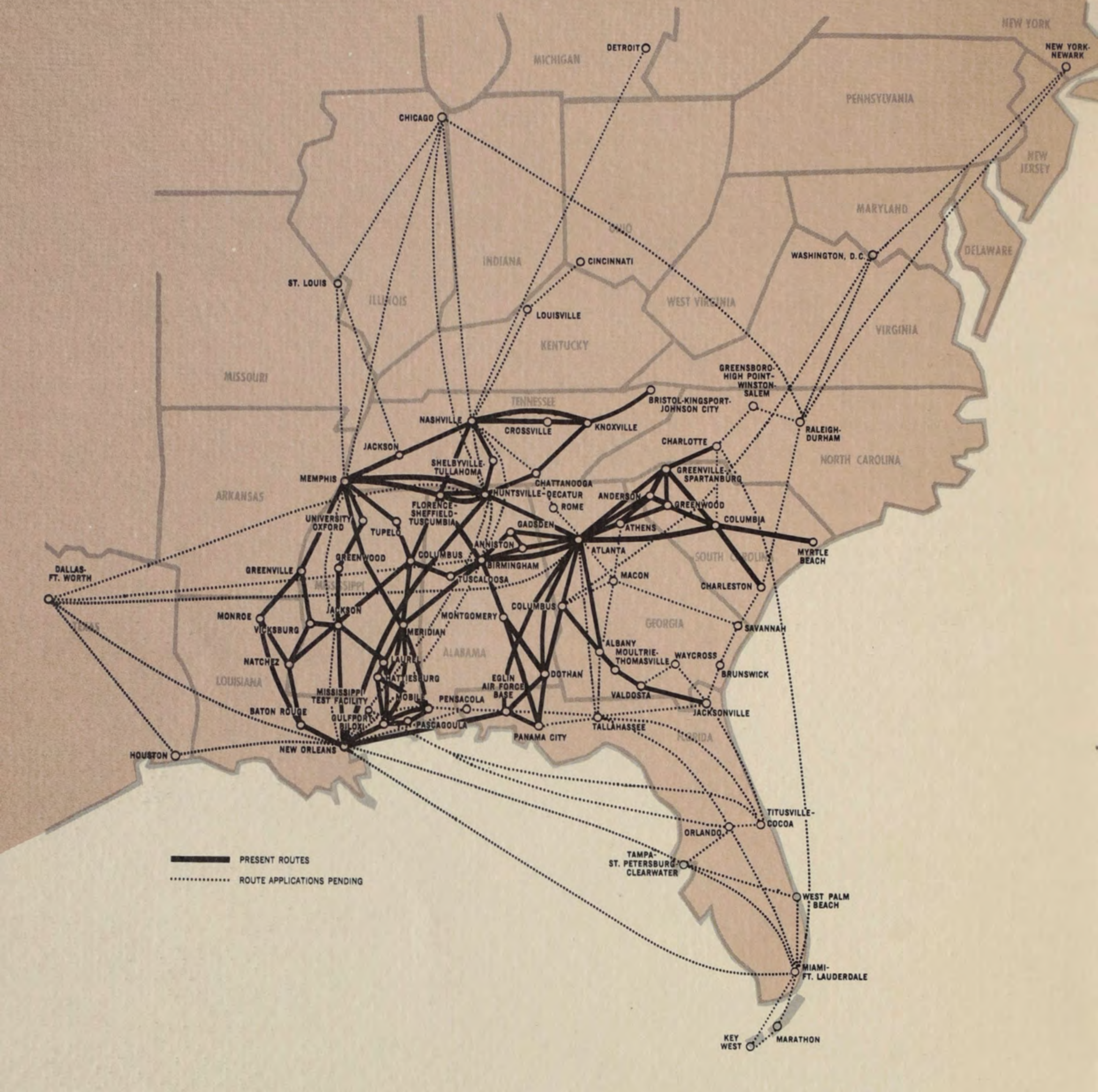
focus on the future

1967 ANNUAL REPORT

SOUTHERN AIRWAYS, INC.



SOUTHERN AIRWAYS, INC.

STOCKHOLDERS, CUSTOMERS, EMPLOYEES AND FRIENDS:

The inauguration of jet service during 1967 made the year a most important milestone in the history of your Company. Southern Airways entered a new era on June 15 when the first jet schedules were operated with Douglas DC-9 FanJET equipment.

Total revenues reached an all-time high of $24,255,632, representing a 10% increase over last year. Total passengers for the period, also a record, were 1,199,573, an increase of 12.7% over 1966. Operating expenses increased markedly as a result of increased capacity provided by larger aircraft and higher unit costs of the piston fleet. Expenses were $24,323,742, resulting in a net loss – the first since 1960 – which, after credit adjustments, amounted to $158,715. This loss compared to net income of $859,743 in 1966. On a per share basis, the loss in 1967 was $0.16, contrasted with earnings of $0.85 in the prior year.

A significant event occurred when, on July 31, Southern retired the time-honored, although no longer economic, DC-3 aircraft. Replacement of the old airplanes by the larger and more modern Martin-404 equipment at certain of the smaller, less productive cities will – and, indeed, in 1967 did – increase the cost of serving such points. We are confident, however, that with realignment of the route system to permit more useful scheduling and with the resultant traffic growth, most smaller points will produce increased revenues sufficient to offset increased costs.

