1972 Report To Stockholders

Southern Airways, Inc.

Cover

There is a new addition to the Southern skies and soon the airline's entire jet fleet will display this contemporary design featuring a new corporate symbol, the Flight Mark. Whether flying throughout, from or to the Southeast, Southern's jet fleet will contribute to the comfort, convenience and pleasure of its passengers.

Southern

Financial and Operating Highlights

Southern Airways, Inc.

Years ended December 31,	1972	1971	Growth
Passenger revenues	**$ 52,052,000**	$ 45,302,000	14.9%
Operating revenues	**$ 68,637,000**	$ 60,334,000	13.8%
Operating income	**$ 2,893,000**	$ 407,000	610.8%
Net income (loss)	**$ 1,600,000***	$ (1,059,000)	–
Primary earnings (loss) per share including extraordinary credit	**$ 1.06***	$ (1.02)	–
Yield per passenger mile	**8.7¢**	8.6¢	1.2%
In scheduled service: Revenue passenger miles	**596,197,000**	527,552,000	13.0%
Available seat miles	**1,279,175,000**	1,222,289,000	4.7%
Passenger load factor	**46.6%**	43.2%	7.9%
Revenue passengers carried	**2,101,000**	1,875,000	12.1%
Revenue plane miles flown	**20,844,000**	20,003,000	4.2%
Number of employees	**2,084**	1,994	4.5%

**This amount is exclusive of ransom money not yet returned by the Republic of Cuba. In the event this is written off, it will result in a loss of $359,000 and $.30 per share.*

Contents

ILLUSTRATION BY TOM ALBIN

To our stockholders

Our Reports during the past five years have emphasized activities that were strengthening the Company and contributing to growth that was expected to materialize in the near future. Now, we can report these activities have reached fruition, and this past year is established as the most significant in our history. New highs were attained in all areas as revenues reached $68.6 million and our largest profit—$1.6 million—resulted.

Factors contributing to this success include a greatly improved economy, a tight reign on costs, expanded sales and maturing markets, and an outstanding effort on the part of the employees who comprise the "Southern family."

Nevertheless, the year had some problems, the most significant of which was the hijacking of a Southern DC-9 in November. The subsequent events were reported by news media throughout the world. The skill and determination of our flight crew resulted in the safe return of the passengers and aircraft. Ransom paid to insure the safety of the passengers is expected to be ultimately returned to the Company.

To insure continued growth, 13 additional DC-9s have been acquired and the first four of these are now in service. This will enable us to offer substantial improvements in service. This and other significant events are explained further in this report.

Realizing that you are interested in our current operations, expansion opportunities, and the related problems facing Southern during 1973, we are departing from the usual annual report format. This year, we have selected key points brought up most frequently by the many publics we serve. In the pages following are answers to the questions we hear most often.

Respectfully,

Frank W. Hulse
President

April 30, 1973

Answers for our publics

MR. HULSE: "The five of you have been asked to participate in the presentation of Southern's 1973 Report to Stockholders. We appreciate your representing some of our most important publics: our more than 6,000 stockholders, who own this Company; the 2,575 loyal employees who operate our Company; the banks and other members of the financial community on whom we depend for capital; the news media, ever responsible for keeping the public aware of our successes—and sometimes our failures; and certainly the customer and general public which is the reason we are in business and on whom our existence depends.

"Before we open this discussion to your questions, let me tell you some of the things we are accomplishing at Southern.

"Your Company has been returned to operating profitability. Many factors contributed to this. Revenues are the highest in our history, and while attaining this, we have been able to control our expense levels and operate with minimum overhead. Also, subsidy received was consistent with the needs of service to our small communities which do not generate a profitable level of passenger activity. This is, of course, as it must be.

"We are acquiring 13 additional DC-9 aircraft, bringing our jet total to 28, the second largest jet fleet in the regional airline industry. This enables us to decrease the number of Martin 404 planes operated. At the same time, we are being asked by some why we are not replacing the remaining Martins with turbo-prop equipment. This we have elected not to do as we believe the turbo-prop equipment available today offers our passengers

Southern serves five important publics and many representative questions are answered in this Report.

no greater speed or comfort than our Martin fleet. In fact, Southern is the only regional carrier and is among only three U.S. certificated carriers not taking the intermediate step into turbo-prop aircraft. For us, this has been a wise decision as we will serve more than 90 per cent of our passengers with pure-jet aircraft by the end of this year. At such time as an economical small jet is marketed, Southern will consider it as a Martin replacement.

"Southern is seeing a change in the pattern—and need—for scheduled airline service in many Southeastern cities. This area has few natural and almost no man-made barriers. We have neither the mountains of the Northeast and Far West, nor the deserts and plains of the West, nor congested city life of the Upper East Coast. In turn, excellent highways make automobile travel to regional airports or to large city airports a logical substitution for short air hops. The result is that many air travelers on our system are taking advantage of our flight frequencies at nearby, large airports. This is resulting in the suspension of service at some smaller cities, contributing to a reduction in subsidy, but without inconvenience to local passengers who are often little more than a half-hour drive from our jet service with accompanying better schedules.

"More of this change is expected along the Southern system. Coupled with some improved passenger services that we are introducing, we believe we will offer even more convenience to the air traveler moving throughout, from and to the Southeast.

"Another change we are seeing is in our Company employee mix. Southern long has had a policy of promoting from within when available skills meet the job qualifications. This practice encourages employee pride and ensures opportunity for our personnel. Because of our rapid growth, however, we have gone into the job market to fill some positions. We have been fortunate in attracting intelligent, qualified people who will add to our senior management base for further growth.

"Southern has redoubled its efforts

"...in order to achieve the appearance of a modern, progressive airline, we are changing our look."

to increase job opportunities among minorities. Although we seek job qualification first, we have found minority people with these qualifications and we are hiring them.

"Another change very much in evidence is our new identity program. In order to achieve the appearance of a modern, progressive, successful airline, we are changing our look. Remember, I said "look," not *image*. Southern has become an airline in step with the times and we want to communicate the new Southern. To do this, we have developed a new corporate identity, the focal point being the Flight Mark which has become our corporate symbol. Our flight and ground equipment is appearing in modern colors and our ticket and gate facilities, advertising, and printed material will contribute an appearance of professionalism. We will change to our new look as we introduce our newly acquired aircraft, purchase additional equipment, and expand passenger facilities.

"As we see it, we have a three-fold obligation: to provide a satisfactory, reliable standard of service for our customers, to operate as profitably as possible for our stockholders, and to offer our employees fair wages with good working conditions. This continues to be our aim for the coming year.

"Now, I realize that each of you has questions about these and other areas of our performance. Inasmuch as we at Southern work for our stockholders, and furthermore as she is representative of our lady public, I am asking her to begin the first question."

STOCKHOLDER: "I am sure other stockholders would add many questions to those I have so I hope these are representative of all Southern stockholders. The first, and certainly one of the most important things I want to know, is why does Southern need more jets when no new routes have been received?"

MR. HULSE: "This is a question we have been asked many times, particularly by the financial community. During the mid-1960s, the Civil Aeronautics Board began a program to strengthen the regional airline industry. Basically, the plan was to grant regional carriers new, profitable, longer haul routes, using profits therefrom to cross-subsidize losses on service to smaller cities. Accordingly, Southern was awarded several major routes, opening service to Washington, D.C. and New York, N.Y. in September 1968, to St. Louis, Mo. in July 1969, to Tallahassee, Orlando, and Miami, Fla. in February 1970, to Newark, N.J. in March 1970 and to Chicago, Ill. in April 1970.

"Simultaneously, route restrictions within our existing system were reduced, enabling us to offer service between new combinations of city points.

"Unfortunately, the timing was bad as the nation, and particularly the Southeast, was entering a long and severe recession. Although Southern did capture a large share of the new markets, the size and growth of these markets, together with older, subsidy-eligible markets which were the backbone of our system, were curtailed by the recession. As a result, Southern suffered losses during the period 1968 through 1971. Capital that would have been used to acquire additional aircraft to develop the new authority was consumed by those losses.

