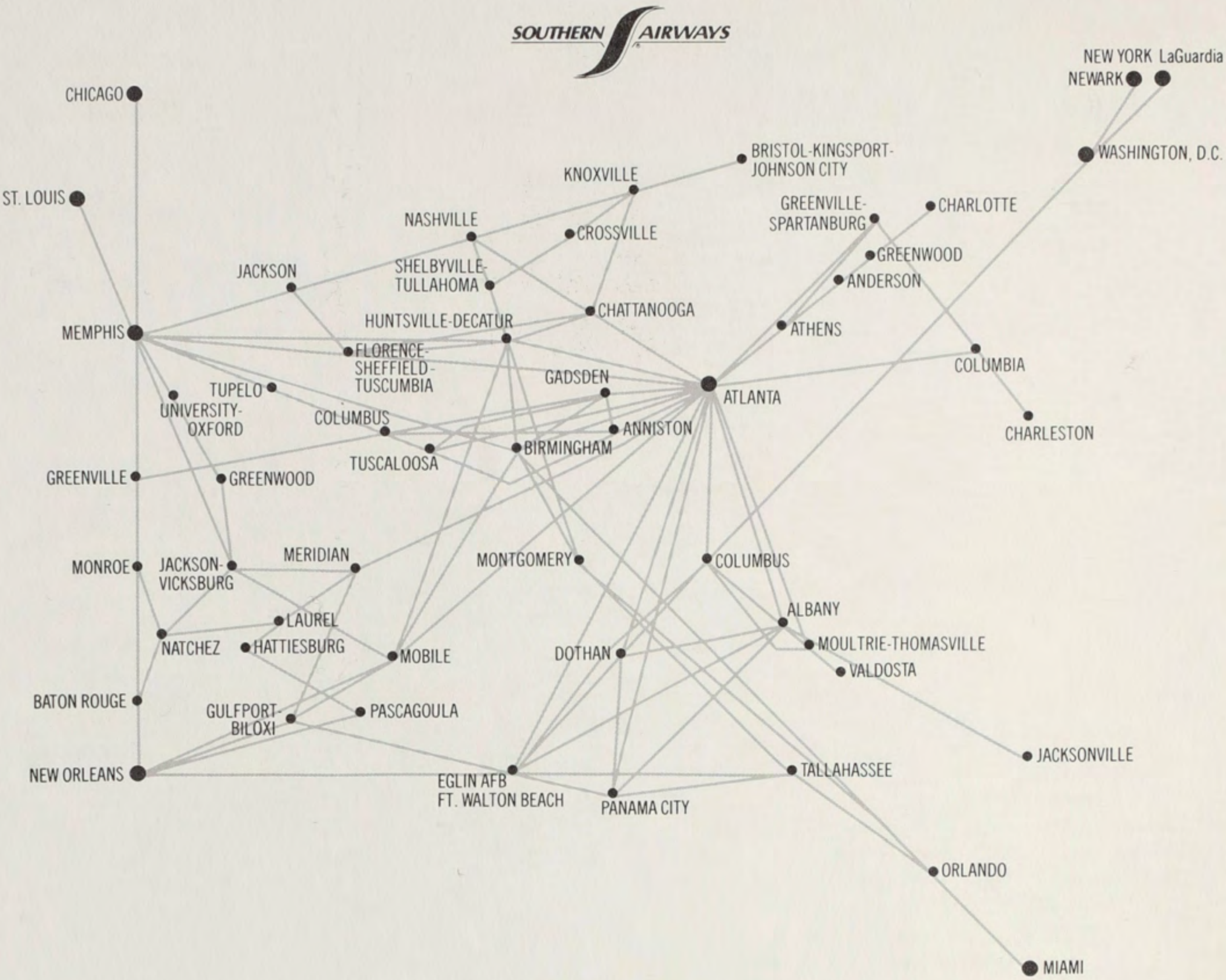
1970 Annual Report

SOUTHERN AIRWAYS, INC.



SELECTED OPERATING STATISTICS*	1970	1969	1968	1967	1966
Plane Miles (000) (all services)	18,580	14,679	12,260	11,803	11,287
Passengers	1,589,481	1,377,421	1,271,497	1,180,297	1,051,554
Passenger Miles (000)	430,736	323,472	254,028	222,142	196,366
Available Seat Miles (000) (all services)	1,228,373	862,388	611,795	498,322	416,738
Passenger Load Factor	38.8%	42.4%	45.8%	45.9%	48.6%
Yield Per Passenger Mile	$ .086	$ .087	$ .081	$ .077	$ .077
Average Passenger Fare	$ 23.36	$ 20.33	$ 16.08	$ 14.49	$ 14.39
Average Passenger Load	25.2	24.3	22.3	19.4	18.0
Average Length of Passenger Haul (miles)	271.0	234.8	199.8	188.2	186.7
Total Cost Per Available Seat Mile (all services)	$ .043	$ .045	$ .049	$ .050	$ .049

*In scheduled service unless otherwise specified.

