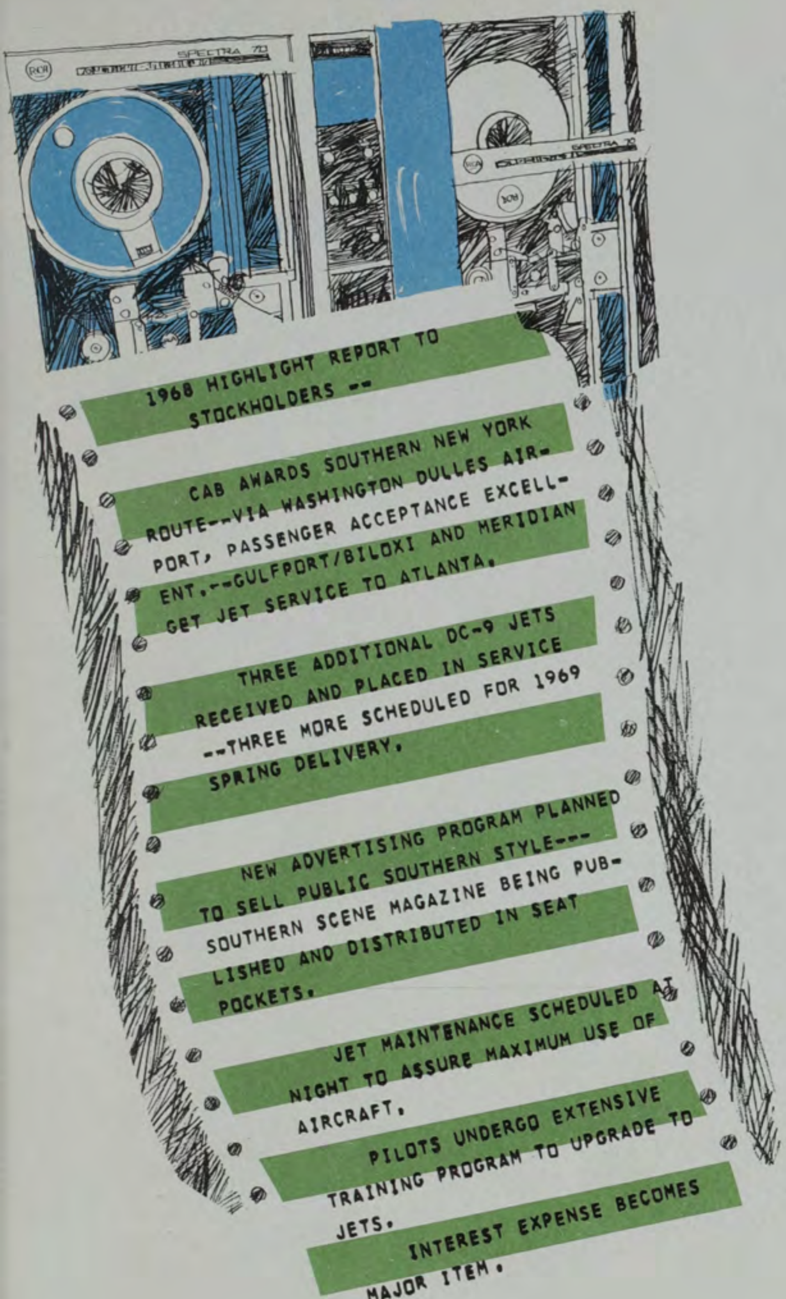
1968 Annual Report

SOUTHERN AIRWAYS, INC.

Report to Stockholders for period ended December 31, 1968

SOUTHERN AIRWAYS, INC.

General Office: Atlanta Airport
Atlanta, Georgia 30320



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Awaiting decision by the Board in the **Gulf States-Midwest Points Service Investigation** is Southern's application to serve Chicago and in the **Central Airlines Route 81 Investigation,** its proposal to serve St. Louis. These decisions could be issued at any time. It is likely the Board will also decide during 1969 the **Southern Tier Competitive Nonstop Investigation** in which Southern seeks a route to Dallas.

Despite favorable Examiners' recommendations that Southern be extended to Chicago and further into Florida, it is of course impossible to predict final Board action. Your management believes that the extensions – in spite of existing service in certain of the markets – will be valuable additions to Southern's system. Southern is participating in numerous other route cases which are discussed elsewhere in this report.

The Company was saddened by the untimely death of Mr. Edward U. Beneke of Columbus, Mississippi. Mr. Beneke had served as a director since 1951.

Southern looks forward to 1969 with optimism. First, its modern jet equipment will make possible the highest quality of service in the Company's history. In 1969 an increasing portion of Southern's revenue passenger miles will be provided by jet equipment. In turn, the efficiency and lower seat mile costs of the aircraft should contribute to improved financial results. As in 1968, charters should provide an important source of revenue. Next, as service over our New York route becomes more fully known, it will prove of increasing benefit to the traveling public and, in turn, develop during 1969 increasingly larger revenues for the Company. Additional benefit will accrue in 1969 from the realignment of our system and the nonstop authority already finalized for Southern by the Board in the route realignment case. The general fare increase will assist the Company in defraying increasing costs and higher fixed charges involved in aircraft acquisition.

In short, the year 1969 offers a challenging opportunity.

Respectfully submitted,

Frank W. Hulse

Frank W. Hulse
President

April 2, 1969

1968:
Southern Style

We Pledge our enthusiastic support to bring our customers the warm and friendly attitude that is traditional with the South.

We Pledge our efforts to demonstrate genuine Southern Style service with emphasis on courtesy and hospitality

We Pledge a renewed pride in our responsibility to our customers, to the growth of Southern Airways and to the growth of the area we serve.

We Pledge our support as a part of the team that is going places . . . SOUTHERN STYLE.

Signed by the 1500 Employees of

SOUTHERN AIRWAYS

Report to Stockholders for period ended Dec

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General Of
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STOCKHOLDERS, CUSTOMERS, EMPLOYEES AND FRIENDS:

In 1968 Southern received the most significant single route award in its history. The Civil Aeronautics Board extended our system to Washington, D.C. and New York City from Eglin Air Force Base, Florida; Dothan, Alabama; and Columbus, Georgia. Service was inaugurated on September 3 with two daily round trips and a third one was added on October 27. The dramatic effect of this award on our operations is evidenced by the fact that in December, only three months after the service started, the new route was developing almost a fourth of the entire system's total revenue passenger miles.

Southern experienced in 1968, as did virtually every local service carrier, increasing expenses which precluded a profit, despite record revenues. Total operating revenues reached a new high of $29,300,278, an increase of 20.8 percent over revenues of $24,255,632 in 1967. Expenses totaled $28,707,198, an increase of 18.0 percent over 1967. In spite of operating profit of $593,080 (as compared to an operating loss of $68,110 in 1967), the final results for 1968 showed a loss of $210,982. This loss was in part due to generally increasing costs and in part to increased interest and other expenses resulting from acquisition of our DC-9 jet aircraft and related equipment.

Recognizing the effect of rising costs, the Civil Aeronautics Board approved a general fare increase effective February 20, 1969. This action, which permits greater relative increases in short haul markets of the kind Southern serves, will substantially increase your Company's revenues. Indeed, if the increase had been in effect in 1968, operating revenues would have been higher by some $2.5 million.

Southern continues its program of strict cost control. In this connection it is significant that, after adjustments to the 1968 results to make the two years comparable, commercial revenues increased 26.3 percent in 1968 over 1967, while operating expenses rose by only 19.9 percent.

Your Company during the year 1968 received delivery of its fourth, fifth, and sixth DC-9-10 aircraft. One of these DC-9's was used in charter service and produced the major portion of the substantially higher charter revenues of $1,934,461 received in 1968 – an increase of 242.8 percent over the $564,311 derived from charters in 1967.

Southern's fleet modernization program to enable it to provide better public service, moved forward satisfactorily in 1968. In November, $8,000,000 of 6½% Convertible Subordinated Debentures, with warrants attached, were privately placed. The proceeds will be used to finance, in part, acquisition of the three DC-9-30 aircraft, the longer "stretched" model of the DC-9, scheduled for delivery in May and June, 1969.

