
Southern
Southern
Southern Airways, Inc.
1974 Annual Report

SOUTHERN AIRWAYS, INC. TAKES PLEASURE IN ANNOUNCING A 1974 PROFIT OF $3,482,000.

Financial and Operating Highlights

Years ended December 31	1974	1973	Gain(Loss)%
Passenger revenues	$ 86,821,000.00	$65,949,000.00	31.6
Operating revenues	$108,352,000.00	$84,609,000.00	28.1
Operating income	$ 6,883,000.00	$ 1,489,000.00	362.3
Net income	$ 3,482,000.00*	$ 417,000.00*	735.0
Primary earnings per share including extraordinary credit	$ 2.19*	$ 0.23*	852.2
Yield per passenger mile	$ 0.104	$ 0.091	14.3
In scheduled service: Revenue passenger miles	832,372,000	721,135,000	15.4
Available seat miles	1,618,776,000	1,643,569,000	(1.5)
Passenger load factor	51.4%	43.9%	17.1
Revenue passengers carried	2,940,000	2,494,000	17.9
Revenue plane miles flown	24,621,000	25,492,000	(3.4)
Number of employees	2,639	2,478	6.5

**Includes in 1974 the cumulative effect of an accounting change which increased net income by $565,000; and in 1973 gains totaling $1,968,000 from the sale of aircraft. Amounts should be read in conjunction with Management's Discussion and Analysis of the Statement of Operations beginning on page 7A and with Notes to Financial Statements beginning on page 20A.*

Southern

General Office: Hartsfield Atlanta International Airport • Atlanta, Georgia 30320 • Phone 404/766-5321

Southern

SOUTHERN AIRWAYS, INC. 1974 ANNUAL REPORT • VOLUME 25, NO. 1

Grand Cayman sunset.

Answering 12,000 calls daily.

Visitors relax on Grand Cayman.

Fezler wins 1974 Southern Open.

General Information

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: McDonald & Little, Inc., Atlanta, Georgia · Designed and printed by Stein Printing Co., Atlanta, Georgia.

Directors

Ivan Allen, Jr., *Chairman of the Board, Ivan Allen Company, Atlanta, Georgia;* Cecil A. Beasley, Jr., *Partner, Ballard & Beasley, Attorneys, Washington, D.C.;* George M. Gross, *Vice President and Associate General Manager, Southern Airways, Inc.;* Graydon Hall*, *Executive Vice President and General Manager, Southern Airways, Inc.;* F. Barton Harvey, Jr., *Partner, Alex. Brown & Sons, Investment Bankers, Baltimore, Maryland;* Frank W. Hulse*, *President, Southern Airways, Inc.;* Alton F. Irby, Jr., *Chairman of the Board, A. F. Irby & Company, Atlanta, Georgia;* Henry P. Johnston, *Radio and Television Consultant, Birmingham, Alabama;* G. Gunby Jordan*, *Chairman of the Board, The Jordan Company, Columbus, Georgia;* Sartain Lanier, *Chairman of the Board, Oxford Industries, Inc., Atlanta, Georgia;* R. Eugene Orr, *President, Orr & Company, Inc., Jacksonville, Florida;* G. Frank Purvis, Jr., *President, Pan American Life Insurance Company, New Orleans, Louisiana;* F. D. Schas†, *Retired Investment Counselor, Memphis, Tennessee;* Elton B. Stephens*, *Chairman of the Board, EBSCO Industries, Inc., Birmingham, Alabama;* Richard A. Trippeer, Jr., *President, Union Planters National Bank, Memphis, Tennessee;* Wm. Bew White, Jr.*, *Partner, Bradley, Arant, Rose & White, Attorneys, Birmingham, Alabama.*

**Member of Executive Committee*
†Senior Director

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;* A. L. Maxson, *Vice President—Finance and Treasurer;* Victor C. Pruitt, *Vice President—Technical Services;* T. M. Shanahan, *Vice President—Flight;* Frank H. Wheeler, *Vice President—Sales and Services;* Thomas A. Wiley, Jr., *Vice President—Marketing;* Ray W. Burden, *Assistant Treasurer;* James H. Ishee, *Controller;* J. Philip Day, *Assistant Vice President—System Planning;* 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;* Cecil A. Beasley, Jr., *Assistant Secretary;* Mary C. Hayes, *Assistant Secretary;* Wm. Bew White, Jr., *Assistant Secretary.*

COVER: Sunsets are colorful along Seven Mile Beach on Grand Cayman Island. Australian pines frame the setting.


SOUTHERN AIRWAYS


Southern

Frank W. Hulse

Report to Southern Stockholders

Again this year, our Annual Report includes the Form 10-K, a detailed analysis of corporate activities required to be filed annually with the Securities and Exchange Commission. Our inclusion of this last year was widely accepted among our stockholders and members of the financial community. This thorough method of reporting was further recognized when our 1973 Report was selected the best corporate report in the Southeast by a chapter of the Advertising Federation of America. It always has been our practice to furnish our stockholders and the public the most complete and timely information possible. We will continue to do so.—F. W. H.

With a great deal of pride and personal satisfaction, I am making this 25th report to our stockholders.

Your Company now is in its second quarter-century. We serve much of the eastern-half of the United States and into the Caribbean. We have completed our most successful year in terms of revenues, profits, overall financial improvement, route expansion, and growth on our previously served routes.

Because of these improvements, we have been able to pay the 1972 and 1973 dividends on our preferred stock, substantially improve the position of our employees, upgrade our ground facilities, virtually complete a program for refurbishing our jet fleet, and further modernize our methods and systems used in serving our customers.

Among all scheduled passenger airlines in the United States, our 1974 rate of return on investment was the third highest, coming within two-hundredths of a per cent of second place.

A major contributor to this success is the high level of efficiency and dedication displayed by our employees. Historically our employee output has been among the highest in the industry. Our improved position has enabled us to recognize this output, and Southern personnel enjoy excellent working conditions, outstanding fringe benefits, and realistic wages.

Having a substantial effect on our future are route actions taken during the past year by the Civil Aeronautics Board.

One of the most important routes yet awarded to Southern is for non-stop service between Nashville, Tennessee, and Detroit, Michigan.

Southern acquired international status as a result of a temporary Civil Aeronautics Board authorization to provide scheduled service between Miami, Florida, and the Cayman Islands, British West Indies. We are seeking permanent authority and are hopeful of receiving it.

Because of good highways and large airports nearby, service was discontinued during 1974 at Anderson and Greenwood, South Carolina, as well as Shelbyville-Tullahoma and Crossville, Tennessee. We will continue supporting service to Natchez, Mississippi, through an agreement with a third-level carrier. We believe this arrangement will adequately serve the area's needs.

During the first two months of 1975, we have found it necessary to make cost reductions and reduce schedules to reflect current traffic levels. We expect these schedule changes to improve load factor, but at the same time, provide our travelers with good frequency and schedule times.

Among our major cost reduction areas is our continuing effort to reduce fuel consumption. Programs implemented in 1974 continue to produce highly desirable results.

We recognize that factors contributing to high growth rates in traffic in 1974 will not carry into the current year. To overcome present economic problems, we are considering innovative fares, new promotional plans, and a continued upgrading of our service.

We have entered our second quarter-century with the same optimism we expressed in 1949.

Respectfully,

Frank W. Hulse
April 8, 1975





Southern Business

Southern Airways' 1974 results are analyzed. Included is a report on the airline's encouraging outlook.

Southern Airways, Inc. achieved quarter-century status in 1974. Accompanying this were record earnings and significant route awards that placed Southern in additional profitable markets as well as giving the airline international standing.

Southern also earned a record net profit of $3,482,000 for the year. The Company's most profitable year previously had been 1972 with earnings of $1,600,000. In 1973, profits totaled $417,000.

Revenues gained 28.1 per cent in 1974, to $108,352,000, compared with $84,609,000 a year earlier. This was the first time Southern exceeded the $100,000,000 mark.

Of the 1974 profit, $565,000 resulted from an accounting change, and $325,000 was contributed by an extraordinary tax credit. The accounting change was a "one time only" credit to convert Southern from an accrual method of accounting for jet engine overhauls to an expense-as-incurred method. The tax credit was the last of the net loss carry-forward available.

Based on the Civil Aeronautics Board accounting method, Southern's 1974 profit was equivalent to a 15.7 per cent return on investment. This compares with a 9.1 per cent return in 1973.

Profit per share in 1974 was $2.19 on a primary basis and $1.40 fully diluted. The common and common equivalent shares used to determine primary and fully diluted earnings per share were 1,598,882 and 2,913,090 respectively.

Revenues

Passenger revenues rose to $86,821,000 as a result of a 15.4 per cent gain in revenue passenger miles flown (one passenger flown one mile) and a 14.3 per cent increase in yield (revenue for one passenger flown one mile). The 1974 yield of 10.4 cents established a new high for Southern. Fare increases contributed to an increase in yield, as did the elimination of a number of discount fares.

Passenger traffic during the first half of 1974 was favorably affected by an automobile gasoline shortage which diverted highway travel to the airlines. A strong summer season further added to passenger growth through the first three quarters of the year.

Also contributing to revenue increases was a record level of cargo sales amounting to $5,136,000 for the year. This resulted from increased sales emphasis on this important income area.

Charter revenues were influenced by 125 flights to Canada, the Bahamas and to the Cayman Islands in the British West Indies. Southern developed $6,908,000 in charter revenues, much of which resulted from flights operating at hours other than during scheduled service.

Public service and other revenues totaled $9,487,000.

Expenses

Despite the encouraging increases in revenues, costs also increased at a rapid rate. Total operating costs increased 22.1 per cent in 1974, compared with 1973, primarily because of a $6,155,000 rise in fuel and a $6,574,000 increase in wages and salaries. Operating cost per available seat mile (one seat available for sale flown one mile) increased 21.6 per cent.

A major contributor to minimizing cost increases was jet fuel savings that resulted from improved flying techniques and technological advancements. This enabled Southern to conserve some three million gallons of fuel in 1974.

Capital Expenditures

Capital spending in 1974 was limited to $1,908,000, primarily representing increases in aircraft spare parts and ground support equipment. No aircraft purchases were made in 1974, although options were taken to acquire three 95-passenger DC9-30 aircraft for delivery in 1976. Three Martin 404s were removed from service. Southern's current fleet level is 21 75-passenger DC9-10 aircraft, four 95-passenger DC9-30s, and 11 40-passenger Martin 404s.

Financial Position

The 1974 profit contributed to a strong year-end cash position amounting to $11,895,000. Investment of these funds produced income of $578,000 during the year.

Southern continued to improve its corporate financial structure and reduce debt-to-equity ratio. Profits changed a $1,406,000 retained earnings deficit to a positive $1,827,000. Stockholders' equity gained $3,233,000. Further improving the debt-to-equity ratio in 1974 was debt repayment totaling $7,951,000.





The 1972 and 1973 dividends due on Series A and Series B preferred stock were paid in December 1974. No action has been taken on the 1974 dividend. Through a secondary offering, the 166,667 shares of Series B Convertible Preferred Stock were sold to more than 800 individual Southern employees. These shares subsequently were converted into common shares on December 31, 1974. In addition to increasing publicly held common shares and eliminating an entire class of preferred stock, this transaction increased the number of employee stockholders to more than one-third of Southern's employees. Total common stockholders increased from 4,495 in December 1973 to 5,333 in December 1974.

Improved Services

Benefiting from its improved financial position, Southern has made significant progress in expanding and modernizing facilities for serving customers.

At Memphis, Tennessee, Southern has become the number two carrier among 10. To accommodate the increasing passenger demand, Southern has acquired larger ticket counter space and now occupies a total of 10 gates with accompanying passenger waiting areas. Currently, Memphis is second only to Atlanta, Georgia, in number of passengers boarded by the company.

In New Orleans, Louisiana, Southern recently relocated in a new terminal wing. This permitted needed expansion of ticket counters and gate areas. New Orleans is Southern's third largest city, based on passenger boardings.

Typical of the growth among smaller cities on the Southern system is the new terminal at Pine Belt Regional Airport serving Laurel and Hattiesburg, Mississippi. Previously, separate service was provided to each city. As a result of the joint airport development, the area now accommodates Southern's DC9 aircraft. In turn, during the first two months of 1975, the new regional airport served 158.4 per cent more passengers than in the similar period in 1974 when separate airports were operated.

Fort Walton Beach, Florida, a major vacation destination on the Gulf of Mexico, is provided air service at Eglin Air Force Base. Terminal facilities long have been inadequate to serve this growing area. A modern terminal has been opened, built on county-owned property adjoining Eglin A.F.B. This now is among the most functional and attractive facilities on the Southern system.

A new terminal has been built at Knoxville, Tennessee; and Southern occupies prime space, offering excellent corporate identity and passenger convenience.

Although Southern expects to move in three years to a new terminal complex at Hartsfield Atlanta International Airport, substantial improvements have been made in presently occupied facilities, both in the area of passenger comfort and general appearance. Also, at Hartsfield International, Southern soon will occupy expanded freight facilities that are expected to increase customer use as well as improve handling procedures.

In addition to airport improvements, Southern has significantly upgraded the level of service provided individual passengers. During the past two years, Southern has operated one of the most advanced computerized reservations systems in the airline industry. Added to this is an itinerary pricing and automated fare quotation system. Individual passenger tickets are produced by computer and printed in seven seconds. This reduces delays for passengers and increases employee efficiency.

This automation substantially decreases the time required to book a reservation. Currently, reservations agents answer incoming calls, on an average, in less than 15 seconds. The average time for handling each passenger has been reduced to two and one-half minutes.

A new advertising program, begun in mid-1974, has been aimed at Southern's sustaining market, the business traveler. The new theme, "Nobody's Second Class on Southern," was developed to communicate Southern's single class service, the roomier seating arrangement used on Southern aircraft, and the overall upgrading of service and facilities. Response to the campaign has been strong.

Technological Expansion

As part of the continued program to reduce costs and improve efficiency, Southern expanded capability for in-house repairs and fabrication of support parts.

Further improving Southern's service to its customers will be a $25,625,000 maintenance and training facility under construction at Hartsfield Atlanta International Airport. The project is funded by City of Atlanta Airport Revenue

Southern Business *continued*

Bonds and Southern has leased the 45-acre development for 30 years with a 20-year option.

The training center is scheduled for occupancy in October 1975 and the maintenance base will be completed by August 1976.

Included in the facility is a jet engine test cell that will be completed in October 1975. This will eliminate the need to send engines to a testing facility in Miami. Previously, this procedure required three days. Upon completion of the facility, this work can be accomplished in Atlanta in five hours.

Expanded Routes

Contributing to the need for improvement in ground and service facilities have been recent route awards which are expected to be major profit contributors in the future.

On December 4, 1974, Southern implemented service to Detroit, Michigan, and to the Cayman Islands, B.W. I. The Detroit route is expected to be one of the most significant, in terms of profit, yet received.