Southern's acquisition and introduction of jet equipment quite literally opens a new era for your Company. Its importance was recognized by the Honorable Charles S. Murphy, Chairman of the Civil Aeronautics Board, who came to Atlanta and personally participated in Southern's DC-9 inaugural ceremonies, flying the first scheduled jet trip from Atlanta to Huntsville. By August 1, three of the new DC-9 FanJETS were in operation, providing service to 18 cities on Southern's system. By year end, these three DC-9 aircraft alone were developing about one-third of the Company's total revenue, a fact which reflects the immediate public acceptance of the new equipment.

To date, Southern has taken delivery on five 75-passenger DC-9 FanJETS. The sixth is expected to be delivered in June. In addition, plans are under way to acquire three 95-passenger DC-9-30 aircraft by mid-1969. These will be used on new routes that the Company anticipates it will be awarded in cases currently pending before the Civil Aeronautics Board.

The DC-9 FanJET aircraft, together with important route extensions for your Company, will result in opportunities for Southern to provide a quantity and quality of public service and, in turn, to increase its earnings far beyond anything possible at any time during Southern's past history. This aircraft is exceptionally well suited for use over the relatively long route extensions which Southern proposes in several cases the Civil Aeronautics Board is expected to decide during the remainder of 1968 and in 1969. The issue of route extensions to important terminals such as New York, Chicago, Dallas and Miami together with realignment of the present route structure will be decided in these proceedings.

While Southern may not receive all the authority it seeks in these cases, your management is confident that the Company is on the threshold of meaningful route extensions that will upgrade the route system and provide a unique opportunity to fully utilize the new jet equipment on hand and on order.

The Company was saddened by the death of Ike F. Jones, vice president, and of retired secretary-treasurer George F. Estey during the year. Each of these gentlemen played a significant role in the early organization and management of Southern Airways.

The Board of Directors joins the undersigned in expressing appreciation to the employees whose loyalty and ability will provide the basis for new achievements in 1968.

Frank W. Hulse
President

April 10, 1968

The President's Point of View

focus on the future

A New Look at Southern

Scheduled jet service began June 15, 1967 but already your Company had established a world jet record. On May 9, delivery of airplane number 901, Southern's first Douglas DC-9 FanJET, was made at the Douglas plant in Long Beach, Calif. Five days earlier, Southern had announced its intention to try for a cross-country speed and distance record with the DC-9, and the public and press were notified of this intention.

The estimated flight time announced to the press was 4 hours, 13 minutes. Number 901 closed its doors at 7:27 a.m. PDT and 4 hours, 13 minutes and 12 seconds later landed at Charleston, S. C. The new world record was officially sanctioned by the Federal Aviation Administration and by the National Aeronautic Association representing Federation Aeronautique Internationale.

On June 15, Civil Aeronautics Board Chairman Charles S. Murphy was ushered to the Southern concourse at the Atlanta Airport for commencement of jet service inaugural ceremonies. Hundreds of employees, representatives of the local and national press and well-wishers from other airlines crowded your Company's jet gate area. Mrs. Mary C. Hayes, Assistant Secretary and number one on the employee seniority list, duly christened your first jet with these words: "Dedicated to the comfort and convenience of the South and the continued prosperity of SOUTHERN AIRWAYS!"

At 11:05 a.m., with every seat filled, Flight 51 departed Atlanta Airport, dipped its wings and began a new era.

Later in the day, your Company's second jet flight, Flight 61 to Huntsville, Ala., carried as its first passenger CAB Chairman Murphy, accompanied by your President and other officers.

On July 1, after delivery of the second jet, service was inaugurated between Atlanta and New Orleans via Huntsville. By August 1, 18 cities were receiving FanJET service and Southern became the first airline to service Charleston, S. C. with all pure jet aircraft.

Early in the year, management decided that concurrent with the new aircraft, it would introduce a new stewardess look. Prestige for the stewardesses and publicity benefit to the Company were the deciding factors in selecting world-renowned designer Pierre Balmain of Paris. Acceptance of the ensembles was universal, and the young ladies have been featured on numerous television programs, interviewed on radio and thousands of inches of newspaper coverage were given to the outfits of bright orange, named by Balmain, "d'abricot."

For the ticket counter distaff, the same Balmain design but in a brilliant blue was selected.

Male sales and service personnel now wear a distinctive gold blazer personalized by blue and gold buttons with the "Accent S" logo. The standard of dress of Captains and First Officers needs no improvement for their look has long been considered outstanding.

Planning Eased Our Transition

Careful planning by the flight operations and the maintenance and engineering departments during the previous year permitted transition into jet equipment with minimum difficulty. Utilizing the experience of other DC-9 operators, we set up established, sophisticated methods to provide support to the jet fleet. By utilizing training facilities at the Douglas Aircraft factory in Long Beach, Calif. and by using the flight simulator program available through another airline, your Company was able to effect a ground training program that, in turn, earned compliments from the FAA.

During the pre-jet activities, our own training personnel qualified pilots, stewardesses and dispatchers for DC-9 service. Also during the year, we upgraded more than 45 pilots from our retired DC-3's to Martin-404's. We established a new record during our required pre-flight jet evacuation demonstration, again with plaudits from the FAA.

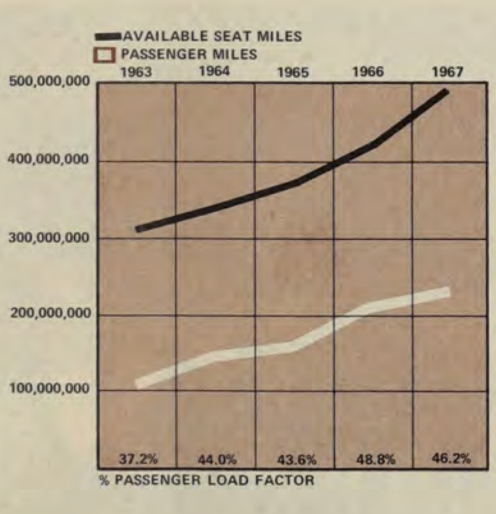
While flight operations was making its preparation for jet service, maintenance and engineering took many new approaches within its functions. The engineering department was reorganized, many activities were redefined and increased emphasis was placed on product support engineering. In concert with reliability engineering, we are continuously monitoring the maintenance and performance of the aircraft, individually and as a fleet, and evaluating changes and modifications as products improve.