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April 2, 1969

Revenues

Operating revenues in 1968 reached a new record – $29,300,278. This was an increase of $5,044,646, or 20.8 percent over 1967 revenues. Passengers produced $20,503,123, 19.5 percent or $3,347,917 over the previous year. Cargo, including mail, express, and freight rose to $1,949,557, a 19.1 percent increase above 1967. Charter revenues soared 242.8 percent – $1,370,150 above the 1967 level.

Public service revenue (subsidy) continued its downward trend from 1967 when it represented 17.5 percent of the total revenue. In 1968, public service revenue totaled $4,038,298 or 13.8 percent of the 1968 operating revenues. Public service revenue per passenger fell 11.9 percent, from $3.61 in 1967 to $3.18 in 1968. Total public service revenue decreased $216,859, or 5.1 percent below the amount received in 1967.

Expenses

Operating expenses increased $4,383,456 from $24,323,742 in 1967 to $28,707,198 in 1968. This increase of 18 percent is in contrast to the previously mentioned operating revenues increase of 20.8 percent, and increase of commercial revenue (excluding subsidy) of 26.3 percent.

The overall rise in operating expenses resulted from general inflationary increases in the economy as well as continued Company expansion brought about by route extension and improved service to our present cities.

Results

Southern had an operating profit for the year 1968 of $593,080 after accounting changes described in Notes A and B to the financial statements, as compared to an operating loss for the year 1967 of $68,110. A 94.3 percent increase in interest costs, from $584,621 in 1967 to $1,135,812 in 1968 resulted in a loss before income tax credits of $422,841 in the current year. This is contrasted to a loss before income tax credits of $595,994 in the prior year.

After provision for refund of federal income taxes paid in prior years and use of investment tax credits, a net loss for the year of $210,982 was incurred, compared to a loss of $237,695 (as restated) in the prior year.

The comparative financial statements of December 31, 1968 and 1967 included retroactive adjustments applicable to public service revenue, as a result of the final settlement of such payments for all years prior to 1967. As more fully described in Note C to the financial statements, these items are not applicable to current years' operations and have therefore been recorded through charges, net of income taxes, directly against retained earnings rather than included in results of operations for the current year. The specific provisions of the subsidy formula giving rise to these types of retroactive differences were eliminated as of January 1, 1967, and similar adjustments should not arise in the future.

Effective with the year 1968, the Company has elected for federal income tax purposes to utilize accelerated depreciation on certain DC-9 equipment and the current deduction of certain expenses which are deferred for book purposes. Appropriate provision has been made for the income taxes which may become payable in future years when depreciation and deferred expenses for tax purposes are less than for financial reporting purposes.

FIVE YEAR COMPARISON	1968	1967	1966	1965	1964
OPERATING STATISTICS					
Passengers (scheduled service)	1,271,497	1,180,297	1,051,554	848,149	721,493
Passenger Miles (000) (scheduled service)	254,028	222,142	196,366	156,421	137,228
Plane Miles (000)	12,260	11,803	11,287	10,611	9,865
Available Seat Miles (000)	611,795	498,322	416,738	374,757	324,830
Cargo Ton Miles	3,018,209	2,593,645	2,281,380	1,763,784	1,332,855
Completion Factor	98.1%	97.8%	98.5%	98.5%	97.7%
Average Passenger Load (scheduled service)	22.3	19.4	18.0	15.3	14.3
Passenger Load Factor (scheduled service)	45.8%	45.9%	48.6%	43.2%	43.5%
Employees At End Of Year	1,538	1,499	1,365	1,248	1,157
FINANCIAL STATISTICS					
Employee Wages and Benefits (000's)	$ 14,240	$ 12,582	$ 10,800	$ 9,516	$ 8,433
Commercial Revenues (000)	$ 25,262	$ 20,000	$ 17,513	$ 14,688	$ 11,728
Net Income (Loss) (000)	$ (211)	$ (238)	$ 807	$ 938	$ 678
Stockholders' Equity (000)	$ 4,638	$ 4,849	$ 4,937	$ 4,291	$ 3,477
Common Shares Outstanding	1,024,871	1,024,871	1,005,000	1,005,000[1]	1,002,334[1]
Book Value per Share	$ 4.53	$ 4.73	$ 4.91	$ 4.27[1]	$ 3.47[1]
Net Income per Share (Loss)	$ (.21)	$ (.23)	$ .80	$ .93[1]	$ .70[1]

[1] Adjusted to reflect three-for-two stock split in May 1966.

Financing

In November, the Company arranged to sell through private placement, $8,000,000 of 6½ percent Convertible Subordinated Debentures with warrants attached to purchase an additional 144,000 shares of common stock of the Company. The debentures are convertible at and the warrants exercisable at $16 per share. These funds will be used to partially pay for the three DC-9-30 jet aircraft, and related spares, scheduled for delivery in May and June 1969.

It is anticipated that the debenture issue, together with leasing arrangements presently under negotiation, will provide sufficient financing for the jet aircraft to be received in 1969.

The Company made extensive analyses of potential Martin-404 replacements during 1968. It was found that there was no specific aircraft available to economically replace the Martin at the present time. However, as the result of greater scheduling flexibility on the realigned system, certain Martin flights can be economically replaced by DC-9's. Equipment reviews are continually being made to determine that Southern is using the aircraft most appropriate to its route system.

On December 31, 1968, there were 2,000,000 shares of common stock authorized of which 1,024,871 were outstanding and owned by more than 4,400 shareholders throughout the United States and foreign countries.

Public Service Revenue

Public service revenue (subsidy) as previously stated, is becoming a lesser portion of your Company's total revenues. It is anticipated that this will continue to be reduced and any anticipated route awards will be on a subsidy ineligible basis. Your Company has long sought a profit position and route structure which would enable it to operate without subsidy.

Passenger Traffic

The 1,271,497 passengers carried in scheduled service during 1968 was an all-time high. This was a 7.7 percent increase over the 1,180,297 persons transported in 1967. Revenue passenger miles from scheduled service rose 14.4 percent from 222,142,000 in 1967 to 254,028,000 in 1968. The yield per revenue passenger mile increased 5.2 percent from 7.7 cents in 1967 to 8.1 in 1968.

While the number of passengers boarded increased, a general softening in air travel during much of the year resulted in less increase than your Company had anticipated.

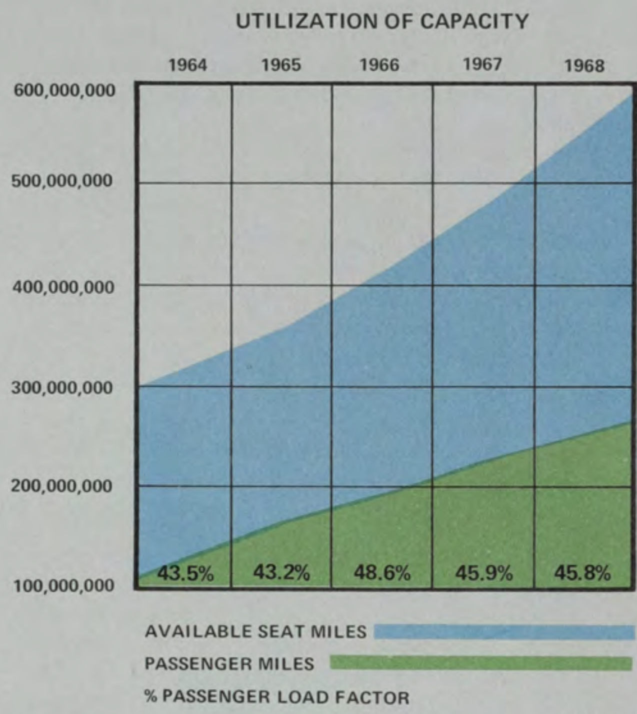
Fare levels were raised slightly by the rounding of all fares to the next whole dollar. An increase in our youth fare rates and our change in military standby fares resulted in the increased overall revenue passenger mile yield.