Southern had sought Nashville-Detroit service for more than four years. Prior to the route being awarded, this was the largest major domestic city-pair market without direct air service. Travel between these points previously required a change of planes and more than three hours travel time. Travelers now can be accommodated on this non-stop route in just over one hour.

In granting the route between Nashville and Detroit, the Civil Aeronautics Board called attention to Southern's success in expanding service to St. Louis, Missouri, and to Chicago, Illinois. The Board determined that Southern could benefit more passengers than could other carriers seeking the route, based on the number of cities Southern serves south of Nashville.

The Cayman Islands entry is Southern's first scheduled service as an international carrier and offers an opportunity to develop a kind of vacation market not previously available to Southern's customers.

Prior to starting scheduled service to the islands, Southern operated more than 50 charter flights to the Cayman Islands and this experience was highly valuable in Southern's introducing service to this group of Caribbean islands.

A city ticket office has been opened in downtown George Town, the capital city. This office, as well as the airport operation, is run by Caymanians under direction of a manager with long company experience.

Although operating under a temporary Civil Aeronautics Board authorization, the company is seeking permanent authority and believes it can make a major contribution to the development of tourism in the Cayman Islands, already recognized as a delightful vacation spot.

Another pattern of service expected to be of major importance to the company is the entry into Chicago's O'Hare Airport. This service began January 15, 1975, after a five-year effort to obtain city authority to operate at the city-owned airport.

Southern previously served only Chicago's Midway Airport. Because of the lack of connecting flights there, Midway travel is limited virtually to

people going to and from Chicago. O'Hare service now permits Southern's passengers to connect to flights throughout the United States as well as to international flights.

Southern's Outlook

While the long-term outlook for Southern is encouraging, particularly when considering the high quality route awards of recent years, 1975 will be a challenging year because of the poor economic climate in which the company must operate. Because of the overall decline of available traffic that began in the latter part of 1974, and has continued into 1975, an eight per cent reduction in staffing was instituted in January 1975. Schedules were reduced in February to eliminate low load factor flights, where the public's needs would not be affected adversely.

Additional emphasis is being placed upon the pleasure traveler, making this market aware of the services provided by Southern and making it easier to use Southern when dependable transportation is sought.

Southern will remain competitive with all fares. Currently being considered are innovative fare proposals designed to stimulate additional air travel. Southern serves many of the vacation and travel spots of the eastern half of the United States, as well as the Cayman Islands, and these markets offer a large development potential.

It is unlikely that the major boost in air travel resulting from automotive gasoline shortages in 1974 will be repeated in 1975. Nevertheless, a greater awareness of Southern as an alternative means of transportation will continue to attract passengers to the company.

Expenses in 1975 will be subject to inflationary pressures. Fuel prices will be negotiated when current contracts expire at mid-year. Wage increases will be incurred. Increases in costs are expected to be offset by a combination of greater efficiency, higher loads and fare adjustments.

The company will in the future, as it has in the past, participate in Civil Aeronautics Board route proceedings and aggressively pursue every opportunity to expand and upgrade the quality of its route system.

Southern has put it all together, a carefully operating, quickly reacting company that remains responsive to the needs and the attitudes of the public.

As a result, new customers are being attracted and old ones retained. For those who haven't seen the change, the airline has its own response.

"If you haven't flown Southern lately, you haven't flown Southern."

Southern's people make Southern Airways. Competent, dedicated, friendly men and women work to provide reliable, convenient passenger and cargo service. In support of this, Southern breaks ground, above right, for a $25,625,000 maintenance base and training center. Holding a drawing of the facility are (l-r) Frank W. Hulse, Victor C. Pruitt, Graydon Hall, George M. Gross, and Atlanta Mayor Maynard Jackson.

Illustration by Don Loehle

the going is easy and so is the staying

Southern serves vacationland. In 14 states, the District of Columbia and on one grand island. From Broadway to Pennsylvania Avenue, Miami Beach and downtown George Town. Along the Florida Panhandle and the man-made beaches of Gulfport and Biloxi to the French Quarter. Up the Mississippi to Memphis and its Blues. And to swinging St. Louis and lakeside Chicago. And there is Motown and Music Town. And a lot of America in between.

Southern Country.

Take the southern-most point. The Cayman Islands. They are less than 500 miles south of Miami but they are out of this world.

Here is a different kind of Caribbean island. No neon, no garish night clubs, no casinos, no hassle. Nothing but peace and harmony.

Three islands make up the Cayman Islands—Little Cayman, Cayman Brac and Grand Cayman, the largest. Grand Cayman is some kind of an island. A fun place to visit and a fun place to get to. Like flying there on Southern.

When you board in Miami for the hour-plus flight, you settle down with a glass of island punch. Then you select from a choice of snacks. Such as lobster tails, chicken with a sweet sauce, or a medley of fruit. Plus complimentary beverages.

And before you know it, you are clearing immigration and being greeted by a friendly taxi driver who speaks in a *patois* of the Queen's English.

Welcome to Grand Cayman. Now, you are ready to discover it.

In some respects, little has changed since Christopher Columbus first charted the island.

Grand Cayman is some 24 miles long, from four to eight miles wide. The population approximates 12,000. Unemployment is unknown, everyone smiles, and everyone is happy to have you in residence.

About the only time anyone raises a voice is to remind a tourist to drive on the left side of the road.

This comes from the Cayman's association with England. The residents are proud of their crown colony status, and their political and cultural ties with the Queen. The Union Jack forms part of the Cayman flag and, while the currency

Grand Cayman is an easy island to discover. Bikes with or without motors are a favorite means. A stop on every ride is the harbor in George Town where freighters tie up. Another stop is Mariculture. Here, sea turtles are farmed in a controlled environment.

is Cayman, it pictures Queen Elizabeth.

Even so, most Cayman customs have been localized. The islands have their own distinctive history—and future. The beginning came from volcanic eruptions which created the lava-like rock that abounds and forms much of the scenic coast line. The population came from wrecked mariners, freed slaves, expatriated Europeans, United Kingdom emigrants and fortunate Americans.

Columbus found the islands full of turtles and chose the name *Las Tortugas* —the turtles. Later, Spanish maps introduced the name Cayman, thought to evolve from the lizards on the island.

The first visitors were sailors stocking turtles as fresh meat. The first settlers came in the mid-1650s. They are thought to have been part of Oliver Cromwell's forces in Jamaica.

England acquired the islands in a 1670 treaty. A 1713 treaty ending privateering among England, France and Spain caused the Caymans to become a pirate haven. Edward Teach—Blackbeard—was a frequenter of the islands after plundering throughout the Caribbean.

While much of Cayman history is based upon legend, it is authenticated that land grants were made as early as 1734, with others following in 1741. An event of major significance occurred in 1788 when 10 merchant vessels wrecked off Grand Cayman. It is thought the lead ship first struck a reef, then fired a warning flare that was misinterpreted by the other captains. The disaster was named Wreck of Ten Sails.

It is believed the island's tax-free status came as a reward from the King of England for the islanders' aid to the shipwrecked crews. Today, there are no income, property or inheritance taxes.

The population increased slowly. In 1802 a census indicated 933 residents, one-half of which were slaves. A century later the residents had increased to 5,000, of which 1,500 were thought to be seamen.

Today, the Caymans continue to furnish seamen to ships throughout the world. Many men are away for a year or more, returning by air for long vacations before rejoining ships in distant ports.

The close affinity to the sea comes not only from following the sea as a vocation, but also the dependency upon the sea as a contributor to the islands' economy.

The Caymans produce little food and almost no commodities. Thus, import is vital, and sea and air routes support the islanders' needs. As there are no deep-water ports, only small freighters dock at George Town, the capital city. Cruise ships now call for brief visits, bringing tourists in by launch for an afternoon visit. Vacationers arrive by air. But it is the sea that attracts these tourists to the islands.

Grand Cayman is a water-lovers paradise. The beaches are wide and white. The water varies from deep blues to pastel greens. The diving and snorkeling are unrivaled. Lobsters are found at the end of a 12-foot dive and fishing on boats, beaches or docks is plentiful year-round.

This does not mean, however, that Grand Cayman is only for the active. It is the best do-nothing spot in the world. The pace is slow. For those who want to laze, comfortable hammocks sway easily amid the Australian pines in front of most hotels. The serenity is total.

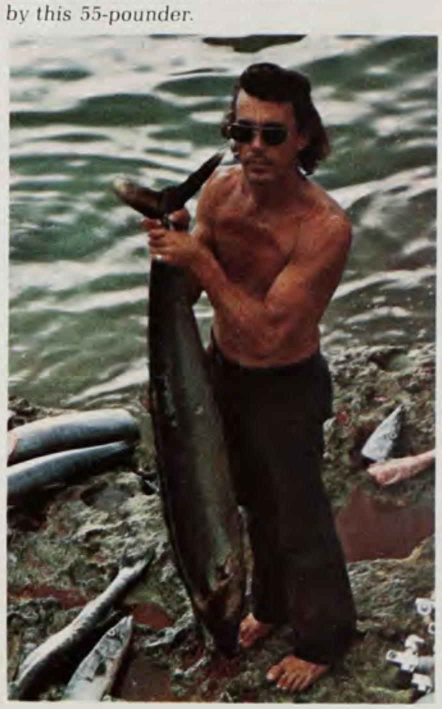
There are no crowds. Tourism is not crowd-oriented. It is soft-sell. You are not urged to come; you are simply promised a delightful vacation when you do come. In turn, hotels are generally small, and many are run in a casual but comfortable manner. Of course, there are exceptions for those seeking more opulence.

For maximum comfort and spaciousness, modern apartments and villas are available by day, week or lifetime.

As with most Caribbean resorts, the big season is between mid-December and mid-April. But off-season visits are just as pleasurable, and the prices are even more so.

This is an easy island. Easy to get to and easy to enjoy. The only hard thing about Grand Cayman is leaving, and Southern makes that as easy as possible.

Fish are abundant, as evidenced by this 55-pounder.



Relaxation and fun are yours in Orlando

There is more to Orlando, Florida, than a mouse and a duck. Even though Walt Disney World remains the number one attraction, tourists flying into this Central Florida resort city are within a short rental car ride of events varying between natural splendor and moon-soaring rocketry.

Good hotels and motels with family-attracting rates abound throughout the area. As a city with a strong economy, only partially dependent upon tourists, Orlando offers good restaurants at reasonable prices. The delightful year-round climate completes a perfect atmosphere.

Walt Disney World is not just for children. Adults marvel at the intricate productions.

Although few tourists need an excuse for an Orlando visit or stop-over, conventions utilizing the area's excellent meeting and activity centers are adding another reason. Companies throughout the country are choosing Orlando as a place to meet and a place for wives and children to play.

The attractions are many. Naturally, Walt Disney World is a "must" on everyone's list, and it is as much for adults as for children. It takes at least two days to grasp its wonders, and some visitors will want to spend their entire stay here.

Another stop on the must-see list is Ringling Bros. and Barnum & Bailey's Circus World Showcase. The thrill of the Big Top is enhanced by amazing photographic feats that required photographers to become trapeze artists, animal tamers, clowns and high wire performers.

America the Beautiful

The beauty still is natural in the Great Smoky Mountains National Park. And the bears still roam wild.

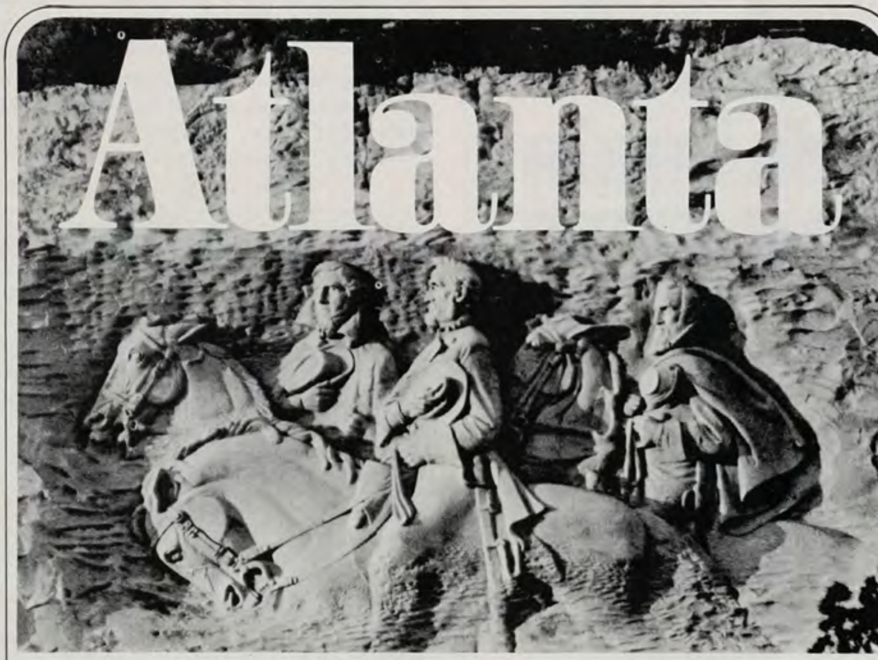
This is America unspoiled. Come for a hike or a week. Regardless of the time you take, its a visit that spans 200 years, back to the way things were when we became a nation.

THE SMOKY MOUNTAINS

The NASHVILLE LOOK

It's as great as the Nashville sound

Ask Dolly, Chet, or Minnie Pearl. Nashville is the capital of the finest home-style music ever whomped up. The accommodations, restaurants and things to see are as great as the music. If you're headed to Opry Land, for business or pleasure, Southern will get you to Nashville and home. Nashville and Southern go together like grits and gravy.



Like our three famous horsemen on Stone Mountain, Atlanta is marching forward. Forward as a leading financial center. Forward as an important convention city. Forward as the place for a family vacation.

Atlanta is served by Southern Airways to and from 53 cities.

Whether you watch the elephants or ride them, dine on unique and exciting food or munch on cotton candy, peanuts, popcorn and pink lemonade, you will feel part of the circus world.

Many of the Orlando area's attractions are water-oriented. Sea World is a $20 million, 125-acre sea adventure where visitors can hold real starfish in their hands and pet and feed dolphins and sea lions. There is a leaping two-ton killer whale, sharks and exotic fish. There are pearl divers and educational graphics of sea animals. Save a day for Sea World.

Cypress Gardens, one of Florida's oldest and most famous attractions, offers 9,000 varieties of plants and flowers. A world-famous daily water ski review includes Aquamaids in their graceful water ballet. This attraction is less than an hour from Orlando.

On the Atlantic, an hour from Orlando, is Kennedy Space Center. Here, public bus tours take visitors to the launch pads where moon-bound flights and Sky Lab launches made history. Free movies, science demonstrations and exhibits complete the exciting space displays.

Orlando and its surrounding area offer something for everyone. Whether you fly there as your final destination or use a Southern stop-over fare en route to and from Miami, visit Orlando. You will see the mouse and the duck, and a lot more too.

Consider Huntsville for a convention

Sports and cultural activities in north Alabama have received a boost through the opening of the 270,000 square foot Von Braun Civic Center in Huntsville.

