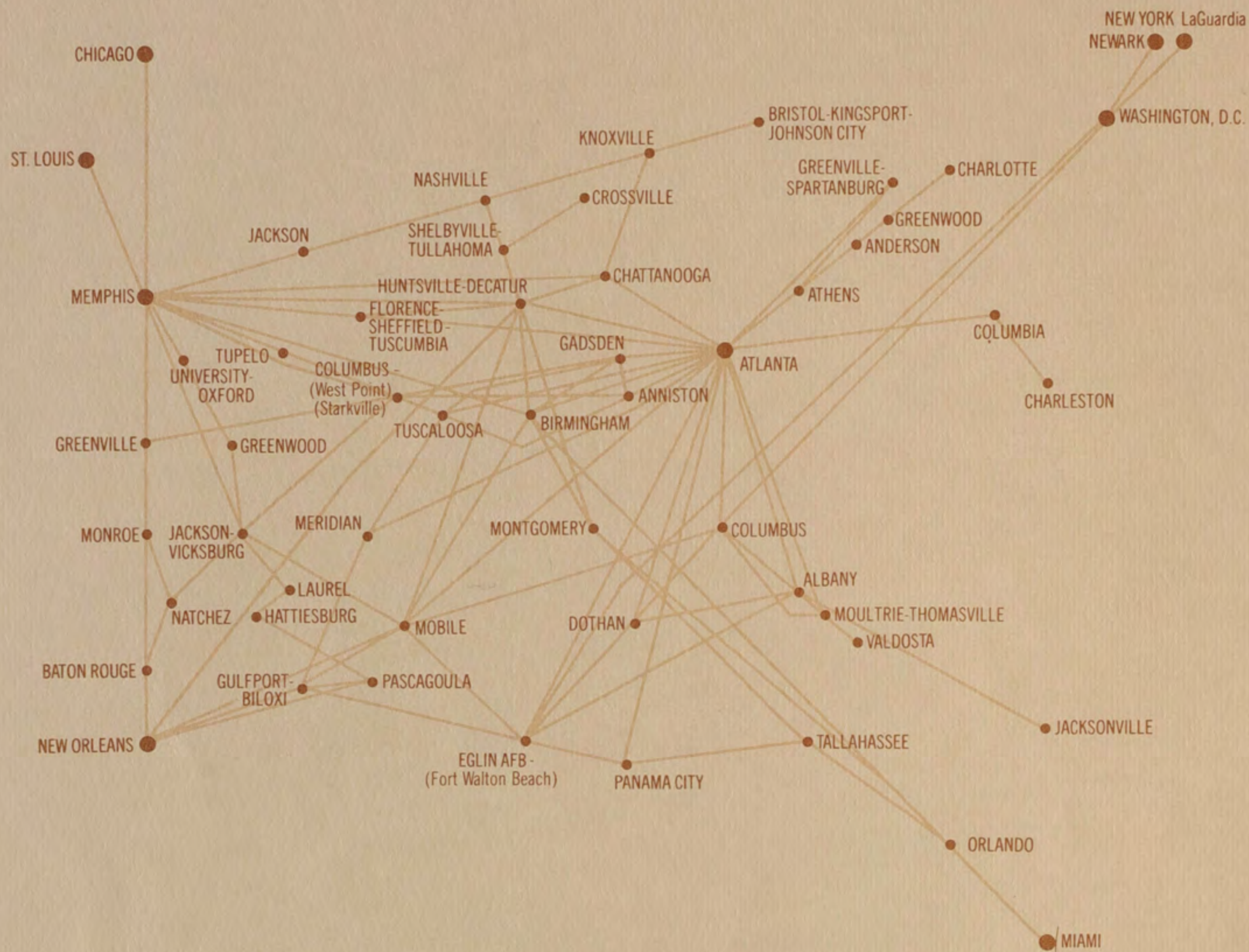
SOUTHERN AIRWAYS, INC.
1971 ANNUAL REPORT



