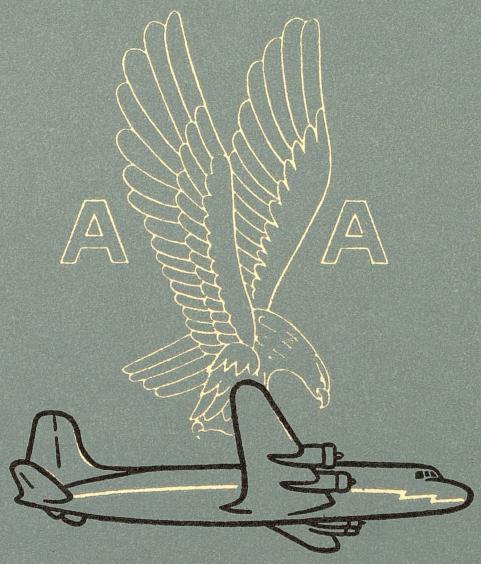
The Strategic Position of the Air Transport Industry



with special emphasis on American Airlines, Inc.

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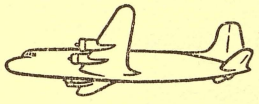

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Strong Growth Trends

Strong growth characteristics continue to underlie the development of the air transport industry. The vigorous past trends indicated in Table I below should persevere, both with respect to absolute gains and relationships to the competitive travel market. Based on estimated traffic for November and December, our own projection anticipates about 8 billion revenue passenger miles for the entire year of 1950, or better than a 21% gain over 1949.

TABLE No. I

GROWTH AND RELATIONSHIP OF AIR PASSENGER MILES TO FIRST CLASS AND TOTAL RAIL PASSENGER MILES

	Passenger Miles*			Percent	
	Rail		Air		
Year	Pullman or 1st Class	1st Class and Coach Total	Domestic Trunk	Total Air of 1st Class Rail	Total Air of Total Rail
1938	7,354	17,601	480	6.5%	2.7%
1939	7,527	18,645	683	9.1	3.7
1940	7,288	19,773	1,052	14.4	5.3
1941	9,166	25,272	1,385	15.1	5.5
1942	17,853	48,763	1,418	7.9	2.9
1943	24,672	82,581	1,634	6.6	2.0
1944	26,944	90,231	2,178	8.1	2.4
1945	26,912	86,327	3,336	12.4	3.9
1946	19,801	58,840	5,903	29.8	10.0
1947	12,261	39,925	6,057	49.4	15.2
1948	11,015	35,329	5,875	53.3	16.6
1949	9,349	29,622	6,610	70.7	23.3
1st 8 Mos. 1950	6,001	17,498	5,035	83.9	28.7

* In millions.

SOURCES: Railroad Traffic—Interstate Commerce Commission
Airline Traffic—Air Transport Association of America

It can be seen that the entire domestic air transport industry flew slightly more than 480 million revenue passenger miles in 1938, or only about 6% of the estimated 1950 total. The gain since 1946 alone has amounted to 35%.

It is highly significant that the airline group has made substantial inroads in the competitive first class travel market. Pullman, or first class rail travel, which has long dominated this field, is rapidly losing ground relative to its newest rival. In 1946 airline travel was equivalent to only 30% of Pullman traffic. By 1949 this ratio had risen beyond 70%, and has since climbed to 84% in the first eight months of 1950. If present trends persist, air travel will not only equal but may well surpass the level of Pullman traffic this year.

Broad Market Horizons

This does not mean that the airline market will be satiated once it attains the Pullman level. A rising ratio of air travel to both Pullman *and* rail coach traffic has been manifested. The previous table reveals that in the post-war year of 1946, air travel equalled only 10% of the total rail volume as represented by *combined* Pullman and coach accommodations. By 1949 this relationship was up to 23%, and, for the first eight months of 1950, achieved a peak penetration of almost 29%.

The normal growth trend of the airlines has been accelerated this year by a combination of factors. Among these were aggressive merchandising of air travel and a rapidly improving safety record, which together with new technological advances in the aeronautical art, have inspired greater confidence in the industry.

Promotional Devices

Aggressive merchandising, in part, has taken the form of various promotional fares. The "Family Fare" plan, introduced by American in 1948, spread throughout the industry. Air coach service, started late in 1948 by Capital in its night schedule, is now firmly established in many trunk line schedules. American and Eastern, among others, now operate selected coach services over major high density traffic segments of their system. American's air coach fares are constructed in such a manner that a full plane load of 70 passengers produces the same or greater revenue as a full standard plane of 52 passengers at the regular or higher fare. The coach tariff originally was established at 4 cents vs. a basic rate of 6 cents per passenger mile for standard service. By a Civil Aeronautics Board edict on November 16, 1950, the basic rate for coach services was raised to 4½ cents per mile. Despite this increase, coach schedules continue popular with the public.