SOUTHERN AIRWAYS, INC.
PRESIDENT'S REPORT

STOCKHOLDERS, CUSTOMERS, EMPLOYEES AND FRIENDS:

The airline industry suffered record losses during 1970 and, unfortunately, Southern was no exception. Its loss of $3,333,212 or $3.25 per share, was caused by depressed economic conditions, higher costs due to inflation, and start-up expenses on new, long-haul services to Miami, Newark and Chicago. On the other hand, our revenues reached all time highs. Revenue passenger miles were up 33.2 percent over 1969, and total revenues were 30.7 percent above last year.

The growth enjoyed by Southern in 1970 was, by no means, universal in the industry. Indeed, I believe this growth -- soundly based upon valuable long-haul route additions -- points the way to a better future for your Company if the economy improves.

In late 1969, the Company began arranging a program to cover the financial requirements of expanding the size of Southern's operations and to provide for slackening in the economic climate of areas which we serve. This program is now in the final stage of completion and involves raising equity capital by offering stock purchase rights to existing stockholders of the Company and to others. The members of the Company's Board of Directors have agreed to purchase up to $1,500,000 of the stock to be offered and tentative arrangements have been made to sell to others approximately $1,000,000 of the stock. A registration statement was filed with the Securities and Exchange Commission on March 18, 1971 with respect to the proposed offering of these securities.

The proposed financing program also involves deferring certain payments due by the Company in 1971 and 1972. The Company has reached a tentative agreement with the banks under its credit agreement, as well as certain lessors of aircraft and certain other creditors, in which the creditors and lessors would agree to defer payments due them totaling approximately $3,200,000, as set out in Note M to the financial statements contained in this Annual Report.

Since January 31, 1971, the Company has not made certain payments to the aforementioned creditors in anticipation of a portion of those payments being deferred under the proposed financing program. The failure to pay those amounts when due constitutes defaults under the Company's long-term debt and lease agreements. On October 1, 1970 the Company was not in compliance with the requirements of its agreements with banks and lessors of aircraft, as explained in Note D to the financial statements, which also constituted conditions of default under the terms of both issues of Convertible Subordinated Debentures.

I hope that you will attend the reconvened Annual Meeting on Monday, May 3, 1971, which will be held at 10:00 o'clock A.M. Eastern Daylight Time in the Scott Hudgens Building, Hapeville, Georgia. Whether or not you plan to attend the meeting in person, please execute and return the enclosed proxy.

Respectfully Submitted,

Frank W. Hulse

Frank W. Hulse
President

March 30, 1971

SOUTHERN AIRWAYS, INC.
BALANCE SHEET
December 31, 1970 and 1969

	1970	1969
ASSETS		
CURRENT ASSETS		
Cash	$ 2,674,346	$ 4,304,163
Accounts Receivable:		
U.S. Government:		
Transportation and public service revenue – Note A	2,912,941	1,222,777
Refundable income taxes	–	436,338
Trade receivables, less allowance for doubtful accounts (1970 – $110,000; 1969 – $40,154)	4,642,234	3,510,227
	7,555,175	5,169,342
Maintenance and operating supplies, at average cost less allowance for obsolescence (1970 – $513,170; 1969 – $279,420)	1,641,659	1,462,334
Prepaid expense	508,819	1,371,978
Total Current Assets	12,379,999	12,307,817
OTHER ASSETS		
Aircraft lease rental deposits – Note E	490,000	210,000
Other	78,742	63,190
	568,742	273,190
PROPERTY AND EQUIPMENT – on the basis of cost – Notes B, D and J		
Flight equipment	26,504,600	25,611,105
Less allowances for depreciation and maintenance	7,754,761	5,736,717
	18,749,839	19,874,388
Other property and equipment	3,980,501	3,206,850
Less allowances for depreciation	2,394,742	1,995,062
	1,585,759	1,211,788
	20,335,598	21,086,176
DEFERRED CHARGES – Note C		
Unamortized preoperating, route extension and development costs	1,049,442	985,521
Deferred lease costs	247,000	363,566
Unamortized long-term debt expense	671,134	758,421
	1,967,576	2,107,508
	$35,251,915	$35,774,691

	1970	1969
LIABILITIES		
CURRENT LIABILITIES		
Accounts payable	$ 3,573,753	$ 1,691,817
Amount due on engine purchase contract	637,300	–
Collections and withholding as agents	2,627,662	2,710,114
Salaries, wages and vacations	1,332,254	1,043,222
Accrued interest payable	455,676	453,269
Accrued taxes and other expense	535,915	986,857
Air travel plan deposits	108,375	112,200
Current maturities of long-term debt – Notes D and L	2,741,555	1,709,239
Total Current Liabilities	12,012,490	8,706,718
LONG–TERM DEBT – Note M		
Notes payable, less current maturities – Notes D and L	8,917,816	9,763,152
Convertible subordinated debentures – Notes D and L	12,682,000	12,682,000
Other – Note E	490,000	140,000
	22,089,816	22,585,152
DEFERRED TAXES ON INCOME – Note F	235,000	235,000
STOCKHOLDERS' EQUITY – Notes D and G		
Common stock, $2 par value		
Authorized – 5,000,000 shares		
Issued and outstanding – 1,024,871 shares	2,049,742	2,049,742
Other paid-in capital	1,229,523	1,229,523
Retained earnings (deficit)	(2,364,656)	968,556
	914,609	4,247,821
COMMITMENTS AND CONTINGENCIES – Note I		
	$35,251,915	$35,774,691

See Notes to Financial Statements.