The center is named after space pioneer Dr. Wernher Von Braun, who lived and worked in Huntsville for almost 20 years. He headed the nation's missile and space program.

The complex will provide 20,000 square feet of exhibit space, seats for 2,000 people, and 11 meeting rooms. A concert hall seats 2,180 persons, and a 16,000 square foot area has been developed into a creative arts museum, gallery and sales space.

The sports arena will be used as an ice-skating rink when not booked for spectator activities. Extensive cultural activities, including concerts and theater, will be presented; and it is expected the complex will aid Huntsville in attracting national and regional conventions.

Huntsville enjoys excellent air service, making it accessible from all parts of the country.

Southern currently provides flights between Huntsville and such points as St. Louis, Missouri; Detroit, Michigan; Atlanta, Georgia; New Orleans, Louisiana; and Miami, Florida, as well as either direct or connecting flights to all other points on Southern's system.

Huntsville, Alabama, has opened the Von Braun Civic Center, certain to become a cultural and convention hub.

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.

Equal Opportunity Policy

It is the policy and practice of Southern Airways, Inc. to recruit, hire and promote qualified applicants regardless of their race, color, religion, sex, age, national origin, or physical handicap.

To further this objective, the Company has established procedures to insure that all personnel actions such as compensation, benefits, transfers, lay-offs, returns from lay-offs, Company sponsored training, education, tuition assistance, social and recreational programs, and all Company facilities are administered without regard to race, color, religion, sex, age, national origin, or physical handicap.

The Southern Open

Where winning is just the beginning

The Southern Open is a career-boosting kind of golf tournament. It has launched some of golf's most noted players and it has been a returning point for another.

Now, played each September at the Green Island Country Club, Columbus, Georgia, the $100,000 tournament has grown to maturity under sponsorship of the Columbus Chamber of Commerce and Southern Airways.

The modern-day version becomes six years old this fall. The beginning was much earlier. It started in Atlanta, Georgia, in 1919.

That year, the winner was Jim Barnes. Barnes already had won the P.G.A. championship in 1916, but his Southern Open win was coupled with the 1919 P.G.A. title. In 1925, Barnes added the British Open title, and these and his other victories were recorded upon his inclusion in the Golf Hall of Fame.

Another golfer almost used the 1919 Southern Open as a winning beginning. Instead, he finished second to Barnes, but this paved his way to titles including the U.S. Amateur, U.S. Open, British Amateur and British Open. This was 1930 and the Grand Slam. The golfer was Bobby Jones, another Hall of Famer.

The Southern Open was played in 1922 in New Orleans, Louisiana, and it was the first win for Gene Sarazen. Again, the Southern Open led to the Hall of Fame. En route, Sarazen added titles including the 1922 and 1932 U.S. Open; the P.G.A. in 1922, 1923 and 1933; the British Open in 1932; and the Masters in 1935.

The Southern Open slipped from recognition after 1923, and the event and name reposed quietly until 1971.

Eyeing a major golf tournament as an attraction for Columbus, local business and civic leaders in 1970 organized the Green Island Open Invitational, a $60,000 tournament. Southern joined in underwriting the event.

Mason Rudolph won the $12,000 first prize, his first win since the Thunderbird, four years earlier.

Response to the 1970 tournament encouraged sponsors to raise the prize money to $100,000. In turn, the name was changed to Southern Open.

Lee Trevino, Jack Nicklaus, Bruce Crampton and Charles Coody did not play in the 1971 tournament. They already were committed to the World Series of Golf that same week. But, other golf "names" were present, and some who were to become more familiar.

Again, the Southern Open trophy went to a player carding his first win. His name was Johnny Miller. Miller and his bride, Linda, took home a $20,000 pay check. Columbus, Georgia, became his starting point toward the Hall of Fame.

Dewitt Weaver became the first Georgian to win the Southern Open, taking the title in 1972. He picked up a title that Bobby Jones missed. The win gave Weaver a push toward golf winnings now approaching a quarter-million dollars.

The 1973 Southern Open marked Gary Player's return to golf after surgery and a lengthy convalescence. There was no question that he was back in his prime. His recovery had been complete, and he won the Southern Open before taking the 1974 Danny Thomas Open, Masters, and British Open titles.

The Southern Open launched another career in 1974. Forrest Fezler, with 1974 winnings of $90,000, and already a good start in 1975, won his first tournament at beautiful Green Island Country Club.

That is the kind of tournament the Southern Open is. And because of this, the pros like it. For those who need a win, or those looking for a boost, the challenge of the course that overlooks the Chattahoochee River beckons them to Columbus in September.

The pros become excited by the civic pride among sponsors and spectators at the Southern Open. There is a lot of pride in saying about a future giant in the game of golf, "I know him; I saw him get his start at the Southern Open."

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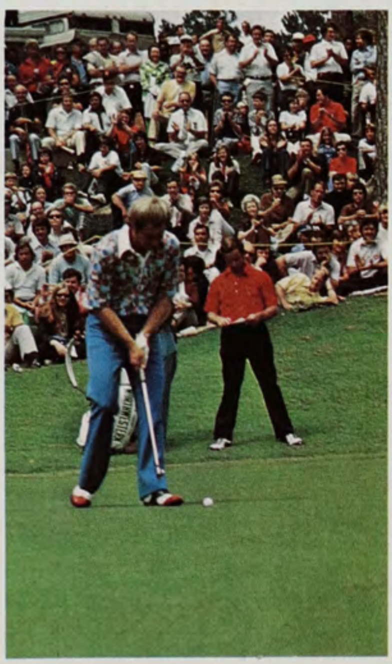
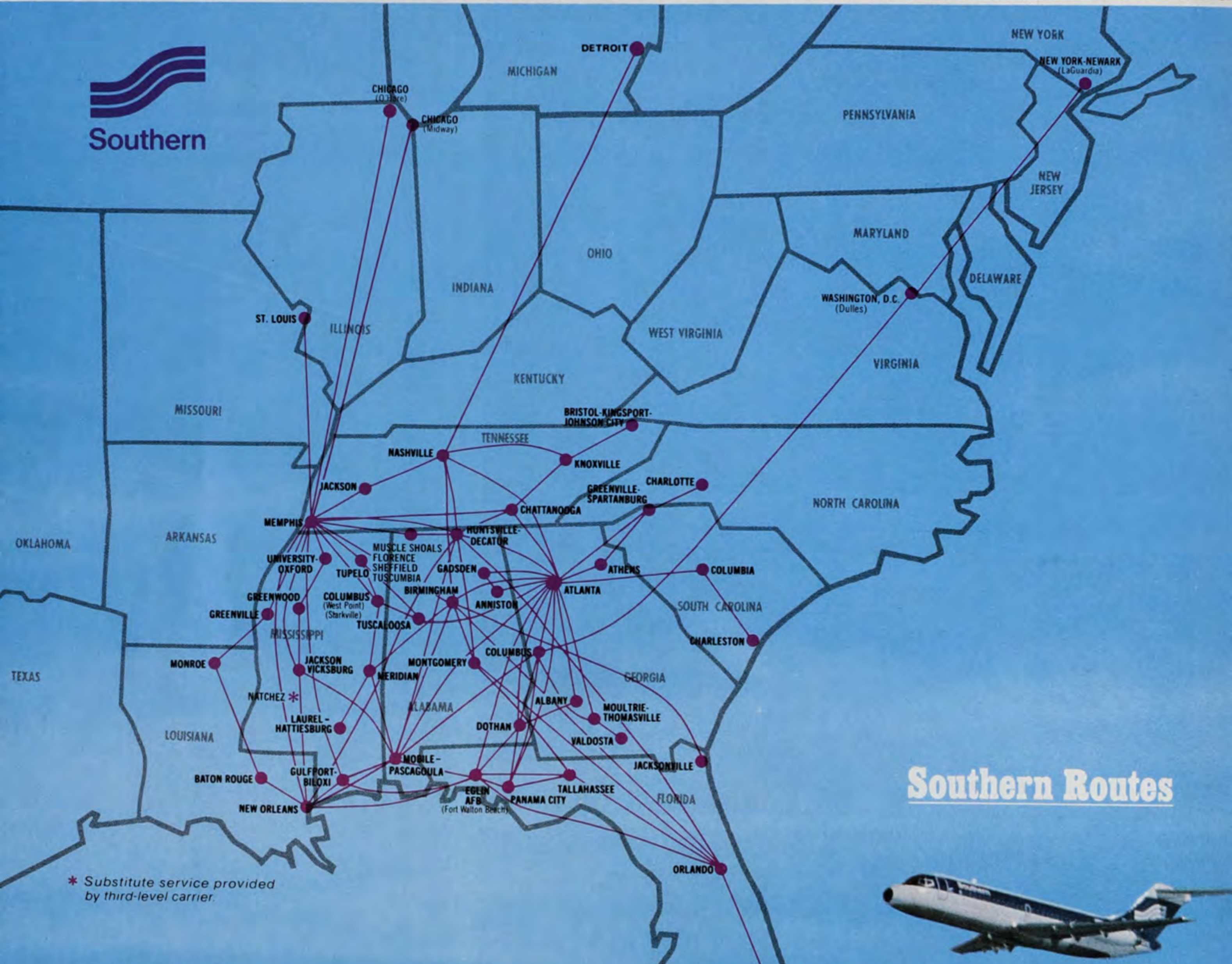
The 1975 Southern Open will be played September 4, 5, 6, and 7. For information about tickets or sponsorships, write: Southern Open, P.O. Box 2056, Columbus, Georgia 31902.

Linda Miller and husband Johnny embrace after he wins the 1971 Southern Open. This was Miller's first professional win. Forrest Fezler carded his first victory in the 1974 event, placing his name on the permanent trophy as well as on a $20,000 check. Right, Fezler putts out on the final round as Bruce Crampton looks on.



Southern Routes



Above, left to right

Washington, D.C. *Jefferson Memorial*
New York, N.Y. *Times Square*
Baton Rouge, La. *State Capitol*
Biloxi, Miss. *Broadwater Beach Hotel*
Jackson, Miss. *City Hall*
New Orleans, La. *Mardi Gras*

Below, left to right

Tuscaloosa, Ala. *Bear Bryant*
Memphis, Tenn. *Growing rapidly*
Atlanta, Ga. *The Famous Street*
Cayman Islands, B.W.I. *Wonderful*
Jacksonville, Fla. *Rising skyline*
Miami, Fla. *Greyhound Racing*

As filed with the Securities and Exchange Commission

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the Fiscal Year Ended December 31, 1974
Commission File Number 0-842

SOUTHERN AIRWAYS, INC.

(Exact name of registrant as specified in its charter)

Delaware	**58-0546353**
(State or other jurisdiction of incorporation or organization)	(I. R. S. Employer Identification No.)
Hartsfield Atlanta International Airport Atlanta, Georgia (Address of principal executive offices)	**30320** (Zip Code)

Registrant's telephone number, including area code: A.C. (404) 766-5321

SECURITIES REGISTERED PURSUANT TO SECTION 12(b) OF THE ACT:

TITLE OF EACH CLASS	NAME OF EACH EXCHANGE ON WHICH REGISTERED
NONE	NONE

SECURITIES REGISTERED PURSUANT TO SECTION 12(g) OF THE ACT:

COMMON STOCK (PAR VALUE $2.00)
(TITLE OF CLASS)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. YES ✓ NO ____

SOUTHERN AIRWAYS, INC.

FORM 10-K

Report for the Year Ended December 31, 1974

ITEM 1. Business

Southern Airways, Inc. (the "Company") is engaged in scheduled air transportation of persons, property and mail, serving cities in the states of Alabama, Florida, Georgia, Illinois, Louisiana, Michigan, Mississippi, Missouri, New Jersey, New York, North Carolina, South Carolina, Tennessee, Virginia, and the District of Columbia pursuant to a permanent certificate of public convenience and necessity issued by the Civil Aeronautics Board (the "CAB"). In addition, under temporary authority granted by the CAB, the Company operates a route between Miami, Florida and Grand Cayman Island, British West Indies. The Company is one of nine certificated scheduled airlines which operate in interstate commerce and serve cities of small and intermediate size as well as major metropolitan areas (hereinafter referred to as the "Local Service Carriers"), as distinguished from the ten major domestic airlines, herein referred to as "Trunk Carriers". In common with other Local Service Carriers, the Company receives a subsidy from the Federal Government for rendering service to small and intermediate-size cities on its domestic routes. At December 31, 1974, the Company had a fleet consisting of 25 Douglas DC9 twin-fanjet aircraft and 11 Martin 404 twin piston-engine aircraft.

Service to Grand Cayman, the Company's only international route, began on December 4, 1974. On this same date, the Company began operations over a newly-authorized route between Nashville, Tennessee and Detroit, Michigan. During the latter part of 1974, the City of Chicago relaxed its ban against new leases at O'Hare Airport and granted the Company permission to serve Chicago through that facility as well as through the Midway facility. Service through O'Hare, which began on January 15, 1975, will result in the availability of more connecting flights than are available at Midway Airport through which the Company's service to Chicago had previously been restricted. Except for the CAB approved termination of service to four small locations, there were no other material changes in the Company's route structure during 1974.

During the last quarter of 1974, both the airline industry and the Company experienced softening in domestic traffic, which partially offset gains during the first three quarters of the year. This trend is expected to continue at least through the first half of 1975, accentuating the Company's usual seasonality pattern under which traffic levels normally bottom out in mid-winter, after peaking in mid-summer. As a result, the Company laid off approximately 200 employees in early 1975. At December 31, 1974, prior to the layoff, the Company had 2,639 employees. Also, in January 1975, the Company leased one of its DC9 aircraft to a foreign carrier for a four-month period.

The Mandatory Fuel Allocation Regulations, issued by the Federal Energy Office and implemented on January 15, 1974, remain in effect until June 30, 1975, unless extended. Under these regulations, the Company, as a Local Service or Regional Air Carrier, receives an amount of fuel equal to 100 per cent of its base period consumption. The base period for aviation fuels is the corresponding month in calendar year 1972, or as may be adjusted by the Federal Energy Office. The Company has been given supplemental allocations for additional aircraft acquired during 1973. This allocation will be sufficient to enable the Company to provide the level of schedules presently programmed for 1975. The Company's contracts for the supply of its fuel requirements from major oil companies run through May 31, 1975, and are expected to be renewed at that time, although at substantially higher prices. Any further reductions in fuel supplies and/or increases in fuel prices could have a material adverse effect on the operations and earnings of the Company. Fuel prices approximately doubled during 1974 and the airline industry received fare relief in the form of a fuel-related increase of 6 per cent in April and a partially fuel related increase of 4 per cent in November. These increases only partially offset rising fuel and other costs.

In addition to fuel conservation measures, it is possible that compliance with statutory requirements related to environmental quality and settlements of related actions may necessitate significant capital outlays, may materially affect the earning power of the airline industry and the Company and may cause material changes in the business.