"Even though Southern was unable

Southern's highly competent pilot force is supported by continuing programs for maintaining high standards and skills.


EXIT

"Our short haul business was so good it was competing with our long haul flights."

to obtain sufficient aircraft to achieve the full market potential, studies were made to define and establish these markets. In other words, we used this as a get ready period for the time when we could add more aircraft into these markets."

BANKER: "Obviously, Southern's marketing studies justified the addition of new aircraft. How did you approach this?"

MR. HULSE: "During the late Sixties and even into 1970 and 1971, we improved our techniques for identifying factors which determine traffic growth. One of the most significant findings was that although overall load factor on many flights was in the area of 50 per cent, a short segment of a given flight might have a near-100 per cent load factor, blocking the entire flight sequence to our long haul passengers. Our short haul business was so good it was competing with our long haul flights.

"Additionally, by early 1972, it was clear that economic recovery had enabled Southern to return to profitability. Seats occupied were catching up with seats available.

"We felt the return to profitability would make possible new financing. Used DC-9s, well suited to our system, could be bought at extremely attractive prices and availability was six months compared with 18 months for delivery of new equipment.

"Marketing studies were intensified and specific benefits to be gained from each additional aircraft were determined, indicating that additional jet aircraft could be utilized profitably on our current system. We were offered 13 DC-9s at an extremely favorable price and it was evident that these could be introduced immediately—and profitably.

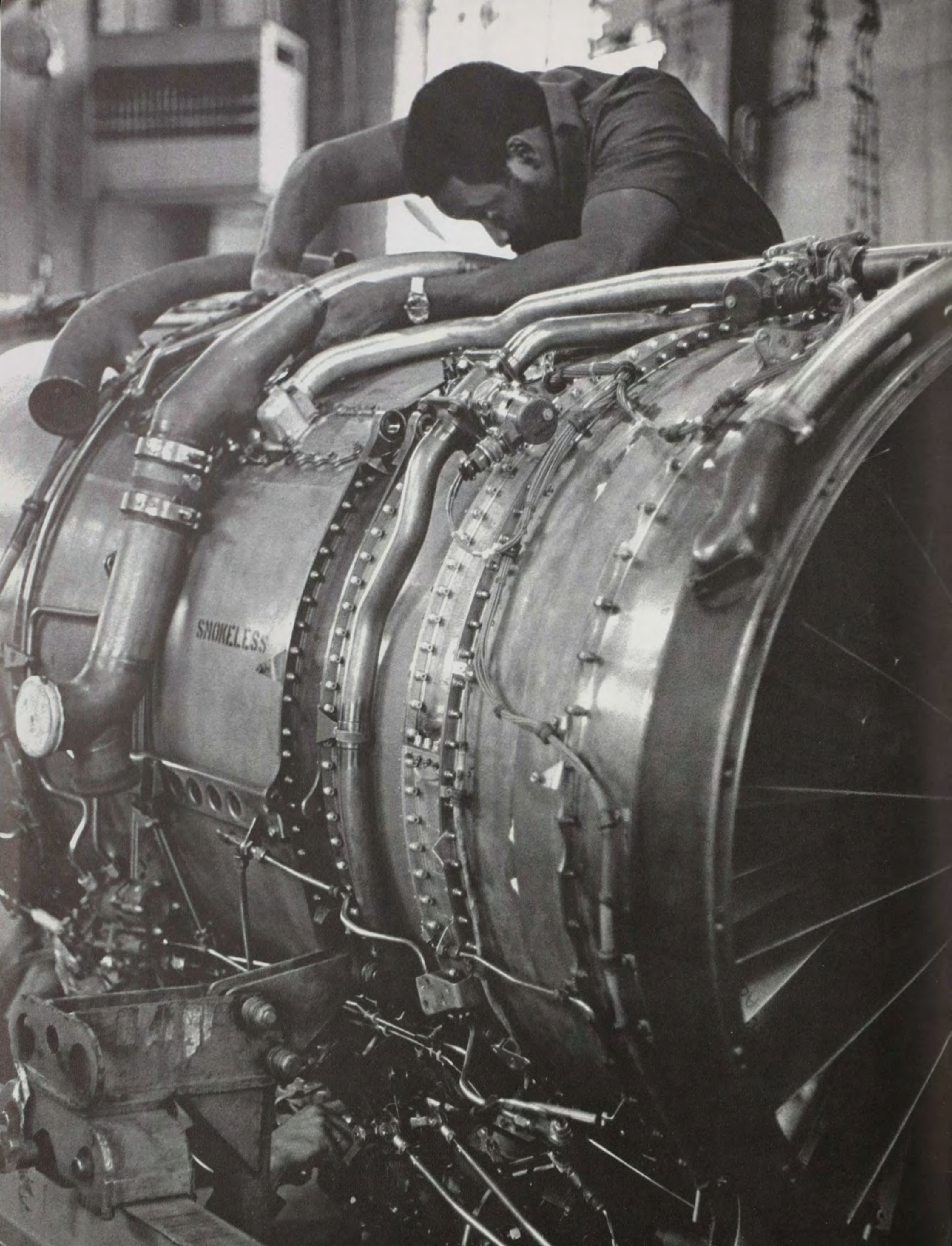
"Our findings were reinforced by an independent analysis and research firm. Their report recommended that the expansion be implemented. With this added assuredness, we began a program that increases our jet fleet by 87 per cent."

NEWSMAN: "We ran a story recently about the details of the financing for these airplanes, a $39 million loan. What other avenues of financing did you explore?"

MR. HULSE: "During the Fall of 1972 we determined that several financing methods were available. Based on this, we signed a letter of intent to purchase the airplanes, which, together with related engines and parts, resulted in a commitment of $30 million. Our Fiscal management considered several programs, including stock issue, debentures, various kinds of loans, and finally, what proved to be the most advantageous method—and the one we selected—under which a group of banks led by The First National Bank of Chicago would make the loan, with 90 per cent of the $27 million needed for aircraft acquisition guaranteed by the Department of Transportation, Federal Aviation Administration, under a Federal law enacted to stimulate growth within the regional airline industry. (Southern's loan is the largest of this kind yet made.)

"The $12 million above the amount for aircraft will be used to reduce existing debt, purchase equipment, and provide additional working capital."

Some 3 million Southern passengers will enjoy inflight service during the next 12 months. Stewardesses receive four weeks of intensive training before they begin their careers.


SMOKELESS

"Much of our present maintenance facility . . . is being taken for airport expansion."

STOCKHOLDER: "Speaking of items in the news, I see that Southern is building a multi-million dollar maintenance base in Atlanta. Is this necessary, and if so, why build it in Atlanta?"

MR. HULSE: "Yes, it is necessary, and there are several reasons for selecting Atlanta.

"Much of our present maintenance facility, located on airport property owned by the City of Atlanta, is being taken for airport expansion. Additionally, these buildings cannot satisfy our ultimate needs, even if we could retain them, as they do not permit efficient maintenance of our expanded fleet. In addition to more functional space in the new facility, we will be able to perform many money-saving activities which are now provided by outside firms.

"Accordingly, we discussed these needs with several major cities on our system and many of these made proposals to build a maintenance base to our specifications. Naturally, there are many factors to consider, not the least of which is our own employees.

"After an extensive study, the conclusion was reached that Atlanta is the most efficient and economical location for the facility for a number of reasons.

"It has taken years to develop our outstanding maintenance staff. These are highly qualified, well trained people. Many are homeowners in the Atlanta area and most have strong family ties here. We determined that as many as one-half of our maintenance personnel would not be willing to relocate. Another consideration was the availability of material suppliers and support services; as a major airline city, Atlanta has these. Another significant factor is the routing of our equipment – Atlanta is the operational hub of our route system.

"This maintenance base will be owned and paid for by the City of Atlanta and will be built with little capital outlay on our part. Southern will lease it for a 30-year period. We believe it will satisfy not only our immediate needs but also will allow the fleet expansion we anticipate for further growth.