SOUTHERN AIRWAYS, INC.
STATEMENT OF OPERATIONS
FOR THE YEARS ENDED DECEMBER 31, 1970 and 1969

	1970	1969
OPERATING REVENUES		
Passenger	$37,187,312	$28,050,097
Mail, express and freight	2,865,938	2,163,178
Public service revenue – Note A	4,822,621	3,579,639
Charter	3,835,306	3,358,146
Other operating revenues – net	735,949	684,448
	49,447,126	37,835,508
OPERATING EXPENSES		
Flying operations	18,071,509	12,659,124
Maintenance	9,045,318	6,110,720
Aircraft and traffic servicing	11,351,075	9,078,742
Passenger service	2,661,228	1,875,449
Promotion and sales	4,273,431	3,002,821
General and administrative	3,191,875	2,286,399
Amortization and provision for depreciation – Note B	2,632,284	2,395,905
	51,226,720	37,409,160
	(1,779,594)	426,348
OTHER DEDUCTIONS AND (INCOME)		
Interest on long-term debt–net of interest capitalized	1,788,784	1,719,541
Insurance proceeds from loss of leased aircraft net of applicable expenses	(286,609)	–
Other (income), less miscellaneous deductions	51,443	15,696
	1,553,618	1,735,237
(LOSS) BEFORE INCOME TAX CREDIT	(3,333,212)	(1,308,889)
INCOME TAX CREDIT – Note F	–	486,961
NET (LOSS)	$(3,333,212)	$ (821,928)
AVERAGE SHARES OF COMMON STOCK OUTSTANDING	1,024,871	1,024,871
NET (LOSS) PER SHARE OF COMMON STOCK – Note K	$ (3.25)	$ (.80)

See Notes to Financial Statements.

SOUTHERN AIRWAYS, INC.
STATEMENT OF RETAINED EARNINGS (DEFICIT)
FOR THE YEARS ENDED DECEMBER 31, 1970 and 1969

	1970	1969
RETAINED EARNINGS, beginning of period	$ 968,556	$ 1,790,484
Net (Loss) for the period	(3,333,212)	(821,928)
RETAINED EARNINGS (DEFICIT), end of period	$(2,364,656)	$ 968,556

See Notes to Financial Statements.

SOUTHERN AIRWAYS, INC.
STATEMENT OF CHANGES IN WORKING CAPITAL
FOR THE YEARS ENDED DECEMBER 31, 1970 and 1969

	1970	1969
SOURCE OF WORKING CAPITAL		
From operations:		
Net (loss)	$(3,333,212)	$ (821,928)
Non-cash items		
Provision for depreciation	2,090,915	2,160,358
Provision for airframe and engine overhaul	1,728,630	1,251,043
Amortization of deferred charges	551,944	376,638
Total From Operations	1,038,277	2,966,111
Additional long-term borrowing	1,952,606	140,000
Proceeds from sale of property and equipment, less gain included in net (loss)	274,976	219,784
Refund of equipment purchase deposits	–	3,179,958
	3,265,859	6,505,853
APPLICATION OF WORKING CAPITAL		
Additions to property and equipment	2,134,662	6,363,077
Expenditures for airframe and engine overhaul	1,209,281	1,201,687
Amounts transferred to current maturities of long-term debt	2,447,942	2,465,085
Deposits on leased aircraft	280,000	210,000
Increase in deferred charges	412,012	707,356
Increase in other assets	15,552	15,735
	6,499,449	10,962,940
(DECREASE) IN WORKING CAPITAL	(3,233,590)	(4,457,087)
Working capital at beginning of year	3,601,099	8,058,186
WORKING CAPITAL AT END OF YEAR	$ 367,509	$ 3,601,099
CHANGES IN COMPONENTS OF WORKING CAPITAL		
Increase (decrease) in working capital assets		
Cash	$(1,629,817)	$ 160,311
Certificates of deposit	–	(5,534,316)
Accounts receivable	2,385,833	877,996
Maintenance and operating supplies	179,325	451,233
Prepaid expenses	(863,159)	598,264
	72,182	(3,446,512)
Increase (decrease) in working capital liabilities		
Accounts payable	1,881,936	370,520
Amount due on engine purchase contract	637,300	–
Collection and withholding as agents	(82,452)	250,590
Salaries, wages and vacations	289,032	221,056
Accrued interest, taxes and other expenses	(448,535)	281,334
Air travel plan deposits	(3,825)	(425)
Current maturities of long-term debt	1,032,316	(112,500)
	3,305,772	1,010,575
(DECREASE) IN WORKING CAPITAL	$(3,233,590)	$(4,457,087)

See Notes to Financial Statements.