The Company is subject to competition in varying degrees between all of the points served by it either by surface carriers or other air carriers. There are a number of Trunk Carriers operating over certain of the Company's route segments. All of these Trunk Carriers are substantially larger than the Company in size and financial resources and some use newer and larger aircraft over these route segments. The Company also is subject to competition over certain of its route segments from Local Service Carriers and from small aircraft operators such as "air taxi" services.

The common stock of the Company is traded in the over-the-counter market. The range of high, low, bid and asked prices during 1973 and 1974, as indicated by the National Quotation Bureau, Inc., follows:

	Bid Prices		Asked Prices	
Year	**High**	**Low**	**High**	**Low**
1973				
First Quarter	6¾	5	7	5⅜
Second Quarter	5¾	4⅞	6	5¼
Third Quarter	5⅝	3⅞	6	4⅛
Fourth Quarter	4⅛	2¾	4½	3⅛
1974				
First Quarter	4⅛	2¾	4½	3⅛
Second Quarter	5½	3⅝	5⅞	4
Third Quarter	4⅞	3¼	5¼	3⅜
Fourth Quarter	4⅞	2¾	5¼	3⅛

The foregoing prices do not represent actual transactions. They represent prices between dealers and do not include retail markup, mark-down or commission. There have been no active markets in the Company's convertible preferred stocks, convertible subordinated debentures, or warrants during 1973 or 1974. During the fourth quarter 1974, the Company declared and paid dividends totaling 72 cents a share on its Series A and Series B Convertible Preferred Stock. This payment represented dividends on these shares for the years 1972 and 1973 of 36 cents a share each year. No dividend has been declared on the preferred shares for 1974. The Company has paid no other dividends on any class of its capital stock since 1967.

ITEM 2. Summary of Operations

STATEMENT OF OPERATIONS

The following statement of operations of Southern Airways, Inc. for the five years ended December 31, 1974, has been examined by Ernst & Ernst, independent accountants, whose report thereon (which is subject to any adjustments which may result from the recovery of the hijacking payment as explained in Note B of Notes to Financial Statements and includes an exception as to consistency with respect to the change in the method of recording certain DC9 engine maintenance cost as described in Note E) appears elsewhere in this Form 10-K Annual Report. Certain prior year amounts have been reclassified in this statement to conform with 1974 presentation. This statement should be read in conjunction with the related financial statements and notes included elsewhere herein.

	Year Ended December 31,				
	1970	1971	1972	1973	1974
	(In Thousands of Dollars Except Per Share Amounts)				
OPERATING REVENUES					
Passenger	$37,187	$45,302	$52,052	$65,949	$ 86,821
Mail, express and freight	2,866	3,090	3,531	4,320	5,136
Public service revenue (A)	4,823	6,974	7,138	6,814	6,805
Charter	3,835	4,067	4,839	5,358	6,908
Other	1,697	1,827	2,072	2,168	2,682
	50,408	61,260	69,632	84,609	108,352
OPERATING EXPENSES					
Flying operations	18,072	20,950	22,431	26,227	34,690
Maintenance (5)	9,045	10,808	11,890	15,171	16,613
Aircraft and traffic servicing	11,351	13,523	15,433	20,009	24,339
Passenger service	2,661	3,774	4,343	5,678	6,561
Promotion and sales	4,274	4,774	5,304	6,713	8,039
General and administrative	3,192	3,461	3,784	4,610	5,475
Depreciation and amortization (A) (E)	2,632	2,637	2,559	3,673	4,397
Other	961	926	995	1,039	1,355
	52,188	60,853	66,739	83,120	101,469
OPERATING INCOME (LOSS)	(1,780)	407	2,893	1,489	6,883
OTHER DEDUCTIONS AND INCOME					
Interest on long-term debt (3)	1,789	1,678	1,362	3,083	3,929
Gain on disposal of aircraft	–	–	–	(1,968)	(46)
Miscellaneous deductions (income) – net	(236)	23	(110)	(55)	(577)
	1,553	1,701	1,252	1,060	3,306
INCOME (LOSS) BEFORE INCOME TAXES, EXTRAORDINARY TAX CREDIT AND ACCOUNTING CHANGE	(3,333)	(1,294)	1,641	429	3,577
INCOME TAXES (CREDIT) (A) (4)	–	(235)	450	109	985
INCOME (LOSS) BEFORE EXTRAORDINARY TAX CREDIT AND ACCOUNTING CHANGE	(3,333)	(1,059)	1,191	320	2,592
TAX BENEFITS OF NET OPERATING LOSS CARRYFORWARD (4)	–	–	409	97	325
CUMULATIVE EFFECT OF ACCOUNTING CHANGE (E) (5)	–	–	–	–	565
NET INCOME (LOSS)	$(3,333)	$(1,059)	$ 1,600	$ 417	$ 3,482
EARNINGS (LOSS) PER COMMON AND COMMON EQUIVALENT SHARE (6)					
Primary:					
Income (loss) before extraordinary tax credit and accounting change	$(3.25)	$(1.02)	$ .77	$ .15	$ 1.64
Extraordinary tax credit	–	–	.29	.08	.20
Cumulative effect of accounting change	–	–	–	–	.35
Net income (loss)	$(3.25)	$(1.02)	$ 1.06	$ .23	$ 2.19
Fully Diluted:					
Income before extraordinary tax credit and accounting change			$ .60		$ 1.10
Extraordinary tax credit			.20		.11
Cumulative effect of accounting change			–		.19
Net income			$ .80		$ 1.40
RATIO OF INCOME TO FIXED CHARGES (7)	.13	.67	1.42	1.08	1.60
RATIO OF INCOME TO FIXED CHARGES AND PREFERRED DIVIDEND REQUIREMENTS (7)	.13	.67	1.36	1.05	1.56

NOTES TO STATEMENT OF OPERATIONS

(1) Alphabetical references refer to the Notes to Financial Statements appearing elsewhere in this Report.

(2) Pension expenses, including amounts paid under a defined contribution plan, were as follows:

Year Ended December 31,				
1970	1971	1972	1973	1974
$661,734	$868,779	$1,211,687	$1,540,017	$1,899,486

Effective July 1, 1972, and September 2, 1974, the Company modified the plans to provide for improved benefits, with related increases in annual pension expense of approximately $230,000 and $51,000, respectively. The Employee Retirement Income Act of 1974 will not have a material effect on pension cost in future periods.

(3) Net of interest capitalized, which in 1973 amounted to $80,289. Amounts capitalized in other years have been insignificant.

(4) Income taxes for the years 1972 through 1974 are comprised as follows:

	1972	1973	1974
Current:			
Federal	$762,000	$194,000	$1,138,000
State	81,000	24,000	134,000
Deferred (net of applicable investment tax credit of $250,000)			
Federal	–	–	250,000
State	–	–	44,000
Investment tax credit (applicable to current taxes)	(393,000)	(109,000)	(581,000)
	$450,000	$109,000	$ 985,000

Deferred income taxes result from timing differences in the recognition of revenue and expense for tax and financial reporting purposes. The sources of those differences in 1974 and the tax effect of each were as follows:

Accelerated depreciation used in prior years for tax purposes	$878,000
Provision for inventory obsolescence for financial reporting purposes in excess of cumulative allowed deductions for tax purposes	(652,000)
Provision for Martin 404 overhaul overhead deducted for tax purposes in prior years	282,000
Other	36,000
Investment tax credit	(250,000)
	$294,000

Current federal income taxes in 1972 ($762,000) and 1973 ($194,000) and the sum of current and deferred federal income taxes in 1974 ($1,638,000 before investment tax credit of $250,000 offsetting deferred taxes) equal approximately 48% (the statutory federal tax rate) of income before taxes after deducting the state tax provision shown above.

Investment credit carryovers, which may be used to offset Federal income taxes payable in future income tax returns, aggregate $1,341,000 and expire in 1977 ($589,000), 1978 ($38,000), 1979 ($307,000), 1981 ($26,000), 1982 ($38,000), 1983 ($220,000), 1984 ($123,000).

The credit to deferred tax expense in 1971 ($235,000) reflects the reversal of deferred taxes provided in a prior year. The reversal resulted from the determination in 1971 that, because of a change in the depreciation method and lives applicable to certain assets for income tax purposes and the carryforward of the 1971 operating loss, the previously provided deferred taxes would not be paid.

NOTES TO STATEMENT OF OPERATIONS (Continued)

(5) DC9 engine maintenance costs would have increased (decreased) approximately $121,000, ($58,000), $49,000 and $150,000 for each of the four years ended December 31, 1973, respectively, if the method of recording certain DC9 engine maintenance costs for 1974 (see Note E of Notes to Financial Statements) had been followed in such periods.

To the extent increased or decreased expenses were not offset by resultant increases or decreases in subsidy revenues and income taxes, which are indeterminable as to specific amounts, net income would have been affected commensurately.

(6) Primary earnings per share for the years 1974 and 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 each year (1,598,882 in 1974 and 1,439,517 in 1972). Common equivalent shares for 1974 and 1972 comprise that number of common shares issuable upon exercise of stock options and warrants (exclusive, in 1972, of warrants for 126,000 shares issued prior to June 1, 1969, and cancelled July 25, 1973) in excess of 20 per cent of the number of common shares outstanding at the end of 1974 and 1972. Proceeds from the assumed exercise of the options and warrants in excess of the amount which would have been required to purchase 20 per cent of the outstanding common stock at the average market price during the year 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. Primary earnings per share for the year 1973 were computed by dividing net income, after reduction for the preferred dividend requirement, by the weighted average number of common shares outstanding during the year – 1,314,016 shares. For the years 1971 and 1970, losses per share were computed by dividing net loss by the weighted average number of common shares outstanding each year – 1,035,048 in 1971 and 1,024,871 in 1970. During these two loss years, there were no preferred dividend requirements. Common equivalent shares and adjustments resulting from their assumed exercise were excluded from the 1973, 1971 and 1970 computations since their inclusion would have increased earnings per share in 1973 and would have decreased losses per share for 1971 and 1970.

Fully diluted earnings per share for the years 1974 and 1972 were determined on the assumption that the weighted average number of common and common equivalent shares for these years were further increased from the beginning of the period by conversion of outstanding convertible debentures and convertible preferred stocks (and, in 1972, by exercise of the warrants for 126,000 shares issued prior to June 1, 1969, and cancelled July 25, 1973), a total of 2,913,090 shares in 1974 and 3,098,588 shares in 1972. These calculations also assume 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 proceeds of exercising the additional warrants was added to income for purposes of the calculation. The assumed conversion of convertible securities in years other than 1974 and 1972 would not have been dilutive.

(7) For purpose of these ratios: (a) income was determined before reduction for income taxes and fixed charges; (b) fixed charges comprise total interest expense, amortization of long-term debt expense, and the interest element of rentals; and (c) related income tax effects were added to preferred dividend requirements.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF THE STATEMENT OF OPERATIONS

GENERAL – Operating income increased to $6,883,000 in 1974 following a decline to $1,489,000 in 1973. Both the 1974 turnabout and the 1973 decline were due in large measure to the 1973 expansion of the jet fleet to 24 DC9 aircraft, an increase of nine. Unfortunately, traffic softened during the last half of 1973, at the time the expanded fleet was becoming operational, thus preventing the Company from fully benefiting from the expansion in that year. This expanded capability, however, enabled the Company to benefit from increased traffic levels during the first half of 1974, including traffic believed to have resulted from the diversion of many automobile travelers to air travel as a result of the gasoline shortage. The low operating income in 1973, combined with the $1,721,000 increase in interest expense resulting from the financing of the fleet expansion, would have produced a net loss for 1973 had it not been for gains totaling $1,968,000 from the sale of four of the 13 DC9's originally purchased. On the other hand, the increased operating income level in 1974, together with the "one-time" cumulative results of an accounting change totaling $565,000 (explained in Note E of the Notes to Financial Statements), enabled the Company to produce net income of $3,482,000 after absorbing a further increase of $846,000 in interest expense. The 1974 interest expense increase resulted primarily from having a full year at the increased loan levels, as opposed to a partial year in 1973, together with increases in the prime interest rate. Net income for 1974 was further boosted by $578,000 in interest income from short term investments compared to $47,000 in 1973. In 1974 the Company completed utilization of its income tax operating loss carryforwards. With the exception of certain state income taxes totaling $41,000 in 1972 and $12,000 in 1973, the tax benefits of the carryforwards completely offset the income tax provisions for those years. In 1974 tax benefits of $325,000 were realized from loss carryforwards for book purposes, which carryforwards were exhausted during the year. For further information on income taxes and remaining investment tax credit carryovers, see Note 4 to Statement of Operations.

OPERATING REVENUES – Operating revenues increased $23,743,000 in 1974 and $14,977,000 in 1973 as a result of increases in traffic volume and yield. Revenue passenger miles increased by 15 per cent in 1974 and by 21 per cent in 1973. These increases in traffic volume levels were due in large measure to the 1973 fleet expansion which increased available seat miles by more than 27 per cent. Yields per passenger mile increased by 14.3 per cent in 1974 following a 4.6 per cent increase in 1973. These increases can be attributed principally to fare increases of 5 per cent in December 1973, 6 per cent in April 1974 and 4 per cent in November 1974; the implementation of a security charge in April 1973; and the restructuring of discount fares in early 1974. Because of discontinuance of service to four cities and a recently revised subsidy formula, management estimates a decline of approximately $1,300,000 in public service revenues in 1975. The significant increase in other operating revenues in 1974 resulted from the sale of surplus spare parts and for services performed on aircraft owned by others.

OPERATING EXPENSES – Operating expenses increased by $18,349,000 in 1974 following a $16,381,000 increase in 1973. The doubling of fuel prices in 1974 added approximately $6,155,000 to 1974 operating expenses. Labor costs, which constitute over 40 per cent of total operating expenses, increased by $6,574,000 in 1974 and by $7,526,000 in 1973 as a result of the expanded work force (the average number of employees increased by 9 percent in 1974 following a 16 percent increase in 1973) and increases in salaries and benefits. This included payroll tax increases of $329,000 in 1974 and $439,000 in 1973. As a result, predominantly of the fleet expansion, depreciation and amortization expense increased by $724,000 in 1974 (including $277,000 in amortization of related preoperating expenses) and by $1,114,000 in 1973. Netted in the 1974 depreciation increase is a reduction of $789,000 attributable to

Martin 404 equipment which became fully depreciated at December 31, 1973. The 1974 and 1973 increases in operating expenses other than fuel, labor and depreciation aggregated approximately $4,900,000 and $7,750,000, respectively. These other increases, which are spread throughout all categories of operating expenses, are due principally to the 1973 fleet expansion, the increased traffic levels to which the fleet expansion contributed and to the continuing inflationary rise in the cost of outside goods and services.