"The City of Atlanta has set aside a 75-acre tract adjoining the airport's newest runway. Construction is scheduled to begin in early 1974 with completion near the end of 1975. The cost is estimated at $18 million."

NEWSMAN: "In the preliminary drawings shown when you released the story on the maintenance base, Southern specified work bays capable of servicing a DC-10 or a 727-200. Does this mean you are eyeing larger aircraft?"

MR. HULSE: "Not at this time, but we are planning for the future."

Maintenance functions are performed in Atlanta and range from complete aircraft overhaul to specific work on engines and aircraft components.

"A collateral benefit of our route system is that we can offer our passengers direct flights..."

NEWSMAN: "Southern has been awarded a substantial number of new routes in the past few years. Do you feel you are likely to receive any more routes in the near future?"

MR. HULSE: "Yes, it's true that we have received some very high quality route additions in the past five years. Now that the national economy has reversed its downward trend, we believe service over these new routes will generate substantial additional traffic and revenues. This will enable us to improve our financial position so that other cities on our system can enjoy improved service to distant terminal points. For example, Southern's extension to Chicago permits our passengers in such communities as Columbus, Miss., Monroe, La. and Mobile, Ala. to utilize direct through-plane jet service with Chicago. Previously these communities' traffic with Chicago was provided only by connecting flights.

"There are still other communities on our system which have not enjoyed the benefits of our route extensions and we will be concentrating on these. A case in point is our application for nonstop authority between Nashville and Detroit. If successful, we will link such presently served communities as Nashville, Huntsville/Decatur, Mobile and Gulfport/Biloxi with Detroit by their first direct, single-plane service. For Birmingham, this will mean its first competitive service. Of course, in the prime Nashville-Detroit market, this backup type traffic will enable us to provide a maximum of Nashville-Detroit flight frequencies. This was a principal factor in a CAB Administrative Law Judge recommending Southern over several competing applicants.

"A collateral benefit of our route system is that we can offer our passengers direct flights between many major points, without the need of congested connections. Our Columbus, Ga.-New York/Newark service eliminates a plane change in Atlanta, as does the new Jacksonville-Memphis schedule. Mobile's Washington and New York service is another example of the benefits of direct, single-plane service."

EMPLOYEE: "We've been flying charters throughout much of the United States, to Canada and to the Bahamas. Will we continue this emphasis on charter flights?"

MR. HULSE: "As you point out, Southern's charter operation is extensive not only in the area we serve but also in the revenue it provides. In fact, our charter sales' contribution to profit is helping to reduce our need for subsidy. We are continuing charter emphasis and hope to increase income from this area."

PASSENGER: "It appears Southern will operate more jets over more routes and will carry more passengers, but what else does the passenger have to look forward to?"

MR. HULSE: "I think we can summarize passenger-oriented improvements as better schedules with more nonstop service, new service between additional city pairs, better reservations service, improved snack and meal service and more efficient ground service."

PASSENGER: "If you accomplish that, Southern *will* have a new appearance."

MR. HULSE: "Yes, and we are determined to accomplish it, even if not all at one time. Let's consider schedules and more nonstop service first.

"The first additional jet went into service on April 1. By June 1, six will be in use and all of the 13 additional aircraft will be in service by the end of 1973. In turn, on April 1 Southern

Southern's highly trained technicians provide virtually all support assistance including refurbishing seats and carpets, radio and avionics service, and jet engine maintenance.

"Memphis and Mobile have become key cities in our expansion plans."

added additional nonstop service between Mobile and Atlanta, first time nonstop service between Mobile and Washington, nonstop service between Memphis and New Orleans and between Memphis and Orlando, and one stop service between Memphis and Miami and between St. Louis and New Orleans. Our June 1 schedule adds new service between Jacksonville and Memphis, Jacksonville and Birmingham and Jacksonville and Columbus, Ga. Additionally, we are increasing New Orleans-Memphis-Chicago and Memphis-New Orleans frequencies.

"Another city receiving attention is Nashville. Very recent new authority permits us to schedule Atlanta-Nashville nonstop service and later this year we have plans for linking Nashville by direct jet flights with points in Alabama, Florida and Louisiana.

"Memphis and Mobile have become key cities in our expansion plans. For example, Southern boarded 106,000 passengers in Memphis in 1968, increasing to more than 240,000 in 1972. We expect to increase this to approximately 350,000 by the end of 1973. At the end of 1972 we had 18 jet flights daily in Memphis. At the end of 1973 we will have 40 jet flights. Memphis is becoming our major connecting point for west-bound travelers and this year we will become the number two airline serving Memphis, pushing hard for first place in 1974.

"We are already first in Mobile in jet departures and we expect a 90 per cent gain in passengers this year. Equally significant is that we are flying these passengers greater distances than before."

A modern reservations center in Atlanta answers 90 per cent of reservations calls. Customers in New York, Chicago, St. Louis and many other cities are answered in Atlanta.

"...we have some of the best inflight service in the regional airline industry..."

PASSENGER: "What effect will these new jets have on routes served by your Martin 404s?"

MR. HULSE: "During the past years we have gradually reduced the number of Martins in our fleet. Two years ago we had 24. By the end of 1973 we will have only ten in our pattern of service. We have accomplished this by substituting jets on many of the high load factor Martin flights. Ultimately, all Martins will be replaced by either DC-9s or some other modern jet powered aircraft."

STOCKHOLDER: "You mentioned improving reservations facilities. Is this an expensive addition?"

MR. HULSE: "Fortunately, no. You may recall, some three years ago we entered into a lease agreement for a computerized reservations system to replace the method that we had outgrown. The system selected neither operated to our expectations nor did it satisfy our requirements. To replace this with the best system possible, all available systems were considered. Last Fall we implemented one of the finest, most efficient reservations networks in the airline industry. Again, we leased the computer support with little capital outlay. It is sufficient to meet our needs for many years. And, I will add, this was accomplished at a favorable lease rate."

PASSENGER: "I have noticed significant improvement in your reservations service. Is this the reason?"

MR. HULSE: "This is part of the reason, probably a major part. But, there are other contributors. For example, we have implemented close control on our reservations center staffing needs. Last year we installed a small computer that determines our staffing needs based on call projections. This warns us when we need to bring in more help. In turn, we have a backup force of thoroughly trained, competent part time reservations agents who can be called in on short notice. This enables us to staff for normal requirements yet have a ready reserve. As a result, our answering time has been reduced remarkably, yet our costs are being kept in line."

BANKER: "Will the improved inflight meal service you mentioned justify the additional expense of the program?"

MR. HULSE: "The passenger acceptance we have encountered certainly proves the value of more frequent snacks and tastier meals. Interestingly, this has been introduced without an increase in cost per passenger. Although we have some of the best inflight service in the regional airline industry, we provide this at the lowest cost per passenger. This has been done by careful planning.

"For example, our serving trays, table ware, and dishes were designed not only as passenger pleasers but

also for being functional. Over a year's time the saving is enormous.

"Much care goes into our food selection. Several years ago we introduced our French Quarter Wine Basket. This includes a hearty roast beef or turkey sandwich, a praline, on some flights a piece of fruit, and a bottle of premium imported wine. This is served on many of our shorter flights and we find that passengers prefer this to a hurried meal. On the other hand, we are now flying many flights of more than one hour and this enables us to serve a meal as we feel it should be offered. On some flights our meals include a choice of entree accompanied by a selection of wines served by the stewardesses, another first in standard class service.

"Southern is the only airline offering all early morning passengers either a continental or a hot breakfast."

Responsive ground service—before and after a flight—is a Southern tradition. Competent, friendly personnel contribute to passengers' convenience.


Southern
FRAGILE

"We try to make Southern a good place to work."

EMPLOYEE: "Many of the points that have been brought up here have been discussed with Company employees during the past few weeks. I don't recall ever having so much information about the operation of the Company. Will this program continue?"