The automatic flight control system and low visability approach capability of your Company's DC-9's are among the most advanced in the industry. To keep pace with these complex units, new technical positions were established and additional test equipment provided. The transition from piston engine equipment to pure jets has been a giant step. A formal commendation from the FAA is evidence that this transition has been made smoothly and indicated the high quality of the support programs your Company has established.

Training received emphasis throughout the Company. In addition to those effected before jet delivery, extensive courses were prepared by our operations training department. Most significantly, we acquired a Transdyne DC-9 procedures trainer to duplicate the actual aircraft cockpit. The trainer provides flight simulation, including appropriate sounds, is fully instrumented and gives a realistic background for all types of instrument flying conditions. Flight emergencies can be simulated and action can be stopped at any time the instructor desires to discuss a particular situation. This trainer not only will save many hours of aircraft time during initial and recurrent pilot training, but because of heavy use of the jets in scheduled service, will also enable us to continue pilot training regardless of airplane availability.

The sales department, which has responsibility for station operations, now conducts detailed training programs in Atlanta as well as in the various stations. Use of audio-visual equipment is being made to teach handling of service procedures for employees with more routine functions.

Following a policy of promoting employees from within the Company whenever possible, 144 persons received promotions. Increased workload called for more personnel, and our employees increased from 1,362 to 1,495 at year end. Even though the labor market in the Southeast has continued to be tight, your Company continues to attract applicants who meet our high standards. We do, however, expect a continued shortage of skilled technicians due to expanding industries in the South and the current military situation.



New Concepts Introduced

In November, Graydon Hall, vice president-sales, and William S. Magill, Jr., vice president-operations, were elevated to positions of senior vice president. Hall assumed responsibility for sales, finance, and administrative services, and Magill's responsibilities now include flight operations, maintenance and engineering, and personnel.

T. A. Wiley, Jr., formerly assistant vice president-sales, became vice president-sales. Earlier, an extensive reorganization of the sales department was completed. The department redefined many staff functions in preparation for increased activities brought about by new jet service and anticipated route expansion.

The centralized reservations office in Atlanta completed the installation of a new computerized reservations system in cooperation with Braniff International. This system provides immediate and accurate availability of reservations, not only on all flights operated by Southern Airways, but also for all flights of every domestic airline in the United States. It immediately updates the seat inventory of all Southern flights, and provides current information regarding the flight operating status of each of our flights. It is estimated that almost two million telephone calls will be answered with this system during 1968.

The introduction of DC-9 service throughout our system, and the additional seats made available by our jets made it possible to improve our Martin "Aristocrat" schedules. Express service was instituted between many cities on our system which previously had only multi-stop service and the terminal points of Atlanta, Memphis and New Orleans. Customer acceptance of these faster flights with few stops evidences the wisdom of the decision to provide this service.

Charter operations have been greatly expanded. One DC-9 and one Martin-404 have been placed exclusively into charter service. Charter sales will be stimulated by our home office and field sales force and by advertising.

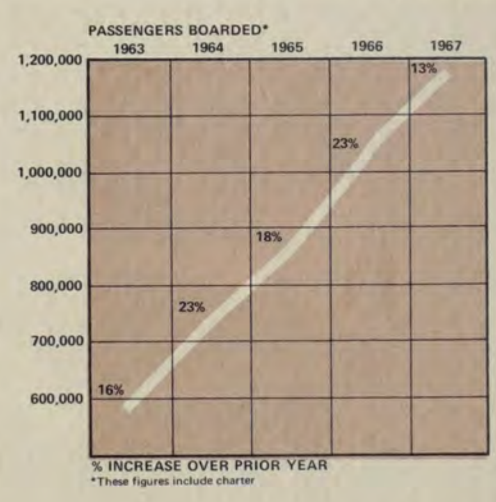
To provide the basis for future growth and recognition of Southern Airways as a hospitable and friendly airline, new marketing concepts have been instituted, and during 1968 the most extensive advertising program Southern has ever undertaken will see the phrase, SOUTHERN STYLE, become the theme of advertising and our approach to the passenger's comfort.

To back up this advertising, your Company has introduced an employee incentive plan to stimulate our people to offer service SOUTHERN STYLE.

The SOUTHERN STYLE ad program is warm and friendly in its approach and we radiate a basic message: "Courteous, friendly and efficient service is our product." This advertising program will appear in newspapers, magazines, radio and television throughout 1968.

SOUTHERN SCENE magazine has been introduced in the seat pockets aboard all Southern flights. This four-color magazine tells stories about the South in general and cities on our system in particular. Published by our public relations department, the magazine is gaining wide acceptance by our passengers. Selected advertising will make this a self-supporting activity.

During the year, we set a new passenger boarding record for a single day, 5,010; a new single month's passenger record, 113, 379; and a new record for a single year, 1,180,297, all based on scheduled service.