ITEM 3. Properties

Aircraft

On December 31, 1974, the Company's fleet consisted of 25 DC9 jet aircraft (including nine aircraft acquired in 1973) and 11 Martin 404 piston aircraft. Some of the Company's aircraft are owned and some are leased. The Company is engaged in a program of permanently reducing the use of the Martin 404 aircraft. Aircraft removed from service have been sold or dismantled. The Company sold, in 1973, four of the 13 DC9-14 jet aircraft acquired in that year. The following table lists the aircraft owned and leased by the Company as of December 31, 1974:

Type of Aircraft	Passenger Capacity	Number of Aircraft: Owned	Leased	Total	Average Age (Years)
DC9 (10 Series)	75	12	9(a)	21	8.1
DC9 (30 Series)	95	1	3(b)	4	5.5
Martin 404	40	11	–	11	25.0

(a) Three of these aircraft are leased for 12-year terms ending in 1980 at an annual rental of approximately $363,465 each; five are leased under long-term leases terminating in 1979 at an annual rental of approximately $390,000 each, and one is leased through June 1976 at an annual rental of approximately $558,000.

(b) One of these aircraft is leased for a 12-year term ending in 1981 at an annual rental of approximately $470,735. The remaining two aircraft were leased in June 1971 for 12-year terms ending in 1983 at annual rentals of approximately $605,538 each.

All of the Company's aircraft, engines, propellers, and spare parts are mortgaged as collateral for notes payable to banks.

All of the aircraft of the Company and other airborne equipment are in good condition and are deemed appropriate and adequate for present operations.

Other Property

The general offices of the Company, in the International Office Park adjacent to the Hartsfield Atlanta International Airport, occupy 45,700 square feet of space at an annual rental of $166,000 under leases having between one and four years to run, and approximately 18,100 square feet in a nearby office building at a current annual rental of approximately $117,000. These facilities house the Company's general offices and reservations, communications and flight dispatch departments for the entire system.

The Company leases various hangar and shop faclities at the Hartsfield Atlanta International Airport occupying approximately 150,542 square feet, plus adjacent land of approximately 500,000 square feet, at annual rentals aggregating approximately $98,000.

On January 2, 1974, the Company entered into an agreement with the City of Atlanta, Georgia, to lease a 310,000 square-foot maintenance base and training center to be constructed at the Hartsfield Atlanta International Airport. Estimated costs, annual rentals, and occupancy (rental commencement) dates are as follows:

ITEM 3. Properties — Continued

	Estimated Costs	Estimated Annual Rental	Approximate Occupancy (Rental Commencement) Dates
Land	$ 1,506,285	$ 120,503	January 2, 1974
Phase One Facilities	7,511,000	545,665	October 1, 1975
Phase Two Facilities	16,608,000	1,214,120	April 1, 1976
	$25,625,285	$1,880,288	

Cost of the Phase One and Phase Two Facilities is to be financed by the City through the issuance of Airport Extension and Improvement Revenue Bonds. The lease extends for a period of 30 years from October 1, 1975, or the date of beneficial occupancy of the Phase One Facilities, whichever occurs first, and may be renewed at the Company's option for an additional term extending to January 1, 2024.

The Company leases office and ticketing space at the different airports from which it operates and in downtown locations in some of the cities which it serves. The aggregate annual rental for such facilities, including the premises and facilities at the Hartsfield Atlanta International Airport not related to the general operations of the Company, is approximately $1,384,000.

On September 9, 1974, the Company entered into an agreement with the City of Atlanta to lease approximately 39,760 square feet of cargo building space plus adjacent land of approximately 2.734 acres at the Atlanta Airport. The lease extends for a period of 15 years after date of occupancy (approximately September 1, 1975) and may be cancelled by the Company after the fifth and tenth years if the Company elects to lease space in another facility expected to be constructed by the City of Atlanta in the future. Annual rental is estimated at approximately $120,400. Under the agreement, the Company may sublease a portion of the unused facility. If the Company subleases a portion of the premises, the estimated annual rental will be reduced accordingly. The Company will occupy newly constructed terminal and cargo facilities near Fort Walton Beach, Florida, in February 1975 under a lease extending to February 1995 and providing for an annual rental of approximately $62,000.

The Company leases computer, message switching and automated ticketing equipment at an annual rental of approximately $715,000 and has contracted to receive passenger reservations services and automated ticketing and fare-quotation services through 1977. Charges for the reservations services exclusive of related computer and message switching equipment rentals ($563,000 in 1974) are based upon the number of unduplicated passengers. Charges for the automated ticketing and fare-quotation services are $124,000 per year.

The Company owns ramp, passenger service and ground communications equipment, shop tools and equipment, automobiles and trucks, furniture and fixtures and underground fuel storage facilities located at various airports. All the Company's ground equipment and other property is in good condition and is deemed appropriate and adequate for present operations.

ITEM 4. Parents and Subsidiaries

To the best knowledge of the Company no person owned beneficially more than 10 per cent of the common stock of the Company as of December 31, 1974.

As of December 31, 1974, the officers and directors of the Company and their associates, as a group, owned beneficially 328,501 shares of common stock, representing 20.8 per cent of the outstanding shares of common stock; 73,436 shares of Series A $0.36 Convertible Preferred Stock, representing 44.7 per cent of the outstanding Series A, with 73,436 common stock purchase warrants attached; $157,000 principal amount of the 5¾% Convertible Subordinated Debentures, representing 3.6 per cent of the outstanding 5¾% debentures, and $4,431,500 principal amount of the 6½% Convertible Subordinated Debentures, representing 76 per cent of the outstanding 6½% debentures.

The Company has no subsidiaries.

ITEM 5. Pending Legal Proceedings

On July 9, 1970, the United States Court of Appeals for the District of Columbia Circuit held unlawful the fare increase effective October 1, 1969, of some 6.35 per cent for all domestic scheduled air carriers including the Company. Subsequently, several suits (in some of which the Company is a named defendant) were filed as class actions by individuals in California, Illinois, and the District of Columbia seeking "reparations" in the amount of the increased amount of the fares paid during the period October 1, 1969, to October 15, 1970, when new carrier tariffs became effective. These suits, consolidated for pretrial proceedings in the United States District Court for the Northern District of Illinois, Eastern Division, by the Judicial Panel on Multi-district Litigation, were stayed until further order of the Court pending decision by the CAB in a proceeding called *Reasonableness of Passenger Fares Charged by Domestic Trunkline and Local Service Carriers From October 1, 1969, Through October 14, 1970* as to the reasonableness of the fares during the period in question. On July 13, 1973, the CAB issued an order finding that fares in effect during the period at issue were not unjust or unreasonable. On December 10, 1973, the United States District Court for the Northern District of Illinois dismissed with prejudice the "reparations" suits as being moot in view of the CAB decision. Petitions for review of the CAB order have been filed in the U.S. Court of Appeals for the District of Columbia, and the dismissal of the "reparations" suits has been appealed to the United States Court of Appeals for the Seventh Circuit.

The Company is a defendant in a suit brought in the Federal District Court for the Southern District of New York by Air Freight Haulage Co., Inc. against the Company and 23 other named defendants. The complaint seeks unspecified treble damages for alleged violations of antitrust laws including attempted monopolization of the trucking of air freight in the New York metropolitan area.

On July 11, 1973, J. H. Troutman and W. C. Troutman filed an action in Fulton County Superior Court, Fulton County, Georgia, against the City of Atlanta and nine scheduled airlines using the Hartsfield Atlanta International Airport, including the Company. The complaint alleges that maintenance of the airport by the City and use of the airport by the airlines has caused damage to, diminution in value of, and loss of rental from their apartment complex located nearby, in the amount of $640,000. The complaint also seeks punitive damages in the amount of $100,000.

On November 14, 1973, Frank W. Scroggins, Trustee in Bankruptcy for Air Transfer, Inc., filed suit against the Company and the other carriers serving the Hartsfield Atlanta International Airport, along with Air Cargo, Inc. and Carolina Cartage, Inc., on the grounds that they had engaged in acts violating the antitrust laws of the United States by keeping Air Transfer, Inc. from being able to fulfill contracts relating to domestic air freight at the Atlanta airport. Plaintiff seeks from the various defendants the sum of $450,000. On December 31, 1974, the Court granted judgment in favor of all defendants. However, a notice of appeal was filed on January 24, 1975.

On January 31, 1974, Charles V. Welden, Jr. filed a suit against the Company in the United States District Court for the Northern District of Alabama, Southern Division, in which he alleges that the Company refused him transportation on a flight from Birmingham to Mobile, Alabama, on January 21, 1974, further alleging he held a confirmed reservation and that the flight was full when he arrived at the airport and he was not furnished transportation. This plaintiff seeks to recover compensatory and punitive damages in the sum of $100,000. He further seeks to recover an additional $100,000 in compensatory and punitive damages for unjust discrimination or undue or unreasonable prejudice or disadvantage, and finally seeks to recover an additional $100,000 as damages on the grounds that the representations of the defendant as to the confirmation of the reservation were false and known by the defendant to be false at the time made to the plaintiff. The trial of this matter has not been held, and at the request of the judge, the plaintiff and the Company entered into settlement negotiations; however, it appears that these negotiations will not resolve the matter.

The Air Transport Association of America, the Air Traffic Conference of America, and 20 carriers, including the Company, are defendants in a suit brought on November 20, 1974, in the United States District Court for the District of Columbia by the Grueninger Travel Service, Inc. The complaint seeks unspecified treble damages for alleged violations of Sections 1, 2 and 3 of the Sherman Act.

The Company has been named as a defendant in a suit brought in November 1973 in the Los Angeles County Superior Court, State of California, against the Air Traffic Conference and its individual carrier members seeking punitive and actual damages for alleged interference with prospective and existing contractual relationships, intentional infliction of emotional distress and trauma and deprivation of and intereference with civil rights.

On January 4, 1974, Gulf Oil Corporation notified the Company that its contract with the Company was withdrawn and future fuel deliveries would only be made on a spot price basis. On April 3, 1974, the Company filed an action in the Federal District Court for the Northern District of Georgia, Atlanta Division, seeking a declaration that the Gulf Oil Company must specifically perform its contract. The Court has issued a preliminary injunction under which Gulf Oil Company is required to continue to deliver fuel to the Company pursuant to the contract. While the outcome of this matter cannot be determined at this time, the Company has provisions which it believes are adequate to cover any amounts that may be due Gulf Oil Company.

The foregoing summary of litigation and similar matters as of January 29, 1975, does not include proceedings in which the Company is an applicant for additional route awards or industry wide rate hearings to determine future rates for various classes of service to which the Company also is a party, nor does it include matters the defense of which is being handled by the Company's insurance carriers or by others pursuant to contractual agreements. In the opinion of management the foregoing suits will have no material effect on the Company's financial position as of December 31, 1974, or results of operations for the years then ended.

ITEM 6. Increases and Decreases in Outstanding Equity Securities

	Preferred Stock $1 Par Value		Common Stock
	Series A	Series B	$2 Par Value
Shares Outstanding, January 1, 1974	165,331	166,667	1,412,663
Common Stock issued upon conversion of Preferred Stock:			
February 7 through December 23, 1974	(900)		900
December 31, 1974		(166,667)	166,667
Shares Outstanding, December 31, 1974	164,431	–	1,580,230

ITEM 7. Approximate Number of Equity Security Holders

The following table sets forth the number of equity security holders of the registrant as of December 31, 1974.

Title of Class	Number of Record Holders
Convertible Subordinated Debentures:	
5¾%, due December 1, 1981	622
6½%, due November 1, 1983	437
Convertible Preferred Stock, Series A, $.36 (Par Value $1)	473
Common Stock (Par Value $2)	5,333
Warrants:	
Series A	544
Series B	1

ITEM 8. Executive Officers of Registrant

Name and Year First Elected Executive Officer	Title	Age at December 31, 1974
Frank W. Hulse (1943)	President and Director	62
Graydon Hall (1961)	Executive Vice President, General Manager and Director	53
George M. Gross (1965)	Vice President, Associate General Manager and Director	48
J. Kenneth Courtenay (1961)	Vice President – Economic Regulations and Secretary	47
A. L. Maxson (1968)	Vice President – Finance and Treasurer	39
Victor C. Pruitt (1972)	Vice President – Technical Services	51
Tilden M. Shanahan (1974)	Vice President – Flight	41
Frank H. Wheeler (1972)	Vice President – Sales and Services	34
Thomas A. Wiley, Jr. (1967)	Vice President – Marketing	51

There is no family relationship between any of the above officers. All executive officers are elected annually by the Board of Directors to serve until the next annual Board of Directors meeting held following the annual stockholders meeting on the first Monday of May of each year. There are no known arrangements or understandings between any executive officers and any other person pursuant to which any of the above-named persons was selected as an officer.

All of the executive officers have been in the employ of the Company for more than five years and, with the exception of Messrs. Pruitt, Shanahan and Wheeler, each has served in the capacity shown above for more than five years. Mr. Pruitt joined the Company in 1969 and held positions as Director – Systems Planning, Assistant Vice President – Systems Planning and Assistant Vice President – Technical Services before being elected Vice President – Technical Services in May 1972. Mr. Shanahan joined the Company as a First Officer in 1960 and subsequently held positions as System Chief Pilot and Director – Flight Division before becoming Vice President – Flight in 1974. Mr. Wheeler joined the Company as Assistant to the President in 1969. He subsequently became Director of Sales Development prior to being appointed to head the Company's Sales Department in 1970. He was elected Assistant Vice President – Sales in 1971 and became Vice President – Sales and Services in July 1972.

ITEM 9. Indemnification of Directors and Officers

Pursuant to the provisions of Section 145 of the General Corporation Law of the State of Delaware, every corporation created thereunder has the power to indemnify any and all

ITEM 9. Indemnification of Directors and Officers — Continued

of its directors, officers, employees or agents, including former directors, or officers, against expenses, judgments, fines and amounts paid in settlement actually and reasonably incurred by any such person in connection with such action, suit or proceeding, if such persons acted in good faith and in a manner reasonably believed to be in or not opposed to the best interest of the corporation. The Board of Directors of the Company on May 6, 1968, adopted a resolution authorizing the Company to reimburse or indemnify each past, present, or future director, officer or employee of the Company, and each person who may have served, is serving or may serve as a director, officer or employee of any other corporation at the request of the Company because of the Company's interest in such corporation as a shareholder or creditor to the extent and in the method, and as authorized by Section 145 of said law, and providing that the standard of conduct for the Company's directors, officers, employees or agents be the same as that set out in Section 145 of said law. This resolution is still in full force and effect.

ITEM 10. Financial Statements and Exhibits

(a) Financial Statements

The following financial statements and schedules are filed as part of this report:

Report of Independent Accountants

Balance Sheet – December 31, 1974 and 1973

Statement of Operations – For the five years ended December 31, 1974 (included in Item 2)

Statement of Stockholders' Equity – For the five years ended December 31, 1974

Statement of Changes in Financial Position – For the five years ended December 31, 1974

Notes to Financial Statements

Schedule II – Amounts Receivable from Underwriters, Promoters, Directors, Officers, Employees, and Principal Holders of Equity Securities for the year ended December 31, 1973

Schedule V – Property and Equipment for the years ended December 31, 1974 and 1973

Schedule VI – Allowances for Depreciation and Maintenance of Property and Equipment for the years ended December 31, 1974 and 1973

Schedule VII – Part B – Preoperating Expenses and Similar Deferrals for the years ended December 31, 1974 and 1973

Schedule XII – Valuation and Qualifying Accounts and Reserves for the years ended December 31, 1974 and 1973

All other schedules (Nos. I, III, IV, VIII, IX, X, XI, XIII, XIV, XV, XVI, XVII, XVIII and XIX) for which provision is made in the applicable regulation of the Securities and Exchange Commission are not required under the related instructions or are inapplicable, and therefore have been omitted.