MR. HULSE: "Most certainly. Management recognizes that all employees must be informed and trained. As a pilot, you are one of the most skilled in the industry. You are receiving the best recurrent training possible and this will continue. In addition, you will see continuing programs to keep all Southern employees aware of both goals and problems. Training is receiving significant attention, and this extends to every job classification, beginning with entry positions. Every ramp agent receives 40 hours of classroom instruction before putting on a uniform. This makes a substantial contribution to upgraded ground service and on-time performance. Reservations agents are schooled four full weeks before they are assigned duties. Our stewardesses are given four weeks instruction, including both classroom and inflight. And, every employee is being introduced to Southern through a new orientation program designed to acquaint newcomers to our methods and goals.

"We are continuing a management seminar program for all supervisory personnel. To date, almost 200 have taken this excellent two week course. We have seen positive results."

BANKER: "I realize that salaries are of prime importance to your employees, but so are other things. How is Southern competing in the fringe benefit area?"

MR. HULSE: "We try to make Southern a good place to work. Our employees generally agree that their fringe benefits are among the best in the airline industry, and in some areas they lead the industry. We have improved an already first rate group insurance plan. Southern has a liberal employee retirement program. We offer high limits of Company-paid life and accident insurance, optional additional protection, and now have a group program for buying automobile and home insurance at substantial savings. Our personnel are offered generous vacations and holidays. We have recently announced a tuition participation program to stimulate employees to increase their education level. Many of our people are attending college in the evening and a great number of these are in graduate programs."

EMPLOYEE: "Other than the maintenance base, is Southern considering other facilities to make us more functional and even to improve working conditions?"

MR. HULSE: "Very definitely. We anticipate that a new pilot and mechanic training center will be incorporated into the maintenance base. This will enable us to provide all flight and maintenance training within Company facilities. As you know, in addition to our maintenance and training facilities, we occupy office and support space in all or part of five buildings around the Atlanta airport. We have had several attractive offers to combine this into one leased property and this is being considered."

EMPLOYEE: "Our ticketing and ground service at several of the larger cities we serve is still provided by other carriers. Is this going to change?"

MR. HULSE: "When we began serving New York, Chicago, St. Louis, Miami and Newark, it was impossible to get counter space and gate areas to meet our needs. Accordingly, we contracted with various carriers and they have been providing this service for us. We recognize this as being far less desirable than our own operations, but the key has been getting space in the terminals. We have worked out very desirable arrangements at Chicago and St. Louis and we are preparing to open our own operations at each of these cities. We are continuing to look at other contract-operated stations and will improve our operations there when facilities are available. Let me point out, this is not an unusual situation as we have provided ground services for a trunk airline serving Atlanta."

Southern flies not only people but also "things," ranging from specialized industrial cargo to family pets. A small package delivery service, Lickety-Split, provides fast service to small item shippers.

"...the best look at Southern is aboard one of our flights."

EMPLOYEE: "Is it true that we are developing a new waste treatment plant in Atlanta?"

MR. HULSE: "We have never shouted about our contribution to an improved environment. Nevertheless, we have several environmental programs underway. One of these is the waste treatment plant you mentioned. It will be a deterrent to both solid and liquid waste entering streams adjoining the Atlanta airport. This is being developed in a joint effort with the City of Atlanta and is scheduled for operation by the end of this year. Southern is spending in excess of $300,000 for this badly needed addition. In another area, we are 90 per cent complete in a program retrofitting our jet engines to reduce smoke and particulate matter. We anticipate other programs to further reduce engine emissions and noise. Also we are a major participant in landing and takeoff patterns that result in reduced noise pollution levels over residential areas.

"Let me summarize a few points. Essentially, 1973 began a significant era in Southern's history, but the real change will not be recognized until 1974. Then, we will have a full year's results from our expanded fleet. Our employee level will have grown more than 25 per cent, compared with 1972, and revenues will have soared to over $100 million, an increase of more than 55 per cent. Passenger travel on our routes will increase 60 per cent compared with 1972 levels. We will have developed a strong identity in all cities we serve and a reference to Southern will be synonymous with quality air service.

"The participation of each of you is appreciated. Certainly, your questions are representative of those we hear most frequently. Regardless of the in depth approach we take in any discussion, the best look at Southern is aboard one of our flights. I hope those of you not in our employee family will give us an opportunity to show you how we are improving. We want you to know that 'Southern is going your way.' We hope you will come our way."

About this Report

The panel on page 3, representing Southern's many publics, includes (left to right) William C. Henry, a vice president of the Trust Company of Georgia, Heyward Siddons of Stein Printing Company who posed as the newsman, Captain James E. Bass, a Southern pilot for 22 years, Mrs. Frances B. Ray, secretary to Southern's president, and as the customer, H. Roy Kaye of Stein Printing Company where this report was designed and produced. No professional models were used in this Report and all pictured are either actual passengers photographed with consent, or Southern employees. The cover and most of the interior photography is by Frank Garner.

Notice to Stockholders of Southern Airways, Inc.

Any person who owns as of December 31 of any year, or subsequently acquires ownership, either personally or as a trustee, of more than five per cent (5%) in the aggregate of any class of capital stock or capital of Southern Airways, Inc. shall file with the Civil Aeronautics Board a report containing the information required by Part 245.12 of the Board's Economic Regulations. This report must be filed on or before April 1 of each year as to the capital stock or capital owned as of December 31 of the preceding year and in the case of capital subsequently acquired, a report must be filed within ten (10) days after such acquisition, unless such person has otherwise filed with the Civil Aeronautics Board a report covering such acquisition or ownership.

Any bank or broker covered by this provision, to the extent that it holds shares as trustee on the last day of any quarter of a calendar year, shall file with the Civil Aeronautics Board within thirty (30) days after the end of the quarter, a report in accordance with the provisions of Part 245.14 of the Board's Economic Regulations.

Any person required to report pursuant to these provisions who grants a security interest in more than five per cent (5%) of any class of the capital stock or capital of an air carrier, shall within thirty (30) days after granting such security interest, file with the Civil Aeronautics Board a report containing the information required in Part 245.15 of the Economic Regulations.

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.

Statement of Operations

Southern Airways, Inc.

Years Ended December 31,	1972	1971
OPERATING REVENUES		
Passenger	**$52,052,394**	$45,301,780
Mail, express and freight	**3,531,100**	3,090,002
Public service revenue	**7,137,964**	6,973,875
Charter	**4,838,759**	4,067,008
Other operating revenues—net	**1,077,220**	900,907
	68,637,437	60,333,572
OPERATING EXPENSES		
Flying operations	**22,431,226**	20,949,971
Maintenance	**11,890,014**	10,807,844
Aircraft and traffic servicing	**15,433,205**	13,522,854
Passenger service	**4,343,393**	3,773,582
Promotion and sales	**5,303,672**	4,774,385
General and administrative	**3,783,878**	3,461,427
Depreciation and amortization—Notes A and I	**2,559,029**	2,636,732
	65,744,417	59,926,795
OPERATING INCOME	**2,893,020**	406,777
OTHER DEDUCTIONS (INCOME)		
Interest on long-term debt	**1,361,913**	1,678,112
Miscellaneous deductions (income)—net	**(109,460)**	22,449
	1,252,453	1,700,561
INCOME (LOSS) BEFORE INCOME TAXES	**1,640,567**	(1,293,784)
INCOME TAXES (CREDIT)—Note D		
Current		
Federal	**762,000**	—
State	**80,500**	—
Deferred	**—**	(235,000)
Investment credit	**(393,000)**	—
	449,500	(235,000)
INCOME (LOSS) BEFORE EXTRAORDINARY CREDIT	**1,191,067**	(1,058,784)
TAX BENEFITS OF OPERATING LOSS CARRYFORWARD—Note D	**409,250**	—
NET INCOME (LOSS)	**$ 1,600,317**	$ (1,058,784)
EARNINGS (LOSS) PER COMMON AND COMMON EQUIVALENT SHARE—Note H		
Primary		
Income (loss) before extraordinary credit	**$ .77**	$ (1.02)
Extraordinary credit	**.29**	—
Net income (loss)	**$ 1.06**	$ (1.02)
Fully Diluted		
Income (loss) before extraordinary credit	**$ .60**	$ (1.02)
Extraordinary credit	**.20**	—
Net income (loss)	**$ .80**	$ (1.02)

See Notes to Financial Statements.