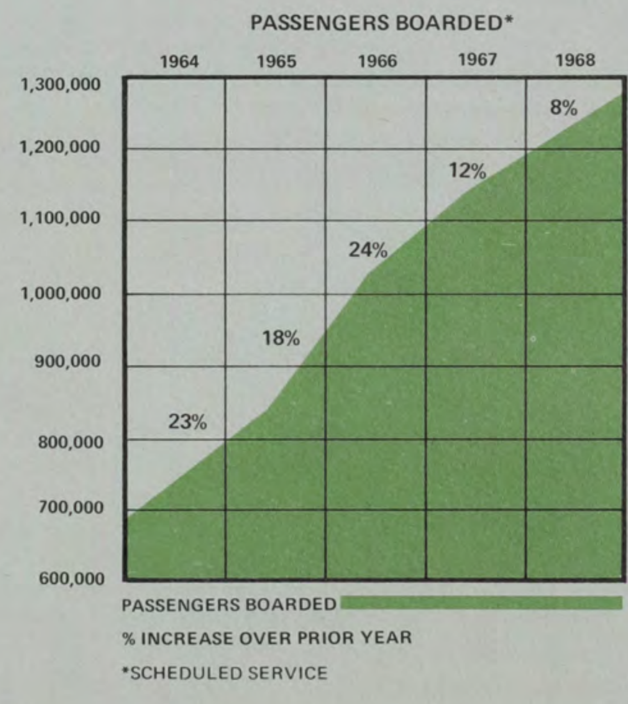
A general fare increase for all airlines, approved by the Civil Aeronautics Board effective February 20, 1969, will substantially improve our basic fare structure during 1969.

Cargo

Air freight, air mail, and air express all showed significant gains during the past year. Cargo ton miles increased 16.4 percent to 3,018,209, from 2,593,645. This gain resulted primarily from the additional capacity afforded by the DC-9's. In addition to greater lift capacity and speed, the DC-9's are capable of carrying larger and heavier individual items.

First class mail shipments by air have increased and these are expected to continue in line with the Post Office Department's desire to move as much mail as possible by air.





Gulfport/Biloxi and Meridian received jet service direct to Atlanta.

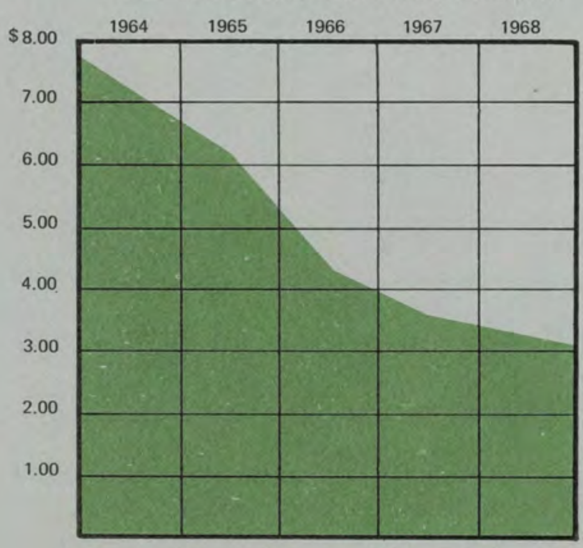
Future Planning

To provide for immediate as well as long range expansion within your Company, it was decided to retain the services of a general management consulting firm. In early 1968, a survey was commenced. This has now been concluded and the results and recommendations are under consideration and will be implemented in the near future.

The Employment Picture

Your Company has enjoyed a plentiful employee supply, and with the exception of electronics and avionics technicians and stewardess trainees, few vacancies have been difficult to fill. A realistic wage scale, coupled with lower living costs throughout most of our system (compared with much of the country), enables our people to enjoy one of the highest living standards in the airline industry.

PUBLIC SERVICE REVENUE PER PASSENGER



To provide Flight Crew scheduling for the New York service, a fourth crew base was established in Fort Walton Beach, Fla., servicing our originating flights from Eglin Air Force Base. This has been a popular crew base, offering excellent living conditions and the fine recreational facilities of the Gulf Coast.

We enjoy one of the lowest employee turnover rates in the airline industry. Many factors enter into this, but a major one is that 138 people at Southern earned promotions during 1968. And, of the 1,538 persons employed at year end, more than 700 have been with the Company more than five years.

Job classifications, excluding management, now number 68, ranging from porters and aircraft cleaners to operations research analysts, reliability analysts, and aeronautical engineers.

It has long been a Company policy to hire and train locally. Seldom does Southern uproot its people. Experience indicates the wisdom of this practice, for personnel with strong home and family ties remain stable in their job positions.

Training Programs

An increase in DC-9 FanJET flying spurred training activity to a record 23,000 student hours spent in the classrooms. The major portion was for up-grading Martin 404 crews to fly the larger and faster DC-9 aircraft. Pilot flight instructors spent over 750 hours in the air for this purpose and also to provide the routine practice that enables our flight crews to maintain their high standard of proficiency.

Extensive pilot and stewardess training programs have been brought about as a result of additional DC-9's being put into service. Six flight crews are needed to support each jet. While there is relatively little turnover among Southern pilots and co-pilots, there is a continuing need to upgrade these men to jet qualifications. Annual stewardess turnover may reach as high as 42 percent, attributable primarily to marriage. To replace these brides, a new class begins every two months and each trainee undergoes almost four weeks of ground and flight training before she pins on her Accent 'S' and dons her Pierre Balmain-designed uniform.

Additional programs train ramp agents, baggage agents, fuelers, ticket agents and gate agents.

New and replacement reservations agents receive three weeks of instruction before they are assigned a full-time position. More than two weeks are spent in the classroom before a reservations agent first talks with a Southern passenger. And, these first passenger inquiries are answered under direct supervision of an instructor.

Programs for maintenance personnel have been expanded to provide jet maintenance instruction. As a result, few new employees have been required even with the jet changeover.

Passenger and Employee Safety

For the nineteenth consecutive year, your Company continued the enviable position of operating without a passenger or employee fatality. Employee on-job accidents were in line with industry standards, and loss time accidents were minimal. Again, we operated with credit-rating on our Workmen's Compensation insurance.

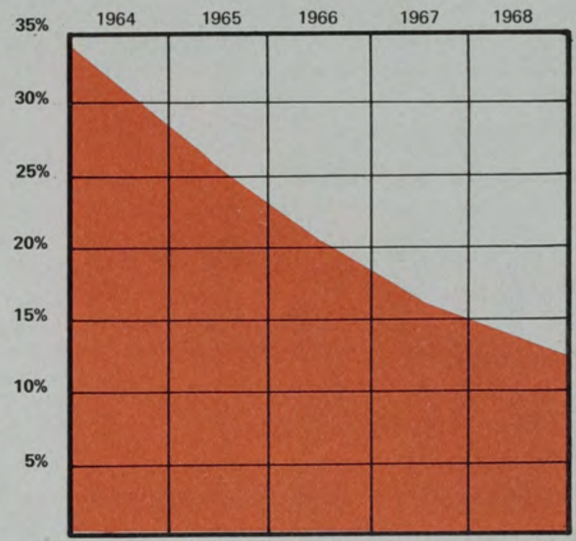
The success of both passenger and employee safety achievements must be attributed to high safety standards. Complacency is not tolerated, and safety is never taken for granted. Our personnel are continuously made aware of the public's safety — and their own.

Maintaining the Fleet

Maintenance and Engineering has made a significant contribution to reduced costs by instituting a system of continuous maintenance for our DC-9 FanJETs. Supported by a maintenance management system that relies heavily upon computer support for planning and scheduling of all maintenance work, along with a very effective computerized inventory management system, it has been possible to overhaul and maintain the jet fleet with a minimum of non-productive 'ground' time. These functions are performed at night after the aircraft have returned from their last flight. By revolving the flying schedules of each jet, it is possible to schedule one jet each night for the central maintenance facility. The management control systems insure that maximum utilization is obtained from the application of labor, material and facilities that make up a substantial portion of the Company's resources.

Careful planning and quick engineering response in solving maintenance problems has shown Southern to be one of the leaders in the industry in maintenance cost and maintenance operating performance.

PUBLIC SERVICE REVENUE AS % OF TOTAL REVENUE



Inauguration of Washington service brought out members of the Senate, the House of Representatives, and the Civil Aeronautics Board. Military officials, civic leaders, travel agents, the press, and representatives of domestic and international airlines greeted the first Southern jet at Dulles.