Coach services, obviously, have opened up new traffic vistas for the airlines, and may well represent an important key to broader future markets. For the time being, this type of service may not spread much further, as accelerated mobilization and economic activity should maintain demand for standard flights at high levels. Sufficient experience, however, has been obtained from air coach operations to prepare this promotional device for greater utilization when the need for such a traffic stimulant arises.

Safety and Technological Gains

Constantly improving passenger service and a growing appreciation of the sound safety record have been important elements in establishing new gains in air travel. Passenger fatalities have declined from 4.5 per 100 million passenger miles in 1938 to 1.4 in 1949 and 1948. Further improvement in the safety record was experienced in 1950.

The industry has made important strides in all-weather flying, greatly facilitating "on time" performance. The expanded improvement in airways navigation aids, traffic control and supporting facilities, conducted by the Air Navigation Development Board and financed largely by a long-term government program, all serve to improve the dependability and safety of air transportation. These conditions will win new converts to air travel, further broadening its markets.

With industrial production, as a result of our current mobilization program, placing a premium on speed in transportation and communications, it is evident that the growth factor in airline volume is likely to be accelerated sharply in the period immediately ahead.

AIRLINE OPERATIONS IN TIME OF MOBILIZATION OR WAR

Flexibility

The airlines are of strategic importance in times of national crisis. During World War II, the industry turned over almost half of its fleet to the armed forces and, in addition, performed a wide variety of operations for the government including extensive contract flying, training programs for Army and Navy personnel, modification and maintenance of military equipment and special research projects on aircraft and aviation devices and fuel.

The real impact to wartime airline operations, however, came from commercial services made more compact and stimulated at the same time by military exigencies.

Of about 325 transport planes in domestic service on December 7, 1941, almost half were requisitioned by the military. With 51% of the former number of aircraft, the airlines operated some 71% of their former mileage. Despite these limitations imposed by equipment shortages, the airlines continued to show increases in every revenue department during the four-year war period.

A combination of factors were responsible for this unique showing. In the first place, there was no problem of filling planes to capacity levels since passengers were willing to put up with almost any inconvenience made in the name of the war effort.

Earnings Impact

Under such wartime influences, multiple leverage factors came into active play, on the upside, to translate virtually all revenue increases above the breakeven point into profits. The average passenger load factor rose to around 90%. The impact on earnings was obvious when it is realized that passenger load factors above 70% afford profitable operations during normal periods. Similar conditions applied to cargo and mail loads; such volume at the peak of the war was more than three times that of the pre-war experience.

It is significant that reduced round-trip rates and other promotional fares were eliminated during the war period.

Airline Arteries Essential

The need to transport high priority passengers, cargo and mail, and to maintain an accelerated flow of industrial production was amply demonstrated during World War II. Governmental recognition of this is manifested in the recent granting of priority orders to obtain essential parts to keep commercial transports in operation. Further, U. S. airlines have some 180 new transports currently on order for delivery during 1951 and 1952. Thus far, there is every indication that the airlines will be permitted to accept these planes as scheduled. They will be utilized in commercial service or operated for the military under contract.

The airlines are reconciled to losing a substantial number of their four-engine aircraft to the military. Such diversions may range from at least 25% and, in the event of extreme military emergency, to a possible 100% of the four-engine planes available to the separate air carriers. Airline operations and earnings during a period of national emergency would, of course, be affected directly by the number and type of aircraft each carrier was permitted to operate.

If and when a tight supply situation develops among the available air transports, it is possible that extensive reallocation of aircraft would be made among the separate airlines. Feeder and other light density air carriers would most likely feel the heaviest losses in equipment. On the other hand, airlines serving the most active industrial or military sections of the country would be affected the least from loss of aircraft and at the same time have the greatest traffic stimulus.

Leverage Compounded

The reduction in numbers of planes available for commercial service could be more than offset by greater utilization and attendant factors. These constructive elements may be enumerated as follows:

(a) Instead of flying planes on the average of around 6:41 hours per day, the 1949 experience, utilization could well exceed 10 hours daily, the past wartime experience.

(b) The per plane average of 1,691 miles flown per day during 1944 would easily be surpassed by the airlines once greater daily hourly utilization of aircraft increased. Today's aircraft have higher block-to-block speeds than those prevailing in 1941.

(c) Capacities of each airplane would be materially increased. For example, the DC-3 21-place plane can be made to carry 28 seats. The standard DC-6, seating between 50 to 52, can be increased to a capacity of 70 to 80 passengers.

(d) Once again, passenger load factors instead of ranging from the 50's to the 70's, would be boosted and maintained at or above 90%.

All of these conditions, operating in unison, would serve to compound the upward leverage factor in airline operations.

Moreover, with such high traffic demands prevailing, there no longer would be any necessity of enticing passengers with special promotional fares. Accordingly, air coach fares, family fares and special excursion deals might well be eliminated for the duration. These fare concessions all tend to stimulate traffic; an undesirable goal in a war economy. Instead of a part of traffic moving at coach fares of 4½ cents per mile, the industry average might be moved up to a uniform level of between 5.5 cents and 6 cents per passenger mile.