Balance Sheet

Southern Airways, Inc.

ASSETS December 31,	**1972**	**1971**
CURRENT ASSETS		
Cash and short-term investments	**$ 5,744,808**	$ 5,057,849
Accounts receivable		
U.S. Government—Transportation and public service revenue	**2,127,449**	1,481,210
Trade receivables, less allowance for doubtful accounts (1972—$28,945; 1971—$41,849)	**5,341,247**	4,989,452
	7,468,696	6,470,662
Maintenance and operating supplies, at average cost less allowance for obsolescence (1972—$928,817; 1971—$695,787)—Note A	**1,885,545**	2,015,280
Prepaid expenses	**824,001**	791,765
Total Current Assets	**15,923,050**	14,335,556
OTHER ASSETS		
Hijacking payment—Note B	**2,000,000**	—
Equipment purchase deposits	**416,840**	—
Miscellaneous	**109,290**	90,621
	2,526,130	90,621
PROPERTY AND EQUIPMENT—on the basis of cost—Notes A and C		
Flight equipment	**26,766,370**	27,237,131
Other property and equipment	**3,822,489**	3,625,547
	30,588,859	30,862,678
Less allowances for depreciation and maintenance	**13,601,677**	12,123,973
	16,987,182	18,738,705
DEFERRED CHARGES—Note A		
Unamortized preoperating, route extension and development costs	**417,918**	691,245
Deferred lease costs	**188,560**	217,788
Unamortized long-term debt expense	**452,977**	580,524
	1,059,455	1,489,557
	$36,495,817	$34,654,439

LIABILITIES December 31,	**1972**	**1971**
CURRENT LIABILITIES		
Accounts payable	**$ 3,008,194**	$ 2,983,250
Collections and withholdings as agent	**4,837,482**	3,298,405
Salaries, wages and vacations	**1,745,155**	1,647,268
Accrued interest payable	**342,532**	248,002
Accrued taxes and other expense	**367,689**	462,807
Air travel plan deposits	**97,750**	102,000
Current maturities of long-term debt—Note C	**—**	2,202,471
Total Current Liabilities	**10,398,802**	10,944,203
LONG-TERM DEBT—Note C		
Notes payable, less current maturities	**9,238,016**	8,535,032
Convertible subordinated debentures	**11,345,000**	12,682,000
	20,583,016	21,217,032
STOCKHOLDERS' EQUITY—Notes C and E		
Preferred Stock, $1 par value, authorized 2,000,000 shares issuable in series:		
Series A $.36 convertible—voting (liquidation value $6 per share plus cumulative dividend—aggregate of $1,209,055 in 1972 and $1,523,316 in 1971) issued and outstanding—190,103 shares (1972) and 253,886 shares (1971)	**190,103**	253,886
Series B $.36 convertible—non-voting (liquidation value $6 per share plus cumulative dividend—aggregate of $1,060,002 in 1972 and $1,000,002 in 1971) issued and outstanding—166,667 shares	**166,667**	166,667
Common Stock, $2 par value: Authorized—7,500,000 shares Issued and outstanding—1,271,191 shares (1972) and 1,061,766 shares (1971)	**2,542,382**	2,123,532
Other paid-in capital	**4,437,970**	3,372,559
Retained-earnings (deficit)	**(1,823,123)**	(3,423,440)
	5,513,999	2,493,204
COMMITMENTS AND CONTINGENCIES—Note G		
	$36,495,817	$34,654,439

See Notes to Financial Statements.

Statement of Changes in Financial Position

Southern Airways, Inc.

Years ended December 31,	1972	1971
FUNDS PROVIDED		
From operations		
Income (loss) before extraordinary credit	**$ 1,191,067**	$ (1,058,784)
Items not requiring outlay of working capital in current period		
Depreciation	**2,039,695**	2,094,991
Increase in allowance for maintenance	**544,721**	322,946
Amortization of deferred charges	**382,153**	484,478
Deferred income tax (credit)	**—**	(235,000)
Total from operations, exclusive of extraordinary credit	**4,157,636**	1,608,631
Extraordinary credit	**409,250**	—
Long-term borrowings	**2,952,130**	787,757
Sale of Preferred Stock	**—**	2,637,379
Exercise of Common Stock Purchase Warrants	**145,314**	—
Conversions to Common Stock		
Debentures	**1,337,000**	—
Series A Preferred Stock	**63,783**	36,895
Property and equipment sold or converted to lease, less gain included above	**92,368**	588,915
Refund of equipment purchase and lease deposits	**—**	490,000
	9,157,481	6,149,577
FUNDS USED		
Additions to property and equipment	**925,261**	1,409,959
Hijacking payment	**2,000,000**	—
Equipment purchase and lease deposits	**416,840**	—
Reduction of long-term notes payable	**2,249,146**	3,008,041
Conversions to Common Stock		
Debentures	**1,337,000**	—
Series A Preferred Stock	**63,783**	36,895
Increase in deferred charges	**13,887**	6,459
Increase in other assets	**18,669**	11,879
	7,024,586	4,473,233
INCREASE IN WORKING CAPITAL	**2,132,895**	1,676,344
Working capital at beginning of period	**3,391,353**	1,715,009
WORKING CAPITAL AT END OF PERIOD	**$ 5,524,248**	$ 3,391,353
INCREASE (DECREASE) IN WORKING CAPITAL BY COMPONENTS		
Cash and short-term investments	**$ 686,959**	$ 2,383,503
Accounts receivable	**998,034**	(1,084,513)
Maintenance and operating supplies	**(129,735)**	373,621
Prepaid expenses	**32,236**	282,946
Accounts payable	**(24,944)**	807,803
Collections and withholdings as agent	**(1,539,077)**	(670,743)
Salaries, wages and vacations	**(97,887)**	(315,014)
Accrued interest, taxes and other expenses	**588**	280,782
Air travel plan deposits	**4,250**	6,375
Current maturities of long-term debt	**2,202,471**	(388,416)
INCREASE IN WORKING CAPITAL	**$ 2,132,895**	$ 1,676,344

See Notes to Financial Statements.

Statement of Stockholders' Equity

Southern Airways, Inc.

Years ended December 31, 1972 and 1971	Preferred Stock $1 Par Value Series A	Preferred Stock $1 Par Value Series B	Common Stock $2 Par Value	Other Paid-In Capital	Retained-Earnings (Deficit)
Balance, January 1, 1971	$ –	$ –	$2,049,742	$1,229,523	$(2,364,656)
Net loss	–	–	–	–	(1,058,784)
Preferred Stock sold	290,781	166,667	–	2,179,931	–
Common Stock issued upon Conversion of Preferred Stock	(36,895)	–	73,790	(36,895)	–
Balance, December 31, 1971	253,886	166,667	2,123,532	3,372,559	(3,423,440)
Net income	–	–	–	–	1,600,317
Common Stock issued upon:					
Conversion of Preferred Stock	(63,783)	–	127,566	(63,783)	–
Conversion of $1,000,000 principal amount of 6-1/2% Convertible Subordinated Debentures, less $53,692 deferred finance cost	–	–	200,000	746,308	–
Conversion of $337,000 principal amount of 5-3/4% Convertible Subordinated Debentures, less $8,144 deferred finance cost	–	–	62,046	266,810	–
Exercise of stock purchase warrants	–	–	29,238	116,076	–
Balance, December 31, 1972	$190,103	$166,667	$2,542,382	$4,437,970	$(1,823,123)

See Notes to Financial Statements.

Notes to Financial Statements

December 31, 1972

Report of Independent Accountants

Board of Directors
Southern Airways, Inc.
Atlanta, Georgia

We have examined the balance sheet of Southern Airways, Inc. as of December 31, 1972 and 1971, and the related statements of operations, stockholders' equity, and changes in financial position for the two years ended December 31, 1972. 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.