SOUTHERN AIRWAYS, INC.
NOTES TO FINANCIAL STATEMENTS
December 31, 1970

NOTE A – SUBSIDY

For the period August 1, 1970 through June 30, 1971, Southern and the other local service carriers are receiving Public Service Revenues (subsidy) based upon a new formula (Class Rate V) which significantly increases the level of subsidy otherwise payable to the carriers under the old formula (Class Rate IV-A), from the $36,300,000 actually paid the carriers in 1969 to an annual rate of approximately $60,000,000. This rate will require an additional appropriation of approximately $8,000,000 in order for the Civil Aeronautics Board to have sufficient funds to pay this new rate through June 30, 1971. It is expected that Congress will make these additional funds available to the CAB.

Under the new formula, the Company has accrued subsidy for the period August 1, 1970 through December 31, 1970 in the amount of $2,863,444, as contrasted to the amount which would have been payable to the Company under the old formula of $1,378,799, resulting in total Public Service Revenues of $4,822,621 for the year ended December 31, 1970. The new Class Rate V Subsidy Formula, which is based on the service being provided to small communities during May, 1970, is estimated to produce subsidy for the Company at an annual rate of about $6,800,000.

NOTE B – PROPERTY, EQUIPMENT, DEPRECIATION, MAINTENANCE AND REPAIRS

Provisions for depreciation of property and equipment are computed on the straight-line method calculated to amortize the cost of the properties over their estimated useful lives. Reference is made to Note J regarding changes in accounting applicable to depreciation and repairs and maintenance. Estimated useful lives are as follows:

	M-404	DC-9	Ground Equipment
Airframes, engines, propellers, communications equipment and rotable parts	(A)	15 years	
Ground equipment			3-10 years

(A) Common depreciation point of December 31, 1973

Based upon a review during 1970 of the useful life of the Martin 404 aircraft, the Company believes that the economic useful lives of those aircraft will be essentially exhausted by the end of 1973. Prior to 1970, these aircraft and related capitalized spares were being depreciated over a seven-year period which would result in all airframes being reduced to a salvage value by the end of 1973, and would result in significant undepreciated balances in overhaul and spare parts accounts at that time. Accordingly, in order to more properly match expenses of the Martin fleet with revenues obtained therewith, the Company has adopted, effective as of the beginning of 1970, a common depreciation and amortization point of December 31, 1973, for the complete write-off of the Company's investment in Martin aircraft, which at December 31, 1970 amounted to $4,365,000. At December 31, 1970, five Martin aircraft had been withdrawn from service and will be sold or used in maintaining the remaining Martin aircraft in an airworthy condition. Any proceeds from the sale of these aircraft will be credited to the allowance for depreciation.

Expenditures for ordinary maintenance and repairs are charged to expense. Expenditures for major spare parts are capitalized and minor parts are recorded in inventory accounts and charged to expense as used.

Residual amounts of property and equipment are not eliminated from the accounts until the items are retired. At the time properties are retired, the amounts of cost and allowance for depreciation and maintenance are eliminated from the accounts. Profits and losses on disposals of flight equipment (exclusive of rotable parts) are credited or charged to operations. Proceeds from the disposal of rotable parts are credited to the allowance for depreciation account.

NOTE C – DEFERRED CHARGES

Expenditures for preoperating and route extension and development costs are deferred and are amortized over a period of five years from the dates operations of the routes are started.

Costs associated with obtaining leased DC-9 aircraft are being amortized over the lives of the leases.

Expenditures associated with obtaining long-term debt are being amortized over the life of the financing arrangements.

NOTE D – LONG-TERM DEBT

Long-term debt at December 31, 1970 and December 31, 1969 is summarized as follows:

	December 31 1970	1969
Notes payable to banks in quarterly installments through 1976 (1) (5) (6)	$5,392,500	$6,255,000
Notes payable to banks due December 31, 1975 (1) (5) (6) (7)	3,000,000	3,000,000
Notes payable to banks in quarterly installments through 1974 (2) (5) (6)	1,695,652	2,217,391
Note payable to bank due December 31, 1971 through January 31, 1973 (5) (8)	613,000	–
Notes payable to fuel supplier due December 31, 1971 (9)	250,780	–
10% notes payable to lessor due January 31, 1971	315,000	–
6% note due in monthly installments to October 1975	392,439	–
5¾% Convertible Subordinated Debentures due December 1, 1981 (3) (6)	4,682,000	4,682,000
6½% Convertible Subordinated Debentures with warrants attached due November 1, 1983 (4) (6)	8,000,000	8,000,000
Other – Note E	490,000	140,000
	24,831,371	24,294,391
Less current maturities	2,741,555	1,709,239
	$22,089,816	$22,585,152

(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 5¾% Convertible Subordinated Debentures due December 1, 1981, are convertible (until maturity or prior redemption) into Common Stock at $16 per share (see Note G) are subordinated, generally, to all existing and future indebtedness for borrowed money; are callable at premiums ranging from 4.75% 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.