ITEM 10. **Financial Statements and Exhibits — Continued**

(b) Exhibits

The following exhibits are filed as part of this report:

1. Computation of Earnings per Common and Common Equivalent Share.
2. Computation of (a) Ratio of Income to Fixed Charges and (b) Ratio of Income to Fixed Charges and Preferred Dividend Requirements.

Items 11 through 15, constituting Part II of the Form 10-K, have been omitted from this Report pursuant to the provisions of Instruction H to Form 10-K, since a definitive proxy statement pursuant to Regulation 14A under the Securities Exchange Act of 1934 will be filed within 120 days after the close of the fiscal year.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

SOUTHERN AIRWAYS, INC.

A. L. Maxson

By **A. L. Maxson, Vice President-Finance and Treasurer**

Dated: March 7, 1975

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, 1974, and December 31, 1973, the related statements of operations, stockholders' equity and changes in financial position for the five years ended December 31, 1974, and the schedules listed in response to Item 10(a). 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 discussed in Note B to the financial statements, in 1972 the Company made a ransom payment of $2,000,000 in connection with the hijacking of an aircraft. The amount paid has been retained by the Republic of Cuba. The Company is attempting recovery of the ransom; however, there can be no assurance of its return.

In our opinion, subject to any adjustments which may result from the recovery of the hijacking payment discussed in the preceding paragraph, the financial statements referred to above present fairly the financial position of Southern Airways, Inc. at December 31, 1974, and December 31, 1973, and the results of its operations and changes in its financial position for the five years ended December 31, 1974, in conformity with generally accepted accounting principles consistently applied during the period except for the change, with which we concur, in the method of recording certain DC9 engine maintenance costs as described in Note E to the financial statements. Further, it is our opinion, subject to any adjustments which may result from the recovery of the aforementioned hijacking payment, that the accompanying schedules present fairly the information set forth therein in compliance with the applicable accounting regulations of the Securities and Exchange Commission.

Ernst + Ernst

ERNST & ERNST

Atlanta, Georgia
January 29, 1975

SOUTHERN AIRWAYS, INC.

BALANCE SHEET

ASSETS

	December 31, 1974	December 31, 1973
CURRENT ASSETS		
Cash, including short-term investments of $8,900,000 in 1974 – Note C	$11,895,001	$ 8,068,694
Accounts receivable		
U. S. Government – transportation and public service revenue	1,826,140	2,146,684
Trade receivables, less allowance for doubtful accounts (1974 – $98,935; 1973 – $99,682 – Schedule XII)	8,148,314	7,132,492
	9,974,454	9,279,176
Notes receivable – sale of aircraft	–	4,845,895
Maintenance and operating supplies, at average cost less allowance for obsolescence (1974 – $1,319,134; 1973 – $1,165,589) – Note A (Schedule XII)	4,576,614	2,871,484
Prepaid expenses	768,107	727,503
Total Current Assets	27,214,176	25,792,752
OTHER ASSETS		
Hijacking payment – Note B	2,000,000	2,000,000
Equipment purchase deposits – Note G	200,000	–
Miscellaneous	228,055	198,337
	2,428,055	2,198,337
PROPERTY AND EQUIPMENT – on the basis of cost –		
Notes A, C, and E (Schedules V and VI)		
Flight equipment	50,651,758	51,108,291
Other property and equipment	5,392,261	4,829,154
	56,044,019	55,937,445
Less allowances for depreciation and maintenance	19,629,808	19,470,533
	36,414,211	36,466,912
DEFERRED CHARGES – Note A (Schedule VII)		
Unamortized preoperating, route extension and development costs	1,117,075	1,548,934
Deferred lease costs	129,938	159,249
Unamortized long-term debt expense	352,466	406,778
	1,599,479	2,114,961
	$67,655,921	$66,572,962

SOUTHERN AIRWAYS, INC.

BALANCE SHEET

LIABILITIES AND STOCKHOLDERS' EQUITY

	December 31, 1974	December 31, 1973
CURRENT LIABILITIES		
Accounts Payable	$ 7,504,632	$ 5,772,648
Collections and withholdings as agent	7,236,997	5,847,769
Salaries, wages and vacations	3,163,182	2,302,950
Accrued interest payable	956,140	285,884
Accrued taxes and other expense	837,149	376,402
Air travel plan deposits	86,275	92,649
Current maturities of long-term debt – Note C	3,836,252	6,950,770
Total Current Liabilities	23,620,627	21,629,072
LONG-TERM DEBT – Note C		
Notes payable, less current maturities	22,686,767	27,523,019
Convertible subordinated debentures	10,178,000	10,178,000
	32,864,767	37,701,019
DEFERRED CREDITS		
Subsidy adjustment – Note B	600,000	200,000
Deferred income taxes	294,000	–
	894,000	200,000
STOCKHOLDERS' EQUITY – Notes C and D		
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 dividends – aggregate of $1,046,105 in 1974 and $1,119,942 in 1973), issued and outstanding 164,431 shares (1974) and 165,331 shares (1973)	164,431	165,331
Series B $.36 convertible – non-voting (liquidation value $6 per share in 1973 plus cumulative dividends — aggregate of $60,000 in 1974 and $1,120,002 in 1973), issued and outstanding 166,667 shares in 1973 – Note D	–	166,667
Common Stock, $2 par value, authorized 7,500,000 shares, issued and outstanding 1,580,230 shares (1974) and 1,412,663 shares (1973)	3,160,460	2,825,326
Other paid-in capital	5,124,355	5,291,922
Retained earnings (deficit)	1,827,281	(1,406,375)
	10,276,527	7,042,871
LEASES, COMMITMENTS AND CONTINGENCIES – Notes F and G		
	$67,655,921	$66,572,962

See Notes to Financial Statements.

SOUTHERN AIRWAYS, INC.

STATEMENT OF STOCKHOLDERS' EQUITY

Five Years Ended December 31, 1974

	Preferred Stock $1 Par Value		Common Stock	Other Paid-In	Retained Earnings
	Series A	Series B	$2 Par Value	Capital	(Deficit)
Balance, January 1, 1970	$ —	$ —	$2,049,742	$1,229,523	$ 968,556
Net loss	—	—	—	—	(3,333,212)
Balance, December 31, 1970	—	—	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 6½% Convertible Subordinated Debentures, less $53,692 deferred finance cost	—	—	200,000	746,308	—
Conversion of $337,000 principal amount of 5¾% 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)
Net income	—	—	—	—	416,748
Common stock issued upon conversion of preferred stock	(24,772)	—	49,544	(24,772)	—
Conversion of $1,167,000 principal amount of 6½% Convertible Subordinated Debentures, less $54,876 deferred finance cost	—	—	233,400	878,724	—
Balance, December 31, 1973	165,331	166,667	2,825,326	5,291,922	(1,406,375)
Net income	—	—	—	—	3,481,691
Dividends on preferred stock ($.72 per share)	—	—	—	—	(248,035)
Common stock issued upon conversion of preferred stock	(900)	(166,667)	335,134	(167,567)	—
Balance, December 31, 1974	$164,431	$ —	$3,160,460	$5,124,355	$ 1,827,281

See Notes to Financial Statements.

SOUTHERN AIRWAYS, INC.

STATEMENT OF CHANGES IN FINANCIAL POSITION

	Years Ended December 31,				
	1970	1971	1972	1973	1974
FUNDS PROVIDED					
From operations					
Income (loss) before extraordinary tax credit and accounting change	$(3,333,212)	$(1,058,784)	$ 1,191,067	$ 319,748	$ 2,591,261
Items not requiring outlay of working capital in current period					
Depreciation	2,090,915	2,094,991	2,039,695	3,193,436	3,840,039
Increase (decrease) in allowance for maintenance	519,349	322,946	544,721	1,705,604	(84,644)
Amortization of deferred charges	551,944	484,478	382,153	362,813	546,261
Deferred income tax (credit)	—	(235,000)	—	—	294,000
Subsidy adjustment — Note B	—	—	—	200,000	400,000
Total from operations exclusive of extraordinary tax credit	(171,004)	1,608,631	4,157,636	5,781,601	7,586,917
Extraordinary tax credit	—	—	409,250	97,000	325,055
Total from operations	(171,004)	1,608,631	4,566,886	5,878,601	7,911,972
Long-term borrowings	2,372,606	787,757	2,952,130	38,700,000	—
Sale of preferred stock	—	2,637,379	—	—	—
Exercise of common stock purchase warrants	—	—	145,314	—	—
Conversions to common stock:					
Debentures	—	—	1,337,000	1,167,000	—
Preferred stock	—	36,895	63,783	24,772	167,567
Property and equipment sold or converted to lease, less gain included in operations	274,976	588,915	92,368	8,771,567	521,357
Refund of equipment purchase and lease deposits	—	490,000	—	416,840	—
	2,476,578	6,149,577	9,157,481	54,958,780	8,600,896
FUNDS USED					
Additions to property and equipment	2,134,662	1,409,959	925,261	33,150,337	1,907,691
Utilization of DC9 engine maintenance reserve	—	—	—	—	1,750,984
Hijacking payment	—	—	2,000,000	—	—
Equipment purchase and lease deposits	280,000	—	416,840	—	200,000
Reduction of long-term notes payable	1,520,442	3,008,041	2,249,146	20,414,997	4,836,252
Dividends on preferred stock	—	—	—	—	248,035
Conversions to common stock:					
Debentures	—	—	1,337,000	1,167,000	—
Preferred stock	—	36,895	63,783	24,772	167,567
Increase in deferred charges	412,012	6,459	13,887	1,473,195	30,779
Increase in other assets	15,552	11,879	18,669	89,047	29,719
	4,362,668	4,473,233	7,024,586	56,319,348	9,171,027
INCREASE (DECREASE) IN WORKING CAPITAL	(1,886,090)	1,676,344	2,132,895	(1,360,568)	(570,131)
Working capital at beginning of year	3,601,099	1,715,009	3,391,353	5,524,248	4,163,680
WORKING CAPITAL AT END OF YEAR	$ 1,715,009	$ 3,391,353	$ 5,524,248	$ 4,163,680	$ 3,593,549

SOUTHERN AIRWAYS, INC.

STATEMENT OF CHANGES IN FINANCIAL POSITION (Continued)

	Years Ended December 31,				
	1970	1971	1972	1973	1974
INCREASE (DECREASE) IN WORKING CAPITAL BY COMPONENT					
Cash and short term investments ..	$(1,629,817)	$ 2,383,503	$ 686,959	$ 2,323,886	$ 3,826,307
Accounts and notes receivable	2,385,833	(1,084,513)	998,034	6,656,375	(4,150,617)
Maintenance and operating supplies.	179,325	373,621	(129,735)	985,939	1,705,130
Prepaid expenses	(863,159)	282,946	32,236	(96,498)	40,604
Accounts payable	(2,099,236)	807,803	(24,944)	(2,764,454)	(1,731,984)
Collections and withholdings as agent	82,452	(670,743)	(1,539,077)	(1,010,287)	(1,389,228)
Salaries, wages and vacations	(289,032)	(315,014)	(97,887)	(557,795)	(860,232)
Accrued interest, taxes and other expenses	448,535	280,782	588	47,935	(1,131,003)
Air travel plan deposits	3,825	6,375	4,250	5,101	6,374
Current maturities of long-term debt	(104,816)	(388,416)	2,202,471	(6,950,770)	3,114,518
INCREASE (DECREASE) IN WORKING CAPITAL	$(1,886,090)	$ 1,676,344	$ 2,132,895	$(1,360,568)	$ (570,131)

See Notes to Financial Statements.

NOTES TO FINANCIAL STATEMENTS

DECEMBER 31, 1974

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 life. For DC9 flight equipment the life is 15 years (new equipment and rotable parts) and 10 years (used equipment), with a salvage value of 10 per cent; for ground equipment, the life ranges from 3 to 10 years.

The Company is engaged in a program of permanently reducing the use of Martin 404 flight equipment. At December 31, 1974, the Company's investment in Martin 404 flight equipment is fully depreciated except for $486,000 related to engine overhauls, which will be charged to operations based on hours flown.

At the time properties are retired, the amounts of costs and allowances for depreciation and maintenance are eliminated from the accounts. Profits and losses on disposals of DC9 flight equipment (exclusive of rotable parts) are credited or charged to operations. Proceeds from the disposal of DC9 rotable parts are credited to the allowance for depreciation account. Prior to December 31, 1973, proceeds from the disposal of Martin 404 flight equipment and rotable parts were credited to the allowance for depreciation account; subsequent to that date, profits and losses on disposals are included in operations.

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 DC9 aircraft is made at an annual rate of 4 per cent.

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 DC9 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 tax credit, and available investment tax credit is recognized to the extent it can be realized or offset against income taxes currently payable or deferred.

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. At December 31, 1974, the pension fund assets exceeded the actuarially computed value of vested benefits for all plans.

PUBLIC SERVICE REVENUE

The Company receives public service revenue from the CAB for providing service to small and intermediate-size cities on its routes. Amounts received and recognized as revenues are those paid for the period based on the formula then in effect.

Note B — Hijacking Payment

In November 1972, the Company paid $2 million in ransom in connection with the hijacking of one of its DC9 aircraft. This ransom 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 will 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.

Effective July 1, 1973, the CAB implemented a subsidy revenue formula in which the $2 million ransom payment is recognized. This formula, which is amended periodically, has resulted in increased subsidy revenues; however, the Company must return to the CAB a proportionate amount of the increased subsidy funds if and when the ransom payment or any part thereof is returned. Accordingly, the estimated portion of subsidy payments subject to such return provision is being deferred until such time as the recoverability of the ransom payment is determined.

Note C — Long-Term Debt

	At December 31,	
	1974	1973
Notes payable to banks under credit agreement dated February 20, 1973		
"A" Loans, payable quarterly through 1982	$17,623,019	$22,873,789
"B" Loans, payable quarterly through 1979	8,900,000	10,000,000
"C" Loans, payable quarterly through 1977	—	1,600,000
Convertible Subordinated Debentures		
5¾% due December 1, 1981	4,345,000	4,345,000
6½% due November 1, 1983	5,833,000	5,833,000
	36,701,019	44,651,789
Less Current Maturities	3,836,252	6,950,770
	$32,864,767	$37,701,019

The "A" and "B" Loans bear interest at the lead bank's prime rate (10.25 per cent at December 31, 1974) plus 1 per cent and 2 per cent, respectively, and are payable in quarterly installments. Substantially all of the Company's assets are pledged as collateral under the terms of the credit agreement. Additionally, the "A" Loan is 90 per cent guaranteed by the Federal Aviation Administration.