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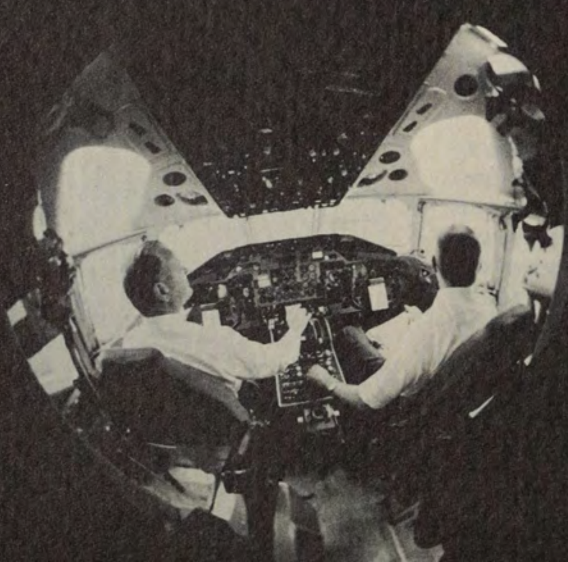


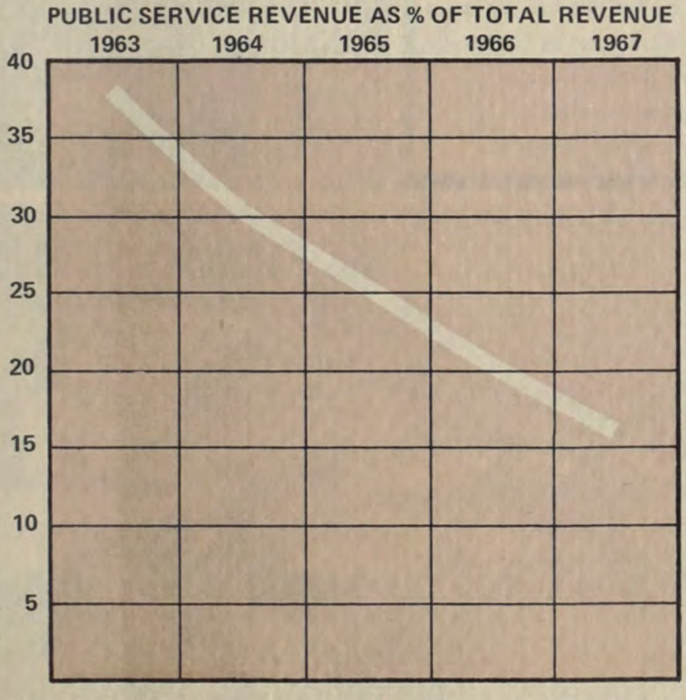
Route Expansion Activities

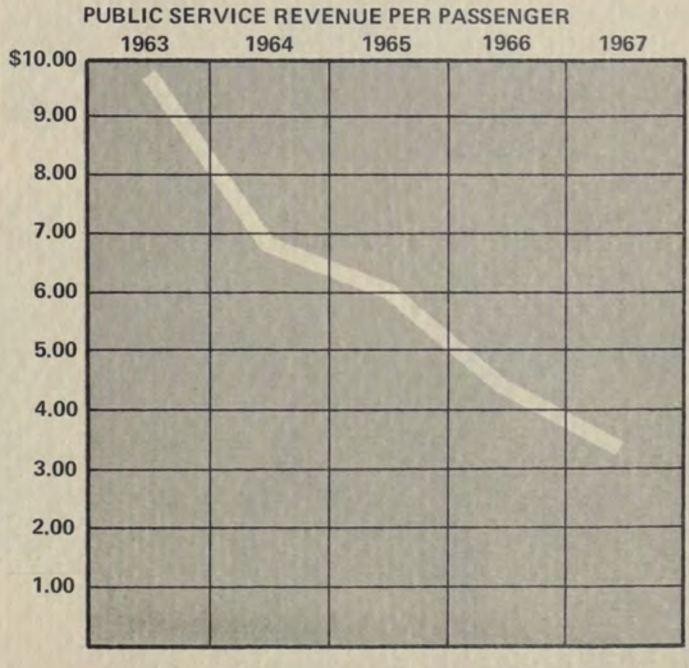
The year 1967 saw the beginning of several route proceedings before the Civil Aeronautics Board, the result of which will have a significant effect on the future of the Company. One of the most important of these was an application filed June 30, 1967 to add a new segment between Eglin AFB, Fla. and New York, N. Y./Newark, N. J. via Dothan, Ala., Columbus, Ga. and Washington, D. C. (to be served through the Dulles International Airport). In response to this application, the Civil Aeronautics Board by show cause procedure found that this authority should be granted to Southern. This decision was appealed by two competitive air carriers, thus it became necessary to hold a full evidentiary hearing. This was conducted late in January 1968 at the conclusion of which the Bureau of Operating Rights, a division of the CAB's staff, took the position that Southern should be granted this authority. A decision by the hearing examiner is expected during the second quarter of 1968.

In June of 1967, the CAB instituted the SOUTHERN AIRWAYS, INC. ROUTE REALIGNMENT INVESTIGATION in which it proposes to consolidate the existing 15 segments into eight segments and extend the Company's operating authority into the Florida peninsula via Tallahassee, Orlando, Kennedy Space Center, Miami/Fort Lauderdale, Marathon and Key West. The purpose of the investigation, as stated by the Board, is to allow Southern to improve its service to the public and reduce its subsidy requirement. The hearing in this proceeding started April 9, 1968 and final Board decision should be known early in 1969.