(4) The 6½% Convertible Subordinated Debentures due November 1, 1983, are convertible (until maturity or prior redemption) into Common Stock at $16 per share (see Note G); 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.

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

(6) The agreements relating to these notes payable and both issues of Convertible Subordinated Debentures place certain requirements and restrictions upon, among other things, (a) net current assets, (b) indebtedness and lease obligations, (c) net worth, (d) capital expenditures, and (e) payments relating to capital stock including dividends. On October 1, 1970 and December 31, 1970, the Company did not comply with these requirements with respect to net current assets and indebtedness and lease obligations which are also conditions of default under the terms of its long-term aircraft lease agreements. The Company plans to obtain an amendment to its agreements with creditor banks and lessors of aircraft to enable compliance with these requirements and restrictions.

(7) Prepayments are required equal to 25% of the first $1,000,000 of net income of the Company, plus 35% of the net income in excess of $1,000,000 for the 12 month period ending the preceding December 31.

(8) This note is payable in quarterly installments commencing December 31, 1971, with a final payment on January 31, 1973. It bears interest at the rate of 9½% and is guaranteed by McDonnell Douglas Corporation. It is subordinated in certain aspects to the notes payable due through 1976 and the notes payable through 1974. Payment of this note is collateralized by a second mortgage on the DC-9 flight equipment.

(9) These notes payable bear interest at 8½% to 9% and are in some respects subordinated to the notes payable due through 1976 and the notes payable due through 1974.

Minimum aggregate principal payments on long-term debt for the next five years are as follows:

Year	Amount
1971	$2,741,555
1972	1,970,780
1973	1,605,579
1974	1,117,489
1975	3,950,229

NOTE E – OTHER NOTES PAYABLE

Other notes payable represent six month notes payable, with interest at 10%, to a lessor for security deposits on aircraft leased under renewable six month leases. Since the Company plans to renew the leases applicable to these planes and continue to renew these notes as they mature, the deposits on leased aircraft have been included in other assets and the notes payable have been included as other long-term debt in the accompanying financial statements. The amounts for 1969 have been reclassified from current assets and current liabilities.

NOTE F – INCOME TAXES

The loss for income tax purposes for 1969 and 1970 exceeds the loss shown in the Statement of Operations because of certain expenses deferred for financial statements and additional depreciation to be claimed for income tax purposes. Depreciation for financial statements is computed on the straight line method, but certain assets are depreciated on accelerated methods for income tax purposes. Because of the aforementioned differences in treatment of certain items for income tax purposes, there is a net operating loss carryforward to future years for income tax purposes of approximately $5,850,000 at December 31, 1970, which expires in 1974 ($970,000) and 1975 ($4,880,000). Net operating loss carryforward for financial statement purposes at December 31, 1970, was approximately $3,300,000.

The Company uses the flow-through method of accounting for investment credit and the available investment credit is recognized to the extent that it can be realized or offset against current or deferred income taxes. Investment credit realized as a reduction of deferred income taxes amounted to approximately $207,000 at December 31, 1970.

Investment credit carryover at December 31, 1970, for use in offsetting federal income taxes in future income tax returns amounted to approximately $1,220,000 and expires in 1976 ($65,000), 1977 ($810,000), 1978 ($37,000), and 1979 ($308,000).

NOTE G – COMMON STOCK AND OTHER PAID-IN CAPITAL

In May, 1969, the charter of the Company was amended to increase the authorized capital of the Company from 2,000,000 shares of $2 par value Common Stock to 5,000,000 shares of $2 par value Common Stock.

This change constitutes the only change in Common Stock and other paid-in capital for the two years ended December 31, 1970.

At December 31, 1970 and December 31, 1969, 1,006,625 shares of Common Stock of the Company were reserved as follows:

	Shares Reserved December 31 1970	1969
Qualified Stock Option Plan approved by Board of Directors in 1965:		
Exercisable one-third each year beginning in 1969 at a price of $19.18 per share	1,000	1,000
Exercisable one-third each year beginning in 1970 at a price of $13.75 per share	900	900
Exercisable one-third each year beginning in 1971 at prices ranging from $8.69 to $11.76 per share	7,100	7,100
Currently exercisable at a price of $10.16-2/3 per share	–	33,750
Shares available for additional options which may be granted under the Plan	36,000	2,250
	45,000	45,000
Employee Stock Option Plan approved by Board of Directors in 1967:		
Exercisable in June, 1970 at a price of $11.52 per share	–	1,833
Shares available for options which may be granted under the Plan	25,000	23,167
	25,000	25,000
Shares reserved for conversion of 5¾% Convertible Subordinated Debentures	292,625	292,625
Shares reserved for conversion of 6½% Convertible Subordinated Debentures	500,000	500,000
Shares reserved for sale pursuant to stock purchase warrants issued with 6½% Convertible Subordinated Debentures at a price of $16 per share	144,000	144,000
TOTAL	1,006,625	1,006,625