In connection with the credit agreement, the Company maintains average compensating balances, based on bank ledger balances adjusted for treasury tax contribution and uncollected funds, equal to 15 per cent of the average of the "A" and "B" Loans outstanding. Based upon outstanding borrowings at December 31, 1974, the Company should maintain average compensating balances of approximately $5,253,000, which stated in terms of the Company's book cash balances is approximately $3,594,000. The difference is attributable to average uncollected funds and float. During 1974, the Company maintained average compensating balances of approximately $5,719,000. Compensating balances are not restricted as to withdrawals, serve in some instances as compensation to the participating banks for their account handling function and other services, and additionally serve as part of the Company's minimum operating cash balances.

Under its "C" Loan Commitment, the Company may borrow from the First National Bank of Chicago up to a maximum of $790,356. This commitment will be reduced by $100,000 at March 31, 1975, and at the end of each succeeding calendar quarter. The commitment is further reduced by any direct or indirect recovery of the hijack ransom payment (See Note B). The "C" loans bear interest at 155 per cent of the bank's prime rate.

The 5¾% 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 2.75 per cent downward; and require annual sinking fund payments beginning December 1, 1976, in an amount equal to 10 per cent 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 6½% Convertible Subordinated Debentures due November 1, 1983, are convertible (until maturity or prior redemption) into common stock at $10 per share; are subordinated, generally, to all existing and future indebtedness for borrowed money, are callable at premiums ranging from 6 per cent downward; and require annual prepayments beginning November 1, 1978, in an amount equal to 10 per cent 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 amounts.

The terms of the credit agreements 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. Retained earnings available for the payment of dividends at December 31, 1974, under the most restricted requirement, amounted to approximately $150,000.

A summary of minimum principal payments under the credit agreement loans and both issues of convertible subordinated debentures is as follows:

	Credit Agreement Loans		Convertible Subordinated	
Year	"A"	"B"	Debentures	Total
1975	$ 2,220,252	$1,616,000	$ —	$ 3,836,252
1976	2,220,252	1,150,000	434,500	3,804,752
1977	2,220,252	1,200,000	434,500	3,854,752
1978	2,220,252	1,500,000	1,017,800	4,738,052
1979	2,220,252	3,434,000	1,017,800	6,672,052
Thereafter	6,521,759	—	7,273,400	13,795,159
	$17,623,019	$8,900,000	$10,178,000	$36,701,019

Prepayments equal to 25 per cent of net income in excess of $1,500,000 plus 50 per cent of net income in excess of $3,000,000 earned in any fiscal year is required under the "B" Loan. Prepayments due in 1975 under this provision of $616,000 are reflected in the above summary for that year.

Note D — Capital Stock and Options

The Series A Preferred Stock 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 receive $6 per share plus accumulated dividends. The liquidation preference for the 164,431 shares outstanding at December 31, 1974, including the dividend requirement described below, aggregated $1,046,105 which is $881,674 more than the aggregate par value of such shares. All 166,667 shares of Series B $.36 Preferred Stock were converted to common stock, $2 par value, on December 31, 1974, on a share for share basis.

Each share of preferred stock is entitled to receive annual dividends of 36 cents per share cumulative only to the extent of annual net profits. Payment of dividends is also subject to the limitations prescribed by the Indenture Agreements covering the 5¾% and 6½% Convertible Subordinated Debentures and to limitations contained in Credit Agreements (See Note C). The dividend requirement on preferred shares at December 31, 1974, aggregated $119,519, including $60,000 of dividends on Series B converted on December 31, 1974.

Authorized common shares include 1,675,053 shares and 1,842,620 shares reserved at December 31, 1974 and 1973, respectively, for issuance as follows:

	1974	1973
For convertible securities conversions:		
5¾% Convertible Subordinated Debentures (Note C)	400,093	400,093
6½% Convertible Subordinated Debentures (Note C)	583,300	583,300
Series A Convertible Preferred Stock	164,431	165,331
Series B Convertible Preferred Stock	—	166,667
	1,147,824	1,315,391
For exercise of outstanding warrants at $6 per share, issued with Series A (290,562 shares) and Series B (166,667 shares) Convertible Preferred Stock	457,229	457,229
For options under Qualified Stock Option Plan (45,000 shares) and Employee Stock Option Plan (25,000 shares)	70,000	70,000
	1,675,053	1,842,620

At December 31, 1974, there were outstanding options for 44,000 shares of common stock under the Company's Qualified Stock Option Plan, of which 36,000 shares (at $5.25 per share) expire in 1976, 5,000 shares (at $5.81 per share) expire in 1978 and 3,000 shares (at $3.50 per share) expire in 1979. Option transactions during the years ended December 31, 1973 and 1974, are summarized as follows:

	Number of Shares	Option Price	
		Per Share	Total
Outstanding, January 1, 1973	38,000	$5.25 - $11.76	$222,250
Granted	5,000	5.81	29,050
Cancelled	(1,000)	5.25	(5,250)
Outstanding December 31, 1973	42,000	5.25 - 11.76	246,050
Granted	6,000	3.50 - 5.25	26,250
Expired	(4,000)	8.69 - 11.76	(43,750)
Outstanding December 31, 1974	44,000	3.50 - 5.81	$228,550

There were 1,000 shares and 3,000 shares, respectively, available for future grant at December 31, 1974 and 1973.

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 per cent of the fair market value of the stock on the date 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 one-third of the number of shares at any time after 24 months following date of grant, with respect to an additional one-third after 36 months, and with respect to the balance after 48 months. No options were exercised in 1974 or 1973. Options became exercisable during 1974 and 1973, as follows:

	1974	1973
Number of Shares	12,000	12,336
Option Price:		
Per Share	$ 5.25	$5.25 - $11.76
Total	$63,000	$ 72,363
Quoted Market Price at Date Exercisable:		
Per Share	$ 3.50	$3.00 - $6.00
Total	$42,000	$ 39,430

Options for 24,000 shares (aggregating $126,000 at option prices) and 15,000 shares (aggregating $101,500) were exercisable at December 31, 1974 and 1973, respectively.

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 E — 1974 Accounting Change

Because of the increased size of its jet fleet, together with changes in engine maintenance technology which permit a progressive maintenance program, the Company changed its method of recording certain maintenance costs of DC9 engines, effective January 1, 1974, to the method of charging all such costs to operations as incurred. In 1973 and prior years, the Company followed the "built-in-overhaul" method of providing airworthiness reserves for certain maintenance costs of DC9 engines. Under this method, the estimated cost of certain specified maintenance operations was segregated from those engine costs to be depreciated over the estimated useful life of the engine. A related maintenance reserve was then accumulated through regular charges to operations based upon hours used. The reserve was reduced when charges were incurred applicable to the provided maintenance operations. A similar method was used for leased engines. The cumulative effect of this change ($565,000) is reflected as a credit in the statement of operations for 1974. (See Note 5 to Statement of Operations.)

Note F — Leases

Total rental expense for all leases amounted to:

	1974	1973
Financing leases (minimum rentals):		
Flight equipment	$4,748,204	$4,759,488
Other financing leases	1,704,876	1,227,425
Other leases:		
Minimum rentals	1,093,002	975,173
Contingent rentals	442,708	370,910
	$7,988,790	$7,332,996

Contingent rentals relate principally to charges for reservation services based upon the number of unduplicated passengers in excess of a specified minimum of $120,000 per annum. Rentals received from subleases are immaterial.

Future minimum rental commitments as of December 31, 1974, for all non-cancelable leases and for the new maintenance center at the Hartsfield Atlanta International Airport are as follows:

	Financing Leases				
	Flight Equipment	Maintenance Center	Other Financing Leases	Other Leases	Total
1975	$ 4,722,208	$ 256,919	$ 1,635,191	$1,114,906	$ 7,729,224
1976	4,722,208	1,576,761	1,429,645	644,269	8,372,883
1977	4,722,208	1,880,288	1,300,238	191,271	8,094,005
1978	4,722,208	1,880,288	976,089	69,865	7,648,450
1979	3,745,111	1,880,288	888,739	34,006	6,548,144
1980-1984	5,614,815	9,401,440	4,232,843	87,430	19,336,528
1985-1989	—	9,401,440	3,820,196	17,800	13,239,436
1990-1994	—	9,401,440	1,857,691	—	11,259,131
Remainder	—	20,213,093	271,702	—	20,484,795
	$28,248,758	$55,891,957	$16,412,334	$2,159,547	$102,712,596

Under a lease agreement with the City of Atlanta dated January 2, 1974, the Company's rental obligation for land acquired for the new maintenance center began on January 2, 1974, and its rental obligation for the facilities under construction will begin on the earlier of the dates of beneficial occupancy or the dates shown below. Estimated costs, annual rentals, and rental commencement dates are as follows:

	Estimated Cost	Annual Rental	Approximate Rental Commencement Dates
Land	$ 1,506,285	$ 120,503	January 2, 1974
Phase One Facilities	7,511,000	545,665	October 1, 1975
Phase Two Facilities	16,608,000	1,214,120	April 1, 1976
	$25,625,285	$1,880,288	

Cost of the Phase One and Phase Two Facilities is to be financed by the City through the issuance of Airport Extention and Improvement Revenue Bonds in the principal amounts needed to provide monies for the estimated costs shown above, which will be the City's maximum obligation. Cost of improvements in excess of the estimated amount must be borne by the Company. The lease extends for a period of 30 years from October 1, 1975, or the date of beneficial occupancy of the Phase One Facilities, whichever occurs first, and may be renewed at the Company's option for an additional term extending to January 1, 2024.

Most of the Company's other leases do not contain formal renewal options. However, consistent with the prevailing practice in the industry, leases with relatively short terms are generally renegotiated and extended at the conclusion of their terms, and leases with relatively long terms generally provide for renegotiation of their provisions at specified intervals throughout their term.

The estimated present values of the net fixed minimum rental commitments for all non-capitalized financing leases are:

	Interest Rates Used					
	Weighted Average		Range		As of December 31,	
	1974	1973	1974	1973	1974	1973
Flight equipment	7.45%	7.45%	5.3%- 8.7%	5.3%- 8.7%	$22,019,882	$25,021,221
Computer and message switching equipment	12.64	11.89	6.8 -23.7	6.8 -23.7	1,102,165	1,557,437
Airport terminal facilities	6.34	5.09	2.9 - 7.5	2.9 - 7.5	5,000,676	3,028,358
General office and maintenance facilities (includes land for new maintenance center in 1974)	6.52	5.02	3.5 - 7.2	3.5 - 6.3	2,186,730	793,352
Miscellaneous ground equipment	6.19	6.22	4.6 - 6.8	4.6 -10.0	16,724	24,643

The present values were computed after reducing total rental commitments, where required, by estimated or actual amounts applicable to lessors' payments of taxes, insurance, maintenance and other operating expenses.

If all financing leases had been capitalized and it was assumed that the estimated present values were amortized on a straight-line method over the terms of the leases and that interest expense was accrued on the outstanding lease obligations at the rates shown above, the increase in expenses would have been as follows:

	1974	1973
Rent expense — net	$(6,048,000)	$(5,680,000)
Amortization of leased property	4,260,000	4,038,000
Interest expense	2,257,000	2,265,000
Income taxes	(131,000)	—
Increase in expenses	$ 338,000	$ 623,000

To the extent that the increased expenses were not offset by resultant increases in subsidy revenues and related income taxes, which are indeterminable as to specific amounts, net income would have been decreased commensurately.

Landing fees were $2,161,912 in 1974 and $1,838,376 in 1973.

Note G — Other Commitments and Contingencies

In connection with the sale of two aircraft in 1973, the Company agreed to indemnify the purchaser against loss to the extent of $350,000 in the event the third party to which the purchaser resold the aircraft should default in payment to the purchaser.

The Company has commitments for the acquisition of three used DC9-30 aircraft valued at approximately $12,000,000. The Company is currently negotiating the financing of these aircraft. These aircraft are expected to be placed into service in mid-1976.

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 $2,000 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.

Reference is made to Item 5 of this Report "Pending Legal Proceedings," for information applicable to litigation.

Note H — Supplementary Information

	1974	1973
Depreciation and Amortization (Schedules VI and VII):		
Depreciation of property and equipment	$3,840,039	$3,193,436
Amortization of deferred charges	546,261	362,813
Provision for inventory obsolescence	113,371	236,772
	4,499,671	3,793,021
Deduct — Amounts charged to other accounts	102,690	119,584
	$4,396,981	$3,673,437
Taxes, other than income taxes, charged to operating expenses:		
Payroll taxes	$1,785,487	$1,456,401
Fuel and oil taxes	237,223	150,423
Property taxes	427,000	360,000
Sales and use taxes	332,555	243,980
Other	137,584	127,028
	$2,919,849	$2,337,832
Rents:		
Rental expense under leases (Note F)	$7,988,790	$7,332,996
Portion of gross lease rentals not charged to rent expense in accordance with CAB classifications and miscellaneous rentals, net	(57,280)	(98,118)
	$7,931,510	$7,234,878
Advertising Costs	$1,188,635	$1,248,202

There were no royalties or research and development costs.

SOUTHERN AIRWAYS, INC.

SCHEDULE II — AMOUNTS RECEIVABLE FROM UNDERWRITERS, PROMOTERS, DIRECTORS, OFFICERS, EMPLOYEES, AND PRINCIPAL HOLDERS OF EQUITY SECURITIES

Column A	Column B	Column C	Column D	Column E
Name of Debtor	Balance at Beginning of Period	Additions	Deductions Amounts Collected	Balance at End of Period
		Year Ended December 31, 1973		
SOADO Venture	$ —	$60,537	$60,537	$ —

Represents expenses paid by the Company in connection with a secondary offering of Company's securities to stockholders of the Company as of June 22, 1973. Such amounts were repaid to the Company by the selling group at the conclusion of the offering period.

SCHEDULE V — PROPERTY AND EQUIPMENT

Column A	Column B	Column C	Column D	Column E	Column F
Classification	Balance at Beginning of Period	Additions	Retirements	Other Changes-Add (Deduct)-Describe	Balance at End of Period
		Year Ended December 31, 1973			
Flight Equipment	$26,766,370	$34,540,598(A)	$10,198,677(A)	$ —	$51,108,291
Ground Equipment	3,822,489	1,025,341	18,676	—	4,829,154
	$30,588,859	$35,565,939	$10,217,353	$ —	$55,937,445
		Year Ended December 31, 1974			
Flight Equipment	$51,108,291	$ 1,078,297	$ 1,573,360	$ 38,530(B)	$50,651,758
Ground Equipment	4,829,154	829,394	266,287	—	5,392,261
	$55,937,445	$ 1,907,691	$ 1,839,647	$ 38,530	$56,044,019

(A) Principally, the purchase of 13 DC9 aircraft and subsequent sale of four DC9 aircraft in 1973.