SELECTED OPERATING STATISTICS*	1971	1970	1969	1968	1967
Plane Miles (000) (all services)	20,003	18,580	14,679	12,260	11,803
Passengers	1,875,205	1,589,481	1,377,421	1,271,497	1,180.297
Passenger Miles (000)	527,552	430,736	323,472	254,028	222,142
Available Seat Miles (000)(all services)	1,336,982	1,228,373	862,388	611,795	498,322
Passenger Load Factor	43.2%	38.8%	42.4%	45.8%	45.9%
Yield Per Passenger Mile	$ .086	$ .086	$ .087	$ .081	$ .077
Average Passenger Fare	$ 24.11	$ 23.36	$ 20.33	$ 16.08	$ 14.49
Average Passenger Load	28.3	25.2	24.3	22.3	19.4
Average Length of Passenger Haul (Miles)	281.3	271.0	234.8	199.8	188.2
Total Cost Per Available Seat Mile (all services)	$ .046	$ .043	$ .045	$ .049	$ .050

**In scheduled service unless otherwise specified.*

**Stockholders, Customers,
Employees and Friends:**

During the immediate past years, your management has worked to strengthen the Company for the long term. As a result of this program, we have seen our revenues rise from $22,054,000 in 1966 to $60,334,000 in 1971. Our system has been expanded into New York, Washington, Miami, Chicago and St. Louis. Cities now on Southern Airways' system generate one-third of the nation's airline passengers. Expansion during the recent period of depressed airline traffic was expensive for your Company, but it has enabled Southern to build a strong base for future earnings.

With the improvement in economic conditions during 1971, we flew a record 527,552,000 revenue passenger miles, an increase of 22.5 per cent over 1970. This 22.5 per cent increase in revenue passenger miles was accomplished with only a 10 per cent increase in capacity, that is, available seat miles. During the same period we upgraded our service by the replacement of two 75-passenger DC-9's with two 95-passenger stretched DC-9's and expanded jet service into other communities.

Although Southern's recovery during the year was substantial, resulting in an operating profit of $407,000, this was not sufficient to offset nonoperating expenses of $1,701,000 which, after reduction for deferred income tax credit, resulted in a loss of $1,059,000 for the year. Nevertheless, this result was a major improvement over the 1970 loss of $3,333,000.

We were saddened by the untimely death in early January of Richard A. Trippeer, a long-time Director from Memphis, Tennessee. Over the years, he had been one of our staunchest supporters. He has been replaced by Richard A. Trippeer, Jr., a capable, seasoned young businessman, also of Memphis.

I should like to take this opportunity to express my appreciation to our employees and to all our supporters who have stood by us during the recent difficult economic times. I am confident that we have now established a firm foundation and that our prospects for the future are indeed bright.

Respectfully yours,

Frank W. Hulse
President

SOUTHERN AIRWAYS, INC.
BALANCE SHEET
DECEMBER 31, 1971 and 1970

	1971	1970
ASSETS		
CURRENT ASSETS		
Cash and short-term investments – Note D	$ 5,057,849	$ 2,674,346
Accounts Receivable:		
U. S. Government –		
Transportation and public service revenue – Note A	1,481,210	2,912,941
Trade receivables, less allowance for doubtful accounts (1971 – $41,849; 1970 – $110,000)	4,989,452	4,642,234
	6,470,662	7,555,175
Maintenance and operating supplies, at average cost less allowance for obsolescence (1971 – $695,787; 1970 – $513,170)	2,015,280	1,641,659
Prepaid expense	791,765	508,819
Total Current Assets	14,335,556	12,379,999
OTHER ASSETS (Including aircraft lease deposits of $490,000 at December 31, 1970)	90,621	568,742
PROPERTY AND EQUIPMENT – on the basis of cost – Notes B and D		
Flight equipment	27,237,131	26,504,600
Less allowances for depreciation and maintenance	9,333,934	7,754,761
	17,903,197	18,749,839
Other property and equipment	3,625,547	3,980,501
Less allowance for depreciation	2,790,039	2,394,742
	835,508	1,585,759
	18,738,705	20,335,598
DEFERRED CHARGES – Note C		
Unamortized preoperating, route extension and development costs	691,245	1,049,442
Deferred lease costs	217,788	247,000
Unamortized long-term debt expense	580,524	671,134
	1,489,557	1,967,576
	$34,654,439	$35,251,915