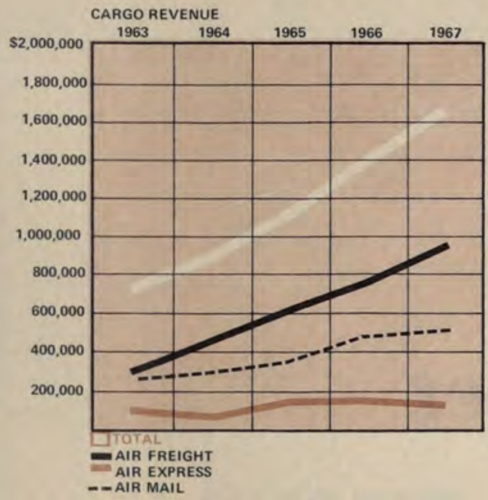
In April of 1967, the hearing was concluded in the CENTRAL AIRLINES ROUTE 81 INVESTIGATION where Southern is seeking authority to operate between Memphis and St. Louis nonstop or via Jackson, Tenn. The Bureau of Operating Rights has recommended award to Southern of nonstop authority in this market. The examiner's decision is expected momentarily.

Another case offering a major expansion opportunity for the Company was heard by a CAB examiner in October of 1967. This case, the GULF STATES-MID-WEST POINTS SERVICE INVESTIGATION,





Clockwise: President Hulse is presented keys to first DC-9 by vice president-maintenance and engineering George M. Gross after record flight. In Paris, Pierre Balmain approves stewardess uniform during fitting. The computer complex in the General Office contains data on daily flights, finances, and mechanical and overhaul needs of aircraft. The last DC-3 went on sale in a Memphis ceremony. In the Atlanta reservations office, this computer equipment gives instant information on flights. Mrs. Mary C. Hayes breaks a christening bottle on the first DC-9 during inaugural at Atlanta jet gate, June 15.



involved applications for authority to operate between Chicago and New Orleans and between Dallas/Fort Worth and Detroit on a nonstop basis as well as via the important intermediate points of St. Louis, Nashville, Memphis, Huntsville, Birmingham and Jackson, Miss. The Board's Bureau of Operating Rights has taken the position that Southern should be granted authority to operate between Memphis and New Orleans nonstop and via Jackson, Miss. The examiner's decision in this proceeding is expected in late summer of 1968.

The last of these proceedings, the SOUTHERN TIER COMPETITIVE NONSTOP INVESTIGATION, instituted by the Board in March of 1967, involves applications by the Company to operate between Atlanta and Dallas/Fort Worth and between Dallas/Fort Worth and Miami via New Orleans and Tampa. The hearing is set for April 23, 1968 and final Board decision should be known by the summer of 1969.

In anticipation of major route expansion, the Company has recently expanded its data processing capability by the installation of third generation computer equipment. This high speed equipment, which will substantially reduce processing time and vastly improve the workload, was delivered on April 1, 1968 and is expected to be fully operational within 60 days.

Revenues and Expenses Rose

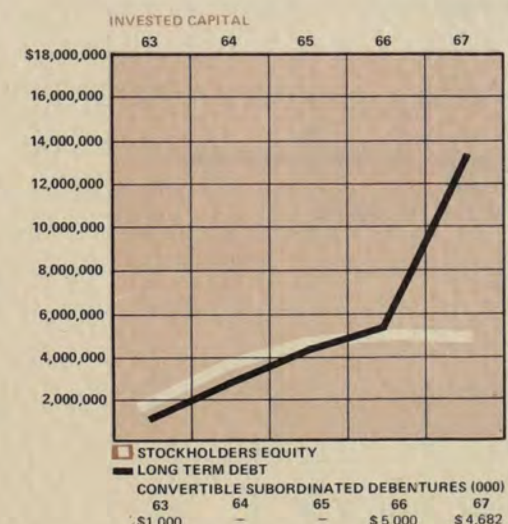
Revenues in 1967 were the highest in the Company's history – $24,255,632. This was an increase of $2,201,564, or a 10% improvement over 1966, and was obtained even with a $285,788 reduction in Public Service Revenue. The two major categories of improvement were passenger revenues which increased $1,971,250, or 13%, and air freight which increased $211, 199, or 28% over the prior year.

As the accompanying chart demonstrates, Public Service Revenue as a per cent of the total revenue continued its downward trend from 20.6% of total revenue in 1966 to 17.5% of total revenue in 1967. This trend will continue into 1968 as a result of both a reduction in the amount of subsidy to be received and the anticipated growth in our operating revenues. Per passenger, subsidy decreased from $4.27 in 1966 to $3.55, a reduction of almost 17%.

Total operating expenses in 1967 amounted to $24,323,742 – an increase of $3,895,553, or 19% above 1966. The major portion of this increase resulted from the expansion in the number of seat miles made available for sale and increased unit costs of the piston aircraft. In 1967 the available seat miles increased 19.6% to a total of 498,322,000.

The introduction of the jet equipment resulted in greater depreciation charges which increased from $861,826 to $1,454, 350 in 1967. In addition, interest costs increased over 133%, from a total of $250,038 in 1966 to $584,621 in 1967, as a result of debt incurred to acquire the DC-9 equipment.

Because of the loss in 1967, your Company is entitled to a refund of taxes paid in prior years amounting to $314,486. In addition, the acquisition of the new jet equipment in 1967 generated investment tax credits of approximately $840,000, of which $274,000 of such credits were carried back to prior years, and the remainder will be available to offset federal income taxes in future years.