Subsidized Earnings in Jeopardy

As operating income increases, airline mail pay will come in for closer scrutiny by the Civil Aeronautics Board. Those carriers now heavily subsidized through mail compensation may find their revenues from this source in real jeopardy.

The moods of the Congress, the President and the CAB are strongly in the direction of decreasing mail subsidies as quickly as possible. Only recently, the CAB ordered a reduction in the final mail rate for Western Air Lines, finding that a temporary rate in effect for the period prior to January 1, 1949, was excessive and above the "need" of the carrier. Similar action against other marginal airlines with relatively high mail pay may be forthcoming as their earnings attain "excessive" levels. There is no exact demarcation line showing where a compensatory service rate ends and a subsidy basis begins. Official implications and actual mail rates do, however, support the contention that a carrier such as American, for example, is on a self-sufficient basis. As such, they afford minimum risk in having their potential earnings recaptured through a reduction in mail compensation.

Excess Profits Tax Shelter

The airlines are accorded special treatment in receiving partial exemption from the excess profits tax as recently enacted by Congress.

One basic formula provides a credit equal to 85% of average earnings in the best three out of four years, 1946 to 1949.

As an alternate, a special formula grants the airlines an excess profits tax credit equal to normal taxes plus 7% on invested capital. Invested capital would include equity, short and long-term debt and surplus. Interest on borrowed capital, however, would be excluded from the EPT credit.

The mail pay exemption provision in the current law follows the same pattern incorporated in the EPT law during World War II.

In substance, the amount of air mail revenues received are deducted from net income subject to the excess profits tax impost. This exemption supplements the additional relief provided in any of the basic EPT formulas that may be applied.

With parcel post currently adding to air mail volumes, this substantial base is broadened even further for EPT exemption purposes. Air parcel post was not in existence during World War II.

The mail pay exemption does not apply once an airline's excess profits taxable income exceeds the amount of mail revenues received. Nevertheless, this special credit will tend to give the air transport industry an unusually high base for protection against excess profits tax imposts.

Only one major carrier, Eastern, paid any excess profits taxes during World War II. It is conceivable, that under certain circumstances, the air mail revenues may be exceeded by the excess profits taxable income for a few of the major airlines. However, the exemption bases available, through the alternate formulas currently adapted to the airlines, are far more extensive this time than prevailed in World War II.

For example, the invested capital for American Airlines is now almost three times as great as that of its average during the last war.

The current Excess Profits Tax legislation is retroactive to July 1, 1950, and is scheduled to expire June 30, 1953. The same law provides for a corporate normal and surtax rate of 47% beginning with January 1, 1951 for most companies. The combined normal and excess profits tax levy can not exceed 62%.

Aircraft Obsolescence

The obsolescent factor on existing air transport types may be postponed as a result of the current accelerated military aircraft procurement program.

This factor can be constructive to those airlines now flying modern, post-war equipment. Considerable attention has been focused recently on the possible advent of jet or turbo-prop transports in commercial service. The successful culmination of this development would, of course, have a far-reaching effect on the finances and operations of all airlines.

Despite the rapid strides made in jet aircraft design, both military and commercial, competent aeronautical authorities have believed that the earliest possible year in which a jet passenger transport type could be introduced into regular service would be 1955. (It must be assumed that all engineering "bugs" will have been eliminated and safety and dependability clearly demonstrated. High fuel consumption and associated traffic problems must also have been brought under control.) This is an optimistic measure of time; others are far less sanguine and anticipate even a longer period before the jet transport will have arrived commercially.

These estimates existed prior to the Korean war. In view of the urgency to accelerate our military aircraft production, it appears that intensive time, resources and manpower will no longer be available to pursue the necessary development on jet transports for commercial service.

Any radically new aircraft type, such as is envisioned by the jet and turbo-prop transport designs, will undergo an even more rigorous and exacting proving period by the CAB before obtaining the coveted certificate so necessary to commercial service.

A condition may be forming in that not only is obsolescence deferred, but tangible increment to earnings (before taxes) may accumulate due to certain equipment being fully depreciated but remaining in service. High depreciation charges take a heavy toll of airline revenues. Any extension of the depreciation base is bound to have an appreciable effect in increasing pre-tax earnings.

Carriers having completed their transition programs to the most modern aircraft models or in the process of taking delivery of current equipment types, now find their positions substantially enhanced if obsolescence submits to an enforced slow-down.

Selectivity Essential for Profitable Commitments

The general economic climate surrounding the airline industry in the period immediately ahead, on balance, is likely to be conducive to a high level of sustained earnings. However, it is apparent that not all air carriers will participate in this boom to the same degree. In fact, a number of airlines will have their earnings in constant jeopardy. Selectivity for profitable industry commitments is more important now than at any time in the past.

In evaluating all known elements, American measures up as having among the greatest potentialities in earning power with the attachment of minimum risks.

AMERICAN AIRLINES, INC.