Scheduling Flights

Flight scheduling continues to receive rigid attention in order to provide a pattern of service in keeping with the needs of the cities served, while at the same time producing the greatest possible amount of passenger revenue for the Company.

Additional jet aircraft permitted expanded service in key markets. Meridian, Miss., acquired its first nonstop jet service to Atlanta. Gulfport-Biloxi, serving Mississippi's "Golden Gulf Coast," was connected directly with Atlanta. The Gulf Coast area is an ever expanding vacation and convention mecca. More than 500 conventions are expected in this area this year, and we shall aggressively solicit this passenger potential.

Airport Congestion

Southern has been fortunate in being able to operate and maintain its flight schedules with a very high on-time performance, especially in view of the serious congestion problems. Of the four busiest airport centers in the country, we serve two: Atlanta and New York. Our six daily jet operations at LaGuardia have been able to operate usually within ten minutes of schedule. This is due to our selected arrival and departure times being at other than peak periods. A similar situation has prevailed in Atlanta, and while we do suffer occasional delays resulting from air traffic, this has not been for us the major problem it has been for some carriers. The situation can change, however, and we are carefully analyzing our schedules in all major markets.

Computer Regeneration

During the year, a major project was upgrading our computer from a second generation RCA 301 to a third generation RCA Spectra 70/35. In order to accomplish this with minimum additional expense, a contract was effected with a regional division of a national company to utilize our computer during the 8:00 P.M. to 5:00 A.M. shift five days a week, a time when the equipment would not be used by Southern.

Following installation of the Spectra 70/35, an upgrading of the Company-wide teletype system was instituted. Analysis had indicated that a computerized message switching system would provide the greatest benefit, replacing a teletype system which has basically been in use since the Company's organization.

The new equipment selected is a specialized communications computer. With minor expansion costs, it will provide for Southern's communications requirements for some time to come.

This equipment will be delivered in April 1969, and will be operational in May.

Southern Style Program

In March, a Company-wide commitment was made to service' for our customers. The year's marketing concept was developed around the basic theme: "Southern Style." Southern Style would imply that our customers would receive "warm, friendly, and courteous service accompanied by on-time performance." But before the marketing shift was made from a 'destinations' to a 'service and performance' approach, every Southern employee was acquainted with the soon-to-be-introduced program. Each signed a pledge that he would perform "Southern Style," and management was assured that it could produce what it advertised.

Concurrent with the new marketing approach, an employee incentive program was launched, the first such used by your Company. Employees could earn rewards for extraordinary individual performances, as well as Company-wide performances, when predetermined corporate and/or departmental goals were achieved.

As a result of the *1968: Southern Style* program, on-time performances reached new highs, employee production increased throughout the Company, and employee morale soared to even greater heights.

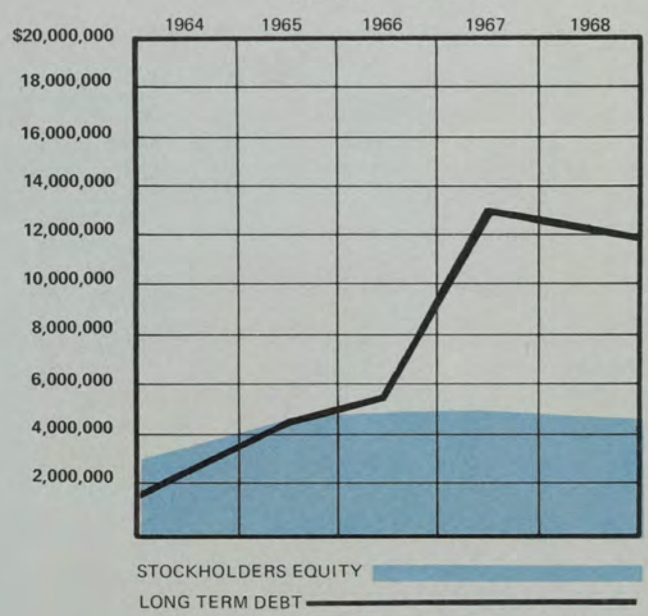
The incentive program terminated at the end of 1968. Consideration is being given to other such programs in the future. The theme, "Southern Style," continues as the major marketing concept of your Company.

Major Marketing Problem

Entry into Washington and New York posed a severe marketing challenge: gaining immediate exposure to the flying public within a limited period of time at a minimum overall expense. The solution evolved around television, the first time this medium has been used so extensively by your Company. Careful analysis of the channels available, relating to their audience, convinced us that spot commercials in prime time on a major network would produce the greatest results for the least amount of dollars spent. Accordingly, a saturation-type program was introduced with as many as ten spots running weekly. This program reached some 5,000,000 homes each week, and the immediate ticket sale responses indicated the wisdom of this selection.

Accompanying the television program was a sustained

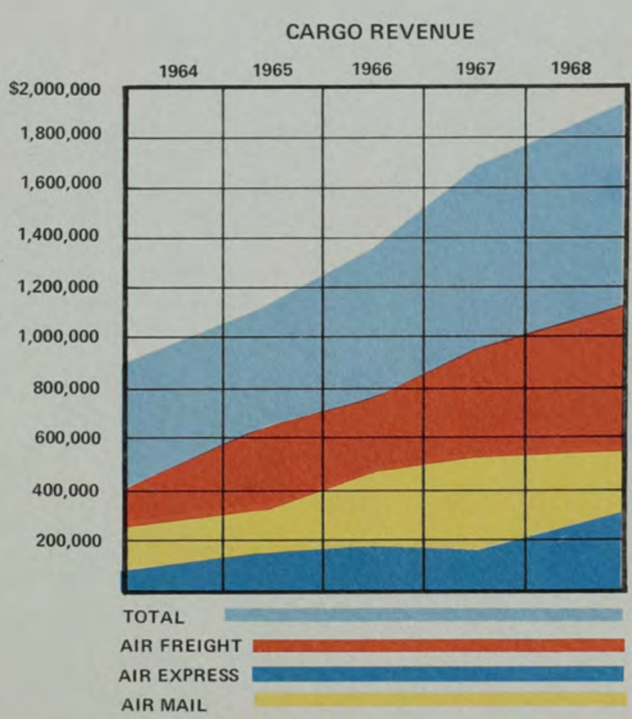
INVESTED CAPITAL



CONVERTIBLE SUBORDINATED DEBENTURES (000)

1964	1965	1966	1967	1968
–	–	$5,000	$4,682	$12,682

Maintnance crews work around the clock. One jet is scheduled into the Maintenance and Overhaul facility each night.



advertising program in the *New York Times.* Ads featuring the themes "Skip the Battle of Atlanta" and "Sherman Went Through Atlanta, But You Don't Have To" followed a "teaser" campaign building up interest in Southern's initiation of service.

In Washington we developed a similar program of spot TV and newspaper advertising in the *Washington Post* with the same themes as used in New York.

Combined with the advertising program was an extensive effort by members of the Home Office and Field Sales Department. In New York and Washington, hundreds of personal calls were made on key travel agencies and transportation department heads of companies having travel to the South. In turn, a city sales office was opened in New York City at 80 East 42nd Street. A combined sales and city ticket office was established in Washington at 1625 K Street. Our stockholders are urged to visit these offices.

Expanding Charter Sales

Long a leading charter operator among regional airlines, new dimensions in charter sales were sought and achieved during 1968. It was determined early in the year to place one 75-passenger DC-9 and one 40-passenger Martin-404 in full-time charter service. This opened the capability of carrying virtually any size group, with particular emphasis on military charters and business and industrial flights. Authority was requested and received to operate charters both to Canada and to the Bahamas. Southern charters can operate without restriction throughout the United States, and charter jets were seen from coast to coast during the year. Charter sales for the

year reached $1,934,461, with even greater results anticipated during 1969. With the delivery of the DC-9-30 jets, carrying 95 passengers, Southern will be an even stronger charter contender.

Stockholders are urged to think of a Southern charter to carry any business or civic group to meetings, conventions, or vacations.