LIABILITIES	1971	1970
CURRENT LIABILITIES		
Accounts payable	$ 2,983,250	$ 3,791,053
Collections and withholding as agents	3,298,405	2,627,662
Salaries, wages and vacations	1,647,268	1,332,254
Accrued interest payable	248,002	455,676
Accrued taxes and other expense	462,807	535,915
Air travel plan deposits	102,000	108,375
Current maturities of long-term debt – Note D	2,202,471	1,814,055
Total Current Liabilities	10,944,203	10,664,990
LONG-TERM DEBT – Note D		
Notes payable, less current maturities	8,535,032	10,755,316
Convertible subordinated debentures	12,682,000	12,682,000
	21,217,032	23,437,316
DEFERRED TAXES ON INCOME – Note E	–	235,000
STOCKHOLDERS' EQUITY – Notes D and F		
Preferred Stock, $1 par value, authorized 2,000,000 shares issuable in series:		
Series A $.36 convertible – voting (liquidation value $6 per share – aggregate of $1,523,316 at December 31, 1971) issued and outstanding – 253,886 shares at December 31, 1971	253,886	–
Series B $.36 convertible – non-voting (liquidation value $6 per share – aggregate of $1,000,002 at December 31, 1971) issued and outstanding – 166,667 shares at December 31, 1971	166,667	–
Common Stock, $2 par value: Authorized shares – 7,500,000 in 1971 and 5,000,000 in 1970 Issued and outstanding – 1,061,766 shares at December 31, 1971 and 1,024,871 shares at December 31, 1970	2,123,532	2,049,742
Other paid-in capital	3,372,559	1,229,523
Retained-earnings (Deficit)	(3,423,440)	(2,364,656)
	2,493,204	914,609
COMMITMENTS AND CONTINGENCIES – Note H		
	$34,654,439	$35,251,915

See Notes to Financial Statements.

SOUTHERN AIRWAYS, INC.
STATEMENT OF OPERATIONS
FOR THE YEARS ENDED DECEMBER 31, 1971 and 1970

	1971	1970
OPERATING REVENUES		
Passenger	$45,301,780	$37,187,312
Mail, express and freight	3,090,002	2,865,938
Public service revenue – Note A	6,973,875	4,822,621
Charter	4,067,008	3,835,306
Other operating revenues – net	900,907	735,949
	60,333,572	49,447,126
OPERATING EXPENSES		
Flying operations	20,949,971	18,071,509
Maintenance	10,807,844	9,045,318
Aircraft and traffic servicing	13,522,854	11,351,075
Passenger service	3,313,744	2,661,228
Promotion and sales	4,774,385	4,273,431
General and administrative	3,921,265	3,191,875
Amortization and provision for depreciation – Note B	2,636,732	2,632,284
	59,926,795	51,226,720
	406,777	(1,779,594)
OTHER DEDUCTIONS AND (INCOME)		
Interest on long-term debt -- net of interest capitalized	1,678,112	1,788,784
Insurance proceeds from loss of leased aircraft net of applicable expenses	–	(286,609)
Other deductions less miscellaneous income	22,449	51,443
	1,700,561	1,553,618
(LOSS) BEFORE INCOME TAX CREDIT	(1,293,784)	(3,333,212)
DEFERRED INCOME TAX CREDIT – Note E	235,000	–
NET (LOSS)	$(1,058,784)	$(3,333,212)
AVERAGE SHARES OF COMMON STOCK OUTSTANDING	1,035,048	1,024,871
NET (LOSS) PER SHARE OF COMMON STOCK – Note I	$ (1.02)	$ (3.25)

See Notes to Financial Statements.