Company and Position

American Airlines, Inc. operates the largest domestic air transport system in the United States. It leads the industry in terms of route miles operated, revenue passenger miles flown and total revenues received. Of all the trunk lines, American has the heaviest traffic densities. Despite various encroachments in recent years, through the award of competitive routes to other carriers, American has consistently averaged about 23% of the total gross revenues generated by the 16 domestic trunk lines.

American's route network comprise key arteries in the air transportation pattern essential to the industrial mobilization and military effort of the United States. As indicated by the accompanying map, American has, in effect, dual transcontinental routes; both emanating from New York but one proceeding via Chicago to Los Angeles with the other running a more southerly course through Tulsa, Oklahoma or Dallas, Texas and on to Los Angeles or San Francisco. In addition, American serves the heavily populated east with a strong network which garners traffic for its transcontinental runs as well as providing profitable shorter haul business. A direct service to Mexico City is also provided from both the east and west coasts. Toronto is American's link to Canada.

American maintains the lead in volume of traffic handled on such competitive routes as New York to Los Angeles, New York to Chicago, Washington to Chicago, Boston to New York and New York to Washington.

American's high passenger traffic density is established by the measure of passengers carried per route mile. On this basis, American's 1949 average was 494 compared with only 307 for United, 260 for TWA, and 182 for Northwest.

American's 9,219 unduplicated miles compares with 8,027 for United and 7,154 for TWA. As of July 1, 1950, the Company served 68 cities as compared with 80 for United, 50 for TWA.

It is highly significant that only two railroads in the United States, The New York Central and Pennsylvania, now exceed American in the amount of annual passenger revenues generated. The growth of air transportation in general and of American in particular is highlighted by its rapid ascension to this level in overall passenger revenue standings from 23rd position in 1935 and 7th place as recently as 1946.

American's operations have been strengthened and simplified by the disposition of its interest in American Overseas Airlines, Inc. The average return being realized by American on its AOA investment did not appear to justify the necessary managerial effort which could more profitably be employed in the direct interest of American. Late in 1950, the sale of AOA to Pan American was consummated. While American absorbed somewhat less than a $1,000,000 book loss on the disposition, ultimately it will receive a total of more than $10,500,000 in cash for its former 62% interest in AOA.

Capitalization

American's healthy operating position is evident through an examination of its most recent balance sheet, as of September 30, 1950, and presented in Table No. II (see Page 20). Its capitalization is more than adequate to assure stability of operations.

The Company's existing capital structure as of September 30, 1950, comprised the following:

3% Sinking Fund Debentures Due June 1, 1966	$40,000,000
Less: Debentures repurchased and held in treasury to meet sinking fund requirements	4,050,000*
	$35,950.000*
3½% Cumulative Preferred Stock ($100 par) (Convertible into 4.76 shares of common stock)	400,000 shares
Common Stock ($1 par)	6,452,835 shares

* Recently the Company reported to the New York Stock Exchange that it had purchased $6,699,000 of its debentures during 1950. Of these, $719,000 had been purchased and reported early in 1950. As of December 31, 1950, the Company had only $30,000,000 of its debentures publicly outstanding.

In addition, a total of 250,000 shares of common stock have been authorized for issuance, under options up to June 1, 1955, at $11.70 per share to approximately 25 officers of the Company.

American's present capital structure is the product of its aggressive post-war expansion program. To help finance the acquisition of its new equipment fleets, the company marketed $80,000,000 of senior securities in June, 1946, represented by the $40,000,000 of 3% debentures and $40,000,000 of 3½% cumulative convertible preferred stock.

This financing, the largest in airline history, was accomplished on highly favorable terms. Subsequent airline security offerings required higher rates for such new funds. For example, United's debentures, sold early in 1947, carry a 3½% coupon. Similarly, the United preferred has a dividend rate of 4½%. Northwest, which sold preference stock in November, 1946, was forced to establish a dividend rate of 4¾% on its issue.


WASH.
MONT.
N. DAK.
MINN.
ME.
ORE.
IDAHO
WIS.
MICH.
N.Y.
VT.
N.H
WYO.
S. DAK.
Rochester
Syracuse
Albany
Boston
Toronto
Utica
Providence
Niagara Falls
Binghamton
Hartford / Springfield
CALIF.
NEV.
Battle Creek
Jackson
Ann Arbor
Detroit
Buffalo
Elmira
Corning
New Haven
Milwaukee
Kalamazoo
Windsor
Scranton-Wilkes Barre
Bridgeport
UTAH
NEB.
IOWA
ILL.
Chicago
Cleveland
New York
PENNA.
South Bend
Akron
Philadelphia
COL.
Peoria
OHIO
Wilmington
Baltimore
Dayton
Columbus
Clarksburg
Washington
San Francisco
Oakland
MO.
Springfield
Indianapolis
Parkersburg
Elkins
KAN.
Cincinnati
Charleston-Kanbar
Huntington
Richmond
IND.
St. Louis
Louisville
W. VA
Lynchburg
VA.
Roanoke
N.CAR.
ARIZ.
Joplin
Springfield
Bristol
N.MEX.
KY.
Nashville
OKLA.
TEXAS
Tulsa
Knoxville
Los Angeles
Oklahoma City
ARK.
TENN.
S.CAR.
Little Rock
Memphis
ALA.
GA.
San Diego
Phoenix
Tucson
Ft. Worth
Dallas
Texarkana
LA.
El Paso
Big Spring
Abilene
Douglas
Midland
Odessa
MISS.
FLA.
San Antonio
Monterrey
Mexico City

Financial Status

American's current financial position is the strongest it has ever been in its history. As of September 30, 1950, it had cash and marketable securities (excluding $13,000,000 earmarked for flight equipment purchases) of $33,392,000 and net working capital in excess of $21,725,000.