(B) Purchase of Martin 404 parts for fully-depreciated Martin 404 aircraft. See contra item in Schedule VI.

SOUTHERN AIRWAYS, INC.

SCHEDULE VI — ALLOWANCES FOR DEPRECIATION AND MAINTENANCE OF PROPERTY AND EQUIPMENT

Column A	Column B	Column C	Column D	Column E	Column F
Description	Balance at Beginning of Period	Additions Charged to Cost and Expenses	Retirements	Other Changes Add (Deduct)-Describe	Balance at End of Period
		Year Ended December 31, 1973			
Flight Equipment	$10,537,760	$ 3,020,102 3,300,894(A)	$ 1,429,811	$(1,595,290) (B) 2,415,602 (C)	$16,249,257
Ground Equipment	3,063,917	173,334	15,975	—	3,221,276
	$13,601,677	$ 6,494,330	$ 1,445,786	$ 820,312	$19,470,533
		Year Ended December 31, 1974			
Flight Equipment	$16,249,257	$ 3,342,097 570,984(A)	$ 814,320	$(3,177,534) (D)	$16,170,484
Ground Equipment	3,221,276	497,942	259,894	—	3,459,324
	$19,470,533	$ 4,411,023	$ 1,074,214	$(3,177,534)	$19,629,808

(A) Provision for airframe and engine overhauls.

(B) Expenditures for airframe and engine overhauls.

(C) Estimated accumulated maintenance cost at date of acquisition applicable to used engines acquired during 1973 representing hours consumed on such engines by prior owner.

(D) Composed of the following:

Expenditures for engine overhauls	$ (655,629)
Utilization of maintenance reserve described at (C) above	(1,750,984)
Write off due to accounting change, Note E	(809,451)
Reserve requirement on parts purchased for fully-depreciated Martin 404 aircraft. See contra item in Schedule V	38,530
	$(3,177,534)

SOUTHERN AIRWAYS, INC.

SCHEDULE VII — PART B — PRE-OPERATING EXPENSES AND SIMILAR DEFERRALS

Column A	Column B	Column C	Column D		Column F
			Deductions		
Description	Balance at Beginning of Period	Additions at Cost -Describe	Charged to Costs and Expenses	Charged to Other Accounts -Describe	Balance at Close of Period
		Year Ended December 31, 1973			
Unamortized preoperating, route extension and development costs	$ 417,918	$1,418,184	$287,168	$ —	$1,548,934
Deferred lease costs	188,560	—	29,311	—	159,249
Unamortized long-term debt expense	452,977	55,011	46,334	54,876(B)	406,778
	$1,059,455	$1,473,195	$362,813(A)	$ 54,876	$2,114,961
		Year Ended December 31, 1974			
Unamortized preoperating, route extension and development costs	$1,548,934	$ 30,779	$462,638	$ —	$1,117,075
Deferred lease costs	159,249	—	29,311	—	129,938
Unamortized long-term debt expense	406,778	—	54,312	—	352,466
	$2,114,961	$ 30,779	$546,261	$ —	$1,599,479

(A) Amortization is credited directly to the asset and charged to operations as follows:

	1973	1974
Depreciation and amortization	$287,168	$445,291
Flying operations	28,089	28,089
Aircraft and traffic servicing	1,222	1,222
Interest on long-term debt	46,334	54,312
Miscellaneous expense	—	17,347
	$362,813	$546,261

(B) Amount applicable to debentures converted, charged to Other Paid-In Capital.
Column E, Other Changes, has been omitted as there were no other changes.

SCHEDULE XII — VALUATION AND QUALIFYING ACCOUNTS AND RESERVES

Column A	Column B	Column C	Column D	Column E
Description	Balance at Beginning of Period	Additions Charged to Costs and Expenses	Other -Describe	Balance at End of Period
	Year Ended December 31, 1973			
Allowance for doubtful accounts	$ 28,945	$138,400	$ (67,663)(A)	$ 99,682
Allowance for obsolescence — maintenance and operating supplies	$ 928,817	$236,772(B)	$ —	$1,165,589
	Year Ended December 31, 1974			
Allowance for doubtful accounts	$ 99,682	$102,000	$ (102,747)(A)	$ 98,935
Allowance for obsolescence — maintenance and operating supplies	$1,165,589	$153,545(B)	$ —	$1,319,134

(A) Bad debts written off, net of recoveries.
(B) Comprises the following:

	1973	1974
Provision for inventory obsolescence	$ 236,772	$ 113,371
Allowance required for parts purchased for fully depreciated Martin 404 equipment	—	40,174
	$ 236,772	$ 153,545

EXHIBIT 1

SOUTHERN AIRWAYS, INC.

COMPUTATIONS OF EARNINGS PER COMMON AND COMMON EQUIVALENT SHARE
(This Exhibit should be read in conjunction with Note (6) to the Statement of Operations)

Years Ended December 31, 1974 and 1972:

	1974		1972	
Amounts	**Primary**	**Fully Diluted**	**Primary**	**Fully Diluted**
Net income before Extraordinary Credit and Accounting Change	$3,481,691	$3,481,691	$1,600,317	$1,600,317
Imputed interest (less related income tax effect at 28% in 1974) related to: (a)				
Options and Warrants issued since June 1, 1969	152,937	152,937	58,760	58,760
Warrants issued prior to June 1, 1969 (cancelled July 25, 1973)	—	—	—	81,900
6½% Convertible Subordinated Debentures	—	272,984	—	482,084
5¾% Convertible Subordinated Debentures	—	179,883	—	260,645
	152,937	605,804	58,760	883,389
Preferred dividend requirement	(119,519)	—	(128,437)	—
Adjusted Net Income (A)	$3,515,109	$4,087,495	$1,530,640	$2,483,706
Extraordinary tax credit (less related income tax effect of imputed interest at 25% in 1972) (a) (B)	325,055	325,055	423,940	630,097
Accounting Change (C)	565,375	565,375	—	—
Adjusted income before extraordinary credit and accounting change (D)	$2,624,679	$3,197,065	$1,106,700	$1,853,609
Shares				
Common shares	1,413,825	1,413,825	1,194,426	1,194,426
Preferred shares	—	330,816	—	374,004
Options and warrants issued since June 1, 1969	185,057(b)	185,057(b)	245,091(c)	245,091(c)
Warrants issued prior to June 1, 1969 (cancelled July 25, 1973)	—	—	—	126,000
6½% Subordinated Debentures	—	583,300	—	741,667
5¾% Subordinated Debentures	—	400,092	—	417,400
(E)	1,598,882	2,913,090	1,439,517	3,098,588
Per Share				
Before extraordinary credit and accounting change (D) ÷ (E)	$ 1.64	$ 1.10	$ .77	$ .60
Extraordinary credit (B) ÷ (E)	.20	.11	.29	.20
Accounting change (C) ÷ (E)	.35	.19	—	—
Net income (A) ÷ (E)	$ 2.19	$ 1.40	$ 1.06	$ .80

Computational Notes:

(a) Rates used are approximate overall effective tax rate each year after reduction for investment tax credit.

(b) Total shares issuable upon exercise (501,103), less 20% of common shares outstanding at December 31, 1974 (316,046).

(c) Total shares issuable upon exercise (499,329), less 20% of common shares outstanding at December 31, 1972 (254,238).

Year Ended December 31, 1973:

	Income Before Extraordinary Credit	Extraordinary Credit	Net Income
Income amounts	$ 319,748	$ 97,000	$ 416,748
Preferred dividend requirement	119,519	—	119,519
Available for common	$ 200,229	$ 97,000	$ 297,229
Divide by weighted average number of common shares	1,314,016	1,314,016	1,314,016
Per share	$ .152	$ .074	$ .226

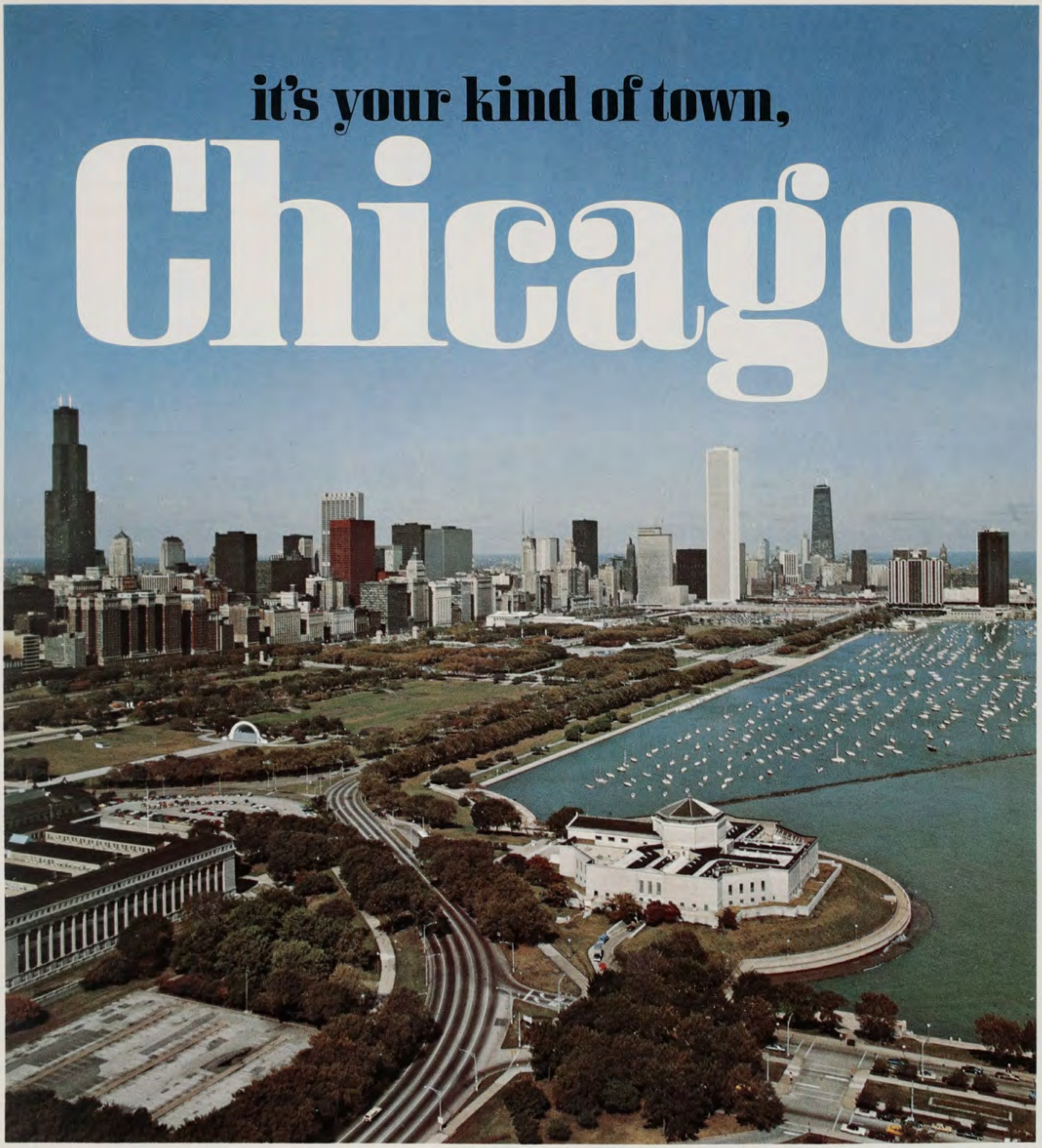
EXHIBIT 2

SOUTHERN AIRWAYS, INC.

COMPUTATION OF (a) RATIO OF INCOME TO FIXED CHARGES AND (b) RATIO OF INCOME TO FIXED CHARGES AND PREFERRED DIVIDEND REQUIREMENTS

(This Exhibit should be read in conjunction with Note (7) to the Statements of Operations)

	Years Ended December 31,				
	1970	1971	1972	1973	1974
Income:					
Net income (loss)	$(3,333,212)	$(1,058,784)	$ 1,600,317	$ 416,748	$ 3,481,691
Income taxes	—	—	449,500	109,000	985,000
Cumulative effect of accounting change	—	—	—	—	(565,375)
Tax benefits of operating loss carryforward	—	—	(409,250)	(97,000)	(325,000)
Deferred Income Tax (credit)	—	(235,000)	—	—	294,000
Fixed charges	3,814,849	3,946,060	3,919,179	5,620,919	6,479,066
Income	$ 481,637	$ 2,652,276	$ 5,559,746	$ 6,049,667	$10,349,382
Fixed charges:					
Interest expense	$ 1,788,784	$ 1,678,112	$ 1,361,913	$ 3,083,390	$ 3,929,321
Amortization of deferred debt expenses	93,026	99,293	66,475	46,334	51,190
Interest element of rentals	1,933,039	2,168,655	2,490,791	2,491,195	2,498,555
Total fixed charges	3,814,849	3,946,060	3,919,179	5,620,919	6,479,066
Preferred dividend requirement and related income tax effect	—	—	160,456	149,399	152,984
Total fixed charges and preferred dividend requirements	$ 3,814,849	$ 3,946,060	$ 4,079,635	$ 5,770,318	$ 6,632,050
Ratio of income to fixed charges	.13	.67	1.42	1.08	1.60
Ratio of income to fixed charges and preferred dividend requirements	.13	.67	1.36	1.05	1.56



That's right, Mayor Daley's toddlin' town has been sung about in more ways and for more reasons than just about any big town. Big, bluff and blustering, Chicago is the cog that makes the Midwest move, the kind of town most businessmen, conventioneers and pleasure-seekers will visit sooner or later. Mostly sooner.

When your plans call for the Windy City, come the Southern route. Southern has non-stop and direct service to both O'Hare and Midway airports. And you'll appreciate Southern's democratic approach to in-flight DC9 comfort. Nobody's Second Class on Southern.

So whether you're headed for the Loop or the North Shore, the Merchandise Mart or the First National Plaza, fly Southern Airways. It's your kind of airline for your kind of town.

Chicago

Cayman Islands

the dream's on us.

Just about everything has been written and said about those paradise islands of the Caribbean. Their splendid isolation, blinding white beaches, colorful flora; their quaint little restaurants and out-of-the-way shops; their laughing people with their odd customs and gentle ways.

In truth, that was the way things were until a great tidal wave of tourists washed away most of the isolation and replaced the romance and other-world feeling with casinos, Fifth Avenue boutiques, haughty waiters, and high prices.

But not in the Cayman Islands. This outpost in the British West Indies retains the peace and serenity of an earlier, less-hectic time. The largest island, Grand Cayman, offers the visitor the chance to unwind in natural, untouched surroundings. It's colorful, scenic, different. The snorkeling's great, the fishing plentiful, the residents far from restless. It's as if you'd been suddenly transported to one of the other Caribbean resorts as it was 20 years ago. When every island was only an island.

THE CAYMAN ISLANDS

For rates and travel information contact your travel agent or Southern Airways, United States Flag Carrier to the Cayman Islands.