As was reported to you last year, your Company had previously made arrangements with a number of banks to provide an additional $7,000,000 to be used in payment for the second three DC-9 aircraft to be delivered in 1968. In the latter part of 1967, however, a study demonstrated that it would be better to lease the second three DC-9's. After a period of negotiations a lease arrangement was concluded with the First National Bank of Atlanta. The bank is purchasing the aircraft for leasing to Southern over a 12-year term, resulting in Southern's receiving a lower interest cost and a longer payment period than the method of financing previously arranged for these aircraft. Two of the aircraft were received under the lease in February 1968 and the third aircraft is scheduled to be delivered in June.

During the year, all our DC-3 aircraft were disposed of at a small profit.

Southern entered into a new $12,000, 000 contract with McDonnell Douglas Corporation as of November 30, 1967 under which the Company is to receive three DC-9-30 aircraft during May, June and July, 1969. We are presently arranging the financing necessary to effect delivery of these aircraft as scheduled.

In 1967, the Company paid its sixth and seventh semi-annual dividends of $.08 each to its shareholders who at December 31, 1967 totaled 4,235.

In July 1967, the Company, subject to approval of the shareholders, set aside a total of 25,000 shares of its common stock to be used for an Employees' Stock Option Plan. The Plan provides for each employee having one year's service to be eligible to purchase up to an amount equal to 5% of his annual salary or $1,000, whichever is less, in common stock of the Company at a price equal to 95% of the stock price on the date on which he is eligible to participate. Payments are made through a payroll deduction plan over a two-year period. At the end of the period the employee is entitled to receive the number of shares he had originally contracted to purchase or elect to have his money refunded to him. Management was gratified at the response of employees as 63% of those eligible elected to participate in the Plan.

balance sheet

December 31, 1967 and 1966

ASSETS

	1967	1966
CURRENT ASSETS		
Cash	$ 2,435,258	$ 3,661,329
Certificates of deposit	–	212,447
Accounts receivable:		
U.S. Government:		
Transportation and public service revenue–Note A	$ 773,359	$ 1,171,422
Refundable income taxes	540,223	–
Trade receivables	2,119,928	1,706,973
	$ 3,433,510	$ 2,878,395
Maintenance and operating supplies, at average cost, less allowances for obsolence (1967 – $223,813; 1966 – $179,621)	910,096	750,161
Prepaid expenses	390,418	74,852
Total Current Assets	$ 7,169,282	$ 7,577,184
INVESTMENTS AND OTHER ASSETS – at cost	32,963	4,814,555
PROPERTY AND EQUIPMENT – on the basis of cost – Note B		
Flight equipment	$20,508,289	$ 9,844,375
Less allowances for depreciation and maintenance	3,839,135	3,442,955
	$16,669,154	$ 6,401,420
Deposits on new equipment – Notes B and E	3,221,955	524,573
	$19,891,109	$ 6,925,993
Other property and equipment	$ 2,672,238	$ 2,176,477
Less allowances for depreciation	1,385,727	1,144,926
	$ 1,286,511	$ 1,031,551
	$21,177,620	$ 7,957,544
DEFERRED CHARGES		
Unamortized preoperating, route extension, and development costs	$ 674,404	$ 272,297
Unamortized long-term debt expense	320,385	229,370
	$ 994,789	$ 501,667
	$29,374,654	$20,850,950

SOUTHERN AIRWAYS, INC.

LIABILITIES

	1967	1966
CURRENT LIABILITIES		
Accounts payable	$ 1,274,430	$ 1,536,164
Collections and withholding as agents	2,169,952	1,844,291
Salaries, wages, and vacations	684,280	565,084
Accrued taxes, advertising, and other expenses	636,952	281,202
Air travel plan deposits	114,750	114,725
Income taxes	–	475,608
Current maturities of long-term debt – Note B	1,374,448	312,500
Total Current Liabilities	$ 6,254,812	$ 5,129,574
LONG-TERM DEBT, less current maturities – Note B		
Notes payable to banks	$13,468,052	$ 5,742,500
5¾% Convertible Subordinated Debentures	4,682,000	5,000,000
	$18,150,052	$10,742,500
STOCKHOLDERS' EQUITY – Notes A, B, and C		
Common Stock, $2 par value; authorized 2,000,000 shares; issued and outstanding 1967 – 1,024,871 shares; 1966 – 1,005,000 shares	$ 2,049,742	$ 2,010,000
Other paid-in capital	797,523	525,246
Retained earnings	2,122,525	2,443,630
	$ 4,969,790	$ 4,978,876
COMMITMENTS–Note E		
	$29,374,654	$20,850,950

See notes to financial statements.

SOUTHERN AIRWAYS, INC.
STATEMENT OF INCOME
Years Ended December 31, 1967 and 1966

	1967	1966
OPERATING REVENUES		
Passenger and excess baggage	$17,155,206	$15,183,956
Mail, express, and freight	1,637,487	1,397,345
Public service revenue – Note A	4,255,157	4,540,945
Charter	564,311	518,951
Other operating revenues – net	643,471	412,871
	$24,255,632	$22,054,068
OPERATING EXPENSES		
Flying operations	$ 7,049,726	$ 6,116,730
Maintenance	5,217,328	4,492,599
Aircraft and traffic servicing	6,517,775	5,506,885
Passenger service	1,101,901	926,301
Promotion and sales	1,852,364	1,518,177
General and administrative	1,130,298	1,005,671
Amortization and provision for depreciation	1,454,350	861,826
	$24,323,742	$20,428,189
	$ (68,110)	$ 1,625,879
OTHER DEDUCTIONS AND INCOME		
Interest on long-term debt – net of interest capitalized	$ 584,621	$ 250,038
Other income, less miscellaneous deductions	35,383	42,842
	$ 549,238	$ 207,196
Income (Loss) Before Income Taxes	$ (617,348)	$ 1,418,683
INCOME TAXES – Notes A and F		
Provision for income taxes	$ (325,014)	$ 686,902
Investment credit, including in 1967, carryback to prior years less applicable refund of $151,194 of public service revenue	(122,793)	(91,417)
	$ (447,807)	$ 595,485
	$ (169,541)	$ 823,198
PROFIT FROM DISPOSAL OF PROPERTY		
Less applicable income taxes	10,826	36,545
NET INCOME (LOSS)	$ (158,715)	$ 859,743
EARNINGS PER SHARE		
Income (Loss) before gain from disposal of property	$ (.17)	$ .81
Gain from disposal of property	.01	.04
Net income (Loss)	$ (.16)	$ .85

See notes to financial statements.