Reservations Expansion

Reservations facilities were expanded with telephone lines added to link New York and Washington with the Consolidated Reservations Office in Atlanta. Inquiries from New York and Washington passengers are answered with a pleasant "Southern accent." Reservations agents' productivity related to length of time per call handled continues to increase, and newly-implemented training procedures by the Reservations Department staff resulted in faster initial productivity among new and replacement personnel.

New Inflight Service

Passengers' inflight service received new attention, brought about by longer flights, better serving facilities on the new jets — and competition. While it has long been considered that most Southern flights were too short to warrant full meal service, excellent light meals were developed, particularly for the New York segment. These also appear on other longer flights at appropriate times of the day.

All Southern passengers are offered complimentary refreshments, and alcoholic beverage sales continue to be well received by the passengers. With the advent of Southern's "stretched" jets, galley facilities will facilitate handling and service.

A Southern Magazine

SOUTHERN SCENE magazine was introduced in March 1968, and is distributed without charge in every seat pocket aboard each Southern plane, as well as at our ticket counters, in many travel agencies, and in selected hotels on the system. This quarterly publication has won praise within as well as without the airline industry, and it has become accepted as a standard among airline inflight magazines. SOUTHERN SCENE has found a profound place as a goodwill builder for the Company, yet is self-supporting through the advertising it contains. During the 12 months beginning April 1, 1969, almost two million persons will be reached by SOUTHERN SCENE, telling stories about the cities we serve, as well as informative facts about the Company.

Stockholders are invited to write the Public Relations Office for a complimentary copy of the next issue.

Thousands of Georgia peaches were passed out by "Southern Belles" when service was inaugurated to New York. Travelers and terminal personnel were the happy recipients.

Route Proceedings

The year 1968 saw the first route award for Southern under the Civil Aeronautics Board's route strengthening policy. After completion of the formal hearing process in early Spring, the CAB in mid-summer effected its examiner's recommendation that Southern be awarded a new segment between Eglin Air Force Base, Fla. and New York/Newark via Dothan, Ala., Columbus, Ga., and Washington, D.C. (via Dulles Airport). The Company inaugurated service over this 1,011 mile segment on September 3, 1968. Traffic response on the initial two daily round trips was excellent and within a few weeks, on October 27, the third round trip was added. By the end of the year, the New York flights were producing 25 percent of the Company's total revenue passenger miles.

1968 also saw two other route proceedings of the Company reach their final stages although short of ultimate Civil Aeronautics Board decision. Oral Argument before the CAB was held late in 1968 in the Central Airlines Route 81 Investigation and in the Gulf States—Midwest Points Service Investigation. In the former, Southern is pursuing an application for nonstop authority between Memphis and St. Louis and in the latter, seeks authority to provide service between Memphis and Chicago and between Memphis and New Orleans both nonstop and via Jackson, Mississippi. Final decision on these two proceedings is expected momentarily.

Hearings were also concluded last year in the Southern Airways, Inc. Route Realignment Investigation. In that proceeding, the Civil Aeronautics Board is considering the realignment of the present system, condensing the current sixteen segments to eight segments and further, considering the extension of the system down the Florida peninsula through Tallahassee, Orlando, Miami and Marathon to Key West, Florida. Earlier this year the Board approved a major portion of the proposed system realignment, but voted to review its examiner's recommendation for the Company's extension into South Florida. A CAB Hearing Examiner had recommended that Southern be granted access to the Florida peninsula from various points on its present system, including Memphis, Birmingham, Montgomery, Dothan, Eglin Air Force Base and Panama City. He failed, however, to recommend approval of Southern's bid for authority between Atlanta and the Florida points. Oral argument before the CAB is scheduled for May 7, 1969 and the Company is hopeful of a prompt decision.

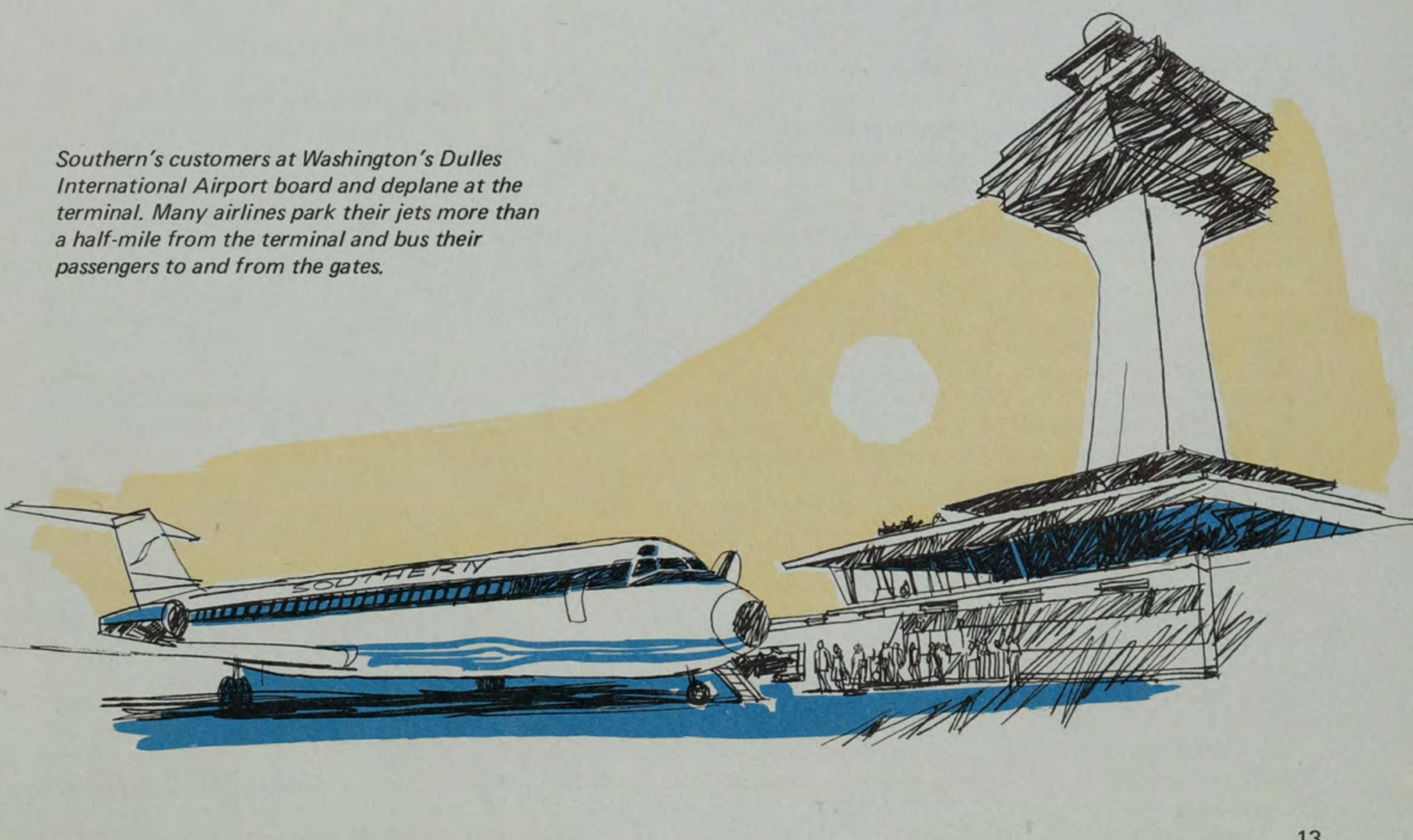
During the spring of last year, the company participated in the Southern Tier Competitive Nonstop Investigation pursuing applications for authority to operate between Atlanta and Dallas/Ft. Worth and between Dallas/Ft. Worth and Miami/Ft. Lauderdale via New Orleans and Tampa/St. Petersburg/Clearwater. Early in 1969, a Civil Aeronautics Board Examiner issued his initial decision recommending against award of any authority to Southern or any other Local Service Carrier applicant. The CAB, on its own motion, announced shortly after the examiner's recommendations were released, that it would review this decision. The Company plans to vigorously pursue its service proposals through further procedural steps.

Another proceeding, instituted last year and still in its early stages, is the North Carolina Points Service Investigation. This case involves the issues of additional air service between New York, Chicago and Miami on the one hand and three North Carolina airports serving Charlotte, Greensboro/High Point/Winston-Salem and Raleigh/Durham on the other. Additionally, the Company's proposal calls for the provision of new or additional single-plane service between several presently served points and New York/Newark. Final decision in this proceeding is anticipated late this year.