During the fourth quarter of 1950, the Company realized $9,750,000 from the first liquidating dividend of $9 per share (90% of the estimated ultimate total) on its holdings of American Overseas Airline stock. Operations after estimated capital expenditures should have made $2,500,000 more cash available. However, purchases of the Company's own debentures probably limited the net gain in cash for the fourth quarter to about $6,400,000.

American's substantial working capital funds may find an outlet in one of three avenues or through a combination of all three. They are:

1. Additional capital expenditures in the near future; both normal or those required by national mobilization developments;
2. Creation of a special fund for future contingencies or long-range equipment acquisition programs;
3. Retirement of additional debentures and/or an initial reduction in the preferred stock outstanding.

1. American has ordered fourteen DC-6B's for delivery in 1951 representing a commitment of more than $16 million, of which $13 million has been set aside in a special fund. In keeping with current aeronautical advances, various modifications may also be made on the company's present equipment fleet. This might require a supplement to cash reserve set aside for purchase of flight equipment. Capital expenditures during the immediate future are difficult to project with any degree of assurance. Mobilization plans will dictate the bulk of near-term programs in new capital outlays. This can range from the extreme of American operating a huge fleet of transports under contract for the military; or new equipment outlays may be held to a minimum due to the shortage of available supplies.

Developments are too fluid to project any capital expenditures for new aircraft beyond those already earmarked, such as the commitments for 14 DC-6B's.

2. Keyed to its long-range development program is the outcome of plans evolved under the pressures of the forthcoming mobilization effort. It is likely that American may seek to husband the bulk of its current funds, if it can, in order to remain in a strong financial position to acquire new types of transports, such as turbo-props or jets. The American management has demonstrated that it is clearly aware of the importance of having completely modern equipment at the earliest opportunity.

The timetable of perfecting this new type of transport for commercial service has been indefinitely postponed as a result of current military urgencies. There is no

doubt, however, that turbo-props and jets are the next big step in equipment and to maintain its leadership in the airline industry, American must move toward this aircraft. This will entail capital outlays of unknown magnitude.

3. Late in 1949 and during 1950, a total of $10,000,000 in debentures were purchased, which if used for that purpose in its entirety would anticipate sinking fund requirements of $1,350,000 annually past June 1, 1957.

Any reduction in the preferred shares may also be governed by the same considerations. In addition, the company cannot purchase any of its preferred shares except to the extent its earned surplus exceeds $10,640,742. This same minimum is prescribed before cash dividends can be paid on the common stock. While earned surplus amounted to $14,151,812 as of September 30, 1950, the purchase of preferred shares to any significant extent at this time would cut sharply into the "cushion" permitting cash dividends on the common stock. Once resuming dividends on the common shares, the company is not likely to impair its ability to maintain such payments regularly.

Financial Gains

The improvement in American's financial position in recent years represents a startling performance and demonstrates the Company's basic earning power.

At June 30, 1947, American's working capital fell to $8,760,000, an uncomfortably low point. As previously noted, net current assets at September 30, 1950, aggregated $21,725,000. This improvement of about $12,965,000 in working capital does not begin to reflect the full extent of American's financial recovery during this period of three years and three months.

A complete exposition of the financial gains achieved by American from June 30, 1947, to September 30, 1950, may be summarized as follows:

Increase in Working Capital	$12,965,000
Special Flight Equipment Fund	13,000,000
Gain in Operating Property and Equipment (at cost)	11,500,000
Net Gain in Investments in Subsidiaries	2,650,000
Purchase of Sinking Fund Debentures	4,050,000
	$44,165,000
Less Increase in Unearned Transport Revenues	1,455,000
Total	$42,710,000

This over-all improvement of about $42,710,000 from June 30, 1947, to September 30, 1950, has resulted in the current exceedingly healthy balance sheet picture.

The same trend should continue through 1951. Depreciation run-offs next year will be higher than the $10 to $11 million in 1950. In the absence of unusual capital expenditures, further gains in the Company's financial position should be recorded.

Flight Equipment

American's bold action in being the first carrier to complete the installation of an all-modern passenger air fleet has placed the company in a dominant competitive position.

In addition to substantially reduced operating costs and improved efficiency, this post-war aircraft and attendant equipment was purchased at prices substantially below prevailing levels. The contrast between original cost and replacement value figures is of dramatic proportions.