In our opinion, subject to the recovery of the hijacking payment as explained in Note B to the financial statements, the accompanying balance sheet and statements of operations, stockholders' equity, and changes in financial position present fairly the financial position of Southern Airways, Inc. at December 31, 1972 and 1971, and the results of its operations, changes in stockholders' equity and changes in financial position for the two years ended December 31, 1972, in conformity with generally accepted accounting principles applied on a consistent basis.

Ernst & Ernst
Ernst & Ernst

Atlanta, Georgia
January 31, 1973, except as to Note C as to which the date is February 28, 1973

NOTE A—SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

PROPERTY, EQUIPMENT, DEPRECIATION, AND OBSOLESCENCE—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.

At the time properties are retired, the amounts of cost and allowances for depreciation and maintenance are eliminated from the accounts. Profits and losses on disposals of DC-9 flight equipment (exclusive of rotable parts) are credited or charged to operations. Proceeds from the disposal of DC-9 rotable parts and Martin 404 aircraft are credited to the allowance for depreciation account. The Company is engaged in a program of reducing the use of the Martin 404 aircraft, the net investment in which amounted to approximately $2,835,000 and $3,793,000 at December 31, 1972 and 1971, respectively.

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.

A provision for obsolescence of the investment in minor spare parts inventory for DC-9 aircraft is made at an annual rate of 4% and for Martin 404 aircraft at a rate sufficient to fully write off such investment by December 31, 1973.

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. Deferred charges associated with long-term debt are being amortized over the lives of the financing arrangements.

INCOME TAXES—Taxes are provided at current tax rates for all items included in the statement of operations regardless of the years when such items are reported for tax purposes.

The Company uses the flow-through method of accounting for investment credit and the available investment credit is recognized to the extent it can be realized or offset against current or deferred income taxes.

PENSION PLANS—The Company has several pension plans, including a defined contribution plan, covering substantially all of its employees. There are no unfunded past service costs. The Company's policy is to fund pension costs accrued.

NOTE B—HIJACKING PAYMENT

In November 1972, the Company paid $2 million in ransom in connection with the hijacking of one of its DC-9 aircraft. The aircraft, passengers and crew were returned to the United States, but the ransom money has been retained by the Republic of Cuba. Negotiations between representatives of the Company and the Cuban government are expected to result in the eventual return of the funds, although there can be no assurance of the return. The Company plans to continue to reflect the hijacking payment as an asset until the funds are returned or there is a determination that the funds will not be returned. Had the ransom money been deemed non-recoverable and written off as an extraordinary charge to income in 1972, the Company would have suffered a net loss of $359,433 ($.30 per share) and stockholders' equity would have been reduced to $3,554,249.

NOTE C—LONG-TERM DEBT

At December 31,	1972	1971
Notes payable to banks under old credit agreement (refinanced in 1973)	$ 7,238,016	$ 8,091,413
Demand notes payable to banks (refinanced in 1973)	2,000,000	–
Various notes payable under deferral agreement	–	2,135,257
Note payable to bank—other	–	510,833
Convertible Subordinated Debentures		
5-3/4%, due December 1, 1981	4,345,000	4,682,000
6-1/2%, with warrants attached, due November 1, 1983	7,000,000	8,000,000
	20,583,016	23,419,503
Less amounts due within one year	–	2,202,471
	$20,583,016	$21,217,032

On February 20, 1973, the Company entered into a credit agreement ("New Credit Agreement") pursuant to which certain banks will lend the Company amounts not to exceed a total of $39,000,000 under the following commitments:

(1) The "A" Loan Commitment in an aggregate principal amount of $27,000,000 to be used as 90 per cent of the purchase price of flight equipment to be purchased from Delta Air Lines, Inc. and others (see Note G). All such aircraft, engines and spare parts will be pledged as collateral on this indebtedness, which is also 90 per cent guaranteed by the Federal Aviation Administration. Borrowings under the "A" Commitment through February 28, 1973, amounted to $3,608,994.

(2) The "B" Loan Commitment in an aggregate principal amount of $10,000,000 to be used to repay existing bank indebtedness under the old credit agreement and the balance to be added to working capital. This loan is collateralized by all other property of the Company. At February 28, 1973, the Company had borrowed the full amount of the "B" Commitment which was used to retire the outstanding debt under the old credit agreement and the demand notes payable, and the balance was added to working capital.

(3) The "C" Loan Commitment in an aggregate amount of $2,000,000 to be reduced by $100,000 per quarter beginning March 31, 1973. Such Commitment will also be reduced by recoveries of the hijacking payment discussed in Note B. At February 28, 1973, no amounts had been borrowed under this Commitment.

Amounts borrowed under the "A" and "B" Commitments on revolving credit notes may be converted to term loan notes payable in quarterly installments beginning July 1, 1974, and May 1, 1974, respectively. The "A" and "B" loan amounts bear interest at the lead bank's prime rate (6-1/4% at February 28, 1973) plus 1% and 2%, respectively. Amounts borrowed under the "C" Commitment are due in quarterly installments and bear interest at 155% of the lead bank's prime rate. The Company has agreed to pay a commitment fee of 1/2 of 1% per annum on the daily average unused amount of the Credit Commitment beginning December 29, 1972.

The 5-3/4% Convertible Subordinated Debentures due December 1, 1981, are convertible (until maturity or prior redemption) into Common Stock at $10.86 per share; are subordinated, generally, to all existing and future indebtedness for borrowed money; are callable at premiums ranging from 3-3/4% 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.

The 6-1/2% Convertible Subordinated Debentures due November 1, 1983, are convertible (until maturity or prior redemption) into Common Stock at $10 per share; are issued in integral multiples of $1000 with an attached warrant for the purchase of 18 shares at $10 a share; are subordinated, generally, to all existing and future indebtedness for borrowed money; are callable on or after November 1, 1973, at premiums ranging from 6-1/2% 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.

The terms of the "Old Credit Agreement," "New Credit 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) capital expenditures, (d) net worth and (e) payments relating to capital stock, including dividends (no amount was available for the payment of dividends at December 31, 1972).

Since the Company repaid in February 1973 the amounts due under its old credit agreement and the $2,000,000 of demand notes payable from proceeds of the "B" Loan Commitment, current maturities of indebtedness at December 31, 1972, have been determined in accordance with terms of the "B" Loan Commitment.

A summary of minimum principal payments applicable to the "New Credit Agreement" (if all funds available are borrowed) and both issues of Convertible Subordinated Debentures is as follows:

	New Loan Commitment				
Year	**"A"**	**"B"**	**"C"**	**Subordinated Debentures**	**Total**
1973	$ –	$ –	$ 400,000	$ –	$ 400,000
1974	1,600,000	750,000	400,000	–	2,750,000
1975	3,200,000	1,000,000	400,000	–	4,600,000
1976	3,200,000	1,150,000	400,000	434,500	5,184,500
1977	3,200,000	1,200,000	400,000	434,500	5,234,500
Thereafter	15,800,000	5,900,000	–	10,476,000	32,176,000
Total	$27,000,000	$10,000,000	$ 2,000,000	$11,345,000	$50,345,000

Prepayments equal to 25% of net income in excess of $1,500,000 plus 50% of net income in excess of $3,000,000 earned in any fiscal year beginning January 1, 1974, will be required under the "B" Note. The above summary of minimum principal payments does not reflect the possible effect of any such prepayment.

NOTE D—INCOME TAXES

At December 31, 1972, operating loss carryforwards to future periods for income tax purposes aggregate approximately $4,108,000 and expire in 1977 ($2,374,000) and 1978 ($1,734,000). The operating loss carryforward for financial statement purposes at December 31, 1972, is approximately $2,208,000. Investment credit carryovers, which may be used to offset federal income tax payable in future income tax returns, aggregate $1,287,000 and expire in 1976 ($65,000), 1977 ($810,000), 1978 ($64,000) and 1979 ($348,000).