Two other route proceedings, both still in the formative stages, but in which the Company has a vital interest, are the Additional Service to Augusta and Columbia Case and the Cleveland/Detroit-Atlanta Investigation. In the former, the Company is proposing to increase its existing operations at both Washington and New York by linking these two points with other of its presently served cities including Columbia, South Carolina. In the latter, the proposal calls for Southern to become the first competitive carrier in the current Atlanta-Detroit and Atlanta-Cleveland markets. Final decisions in these cases are not expected for some time.

Light meals are now served on longer flights. Refreshments are offered on all Southern planes.

Southern's customers at Washington's Dulles International Airport board and deplane at the terminal. Many airlines park their jets more than a half-mile from the terminal and bus their passengers to and from the gates.



balance sheet

December 31, 1968 and 1967

Assets	1968	1967
CURRENT ASSETS		
Cash	$ 4,143,852	$ 2,435,258
Certificates of deposit	5,534,316	–0–
Accounts receivable:		
U.S. Government:		
Transportation and public service revenue–Note C	$ 722,581	$ 773,359
Refundable income taxes	552,482	504,700
Trade receivables	3,016,283	2,119,928
	$ 4,291,346	$ 3,397,987
Maintenance and operating supplies, at average cost, less allowances for obsolescence (1968 – $282,359; 1967 – $223,813)	1,011,101	910,096
Prepaid expenses	773,714	304,882
Total Current Assets	$15,754,329	$ 7,048,223
INVESTMENTS AND OTHER ASSETS – at cost	$ 47,455	$ 32,963
PROPERTY AND EQUIPMENT – on the basis of cost–Notes A, B and D		
Flight equipment	$20,568,356	$20,508,289
Less allowances for depreciation and maintenance	4,610,250	3,839,135
	$15,958,106	$16,669,154
Deposits on new equipment–Notes D and H	3,179,958	3,221,955
	$19,138,064	$19,891,109
Other property and equipment	2,857,605	2,672,238
Less allowances for depreciation	1,663,114	1,385,727
	$ 1,194,491	$ 1,286,511
	$20,332,555	$21,177,620
DEFERRED CHARGES		
Unamortized pre-operating, route extension, and development costs	$ 730,111	$ 674,404
Deferred lease costs	206,780	–0–
Unamortized long-term debt expense	407,899	320,385
	$ 1,344,790	$ 994,789
	$37,479,129	$29,253,595

Liabilities	1968	1967
CURRENT LIABILITIES		
Accounts payable	$ 1,321,297	$ 1,274,430
Collections and withholding as agents	2,459,524	2,101,440
Salaries, wages, and vacations	822,166	684,280
Accrued taxes, advertising, and other expenses	1,012,926	636,952
Air travel plan deposits	112,625	114,750
Employee stock purchase plan	145,866	68,512
Current maturities of long-term debt—Note D	1,821,739	1,374,448
Total Current Liabilities	$ 7,696,143	$ 6,254,812
LONG-TERM DEBT, less current maturities—Note D		
Notes payable to banks	$12,228,237	$13,468,052
Convertible Subordinated Debentures	12,682,000	4,682,000
	$24,910,237	$18,150,052
DEFERRED TAXES ON INCOME—Note E	$ 235,000	$ –0–
STOCKHOLDERS' EQUITY—Notes C, D and F		
Common Stock, $2 par value:		
Authorized – 2,000,000 shares		
Issued and outstanding – 1,024,871 shares	$ 2,049,742	$ 2,049,742
Other paid-in capital	797,523	797,523
Retained earnings	1,790,484	2,001,466
	$ 4,637,749	$ 4,848,731
COMMITMENTS—Note H		
	$37,479,129	$29,253,595

See Notes to Financial Statements.

Southern Airways, Inc.

STATEMENT OF INCOME AND RETAINED EARNINGS

Years Ended December 31, 1968 and 1967

	1968	1967
OPERATING REVENUES		
Passenger and excess baggage	$20,503,123	$17,155,206
Mail, express, and freight	1,949,557	1,637,487
Public service revenue–Note C	4,038,298	4,255,157
Charter	1,934,461	564,311
Other operating revenues–net	874,839	643,471
	$29,300,278	$24,255,632
OPERATING EXPENSES		
Flying operations	$ 9,117,641	$ 7,049,726
Maintenance	5,121,450	5,217,328
Aircraft and traffic servicing	7,502,089	6,517,775
Passenger service	1,282,685	1,101,901
Promotion and sales	2,306,037	1,852,364
General and administrative	1,607,534	1,130,298
Amortization and provision for depreciation	1,769,762	1,454,350
	$28,707,198	$24,323,742
	$ 593,080	$ (68,110)
OTHER DEDUCTIONS AND (INCOME)		
Interest on long-term debt–net of interest capitalized	$ 1,135,812	$ 584,621
Gain on disposal of property	(90,177)	(21,354)
Other (income), less miscellaneous deductions	(29,714)	(35,383)
	$ 1,015,921	$ 527,884
LOSS BEFORE INCOME TAX CREDIT	$ (422,841)	$ (595,994)
INCOME TAX CREDIT–Note E		
Provision for income taxes		
Current	$ (387,862)	$ (314,486)
Deferred	235,000	–0–
Investment credit – including in 1967 carry-back to prior years, less applicable refund of $230,174 of public service revenue–Note C	(58,997)	(43,813)
	$ (211,859)	$ (358,299)
NET LOSS (per share: 1968 – $.21; 1967 – $.23)	$ (210,982)	$ (237,695)
RETAINED EARNINGS at beginning of year, as previously reported	$ 2,122,525	$ 2,443,630
Adjustment of public service revenue, net of applicable income taxes–Note C	(121,059)	(42,079)
RETAINED EARNINGS at beginning of year, as restated	$ 2,001,466	$ 2,401,551
	$ 1,790,484	$ 2,163,856
Cash dividends paid in 1967 – $.16 per share	–0–	(162,390)
RETAINED EARNINGS AT END OF YEAR	$ 1,790,484	$ 2,001,466

See Notes to Financial Statements.

Southern Airways, Inc.
STATEMENT OF SOURCE AND APPLICATION OF FUNDS
Years Ended December 31, 1968 and 1967

	1968	1967
FUNDS PROVIDED BY		
From Income:		
Net loss	$ (210,982)	$ (237,695)
Items not requiring outlay of funds:		
Provision for depreciation	1,703,817	1,353,751
Amortization of deferred charges	233,003	70,042
Deferred taxes on income	235,000	–0–
	$ 1,960,838	$ 1,186,098
Increase in long-term debt – net	–0–	7,725,466
Certificates of deposit applied to purchase of equipment	–0–	4,800,000
Sale of 6 1/2% Convertible Subordinated Debentures	8,000,000	–0–
	$ 9,960,838	$13,711,564
FUNDS APPLIED TO		
Additions to property, plant and equipment – net	$ 845,744	$12,088,025
Equipment purchase deposits – net	13,008	2,485,802
Increase in deferred charges	583,004	569,059
Cash dividends ($.16 per share)	–0–	162,390
Decrease in long-term debt – net	1,239,815	–0–
Increase in investments and other assets	14,492	18,408
	$ 2,696,063	$15,323,684
Increase (decrease) in working capital	$ 7,264,775	$ (1,612,120)
Working capital at beginning of year	793,411	2,405,531
Working capital at end of year	$ 8,058,186	$ 793,411

Southern Airways, Inc.

NOTES TO FINANCIAL STATEMENTS
December 31, 1968

NOTE A – Change in Accounting Principle. The Company has consistently followed the policy of capitalizing direct labor and material costs applicable to Martin 404 airframe overhaul and amortizing such costs over the estimated useful lives of the overhauls. On January 1, 1968, the Company changed its method of accounting for overhead costs applicable to Martin 404 airframe overhaul from expensing such costs as incurred to a method of capitalizing these costs and amortizing such costs over the estimated useful lives of the overhauls. As a result of this change, the net loss for 1968 was decreased by approximately $248,000 ($.24 per share) after applicable income taxes at 24% rate.

