

June 30, 1949

Mr. Walter S. McLucas
Financial Advisor to American Airlines, Inc.
National Bank of Detroit
600 Woodward Avenue
Detroit, Michigan

Dear Mr. McLucas:

It was suggested by Mr. C. R. Smith that I write to you outlining inventory control and procedures of American Airlines and our present inventory position.

We organized the Materials Department two years ago which is responsible for the following: Purchasing, Stores and warehousing, Inventory Control and Surplus Sales. This results in coordinated control of the company inventory in all phases. At the end of April, 1949 the total value of materials and repair parts inventory amounted to \$10,619,000.

The functions of the inventory control division include controlling of inventory on the shelf by reviewing usage. Those parts on which usage is unreasonably high are brought to the attention of the Engineering and Operations Departments to see what can be done to reduce the usage by developing a new part or improving the existing part. Standardization is effected wherever possible; for instance, parts and assemblies installed in Convairs under a Convair number are often found to be identical to parts and assemblies installed in the DC-6 under some other identification number.

We also endeavor to have parts or assemblies routed through our overhaul shop, repaired and put back in stock at the earliest possible date, to avoid increasing inventory levels to supply line requirements during the period such parts are in the process of being repaired.

The DC-3 airplanes have been sold and we are in the process of disposing of the entire remaining DC-3 inventory consisting of airframe and engine repair parts and assemblies. This inventory at the end of April amounted to \$1,467,407 against which a reserve of \$1,261,353 had been provided.

We will retain 13 DC-4 airplanes to be used as cargo airplanes. All repairable units in excess of requirements for operation of these airplanes will be disposed of. Expendable parts were gradually reduced

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over the period during which the passenger fleet was being retired, leaving us with very little surplus of such material.

The inventory provisioned for the Douglas DC-6 and Convair airplanes was held to a minimum realizing the requirements for new airplanes during the initial operating program would be less than that required after the airplanes had approached their first overhaul period. Additional parts must be procured to accommodate increasing requirements due to increased operating hours on the airplanes and parts must be procured for handling the overhaul programs. This inventory is carefully reviewed and action taken to avoid having excess quantities or obsolete parts in stock.

The Materials Department is represented on the Project Control Committee through which consideration is given to new design, additions, improvements and replacements. Prior to the approval and release of such projects, an investigation is made to determine whether or not the engineering change will cause certain parts on hand to become obsolete or surplus to our needs. The value of such parts as will become obsolete or surplus is included in the cost of the proposed engineering change. Action taken by the Project Control Committee is then governed by the need for the proposed engineering change as compared with the total cost of the project, including parts made obsolete or surplus by such engineering change.

The DC-6 and Convair airplanes use the war surplus R-2800 engines which were purchased at a very attractive price. Parts required for overhauling these engines were purchased in reasonably large quantities at prices equivalent to approximately 40% of current engine manufacturer's sales prices.

Due to availability and low cost, large purchases of certain types of parts were made during the initial R-2800 engine parts purchase program. This created an unbalanced inventory in that certain parts were available for 2600 engine overhauls whereas other parts (in most cases the expensive unit cost items) were purchased in lesser quantities. We recently increased our commitments to take care of eighteen (18) months' requirements of such parts of which cylinders was the greatest dollar portion. For example -- cylinders today from Pratt & Whitney Aircraft cost approximately \$360 each whereas these cylinders were purchased from War Assets stock at \$90 each. These recent commitments have shipping dates corresponding with our future requirements thereby avoiding the investment of dollars in an inventory to be put on the shelf.

The remaining inventory totalling approximately \$2,000,000 is comprised of parts common to the DC-4, DC-6 and Convair airplanes, including instruments and radio. We believe this to be current usable inventory. The materials and supplies amount to \$1,022,000 and is controlled as to purchase and use. In fact, this item has been reduced by \$300,000 during the past year.

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The Materials Department is responsible for the sale of all surplus and obsolete inventory, including airplanes, engines and parts. Experience indicates that the current market for surplus, obsolete DC-3 parts is very restricted and where large inventories are being moved to avoid warehousing and storekeeping expenses, the return has been as low as 3¢ to 10¢ of the cost value. Confronted with this condition, we established the reserve for obsolescence as mentioned above over the useful life of the aircraft and the same policy is being followed in respect to setting up a reserve for obsolescence for spare repair parts and assemblies used on DC-6 and Convairs.

I don't believe any of us minimize the importance of this problem and it is a subject reviewed among several of us weekly. Our general feeling is that a balanced job is being done.

I trust that the above is helpful to you. However, should there be further questions in your mind on this subject, please do not hesitate to write.

Yours sincerely,

Wm. J. Hogan
Treasurer

WJH:mp

cc - All American Airlines Directors