The Company plans to change the depreciation method and lives applicable to certain assets for income tax purposes prior to the expiration of existing operating loss carryforwards. Because of these changes and the carryforward of the 1971 operating loss, 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.

NOTE E—CAPITAL STOCK AND OPTIONS

The stockholders approved an amendment to the Company's charter in May 1971 to increase authorized 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.

The Series A and Series B Preferred Stock (authorized in June 1971) is convertible into Common Stock on a share-for-share basis, can be redeemed after July 1, 1976 at $6 per share plus accumulated dividends, and is entitled upon liquidation to $6 per share plus accumulated dividends. The liquidation preference for the 356,770 shares outstanding at December 31, 1972, including the dividend requirement described below, aggregated $2,269,057, which is $1,912,287 more than the aggregate par value of such shares.

Each share of Preferred Stock is entitled to receive annual dividends of $.36 per share, cumulative only to the extent of annual net profits. Since the shares were issued in 1971, a loss year, no dividend had accumulated prior to December 31, 1972. The annual dividend requirement on shares outstanding at December 31, 1972, aggregates $128,437. Payment of dividends is subject to the limitations prescribed by the indentures covering the 5-3/4% and 6-1/2% Convertible Subordinated Debentures and to limitations contained in the old and new credit agreements (see Note C).

Authorized common shares include 2,110,092 shares and 2,323,125 shares reserved at December 31, 1972 and 1971, respectively, for issuance as follows:

	1972	1971
For convertible securities conversions		
5-3/4% Convertible Subordinated Debentures (Note C)	400,093	431,124
6-1/2% Convertible Subordinated Debentures (Note C)	700,000	800,000
Series A Convertible Preferred Stock	190,103	253,886
Series B Convertible Preferred Stock	166,667	166,667
	1,456,863	1,651,677
For exercise of outstanding warrants		
At $10 per share (issued with 6-1/2% Convertible Subordinated Debentures—Note C)	126,000	144,000
At $6 per share (issued with Series A—290,562 shares in 1972 and 290,781 in 1971—and Series B—166,667 shares Convertible Preferred Stock)	457,229	457,448
	583,229	601,448
For options under Qualified Stock Option Plan (45,000 shares) and Employee Stock Option Plan (25,000 shares)	70,000	70,000
	2,110,092	2,323,125

At December 31, 1972, there were outstanding options for 38,000 shares of Common Stock under the Company's Qualified Stock Option Plan, of which options for 4,000 shares (at $8.69 to $11.76 per share) expire in 1974 and options for 34,000 shares (at $5.25 per share) expire in 1976. Option transactions during the two years ended December 31, 1972, are summarized as follows:

	Number of Shares	Option Price Per Share	Option Price Total
Outstanding, January 1, 1971	9,000	$8.69-$19.18	$108,691
Granted	36,000	$5.25	189,000
Cancelled	(1,000)	$11.76	(11,760)
Outstanding, December 31, 1971	44,000*	$5.25-$19.18	285,931
Granted	1,000	$5.25	5,250
Expired	(1,000)	$19.18	(19,180)
Cancelled	(6,000)	$5.25-$13.75	(49,751)
Outstanding, December 31, 1972	38,000*	$5.25-$11.76	$222,250

**Excludes options for 4,000 shares (1972) and 8,000 shares (1971) at $5.25 per share which become effective only after expiration of previously issued options.*

There were 7,000 shares and 1,000 shares, respectively, available for future grant at December 31, 1972 and 1971.

Options granted under the Plan are intended to constitute "qualified stock options" as defined in Section 424 (b) of the Internal Revenue Code of 1954, as amended. Options are exercisable at not less than 100% of the fair market value of the stock on the day of grant, terminate not later than five years after date of grant, and are not exercisable during the first 24 months after date of grant. Each option is exercisable with respect to 1/3 of the number of shares at any time after 24 months following date of grant, with respect to an additional 1/3 after 36 months, and with respect to the balance after 48 months. No options were exercised in 1972 or 1971. Options became exercisable during the years ended December 31, 1972 and 1971, as follows:

	1972	1971
Number of shares	2,000	2,998
Option Price		
Per Share	$8.69-$11.76	$8.69-$19.18
Total	$21,403	$36,214
Quoted Market Price at Date Exercisable		
Per Share	$6.38- $9.13	$4.13-$6.75
Total	$15,336	$17,314

A total of 25,000 shares of Common Stock are reserved for issuance to participating employees under an Employees' Stock Option Plan (an employee stock purchase plan as defined by Section 423 (b) of the Internal Revenue Code of 1954). This plan is currently inactive and there are no participants.

The Company makes no charge to income with respect to options.

NOTE F—PENSION PLANS

Pension expense for the years ended December 31, 1972 and 1971 was $1,211,687 and $868,779, respectively. Effective July 1, 1972, the Company modified one of the plans to provide for improved benefits, with a related increase in annual pension expense of approximately $230,000.

NOTE G—COMMITMENTS AND CONTINGENCIES

The Company has entered into an agreement with Delta Air Lines, Inc. to purchase 13 used DC-9-14 jet aircraft, 4 spare engines and certain other spare parts and equipment. The base price of each aircraft is $1,800,000, subject to certain adjustments. The total consideration, including all related parts and equipment to be purchased from Delta and others is expected to approximate $30 million. It is anticipated that delivery of the aircraft will be completed by October 1, 1973. (See Note C for financing arrangements.)

At December 31, 1972, the Company was leasing eleven DC-9 jet aircraft under leases expiring in 1979 through 1983 at a minimum annual rental of approximately $4,722,000. The Company also leases certain office, ticketing, hangar, computer and shop facilities with minimum aggregate annual rentals of approximately $1,922,000 under various leases with expiration dates through 1992.

In November 1972, the Company entered into a new five-year agreement to receive passenger reservations services. At current traffic levels, the annual charge under the agreement will approximate $600,000.

The Company is the defendant in a number of law suits. In the opinion of management and legal counsel there is adequate insurance coverage for such of those suits as are being defended by the Company's insurance carriers. In the opinion of management, the other suits will have no material effect on the financial statements for 1972.

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 $55,000. In addition, upon his retirement, the Company has agreed to pay $1,250 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 H—EARNINGS (LOSS) PER SHARE

Primary earnings per share for the year ended December 31, 1972, were computed by dividing net income (adjusted as described below and reduced by the preferred dividend requirement) by the weighted average number of common shares and common equivalent shares outstanding during the year—a total of 1,439,517 shares. Common equivalent shares comprise that number of common shares issuable upon exercise of stock options and warrants (exclusive of warrants for 126,000 shares issued prior to June 1, 1969) in excess of 20% of the number of common shares outstanding at December 31, 1972. Proceeds from the assumed exercise of the options and warrants in excess of the amount which would have been required to purchase 20% of the outstanding Common Stock at the average market price during the period were assumed to have been applied to debt reduction and the related interest (net of income tax effect, where applicable) was added to income for purposes of the calculation.

Fully diluted earnings per share for the year ended December 31, 1972, were determined on the assumption that the weighted average number of common and common equivalent shares was further increased from the beginning of the period by conversion of outstanding convertible debentures and convertible preferred stocks and by exercise of warrants issued prior to June 1, 1969—a total of 3,098,588 shares. This calculation also assumes no preferred dividend requirement, and interest (net of income tax effect, where applicable) related to the debentures assumed converted and debt assumed to be retired from the exercise proceeds of the additional warrants was added to income for purposes of the calculation.

For the year ended December 31, 1971, loss per share was computed by dividing net loss by the weighted average number of common shares outstanding (1,035,048 shares). Due to the loss, there was no preferred stock dividend requirement and assumed conversion of convertible securities or exercise of stock options or warrants would not have increased the loss per share.