NOTE B – Change in Life of Depreciable Assets. During 1968 the Company redetermined the estimated economic useful life of its DC-9 aircraft and related equipment and increased the lives of these assets from 12 years to 15 years and reduced the salvage value from 15% to 10%. This change had the effect of decreasing the provision for depreciation approximately $136,000 and decreasing the net loss approximately $103,000 ($.10 per share) after applicable income taxes at 24% rate.

NOTE C – Public Service Revenue. During 1968, the Civil Aeronautics Board proposed reductions in public service revenue in the amount of $189,160 for years prior to 1968. Such amount, net of applicable income taxes of $68,101, has been charged to retained earnings. For comparative purposes, the financial statements for 1967 have been retroactively restated to include these adjustments which increased the net loss by $78,980 resulting from profit-sharing applicable to carry-back of investment credit.

Public service revenue received from the Federal Government is subject to review by the Civil Aeronautics Board. Settlement has been finalized for years through 1966 and provision has been made for all known adjustments for subsequent years.

NOTE D – Long-term Debt. Long-term debt at December 31, 1968 is summarized as follows:

Notes payable to banks in quarterly installments through 1976 (1) (6) (7)	$10,555,000
Notes payable to banks in quarterly installments through 1974 (2) (6) (7)	2,739,130
DC-9 Predelivery Deposit Notes (3)	755,846
5¾% Convertible Subordinated Debentures due December 1, 1981 (4) (7)	4,682,000
6½% Convertible Subordinated Debentures with warrants attached due November 1, 1983 (5) (7)	8,000,000
	$26,731,976
Less current maturities	1,821,739
	$24,910,237

(1) The interest rate is ¼ of 1% above the lead bank's prime rate.

(2) The interest rate is ½ of 1% above the lead bank's prime rate.

(3) The interest rate is ¾ of 1% above the Chase Manhatten Bank (National Association) prime rate but not less than 6% or more than 7%. The notes are due upon completion of financing arrangements for the three DC-9 aircraft scheduled for delivery in 1969, but not later than July 1, 1969. Since these notes are to be repaid out of proceeds of long-term financing, the entire amount is classified as long-term debt.

(4) 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 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 required amount.

(5) The 6½% Convertible Subordinated Debentures due November 1, 1983, are convertible (until maturity or prior redemption) into Common Stock at $16 per share; are issued in integral multiples of $1,000 with a warrant for the purchase of 18 shares at $16 a share attached; are subordinated, generally, to all existing and future indebtedness for borrowed money; are callable on or after November 1, 1973, at premiums ranging from 6.5% downward; and require annual prepayments beginning November 1,1978, in an amount equal to 10% of the principal amount outstanding at November 1, 1977 less credit for principal amount converted or called subsequent to November 1, 1977. Also, the Company may make additional voluntary prepayments equal to the required amount.

(6) All aircraft, engines and related equipment are pledged as collateral on this indebtedness.

(7) The agreements relating to the notes payable and the 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 retained earnings is restricted from payments relating to capital stock and dividends at December 31, 1968.

Pending clarification of the accounting principles applicable to debt issued with stock purchase warrants, the Company has elected not to recognize any debt discount attributable to the stock purchase warrants attached to the 6½% Convertible Subordinated Debentures issued in 1968. Upon clarification of these accounting principles, it may be necessary to apply such principles (which may require the recognition of debt discount) retroactively. If debt discount had been recognized on the debentures sold in 1968, other paid-in capital and unamortized debt discount at December 31, 1968 would have increased approximately $432,000, and additional amortization of debt discount charged to expense during the year would have amounted to approximately $3,600.

NOTE E – Income Taxes. The loss to be carried back for income tax purposes will exceed the loss shown in the income statement because of certain expenses deferred for financial statement purposes and additional depreciation to be claimed for income tax purposes. Provision has been made in the accompanying financial statements for the income taxes deferred to future years.

The Company uses the flow-through method of accounting for investment credit and the available investment credit has been recognized only to the extent that it can be offset against the aforementioned deferred income taxes. The remaining investment credit at December 31, 1968 amounted to approximately $760,000 and expires in 1974 ($722,000) and 1975 ($38 000).

NOTE F – Common Stock and Other Paid-in Capital. At December 31, 1968, 972,118 shares of Common Stock of the Company were reserved as follows:

	Shares Reserved
Qualified Stock Option Plan approved by Board of Directors in 1965:	
Currently exercisable at a price of $10.16 2/3 per share	19,500
Exercisable one-third each year beginning in November 1970 at a price of $13.75 per share	900
	20,400
Employee Stock Option Plan approved by Board of Directors in 1967:	
Exercisable in June 1969 at a price of $18.75 per share	9,272
Exercisable in June 1970 at a price of $11.52 per share	2,786
Shares available for additional options which may be granted under Plan	3,035
	15,093
Shares reserved for conversion of 5¾% Convertible Subordinated Debentures	292,625
Shares reserved for conversion of 6½% Convertible Subordinated Debentures	500,000
Shares reserved for sale persuant to stock purchase warrants issued with 6½% Convertible Subordinated Debentures at a price of $16 per share	144,000
TOTAL	972,118

During the year, the Board of Directors withdrew 9,350 shares and 9,907 shares of Common Stock authorized for issuance pursuant to the Qualified Stock Option Plan and the Employee Stock Option Plan until the Company has authorized additional Common Stock by appropriate amendment of its Certificate of Incorporation. In addition, options previously granted under the Qualified Stock Option Plan for 15,250 shares were suspended from exercise until October 27,1969.

During 1967, 19,871 shares of Common Stock were issued upon conversion of 5¾% Convertible Subordinated Debentures. The excess ($272,277) of the conversion price over the par value ($39,742) of such shares less applicable deferred financing costs was credited to other paid-in capital. This constitutes the only change in Common Stock and other paid-in capital for the two years ended December 31, 1968.

NOTE G – Pension Plans. The Company has several pension plans covering substantially all of its employees. The total pension expense for the year was $633,672, which includes $262,776 under a defined-contribution plan. The Company's policy is to fund normal cost plus accrued interest on the unfunded past service liability. At December 31, 1968, the total of the pension fund exceeded the actuarially computed value of vested benefits and the unfunded past service liability was approximately $522,000. A change during the year in the actuarial assumptions used in computing pension cost applicable to one of the plans had the effect of reducing the net loss for the year by approximately $45,000.

NOTE H – Commitments. On February 1, 1968, the Company leased three DC-9 jet aircraft for a period of twelve years at a minimum net annual rental of $1,090,395.

At December 31, 1968, the Company had on order three DC-9 jet aircraft scheduled for delivery in 1969. The three aircraft represent a commitment of approximately $9,242,000 in excess of the related equipment purchase deposits.

ACCOUNTANTS' REPORT

Board of Directors
Southern Airways, Inc.
Atlanta, Georgia

We have examined the balance sheet of Southern Airways, Inc. as of December 31, 1968, and the related statements of income and retained earnings 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 previously made a similar examination of the financial statements for the preceding year which have been restated for changes in public service revenue as explained in Note C.

During 1968, the Company increased the estimated economic useful life and reduced the salvage value of its DC-9 aircraft and related equipment as described in Note B to the financial statements. This change, with which we concur, had the effect of decreasing the net loss approximately $103,000 for the year 1968.

In our opinion, the accompanying balance sheet and statements of income and retained earnings and source and application of funds present fairly the financial position of Southern Airways, Inc. at December 31, 1968, 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, except for the change, with which we concur, in the method of accounting for overhead applicable to airframe overhaul as described in Note A to the financial statements.

Ernst & Ernst
ERNST & ERNST

Atlanta, Georgia
February 11, 1969

The Marketing Outlook for 1969

Your Company is faced with ever increasing competition from other airlines and from automobile convenience resulting from a superb highway network encompassing the Southeast. In addition, our recent entry into new city markets, as well as anticipated route awards, create both challenges and problems.