SOUTHERN AIRWAYS, INC.
STATEMENT OF CHANGES IN FINANCIAL POSITION
FOR THE YEARS ENDED DECEMBER 31, 1971 and 1970

	1971	1970
SOURCE OF WORKING CAPITAL		
From operations:		
Net (loss)	$(1,058,784)	$(3,333,212)
Items not requiring outlay of working capital in current period:		
Provision for depreciation	2,094,991	2,090,915
Provision for airframe and engine overhaul	2,039,344	1,728,630
Amortization of deferred charges	484,478	551,944
Deferred income tax credit	(235,000)	–
Total From Operations	3,325,029	1,038,277
Additional long-term borrowing	787,757	2,372,606
Sale of Series A and B Preferred Stock – Note F	2,637,379	–
Conversion of Series A Preferred Stock to Common Stock	36,895	–
Net carrying amount of property converted to a lease	519,166	–
Proceeds from sale of property and equipment, less gain included in net (loss)	69,749	274,976
	7,375,975	3,685,859
APPLICATION OF WORKING CAPITAL		
Additions to property and equipment	1,409,959	2,134,662
Expenditures for airframe and engine overhaul	1,716,398	1,209,281
Reductions of long-term debt	3,008,041	1,520,442
Conversion of Series A Preferred Stock to Common Stock	36,895	–
Deposits on leased aircraft	(490,000)	280,000
Increase in deferred charges	6,459	412,012
Increase in other assets	11,879	15,552
	5,699,631	5,571,949
INCREASE (DECREASE) IN WORKING CAPITAL	1,676,344	(1,886,090)
Working capital at beginning of year	1,715,009	3,601,099
WORKING CAPITAL AT END OF YEAR	$ 3,391,353	$ 1,715,009
CHANGES IN COMPONENTS OF WORKING CAPITAL		
Increase (decrease) in working capital assets:		
Cash and short-term investments	$ 2,383,503	$(1,629,817)
Accounts receivable	(1,084,513)	2,385,833
Maintenance and operating supplies	373,621	179,325
Prepaid expenses	282,946	(863,159)
	1,955,557	72,182
Increase (decrease) in working capital liabilities:		
Accounts payable	(807,803)	2,099,236
Collection and withholding as agents	670,743	(82,452)
Salaries, wages and vacations	315,014	289,032
Accrued interest, taxes and other expenses	(280,782)	(448,535)
Air travel plan deposits	(6,375)	(3,825)
Current maturities of long-term debt	388,416	104,816
	279,213	1,958,272
INCREASE (DECREASE) IN WORKING CAPITAL	$ 1,676,344	$(1,886,090)

See Notes to Financial Statements.

SOUTHERN AIRWAYS, INC.
STATEMENT OF STOCKHOLDERS' EQUITY
FOR THE YEARS ENDED DECEMBER 31, 1971 and 1970

	Preferred Stock			
	Series A Par Value $1.00 a Share		Series B Par Value $1.00 a Share	
	Shares	Amount	Shares	Amount
Balance, January 1, 1970				
Net (loss) for the year ended December 31, 1970				
Balance, December 31, 1970				
Issuance of 290,781 shares of Series A $.36 Convertible Preferred Stock with detachable warrants to purchase 290,781 shares of $2.00 par value Common Stock at $6.00 a share, less related expenses of $107,309 – Note F	290,781	$ 290,781		
Issuance of 166,667 shares of Series B $.36 Convertible Preferred Stock with detachable warrants to purchase 166,667 shares of $2.00 par value Common Stock at $6.00 a share – Note F			166,667	$ 166,667
Issuance of 36,895 shares of Common Stock upon conversion of 36,895 shares of Series A Preferred Stock	(36,895)	(36,895)		
Net (loss) for the year ended December 31,1971				
Balance, December 31, 1971	253,886	$ 253,886	166,667	$ 166,667

SOUTHERN AIRWAYS, INC.
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 1971

NOTE A – PUBLIC SERVICE REVENUE

Public service revenues recorded for the period July 1, 1971, to December 31, 1971, are based upon the rate in effect for the year ended June 30, 1971. The rate for the period July 1, 1971, through June 30, 1972, has not been determined by the Civil Aeronautics Board and, therefore, amounts recorded in the last six months of 1971 are subject to adjustment upon final determination.

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. 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 these aircraft will be essentially exhausted by the end of 1973. The Company's net investment in Martin

Common Stock Par Value $2.00 a Share Shares	Amount	Other Paid-In Capital	Retained-Earnings (Deficit)	Total
1,024,871	$ 2,049,742	$ 1,229,523	$ 968,556	$ 4,247,821
			(3,333,212)	(3,333,212)
1,024,871	2,049,742	1,229,523	(2,364,656)	914,609
		1,346,596		1,637,377
		833,335		1,000,002
36,895	73,790	(36,895)		
			(1,058,784)	(1,058,784)
1,061,766	$ 2,123,532	$ 3,372,559	$ (3,423,440)	$ 2,493,204

aircraft amounted to $3,793,000 and $4,365,000 at December 31, 1971 and 1970, respectively. At December 31, 1971, seven Martin aircraft had been withdrawn from service; one had been sold and the remaining six will be sold or used in maintaining the remaining Martin aircraft in an airworthy condition. Any proceeds from the sale of these aircraft are 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 is as follows at December 31, 1971 and 1970:

	1971	1970
Notes payable to banks in quarterly installments through 1976 (1)(2) (3)(4)	$ 4,530,000	$ 5,392,500
Notes payable to banks, due December 31, 1975 (1)(2)(3)(4)(5)	3,000,000	3,000,000
Notes payable to banks in quarterly installments through 1974 (1)(2) (3)(4)	1,173,913	1,695,652

	1971	1970
Note payable to bank in equal quarterly installments to January 1973 (4)(6)	510,833	613,000
Notes payable to lessor, due December 31, 1972 (1)	315,000	315,000
Note payable to vendor in equal installments in October and November 1972 (1)	420,000	420,000
Notes payable to bank for deferred lease payments in equal installments in April, May and June 1973 (1)	433,757	–
Notes payable to fuel supplier in September 1972 (1)	220,000	–
Notes payable to lessor due in equal installments in April, May and June 1973 (1)	134,000	–
8½% to 9% notes payable to fuel supplier due in December 1971	–	250,780
6% notes payable due in monthly installments to October 1975	–	392,439
Other notes payable	–	490,000
5¾% Convertible Subordinated Debentures due December 1, 1981 (3) (7)	4,682,000	4,682,000
6½% Convertible Subordinated Debentures with warrants attached, due November 1, 1983 (3) (8)	8,000,000	8,000,000
	23,419,503	25,251,371
Less current maturities (1)	2,202,471	1,814,055
	$21,217,032	$23,437,316

(1) In May, 1971, effective as of February 1, 1971, the Company entered into a deferral agreement with creditor banks, lessors of aircraft, a fuel supplier and an equipment vendor (Creditors) for the deferral of certain principal and rental payments due in 1971 and 1972. Principal payments of $1,254,184 (originally due $612,500 in 1971 and $641,684 in 1972) due to creditor banks were deferred and will be paid in three installments in October, November and December, 1973; payment of a note payable to a lessor in the amount of $315,000 was deferred to December 31, 1972, and $420,000 due on an engine purchase contract was deferred and will be paid in two equal monthly installments in October and November, 1972. In addition, a fuel supplier agreed to accept notes in the amount of $330,000 due in September, 1972, for fuel deliveries which were made in April and May, 1971 ($220,000) and will be made in March, 1972 ($110,000) and aircraft lease payments of $275,000 (originally due $134,000 in 1971 and $141,000 in 1972) have been deferred and will be paid in three installments in April, May and June, 1973. The Company also entered into an agreement with a bank for loans of $617,794 to be used for lease payments (originally due $433,756 in 1971 and $184,038 in 1972) and these notes will be paid in three equal installments in April, May and June, 1973.

Under the terms of the agreement with Creditors, the Company will make deposits in a "Revolving Cash Collateral Account" consisting of (1) amounts equal to the deferred payments on the original due date of such payments, and (2) cash in excess of projected requirements for a sixty day period as defined in the agreement. The Company may withdraw funds from this collateral account based upon their projected cash needs for the next sixty days. At December 31, 1971, the balance of the account was $2,670,604, consisting of cash ($46,604) and short-term investments, and was pledged as collateral for indebtedness due to Creditors participating in the Deferral Agreement.

The interest rates on these deferred payments are: creditor banks at 2% above the prime rate, but not less than 7% (7¼% at December 31, 1971); deferred lease payments at 9%; note payable to bank for deferred lease payments at 2% above the bank's prime rate, but not less than 7½% (7½% at December 31, 1971); and notes payable to fuel supplier, equipment vendor and another lessor at 10%.

Prepayments on the deferred amounts are required in amounts equal to net income for the twelve month period ending the preceding December 31, and after such deferred amounts have been paid, the balance is to be applied to the prepayment requirement outlined in (5) below. See other restrictions outlined in (3) below.

(2) Based on the agreement with Creditors which became effective May 28, 1971, the interest rate, retroactively to February 1, 1971, is ½ of 1% above the lead bank's prime rate, except while the deferral program continues the interest rate is 1% above the lead bank's prime rate (6¼% at December 31, 1971). Scheduled payments actually deferred under the program will bear interest at 2% above the lead bank's prime rate, but not less than 7%.