ACCOUNTANTS' REPORT

Board of Directors
Southern Airways, Inc.
Atlanta, Georgia

We have examined the balance sheet of Southern Airways, Inc. as of December 31, 1967, and the related statements of income and stockholders' equity and source and application of funds for the year 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. We made a similar examination of the financial statements for the preceding year.

In our opinion, subject to the effect of any future retroactive determination of public service revenues as explained in Note A to the financial statements, the accompanying balance sheet and statements of income and stockholders' equity and source and application of funds present fairly the financial position of Southern Airways, Inc. at December 31, 1967, and the results of its operations and source and application of funds for the year then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

ERNST & ERNST

Atlanta, Georgia
February 21, 1968

SOUTHERN AIRWAYS, INC.

STATEMENT OF STOCKHOLDERS' EQUITY

Years Ended December 31, 1967 and 1966

	1967	1966
COMMON STOCK		
Balance at beginning of year	$ 2,010,000	$ 2,010,000
Par value of 19,871 shares issued upon conversion of debentures	39,742	–
Balance at end of year	$ 2,049,742	$ 2,010,000
OTHER PAID-IN CAPITAL		
Balance at beginning of year	$ 525,246	$ 525,246
Excess of conversion price over par value of 19,871 shares of Common Stock issued upon conversion of debentures, less applicable deferred financing costs	$ 272,277	–
Balance at end of year	$ 797,523	$ 525,246
RETAINED EARNINGS		
Balance at beginning of year	$ 2,443,630	$ 1,744,687
Net income (loss) for the year	(158,715)	859,743
	$ 2,284,915	$ 2,604,430
Cash dividends paid – $.16 per share	162,390	160,800
Balance at end of year	$ 2,122,525	$ 2,443,630

See notes to financial statements.

SOUTHERN AIRWAYS, INC.

STATEMENT OF SOURCE AND APPLICATION OF FUNDS

Years Ended December 31, 1967 and 1966

	1967	1966
FUNDS PROVIDED BY		
From income:		
Net income (loss)	$ (158,715)	$ 859,743
Add items not requiring the outlay of funds:		
Provision for depreciation	1,353,751	803,765
Amortization of deferred charges	70,042	53,659
	$ 1,265,078	$ 1,717,167
Increase in long-term debt	7,725,466	6,462,500
Certificate of deposit applied to purchase of equipment	4,800,000	–
Decrease in investments and other assets	–	14,784
	$13,790,544	$ 8,194,451
FUNDS APPLIED TO		
Additions to property, plant and equipment – net	$12,088,025	$ 2,595,453
Equipment purchase deposits	2,485,802	374,573
Increase in deferred charges	569,059	496,984
Cash dividends ($.16 per share)	162,390	160,800
Certificate of deposit held for purchase of equipment	–	4,800,000
Increase in investments and other assets	18,408	–
	$15,323,684	$ 8,427,810
Decrease in working capital	(1,533,140)	(233,359)
Working capital at beginning of year	2,447,610	2,680,969
Working capital at end of year	$ 914,470	$ 2,447,610

SOUTHERN AIRWAYS, INC.

NOTES TO FINANCIAL STATEMENTS

Note A—**Public Service Revenue**—During the eighteen-month period ended December 31, 1960, the Company received public service revenue under a temporary rate which is subject to adjustment upon determination by the Civil Aeronautics Board of a final rate for that period. In the opinion of management, such final determination by the Board will not result in a reduction in public service revenue for that period, and may result in additional public service revenue for that period and for subsequent years in amounts which are not presently determinable.

Since January 1, 1961, the Company has received public service revenue under Class Rates which provide for profit-sharing or revenue-sharing refunds under certain conditions. The Civil Aeronautics Board has completed audits for the years 1961 through 1964, and adequate provision has been made for the required refunds for those years. In the opinion of management, the amounts reported for public service revenue for the years 1965 through 1967 will not be significantly affected by the final settlement of those years by the Civil Aeronautics Board.

Note B—**Long-Term Debt**—The notes payable to banks at December 31, 1967 (for which all aircraft, engines, and related equipment are pledged as collateral) were as follows:

Maturing 1967 to 1975 (1)	$11,842,500
Maturing 1968 to 1974 (2)	1,000,000
Maturing in 1968 (2) (3)	2,000,000
	$14,842,500
Less amounts due within one year	1,374,448
	$13,468,052

(1) The interest rate, currently 6¼%, is ¼ of 1% above the lead banks' prime rate.

(2) The interest rate, currently 6½%, is ½ of 1% above the lead banks' prime rate.

(3) Represents funds to be used for predelivery deposits on the purchase of three additional DC-9 aircraft. The Company has agreed to repay this loan prior to November 30, 1968 out of proceeds of an issue of its securities subordinated to the indebtedness to banks.