As of September 30, 1950, American showed a total original cost, before depreciation, of $68,914,720 for all of its flight equipment. At current market quotations, this same complement would entail a capital expenditure of over $151,000,000, or better than 220% of the original cost. The depreciated value of this equipment was carried by American at $44,960,268, or less than one-third of estimated replacement cost.

For example, in its original order for Convairs, American paid about $218,000 per airplane, excluding spare engines and parts. Recently, it paid close to $500,000 each for five additional Convairs acquired. Another particularly fortunate transaction was the earlier acquisition of aircraft engine assemblies and components from war surplus.

As of December 31, 1950, American owned the following aircraft:

49	DC-6's
79*	Convairs
13	DC-4's

* Including five acquired after September 30, 1950.

In addition, American is scheduled to take delivery starting early next year of 14 DC-6B's. These planes are of more advanced design and greater capacity. The DC-6's and Convairs are passenger planes while the DC-4's are utilized only in cargo operations.

Standardization on the two basic passenger transports has also facilitated standardization on only one type engine, the Pratt & Whitney R-2800, for all of American's aircraft. This, in itself, has not only reduced the necessity of carrying large inventories of spare parts of various engine types, but most importantly, has materially reduced over-all maintenance costs.

Completion of the post-war equipment modernization program has aided in reducing maintenance costs. This is highly important when it is realized that about 25% of total aircraft operating expenses is represented by maintenance costs.

The progressive reduction in direct maintenance costs for flight equipment per revenue ton mile flown for American is highlighted as follows:

Quarter Ended	Costs per Revenue Ton Mile
Sept. 30, 1950	4.9 cents
June 30, 1950	5.6
March 31, 1950	*7.0
Dec. 31, 1949	6.2
Sept. 30, 1949	6.0
Sept. 30, 1948	6.1

* Reflects strike during period.

It is also obvious that the low capital cost for its aircraft has given American a decided advantage in reduced depreciation charges to be absorbed in operations.

The inherent nature of American's aircraft fleet leaves the Company in a highly strategic position to adjust its operations, if and when mobilization plans may dictate removal of some four-engine aircraft from commercial service. For example, in the extreme event that most of American's DC-6 aircraft should be leased to the military, the company would have a total of 79 Convairs to service its commercial schedules. No other major trunk carrier now operates Convair equipment. This would mitigate against reallocating equipment on an industry-wide basis from American to other lines not now familiar with the aircraft. Moreover, *the route pattern of American is vital to the industrial and military effort of the country* and, as such, would be expected to command a top priority on equipment.

American's aircraft fleet, as now constituted, has the greatest potential commercial passenger airlift capacity of any carrier in the industry.

American's present passenger capacity may be projected as follows on an annual basis, under assumed current operating conditions:

	DC-6	Convair	Total
Number of Planes	49	79	128
Average Daily Hourly Utilization	8	7	—
Total Daily Hours Flown	392	553	945
Average Block Speed (MPH)	220	160	—
Daily Plane Miles	86,240	88,480	174,720
Annual Plane Miles (365 Days) (Millions)	31.48	32.30	63.78
Average Seats Available in Plane	51	39	—
Annual Seat Miles Available (Millions)	1,605	1,260	2,865
Average Pay Load Available Per Plane (Tons)	6.8	4.0	—
Annual Ton Miles Available (Millions)	214	129	343

This estimated annual capacity of 2,865 million passenger seat miles is *conservative* and compares with the maximum capacity of 2,429 million which existed during 1949. The gains in availability become more apparent when it is realized

that American's capacity in this respect amounted to only 891 million passenger seat miles during all of 1945, or about ⅓ of its present estimated total. The above does not include the fourteen DC-6B's to be delivered during 1951.

Similarly, the present estimated 343 million available ton miles is higher than the capacity ton miles of 336.6 million shown in 1949. (The 13 DC-4's owned by American and flown in its cargo service are not included in the current projections as this equipment is assumed to be especially subject for assignment for military contract operations.)

Considerable flexibility exists in increasing the capacity of American's commercial airlift. For example, the increase of but one hour to the daily utilization factor for the Convair fleet can add a total of more than 180 million seat miles annually.

Similarly, leverage increases in capacities can be accomplished by higher block-to-block speeds as well as higher density seating arrangements in the DC-6's.

For example, the DC-6, if converted to high density seating, can accommodate anywhere from 70 to 80 passengers each. This can mean increasing American's existing DC-6 fleet seat capacity from about 40% to 60%. Moreover, this measure of increasing seat capacities can effectively offset a material reduction in the number of DC-6's withdrawn for military purposes, if and when, such a development may occur.

Operating and Earnings Record

The strong growth trend in American's revenues and operating income is revealed in Table No. III (see Page 21). It can be seen that during the pre-war period, the Company's total revenues and attendant profits were strongly in the ascendancy.

American's highly favorable position today stems from plans made in 1946 and implemented through 1948. Yet, this three-year period was a difficult one for the Company, during which its financial position was seriously endangered by net losses aggregating more than $6,670,000.