Data with respect to stock options outstanding at December 31, 1970 and December 31, 1969 is summarized as follows:

	December 31, 1970			December 31, 1969		
Year of Grant	Number of Shares	Option and Market Price Per Share	Total	Number of Shares	Option and Market Price Per Share	Total
1965	–	$ –	$ –	33,750	$10.16–2/3	$343,123
1967	1,000	19.18	19,180	2,833	11.52 – 19.18	40,296
1968	900	13.75	12,375	900	13.75	12,375
1969	7,100	8.69 – 11.76	77,136	7,100	8.69 – 11.76	77,136
	9,000		$108,691	44,583		$472,930

The options generally become exercisable in three annual installments beginning two years after date of grant and expire five years after date of grant. During the five years ended December 31, 1970, no options were exercised and options became exercisable as follows:

Exercisable	Number of Shares	Option Price Per Share	Option Price Total	Quoted Market Price At Date Exercisable Per Share	Quoted Market Price At Date Exercisable Total
1967	11,250	$10.16–2/3	$114,381	$14.50	$163,125
1968	11,250	10.16–2/3	114,381	13.875	156,094
1969	11,583	10.16–2/3 – 19.18	120,768	11.50 – 11.625	133,250
1970	2,466	11.52 – 19.18	31,628	5.50 – 6.375	15,375
			$381,158		$467,844

Upon exercise of the option, the amount received in excess of the par value of the stock is credited to other paid-in capital and no charge is made to income.

NOTE H – PENSION PLANS

The Company has several pension plans, including a defined contribution plan, covering substantially all of its employees. During 1970, the Company changed its plans from deposit administration plans to trustee self-administered plans, increased employee benefits payable under one of these plans, and changed the actuarial assumptions used in computing pension costs (See Note J). Total pension expense, including amounts paid under a defined contribution plan, for the two years ended December 31, 1970 and 1969 was $661,734 and $774,638, respectively. As a result of changing actuarial assumptions, pension plan assets were sufficient to cover the unfunded past service costs of approximately $519,000 as reported at December 31, 1969. The Company's policy is to fund pension cost accrued. At December 31, 1970, the total of the pension funds exceeded the actuarially computed value of vested benefits.

NOTE I – COMMITMENTS AND CONTINGENCIES

At December 31, 1970, the Company was leasing four DC-9 jet aircraft under leases expiring in 1980 and 1981, at a minimum annual rental of $1,561,129; seven DC-9 jet aircraft under six month leases, which assuming the aircraft are retained for a full year, would result in rentals of $2,903,000 in 1971; and a communications system lease expiring in 1977 with a minimum rental of $79,000. The Company also leases certain office, ticketing, hangar and shop facilities with minimum aggregate annual rentals of approximately $1,220,000 under various leases with expiration dates through 1988.

In November 1970, a DC-9 jet aircraft leased by the Company was involved in an accident, in which all passengers and crew members were killed, while on a charter flight to Huntington, West Virginia. Claims may be made against the Company for damage to property and loss of life as a result of this accident, and in the opinion of the Company, all potential claims are adequately covered by insurance. There is pending in the United States Circuit Court of Appeals for the District of Columbia Circuit cases brought by certain unsuccessful applicants before the CAB who attacked the Board's extension of the Company's system from Tallahassee to Orlando and Miami, from Memphis to Chicago, from Memphis to St. Louis, and one-stop authority between St. Louis and New Orleans. In the opinion of management and legal counsel of the Company, the final settlement of all of these matters will have no material effect on the financial position or operations of the Company.

The Company has an employment agreement with its President providing for his employment to September 12, 1977 at an annual salary of not less than $48,500. In addition, upon his retirement the Company has agreed to pay $833 per month to him for life, or in the event of his death, to his lineal descendants for 180 months. No provision has been made in the accompanying financial statements for amounts to be paid under the terms of these agreements.

NOTE J – CHANGES IN ACCOUNTING

During 1969, the Company redetermined the economic useful life of cylinders used in Martin 404 aircraft and reduced the useful life of these assets from seven years to three years. This change had the effect of increasing the provisions for depreciation approximately $153,000 and $146,000 for the years ended December 31, 1969 and December 31, 1970, respectively, and increasing the net loss approximately $98,000 ($.10 per share) and $146,000 ($.14 per share) for the years ended December 31, 1969 and December 31, 1970, respectively.

The Company has consistently followed the policy of providing for DC-9 engine overhaul based on hours of service. Based upon a review of its maintenance program applicable to DC-9 engines, the Company reduced the rate from $12.50 per hour to $7.50 per hour effective January, 1969. This change had the effect of reducing the provisions for maintenance approximately $205,000 and $45,000 for the years ended December 31, 1969, and December 31, 1970, respectively, and decreasing the net loss approximately $131,000 ($.13 per share) and $45,000 ($.04 per share) for the years ended December 31, 1969 and December 31, 1970, respectively.