The 5¾% Convertible Subordinated Debentures due December 1, 1981, are convertible (until maturity or prior redemption) into Common Stock at $16 per share; are subordinated, generally, to all existing and future indebtedness for borrowed money; are callable on or after June 1, 1968, at premiums ranging from 5.75% downward; and require annual sinking fund payments beginning December 1, 1976, in an amount equal to 10% of the principal amount outstanding at December 1, 1975. Also, the Company may make additional voluntary sinking fund payments equal to the mandatory amount.

The agreements relating to the notes payable and to the 5¾% Convertible Subordinated Debentures place certain requirements and restrictions upon, among other things, (1) net current assets, (2) net worth, (3) capital expenditures, and (4) payments relating to capital stock, including dividends. The Company has met all of these requirements, and approximately $89,000 of retained earnings were free of such restrictions at December 31, 1967.

Note C—**Common Stock Reserved**—At December 31, 1967, 362,625 shares of Common Stock of the Company were reserved as follows:

		Shares
Qualified Stock Option Plan approved by Board of Directors in 1965:		
Exercisable one-third each year beginning in October 1967 at a price of $10.16 2/3 per share		37,500
Exercisable one-third each year beginning in May 1969 at a price of $19.18 per share		1,000
Shares available for additional options which may be granted under the Plan		6,500
		45,000
Employee Stock Option Plan approved by Board of Directors in 1967:		
Exercisable in June, 1969 at a price of $18.75 per share	15,953	
Shares available for additional options which may be granted under the Plan	9,047	25,000
Shares reserved for conversion of 5¾% Subordinated Debentures		292,625
	Total	362,625

Note D—**Pension Plan**—The Company has several pension plans covering substantially all of its employees. The total pension expense for the year was $619,007, which includes $207,255 under a defined-contribution plan. The Company's policy is to fund normal costs plus accrued interest on the unfunded past service liability. At December 31, 1967, the total of the pension fund exceeded the actuarially computed value of vested benefits and the unfunded past service liability was approximately $575,000.

Note E—**Commitments**—At December 31, 1967, the Company had on order six DC-9 jet aircraft and related spares scheduled for delivery in 1968 and 1969. The three aircraft scheduled for delivery in 1968 are to be leased under a lease agreement dated as of February 1, 1968 for a period of twelve years at a minimum net annual rental of $1,090,395. The three aircraft scheduled for delivery in 1969 represent a commitment of approximately $10,800,000 in excess of the related deposits (see Note B).

Note F—**Investment Tax Credit**—The Company follows the flow-through method of accounting for investment tax credits. At December 31, 1967 the Company had available unused investment credits of approximately $565,000.

General Offices

Atlanta Airport, Atlanta, Georgia 30320

COUNSEL: Bradley, Arant, Rose & White, Birmingham, Alabama
Ballard & Beasley, Washington, D.C.

AUDITOR: Ernst & Ernst
Atlanta, Georgia

STOCK TRANSFER AGENT:
Trust Company of Georgia
Atlanta, Georgia

ADVERTISING COUNSEL: Harris & Weinstein Associates, Inc.
Atlanta, Georgia

Executive Committee

Frank W. Hulse	Graydon Hall
G. Gunby Jordan	Elton B. Stephens
W. B. White, Jr.	

Officers

Frank W. Hulse
President

Graydon Hall
Senior Vice President

W. S. Magill, Jr.
Senior Vice President

J. Kenneth Courtenay
Vice President–Administrative Services and Secretary

Thomas A. Wiley, Jr.
Vice President–Sales

George M. Gross
Vice President–Maintenance and Engineering

A. L. Maxson
Controller and Assistant Treasurer

W. Bayne Grubb
Assistant Vice President–Flight Operations

Everett L. Martin
Assistant Vice President–Personnel

Ray W. Burden
Assistant Treasurer

Mrs. Mary C. Hayes
Assistant Secretary

Cecil A. Beasley, Jr.
Assistant Secretary

W. B. White, Jr.
Assistant Secretary

Directors

Cecil A. Beasley, Jr.
Ballard & Beasley
Washington, D. C.

Edward U. Beneke
The Beneke Corporation
Columbus, Mississippi

Alexander J. Brunini
Brunini, Everett, Grantham & Quin
Vicksburg, Mississippi

Graydon Hall
Southern Airways, Inc.
Atlanta, Georgia

F. Barton Harvey, Jr.
Alex. Brown & Sons
Baltimore, Maryland

Frank W. Hulse
Southern Airways, Inc.
Birmingham, Alabama

Alton F. Irby, Jr.
Irby-Adams-Cates Co.
Atlanta, Georgia

Henry P. Johnston
Radio and Television Consultant
Birmingham, Alabama

G. Gunby Jordan
The Jordan Company
Columbus, Georgia

Sartain Lanier
Oxford Industries, Inc.
Atlanta, Georgia

R. Eugene Orr
Orr & Company, Inc.
Jacksonville, Florida

G. Frank Purvis
Pan-American Life Insurance Co.
New Orleans, Louisiana

Francis D. Schas
Bullington-Schas & Co.
Memphis, Tennessee

Elton B. Stephens
EBSCO Industries, Inc.
Birmingham, Alabama

Richard A. Trippeer
Trippeer Organizations, Inc.
Memphis, Tennessee

W. B. White, Jr.
Bradley, Arant, Rose & White
Birmingham, Alabama

Gen. Ralph H. Wooten
(Honorary Director)
United States Air Force, Retired
Memphis, Tennessee

SOUTHERN AIRWAYS, INC.

General Offices: Atlanta Airport
Atlanta, Georgia 30320