It was during this period that the Company embarked upon its bold program of effecting complete conversions of its aircraft fleet.

As the war came to an end in 1945, the only "new" aircraft available for commercial service as a replacement to the obsolete DC-3, was the DC-4. This plane was designed prior to 1940 and did not incorporate the technological developments that occurred in aviation during the war. But to meet the tremendous traffic demand, American found it necessary to purchase 50 war surplus DC-4's for temporary service.

Looking ahead, American projected a completely new post-war air transport fleet to meet its anticipated traffic requirements and purchased 50 DC-6's and 75 Convairs.

The DC-6's were scheduled for initial delivery late in 1946; the Convairs, in April, 1947. The delivery of these new planes as well as the modified DC-4 for interim use was delayed for upwards of one year in some instances even though

training programs and other operations were geared to the earlier delivery. These factors and the unfortunate grounding of the DC-6 for about five months beginning late in 1947 had the effect of creating operating losses in the three years, 1946-1948.

The recuperative earning power of American was demonstrated during 1949. With the transition to a new post-war transport fleet completed, the Company was able to show net income, before taxes, of $8,311,237. After a tax provision of $1,800,000, net income of $6,511,237 almost absorbed the cumulative losses of the three preceding years.

It is significant that, in 1949, American was the first domestic airline to show annual revenues in excess of $100 million, or $103,205,873. This was more than double the 1945 total and 15½% higher than 1948.

An even more dynamic earnings record was accomplished in 1950. The inherent advantages of the Company's post-war transport fleet with its attendant low operating cost experiences are continuing their unmistakable imprint on earnings. This new and modern aircraft is also attracting business from competitive lines. American's aggressive merchandising of air travel is likewise winning new converts.

Current Earnings

The impact on American's 1950 earnings due to sustained passenger volume together with its low-cost operation is indicated by the following comparative summary of quarterly results:

	Net Income Before Taxes	
	1950	1949
First Quarter	*$(1,944,684)	$(222,522)
Second Quarter	6,565,011	3,848,430
Third Quarter	8,838,495	3,634,820
Fourth Quarter	7,000,000 (E)	1,076,841
Year	$20,458,822 (E)	$ 8,337,569

* Strike during March interrupted operations.
( ) Deficit.
E Estimated.

The leverage factor on airline earnings is readily apparent from the above summary of results when it is realized that net earnings, before taxes, more than doubled in 1950 while revenue passenger miles gained an estimated 15% during the same time.

The quarterly results also demonstrate that the seasonal decline in earnings, a phenomenon of past years, generally disappears under sustained passenger volumes.

Giving effect to the Excess Profits Tax Act of 1950, American's net earnings for 1950 should reach an all time peak of over $10 million. After preferred dividend requirements, this would be equivalent to about $1.35 on the common stock, as compared with 79 cents per common share in 1949.

Potential Earnings

Any projection of 1951 results is extremely hazardous in view of the many shifting characteristics of airline operations. The extent of the aircraft fleet available to American will probably be a controlling factor. The rate structure pertaining to passenger, mail and cargo business may vary during the course of the year. Any forecast of operations under such circumstances becomes too qualified to have solid significance.

As previously indicated, American has the capacity to handle a substantial increase in volume with its present equipment. Moreover, unless extreme military urgencies develop, American is likely to retain the bulk of its aircraft in commercial service. Under such circumstances, the Company should be fully engaged under extremely favorable conditions. Its level of gross revenues can easily surpass the record total of more than $115,250,000 estimated for 1950. As a low cost operator, American's unit costs may be further reduced with greater volume despite increases in a few expense items.

It should not be difficult for American to accomplish operating results within the following defined area during 1951, if its commercial services are not unduly restricted:

Estimated Revenue Ton Miles	255,000,000
Estimated Revenue Per Ton Mile	$0.52
Estimated Total Revenues	$132,600,000
Estimated Operating Expenses Per Ton Mile (Before Taxes)	$0.43
Estimated Total Operating Expenses (Before Taxes)	$109,650,000
Estimated Net Income (Before Taxes)	$ 22,950,000

Under the new Excess Profits Tax law, American would receive an EPT exemption consisting of a 7% return on its investment, as defined, or some $7,000,000. Giving effect to the 47% corporate tax rate, this basic EPT exemption would be increased to $17,786,500. Interest on borrowed capital would reduce this exemption by about $900,000. This would bring the EPT basic credit exemption down to $16,886,500, leaving about $6,063,500 subject to excess profits taxation before consideration of the special mail pay relief provision. With American's mail revenues expected to reach about $6,500,000 during 1951, the company would not be subject to any excess profits taxation provided there were no tax adjustments, disallowances, and related items. However, these are known to occur in most years. Its normal corporate tax of about $10,786,500 would leave net income of about $12,163,500, equivalent to $1.65 per common share after preferred dividends. Should accounting adjustments or other factors result in pretax earnings less credits exceeding mail revenue, the company would be subject to an excess profits tax equal to an additional 30% of adjusted excess profits net income.