(3) Under the terms of the amendment of the agreement with creditor banks and the Deferral Agreement, both of which are dated as of February 1, 1971, the creditor banks amended their agreements with the Company to waive all events of default (at December 31, 1970, the Company did not comply with certain requirements with respect to working capital, indebtedness and lease obligations and on February 28, 1971, also did not comply with requirements with respect to minimum net worth, which were also conditions of default under the terms of a long-term aircraft lease agreement) which may have existed prior to execution of the amendment, and the restrictive covenants applicable to such agreements were revised. The terms of the Deferral Agreement and both issues of Convertible Subordinated Debentures place certain requirements and restrictions upon, among other things, (a) working capital, (b) indebtedness and lease obligations, (c) net worth, (d) capital expenditures, (e) losses from operations and (f) payments relating to Capital Stock, including dividends (no amounts were available for such payments at December 31, 1971 or 1970). Under the most restrictive terms of these agreements, the Company will be in default with all creditors if (1) the cumulative net loss for

1972 exceeds $1,600,000 or the net loss for any one month during 1972 exceeds $750,000 or (2) the cumulative net loss for the first three months of 1973 exceeds $550,000; or additional losses are incurred thereafter.

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

(5) 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 twelve month period ending the preceding December 31, after certain deferred payments have been made as described in (1) above.

(6) 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 due through 1974. Payment of this note is collateralized by a second mortgage on the DC-9 flight equipment.

(7) The 5¾% Convertible Subordinated Debentures due December 1, 1981, are convertible (until maturity or prior redemption) into Common Stock at $10.86 per share (see Note F); are subordinated, generally, to all existing and future indebtedness for borrowed money; are callable at premiums ranging from 4¼% 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.

(8) The 6½% Convertible Subordinated Debentures due November 1, 1983, are convertible (until maturity or prior redemption) into Common Stock at $10 per share (see Note F); are issued in integral multiples of $1,000 with an attached warrant for the purchase of 18 shares at $10 a share (see Note F); are subordinated, generally, to all existing and future indebtedness for borrowed money; are callable on or after November 1, 1973, at premiums ranging from 6½% 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.

NOTE E – INCOME TAXES

The loss for income tax purposes for 1970 and 1971 varies from the loss shown in the Statement of Operations because of timing differences related to public service revenue payments, certain expenses deferred for financial statements purposes, and the use of accelerated depreciation applicable to certain assets. At December 31, 1971, there is a net operating loss carryforward to future years for income tax purposes of approximately $7,557,000, which expires in 1974 ($970,000), 1975 ($4,880,000) and 1976 ($1,707,000). The net operating loss carryforward for financial statement purposes at December 31, 1971, is approximately $3,573,000.

The Company will change the depreciation method and lives applicable to certain assets for tax purposes in its 1971 tax returns. Because of these changes and the carryforward of the 1971 operating loss described above, deferred taxes ($235,000) provided in prior years will not be paid and, accordingly, have been recognized as an income tax credit in the Statement of Operations for 1971.

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 carryover at December 31, 1971, for use in offsetting federal income tax in future income tax returns amounted to approximately $1,246,000 and expires in 1976 ($65,000), 1977 ($810,000), 1978 ($37,000), 1979 ($308,000), and 1981 ($26,000).

NOTE F – CHANGES IN CAPITAL

The stockholders approved an amendment to the Company's charter in May 1971, to increase the authorized $2 par value Common Stock from 5,000,000 shares to 7,500,000 shares, and to authorize 2,000,000 shares of $1 par value Preferred Stock in one or more series; the terms of each series of Preferred Stock to be determined by the Board of Directors upon issuance.

In June 1971, the Board of Directors authorized the issuance of up to 1,350,000 shares of $.36 Convertible Preferred Stock, Series A and 200,000 shares of $.36 Convertible Preferred Stock, Series B. Each share of Convertible Preferred Stock is entitled to a $.36 cumulative dividend if earned during the year, subject to the dividend restrictions of the Convertible Subordinated Debentures (see Note D). No dividends have accumulated at December 31, 1971. The Preferred Stock is convertible into one share of Common Stock at $6 per share; is entitled upon liquidation to $6 per share; and can be redeemed after July 1, 1976, at $6 per share. The Series A Stock is voting and the Series B Stock is non-voting.