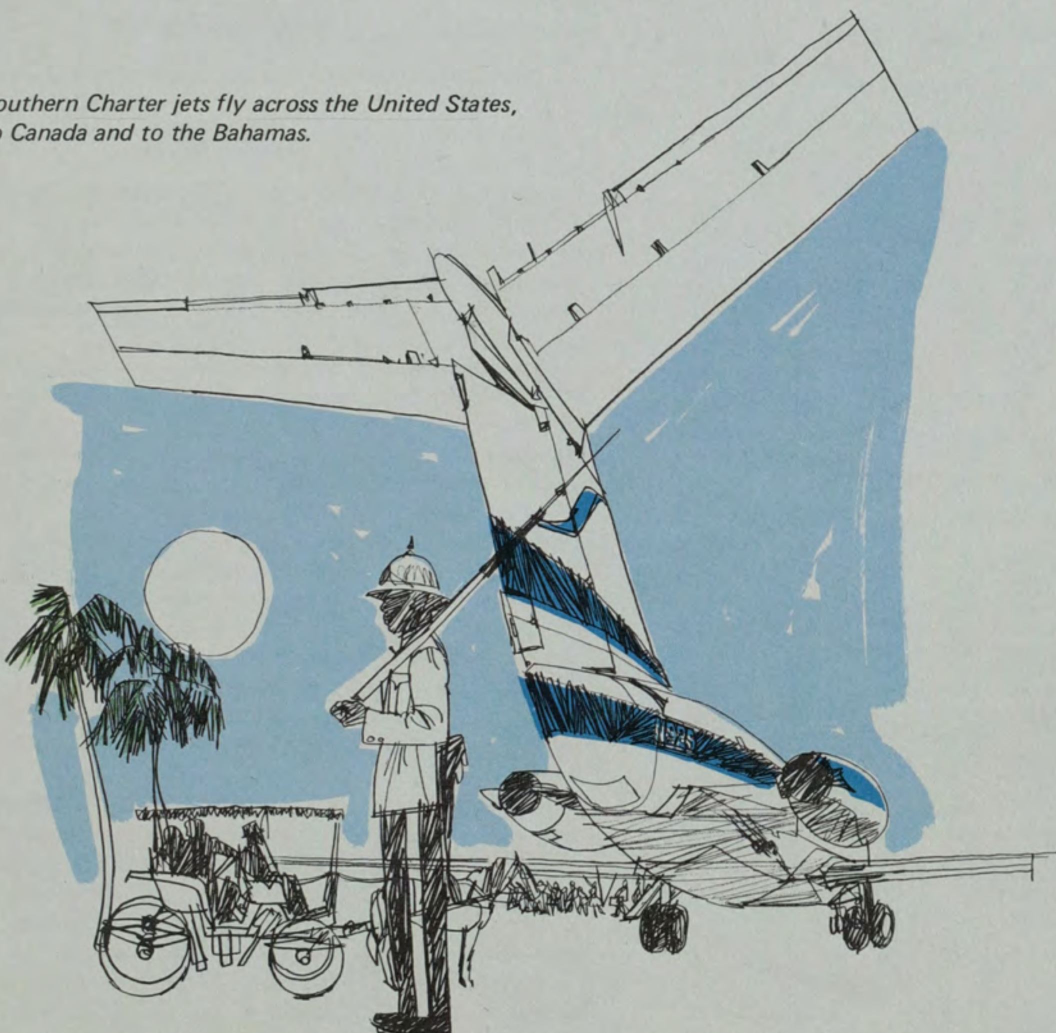
To face these, a new look has been taken at sales and marketing concepts. Continued emphasis will be placed on spot television commercials, particularly in densely populated areas. Newspaper advertising may be replaced in whole or in part by television in some key cities. Radio is receiving continued scheduling. For the first time, Southern is entering an era of color magazine advertising with full page ads touting our twenty-year growth and capabilities appearing in selective trade and general interest publications.

Southern has acquired exclusive rights in its system area to the hit tune, "Everything's Coming Up Roses," from the Broadway play, "Gypsy." New lyrics have been written, and millions of potential passengers will hear these words: "Everyone's Going Up Southern Style."

As new city markets are entered, greater emphasis will be placed on the vacation traveler. Heretofore the business

Thousands of potential passengers and shippers see Southern's promotional displays .

Southern Charter jets fly across the United States, to Canada and to the Bahamas.



nce upon
a time...

A Little Shot

made its mark. This is our twentieth year...our twentieth memento.* The first year's glass is now a collector's item...the years in between have proved to be something worth toasting! We've highlighted each year with new services, new cities or the christening of our DC-9 FanJET fleet two years ago. Last year we saluted our daily flights between New York, Washington and Columbus, Georgia; Dothan, Alabama; Eglin AFB and Panama City, Florida... This year we may be flying to other exciting cities.

*You may start your collection with our 20th souvenir glass by writing: Dept. JG, Southern Airways, Atlanta Airport, Atlanta, Georgia 30320

everyone's going up... **SOUTHERN Style**

Southern Airways, Inc., Atlanta, Georgia 30320

nce upon
a time...

Lonely Grasshoppers

took off and landed in the crossroads of the South...and the world was big and far away. Today Southern Airways regularly takes off and lands in more than 60 cities and brings the air network of the world to the crossroads. Now we're flying more than a million passengers a year in and out and even on to Washington and New York, and our DC-9 FanJETS are the envy of every grasshopper.

everyone's going up... **SOUTHERN Style**

Southern Airways, Inc., Atlanta, Georgia 30320

nce upon
a time...

A Southern Flight

was only when our fine feathered friends soared over the smaller communities. Twenty years ago when you flew into a few big cities in the South...the flying journey ended. Today our DC-9 FanJET fleet and frequent flight schedules put 60 cities in the South on the air map. No longer is the South for the birds...it's for the vacationer who seeks the fun of an eight-state-playground... it's for the businessman who seeks the buying power of an economic boom area and it's for the traveler who seeks Southern Hospitality at Jet speeds. And now we offer the short cut route between New York, Washington and Columbus, Ga.; Dothan, Ala.; Eglin AFB and Panama City, Fla.

everyone's going up... **SOUTHERN Style**

Southern Airways, Inc., Atlanta, Georgia 30320

traveler has represented almost 70 percent of our total. While business travel will continue as the major category, the vacationer will occupy an increasing number of seats. Realizing this, package tour programs to Washington and New York have been developed, with other destinations and attractions to come.

The importance of the connecting passenger is evidenced by the attention being given interline sales. Thousands of reservations agents of other airlines will be visited by our field sales force. These agents will see and hear the Southern story vividly told on sound film. They will be urged to route their passengers via Southern on any portion of the journey not served by their own airline. The importance of this source of business is evidenced by the more than $13,000,000 of revenue exchanged with other airlines during 1968.

Cargo will be sold hard this year. The capability of the DC-9, accompanied by its speed, gives one jet the cargo capacity of four Martin-404 aircraft. Our longer flights make shipping via Southern more attractive to manufacturers.

Here are samples of our 1969 advertising approach. You will see these ads in prominent publications. You will hear "Everyone's Going Up Southern Style" on the radio and on television.

You, the stockholder, are invited to Go Places . . . Southern Style. We now go to more places with more flights, and will continue to have warm, friendly, courteous service: Southern Style. Try it.

EXECUTIVE COMMITTEE

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

DIRECTORS

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

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.
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Oxford Industries, Inc.
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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
R. A. Trippeer, Inc.
Memphis, Tennessee

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

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

COUNSEL:

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

AUDITORS:

Ernst & Ernst
Atlanta, Georgia

STOCK TRANSFER AGENT:

Trust Company of Georgia
Atlanta, Georgia

ADVERTISING COUNSEL:

Harris & Weinstein Associates, Inc.
Atlanta, Georgia

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

George M. Gross
Vice President—Maintenance and Engineering

W. Bayne Grubb
Vice President—Flight Operations

Thomas A. Wiley, Jr.
Vice President—Sales

A. L. Maxson
Treasurer

Everett L. Martin
Assistant Vice President—Personnel

J. R. Price
Assistant Vice President—Properties

Ray W. Burden
Assistant Treasurer

Richard K. Robinson
Controller

Cecil A. Beasley, Jr.
Assistant Secretary

Mrs. Mary C. Hayes
Assistant Secretary

W. B. White, Jr.
Assistant Secretary