During 1970 the Company redetermined the estimated economic useful life of Martin 404 aircraft and related equipment (See Note B). This change had the effect of increasing the provision for maintenance approximately $206,000 and increasing the provision for depreciation approximately $74,000, which resulted in an increase in the net loss for 1970 of approximately $280,000 ($.27 per share).

During 1970, the Company changed actuarial assumptions used in computing pension costs (See Note H). This change had the effect of decreasing pension cost and the net loss approximately $340,000 ($.33 per share).

A summary of the decrease (increase) in the net loss for 1970 and 1969 resulting from these changes is as follows:

	1970	1969
Decrease (increase) in net loss:		
Change in useful life of cylinders used in Martin 404 aircraft	$(146,000)	$(98,000)
Change in rate for providing for DC-9 engine overhaul	45,000	131,000
Change in useful life of Martin 404 aircraft and related equipment	(280,000)	–
Change in actuarial assumptions used in computing pension costs	340,000	–
DECREASE (INCREASE) IN NET LOSS	$(41,000)	$ 33,000
Decrease (increase) in net loss per Common Share	$(.04)	$ .03

NOTE K – LOSS PER COMMON SHARE

Net loss per common share was computed by dividing the net loss by the weighted average number of shares of Common Stock outstanding. Conversion of debentures and exercise of warrants would not have increased the net loss per common share.

NOTE L – SUBSEQUENT EVENTS

In January and February 1971, the Company did not (1) make payments of $612,500 due under the terms of its agreement with creditor banks, (2) repay notes of $315,000 due to a lessor, and (3) make lease payments of $358,923 due under the terms of its long-term lease agreements.

NOTE M – PROPOSED FINANCING ARRANGEMENTS

The Company proposes to enter into an agreement in 1971 with creditor banks, lessors of aircraft and suppliers (Creditors) for the deferral of certain principal and rental payments due in 1971 and 1972. Principal payments of $1,254,185 (originally due $612,500 in 1971 and $641,685 in 1972) due to creditor banks will be deferred and paid in three equal installments in October, November and December, 1973, and payment of a note payable to a lessor in the amount of $315,000 will be deferred to December 31, 1972. In addition, a certain fuel supplier will agree to accept notes in the amount of $330,000 due in three equal installments in September, October and November, 1972, for a portion of fuel deliveries to be made in March and April, 1971 ($220,000) and March, 1972 ($110,000), an engine supplier will accept notes amounting to $420,000 due in three equal installments in September, October and November, 1972, and aircraft lease payments of $893,000 (originally due $568,000 in 1971 and $325,000 in 1972) will be deferred and paid in three equal installments in April, May and June, 1973. This agreement will be contingent upon the Company's obtaining proceeds of at least $2,500,000 from the sale of its equity securities.

In addition, the Company proposes that creditor banks and lessors amend their agreements with the Company to enable the Company to be in compliance with all terms and provisions of these agreements. Under the most restrictive terms of these proposed amendments, the Company will be in default with all creditors if (1) the cumulative net loss for 1971 exceeds $2,500,000 or the net loss for any one month during 1971 exceeds $1,000,000 or (2) the cumulative net loss for 1972 exceeds $1,000,000 or the net loss for any one month during 1972 exceeds $750,000.

NOTE N – SUPPLEMENTARY PROFIT AND LOSS INFORMATION

	1970	1969
Provision for Depreciation–		
Operating Expenses	$2,090,915	$2,129,330
Other	–	31,028
	$2,090,915	$2,160,358
Provision for Airframe and Engine Overhaul – Operating Expenses	$1,728,630	$1,251,043
Amortization–		
Operating Expenses	$ 331,367	$ 205,837
Other	220,577	170,801
	$ 551,944	$ 376,638
Obsolescence – Operating Expenses	$ 210,002	$ 60,738
Taxes other than Income Taxes Charged to Operating Expenses –		
Payroll	$ 640,629	$ 621,309
Fuel and Oil	216,261	354,954
Property	233,500	150,000
Sales and Use	91,698	78,199
Other	65,469	26,404
	$1,247,557	$1,230,866
Rents (including landing fees and rental of airports served)	$6,512,753	$3,847,277

SOUTHERN AIRWAYS

REPORT OF INDEPENDENT ACCOUNTANTS

Board of Directors
Southern Airways, Inc.
Atlanta, Georgia

We have examined the balance sheets of Southern Airways, Inc. as of December 31, 1970, and December 31, 1969, and the related statements of operations, retained earnings (deficit) and changes in working capital for the years then ended. Our examinations were made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

During 1969, the Company reduced the economic life of cylinders used in Martin 404 aircraft and decreased the provision for overhaul applicable to DC-9 engines. During 1970, the Company changed the economic useful life of its Martin 404 aircraft and related equipment and changed the actuarial assumptions used in computing pension costs. These changes, with which we concur, as discussed in Note J of Notes to Financial Statements, had the effect of decreasing the net loss approximately $33,000 ($.03 per share) for the year ended December 31, 1969, and increasing the net loss approximately $41,000 ($.04 per share) for the year ended December 31, 1970.