During 1971, 290,781 Series A Units and 166,667 Series B Units were sold. Each Unit consisted of one share of Series A or Series B Convertible Preferred Stock, respectively, with a detachable warrant to purchase one share of Common Stock at $6 per share through July 1, 1981.

At December 31, 1971 and 1970, there were 2,323,125 shares and 1,006,625 shares of Common Stock of the Company reserved as follows:

(Continues next page)

	1971	1970
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	6,100	7,100
Exercisable one-third each year beginning in 1973 at a price of $5.25 per share	36,000	–
Shares available for additional options which may be granted under the Plan	1,000	36,000
	45,000	45,000
Shares available for options which may be granted under the Employee Stock Option Plan approved by Board of Directors in 1967	25,000	25,000
Shares reserved for conversion of 5¾% Convertible Subordinated Debentures (1)	431,124	292,625
Shares reserved for conversion of 6½% Convertible Subordinated Debentures (2)	800,000	500,000
Shares reserved for sale pursuant to stock purchase warrants issued with 6½% Convertible Subordinated Debentures at a price of $10 per share (2)	144,000	144,000
Shares reserved for conversion of Preferred Stock:		
Series A	253,886	–
Series B	166,667	–
Shares reserved for sale pursuant to stock purchase warrants issued with the Preferred Stocks at a price of $6 per share:		
Series A	290,781	–
Series B	166,667	–
TOTAL	2,323,125	1,006,625

(1) Following the sale of 290,781 Series A Units to stockholders, employees, and a supplier and taking into consideration the 166,667 Series B Units sold, the conversion price of the 5¾% Convertible Subordinated Debentures was reduced from $16 per share to $10.86 per share.

(2) As additional consideration for the holders of the 6½% Convertible Subordinated Debentures who purchased the 166,667 Series B Units, the conversion price of the Debentures and the exercise price of the stock purchase warrants attached were each reduced from $16 per share to $10 per share.

Data with respect to stock options outstanding at December 31, 1971 and 1970, is summarized as follows:

	December 31, 1971			December 31, 1970		
Year of Grant	Number of Shares	Option and Market Price Per Share	Total	Number of Shares	Option and Market Price Per Share	Total
1967	1,000 (a)	$19.18	$ 19,180	1,000	$19.18	$ 19,180
1968	900 (a)	13.75	12,375	900	13.75	12,375
1969	6,100 (a)	8.69 – 11.76	65,376	7,100	8.69 – 11.76	77,136
1971	36,000	5.25	189,000	–	–	–
	44,000		$285,931	9,000		$108,691

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, 1971, 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
1971	2,998	8.69 – 19.18	36,214	4.125 – 6.75	17,314
			$417,372		$485,158

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.

(a) The Company has granted options to purchase 8,000 shares of Common Stock, exercisable at $5.25 per share, to become effective after the expiration of presently outstanding options.

NOTE G – 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. Total pension expense, including amounts paid under a defined contribution plan, for the years ended December 31, 1971 and 1970, was $868,779 and $661,734, respectively. Pension plan assets were sufficient to cover the unfunded past service costs at December 31, 1971. The Company's policy is to fund pension cost accrued.

NOTE H – COMMITMENTS AND CONTINGENCIES

At December 31, 1971, the Company was leasing eleven DC-9 jet aircraft under leases expiring in 1979 through 1983, at a minimum annual rental of $4,722,208. The Company also leases certain office, ticketing, hangar, computer and shop facilities with minimum aggregate annual rentals of approximately $1,622,000 under various leases with expiration dates through 1992.

The Company has a five year agreement to receive passenger reservation service at an estimated annual charge of approximately $500,000.

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.

The United States Court of Appeals for the District of Columbia remanded to the Civil Aeronautics Board *The Southern Airways, Inc. Route Realignment Investigation.* At issue before the Board in this remanded case, now in progress, is extension of the Company's system to Miami/Ft. Lauderdale via Tallahassee and Orlando as well as Memphis-Miami and Atlanta-Nashville non-stop authority. A Board examiner has recommended that this Florida extension and the two non-stop authorizations be granted on a permanent basis to the Company. He also recommended non-stop authority for another carrier in the Memphis-Miami market. The examiner's recommendations are being reviewed by the Board. Meanwhile, the Company will continue to operate the Florida service in question pursuant to temporary Board authority.