NOTE I—SUPPLEMENTARY INFORMATION

	1972	1971
Depreciation and Amortization		
Depreciation of property and equipment	$2,039,695	$2,094,991
Amortization of deferred charges	382,153	484,478
Provision for inventory obsolescence	233,030	182,617
	2,654,878	2,762,086
Deduct—Amounts charged to other operating accounts	95,849	125,354
	$2,559,029	$2,636,732
Taxes, other than income taxes, charged to operating expenses		
Payroll taxes	$1,017,480	$ 804,765
Fuel and oil taxes	176,755	161,003
Property taxes	340,800	327,568
Sales and use taxes	166,254	130,412
Other	103,528	95,020
	$1,804,817	$1,518,768
Rents (including landing fees and rental at airports served)	$8,327,509	$7,610,311
Advertising costs	$ 976,576	$1,102,715

There were no royalties or research and development costs.

Going your way

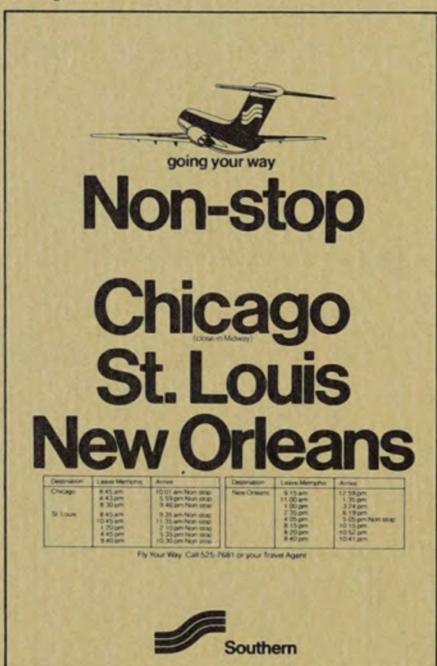
Southern's advertising effort is being expanded for 1973 with emphasis on destinations, frequency of service, and a reminder that "Southern is going your way."

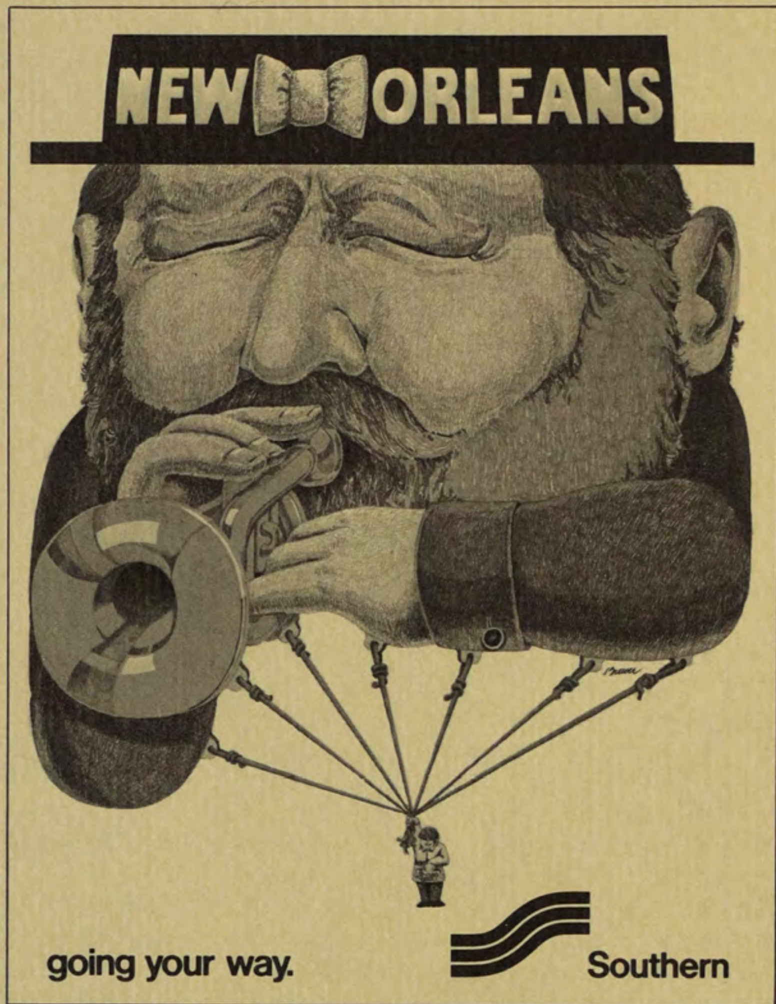
Emphasis is being placed on newspaper ads supported by prime time radio, and in some cities, television.

The aim is the business traveler who frequents our system Monday through Friday and who revels in our resort attractions on the weekends.

Ads like this, 5 newspaper columns wide, are appearing in New York and St. Louis.

Newspapers throughout Southern's system are carrying similar ads in large format.





Southern is introducing a series of colorful posters depicting key vacation destinations.

Television commercials are appearing in Birmingham, Jackson, Miss.; Jacksonville, Memphis, Mobile, Nashville, Orlando, and other cities.

Being a good corporate neighbor is a Southern goal and it means many things. Like our people taking an active part in civic work in the 67 cities we serve. Or our employee contributions to more than a dozen charitable organizations. Or a pilot using his holiday to conduct a tour for a group of youngsters who want to see their first airplane. Or stewardesses working with civic groups when they need help in putting on a program to raise money for some distraught group. Or a secretary writing a personal note to a little boy in Yugoslavia and sending him the airplane picture he asked for. Or Southern flying a delicate box so an eye transplant can be made successfully. We do this. And more.

The Southern Open, played at Columbus, Ga.'s Green Island Country Club, is becoming a major stop for golf's touring pros. Dewitt Weaver, 1972 winner, receives his prize check from Southern President Frank W. Hulse.

Thousands of children in Pennsylvania's flood-wrought Wyoming Valley enjoyed a merrier Christmas thanks to a Southern charter flight carrying gifts and well-wishers from Mississippi's Gulf Coast.

Mobile's F. John Vandillion was presented his own personal stewardess when he became Southern's 2 millionth 1972 passenger, the first time this number has been reached in a single year.

Captain William R. Haas, left, receives a corporate resolution from President Frank W. Hulse acclaiming the skill and stamina displayed during a 30-hour hijacking of a Southern DC-9, November 10-11, 1972. Captain Haas has been praised throughout the world for his heroic efforts in bringing his passengers to safety.

Directors and Officers

Southern's $18 million maintenance base, to be completed in 1976, holds the attention of this senior management group including (seated, left to right), George M. Gross, J. W. Godwin, Graydon Hall, Frank W. Hulse, and (standing) Victor C. Pruitt, J. Kenneth Courtenay, A. L. Maxson, T. A. Wiley, Jr., and Frank H. Wheeler.

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.
A. F. Irby & 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, Inc., Memphis, Tennessee

ELTON B. STEPHENS
EBSCO Industries, Inc., Birmingham, Alabama

RICHARD A. TRIPPEER, JR.
R. A. Trippeer, Inc., Memphis, Tennessee

WM. BEW WHITE, JR.
Bradley, Arant, Rose & White, Birmingham, Alabama

Executive Committee

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

Officers

FRANK W. HULSE
President

GRAYDON HALL
Executive Vice President and General Manager

GEORGE M. GROSS
Vice President and Associate General Manager

J. KENNETH COURTENAY
Vice President – Economic Regulations and Secretary

J. W. GODWIN
Vice President – Flight Division

A. L. MAXSON
Vice President – Fiscal Division and Treasurer

VICTOR C. PRUITT
Vice President – Technical Services

FRANK H. WHEELER
Vice President – Sales and Services

THOMAS A. WILEY, JR.
Vice President – Marketing

RAY W. BURDEN
Assistant Treasurer

JAMES H. ISHEE
Controller

OWEN L. McREE
Assistant Vice President – Sales and Services

WILLIAM E. OAKES
Assistant Vice President – Economic Research

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

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

CECIL A. BEASLEY, JR.
Assistant Secretary

MRS. MARY C. HAYES
Assistant Secretary

WM. BEW WHITE, JR.
Assistant Secretary

Going your way: the fun way

Southern

SOUTHERN AIRWAYS, INC. 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 · Printed by Stein Printing Co., Atlanta, Georgia