As reflected in the accompanying financial statements, the Company had net losses of $821,928 and $3,333,212 in 1969 and 1970, and had a retained-earning deficit of $2,364,656 at December 31, 1970. As explained in item 6 of Note D of Notes to Financial Statements, the Company is not in compliance with the requirements and restrictions of its agreements with creditor banks and lessors of aircraft which also constitutes conditions of default under the terms of both issues of Convertible Subordinated Debentures. In addition, as indicated in Note L of Notes to Financial Statements, in January and February 1971, the Company did not (1) make payments of $612,500 due under terms of its agreement with creditor banks, (2) repay notes of $315,000 due to a lessor, and (3) make lease payments of $358,923 due under the terms of its long-term lease agreements.

The Company's continuation as a going concern is dependent upon (1) its ability to develop future profitable operations, which contemplates receiving public service revenue in the future based upon the new formula (Class Rate V) as discussed in Note A of Notes to Financial Statements, (2) obtaining amendments to its agreements with creditor banks, lessors of aircraft and suppliers providing for the deferral of approximately $3,200,000 of payments due in 1971 and 1972, (3) obtaining proceeds of $2,500,000 from the sale of its equity securities, and (4) the creditor banks and Convertible Subordinated Debenture holders not accelerating maturity of the Company's indebtedness to them. Reference is made to Note M of Notes to Financial Statements for information regarding the Company's proposed financing arrangements.

Because of the materiality of the matters discussed in the preceding paragraphs and the uncertainty of their resolution, we are unable to and do not express an opinion on the aforementioned financial statements as of or for the years ended December 31, 1970 and December 31, 1969.

Ernst & Ernst
Ernst & Ernst

Atlanta, Georgia

February 10, 1971 except as to Note L
as to which the date is February 24, 1971,
and Note M as to which the date is
March 30, 1971.

EXECUTIVE COMMITTEE

FRANK W. HULSE
G. GUNBY JORDAN
W. B. WHITE, JR.
GRAYDON HALL
ELTON B. STEPHENS

DIRECTORS

IVAN ALLEN, JR.
Ivan Allen Company
Atlanta, Georgia

CECIL A. BEASLEY, JR.
Ballard & Beasley
Washington, D. C.

ALEXANDER J. BRUNINI
Brunini, Everett, Grantham & Quin
Vicksburg, Mississippi

GEORGE M. GROSS
Southern Airways, Inc.
Atlanta, Georgia

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 Company
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, JR.
Pan American Life Insurance Company
New Orleans, Louisiana

F. D. SCHAS
Bullington-Schas & Company
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

OFFICERS

FRANK W. HULSE, President

GRAYDON HALL
Executive Vice President-
General Manager

GEORGE M. GROSS
Vice President-Associate
General Manager

W. S. MAGILL, JR.
Senior Vice President
Industry and Government Affairs

J. KENNETH COURTENAY
Vice President-Economic
Regulations and Secretary

RICHARD N. HARBOTTLE
Vice President-Technical Services

W. BAYNE GRUBB
Vice President-
Flight Operations

THOMAS A. WILEY, JR.
Vice President-
Sales and Marketing

JOHN J. JANISCH
Vice President-
Customer Services

A. L. MAXSON
Vice President -
Fiscal and Treasurer

RICHARD K. ROBINSON
Controller

WILLIAM E. OAKES
Assistant Vice President
Economic Research

J. R. PRICE
Assistant Vice President-
Contracts and Properties

VICTOR C. PRUITT
Assistant Vice President-
System Planning

DAVID E. RUSSELL
Assistant Vice President-
Systems and Computer Services

ARNOLD D. WINHAM
Assistant Vice President-
Marketing Administration

A. D. YAWN
Assistant Vice President-
Agency and Pleasure Sales

RAY W. BURDEN
Assistant Treasurer

MRS. MARY C. HAYES
Assistant Secretary

CECIL A. BEASLEY, JR.
Assistant Secretary

W. B. WHITE, JR.
Assistant Secretary

Notice to Stockholders of Southern Airways, Inc.

Under a new rule adopted by the Civil Aeronautics Board in July 1970, any person who owns as of December 31 of any year or acquires ownership, either beneficially or as a trustee, of more than five percent of any class of capital stock of an air carrier shall file with the CAB a report containing information required by Subpart B of Part 245.13 of the Board's Economic Regulations. This report must be filed with the Civil Aeronautics Board on or before April 1 of each year as to capital stock or capital owned as of December 31 of the preceding year and within 10 days of the acquisition, unless such person has otherwise filed with the CAB a report covering such acquisition or ownership. Any stockholder who believes that he may be required to file such a report may obtain further information by writing to the Director, Bureau of Operating Rights, Civil Aeronautics Board, Washington, D.C. 20428.

GENERAL OFFICES

Atlanta Airport
Atlanta, Georgia

COUNSEL
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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

SOUTHERN AIRWAYS, INC.

General Office: Atlanta Airport, Atlanta, Georgia 30320