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 I – 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. Assumed conversion of debentures and Preferred Stocks, and exercise of warrants would not increase the net loss per common share.

(Notes continue next page.)

NOTE J – SUPPLEMENTARY PROFIT AND LOSS INFORMATION

	1971	1970
Provision for Depreciation – Operating Expenses	$2,094,991	$2,090,915
Provision for Airframe and Engine Overhaul – Operating Expenses	$2,039,344	$1,728,630
Amortization –		
Operating Expenses	$ 359,124	$ 331,367
Other	125,354	220,577
	$ 484,478	$ 551,944
Obsolescence – Operating Expenses	$ 182,617	$ 210,002
Taxes other than Income Taxes Charged to Operating Expenses –		
Payroll	$ 804,765	$ 640,629
Fuel and Oil	161,003	216,261
Property	327,568	233,500
Sales and Use	130,412	91,698
Other	95,020	65,469
	$1,518,768	$1,247,557
Rents (including landing fees and rental at airports served)	$7,610,311	$6,512,753

There were no management fees, service contract fees or royalties.

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, 1971 and 1970, and the related statements of operations, stockholders' equity, and changes in financial position for the two years ended December 31, 1971. 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.

As reflected in the accompanying financial statements, the Company had net losses of $1,058,784 and $3,333,212 in 1971 and 1970, respectively, and had a retained-earnings deficit of $3,423,440 at December 31, 1971. As explained in items (1) and (3) of Note D, in May 1971 the Company obtained an amendment to its agreement with creditor banks, dated as of February 1, 1971, providing for the deferral of certain principal payments and a waiver of all events of default which may have existed prior to the execution of the amendment. The terms of the agreements place certain requirements and restrictions upon, among other things, (a) working capital, (b) indebtedness and lease obligations, (c) net worth, (d) capital expenditures, (e) losses from operations and (f) payments relating to capital stock, including dividends. With respect to the provision applicable to losses from operations, the Company will be in default with all creditors if (1) the cumulative net loss for 1972 exceeds $1,600,000 or the net loss for any one month, during 1972 exceeds $750,000 or (2) the cumulative net loss for the first three months of 1973 exceeds $550,000, or additional losses are incurred thereafter. The Company's continuation as a going concern is dependent upon its ability to develop future profitable operations, which currently contemplates receiving public service revenue in the future at a level not substantially below the level presently being received. As discussed in Note A, the Company is presently receiving public service revenue on a temporary rate which is subject to adjustment.

In our opinion, subject to the ability of the Company to attain profitable operations and any adjustments which may result from the final settlement of public service revenue as discussed in the preceding paragraph, the accompanying balance sheets and statements of operations, stockholders' equity, and changes in financial position present fairly the financial position of Southern Airways, Inc. at December 31, 1971 and 1970, and the results of its operations, changes in stockholders' equity and changes in financial position for the two years ended December 31, 1971, in conformity with generally accepted accounting principles applied on a consistent basis.

ERNST & ERNST

Atlanta, Georgia
February 28, 1972

SOUTHERN AIRWAYS

GENERAL OFFICES
Hartsfield Atlanta International Airport
Atlanta, Georgia

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

Notice to Stockholders of Southern Airways, Inc.

Under a 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 per cent 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.

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Executive Vice President
and General Manager

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Vice President and
Associate General Manager

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Regulations and Secretary

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and Treasurer

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Technical Services

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Flight

OWEN L. McREE
Assistant Vice President–
Personnel

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Assistant Vice President–
Economic Research

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

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

FRANK H. WHEELER
Assistant Vice President–
Sales and Services

JAMES H. ISHEE
Controller

RAY W. BURDEN
Assistant Treasurer

MRS. MARY C. HAYES
Assistant Secretary

CECIL A. BEASLEY, Jr.
Assistant Secretary

WM. BEW WHITE, JR.
Assistant Secretary

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GRAYDON HALL
G. GUNBY JORDAN
ELTON B. STEPHENS
WM. BEW WHITE, JR.

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Ivan Allen Company
Atlanta, Georgia

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Ballard & Beasley
Washington, D.C.

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Brunini, Everett, Grantham & Quin
Vicksburg, Mississippi

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Atlanta, Georgia

GRAYDON HALL
Southern Airways, Inc.
Atlanta, Georgia

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Birmingham, Alabama