The above projections exclude the effects of compounded leverage on airline operations as well as income from contract military services. Accordingly, the projected level of operations is not to be considered a ceiling on earnings.

American's earnings are of solid substance in that they are completely devoid of any air mail subsidy. Receiving what the Civil Aeronautics Board considers a "service" rate, any sharp increase in profits that the company may attain is unlikely to be placed in jeopardy through a downward revision of mail compensation.

American's mail revenues accounted for about 5.4% of its total operating revenues in 1949. It is significant that for the first nine months of 1950, American's provision for income taxes ($6,175,283) exceeded its U. S. mail revenues ($4,142,731) by a substantial margin.

A dividend of 25 cents per share was paid on the common stock in September, 1950, marking resumption of payments following the lapse in 1946. While no fixed rate has been established, it is possible that more liberal distributions to stockholders in relation to available earnings will prevail during 1951.

Lowest Cost Operator

American has clearly established its position of being the lowest cost operator in the air transport industry. This is revealed in Table No. IV (see Page 22). It can be seen that its total operating expenses per revenue ton mile have shown progressive declines, serving at the same time to increase profit margins.

For the year ended December 31, 1949, American's total unit revenue ton mile cost was 46.84 cents, lowest in the industry. Its profit margin of 4.92 cents was also the highest in the group.

For the nine months ended September 30, 1950, this unit operating cost averaged 42.90 cents, including the higher cost operation of the first quarter resulting from the strike. For the three months ended September 30, 1950, this unit cost averaged 37.6 cents per revenue ton mile with a profit margin of 13.7 cents, all representing new records for the third quarter. This showing has been made in the face of higher tax imposts. Present indications are that American was again the low cost operator in the air transport industry during 1950. Its excellent equipment position should facilitate its maintaining this distinction during 1951.

February 9, 1951

TABLE NO. II

AMERICAN AIRLINES, INC.

CONSOLIDATED BALANCE SHEET

As of September 30, 1950

($000s omitted)

ASSETS			LIABILITIES AND CAPITAL STOCK		
CURRENT ASSETS:			CURRENT LIABILITIES:		
Cash	$12,641		Accounts Payable	$15,182	
Marketable Securities	20,751		Accrued Salaries and Wages	917	
Accounts Receivable (Net)	16,632		Accrued Income Taxes	6,041	
Inventories of materials and supplies	1,149	$ 51,173	Other Accrued Liabilities	2,091	
			Air Travel Plan Deposits	5,216	$ 29,447
INVESTMENTS AND SPECIAL FUNDS:					
For Purchase of Flight Equipment	$13,000				
Investments and Advances to Subsidiaries:			DEFERRED CREDIT:		
American Overseas Airlines, Inc. (62% owned, at cost less $1,100,000 reserve)	10,570		Unearned Transportation Revenue		2,270
Other Subsidiaries (100% owned)	1,521				
Special Deposits and Miscellaneous	818	25,909	LONG-TERM DEBT (NET):		
			3% Sinking Fund Debentures Due June 1, 1966		35,950*
OPERATING PROPERTY AND EQUIPMENT (NET):					
Flight Equipment	$44,960		CAPITAL STOCK AND SURPLUS:		
Buildings and Other Equipment	10,730	55,690	Preferred Stock ($100 par value)	$40,000	
			Common Stock ($1 par value)	6,453	
DEFERRED CHARGES:			Paid-in Surplus	6,160	
Unamortized Debenture Discount	$ 463		Earned Surplus (Net)	14,152	66,765
Prepaid Rents, Insurance, etc.	1,197	1,660			
Total Assets		$134,432	Total Liabilities and Capital		$134,432

SOURCE: CAB Reports.

* Recently the Company reported to the New York Stock Exchange that it has purchased $6,669,000 of its debentures during 1950. Of these, $719,000 had been purchased and reported early in 1950. As of December 31, 1950, the Company had only $30,000,000 of its debentures publicly outstanding.

TABLE NO. III

AMERICAN AIRLINES, INC.

SYSTEM FINANCIAL SUMMARIES

	Years Ended December 31,									
	1950*	1949	1948	1947	1946	1945	1944	1943	1942	1941
	(000 omitted)									
OPERATING REVENUES:										
Passenger	$72,459	$ 88,309	$76,862	$71,255	$58,746	$37,317	$29,338	$23,356	$21,513	$20,923
Mail	4,192	5,556	4,769	3,172	3,269	5,981	6,685	4,886	3,267	4,270
Express	1,629	1,837	1,881	1,923	2,083	2,417	2,483	2,581	1,720	756
Freight	5,096	6,191	4,623	4,093	2,860	967	47			
Other	1,635	1,312	1,151	1,288	1,125	733	691	628	482	350
Total Operating Revenues	$85,011	$103,206	$89,286	$81,731	$68,083	$47,416	$39,244	$31,451	$26,982	$26,299
OPERATING EXPENSES	$70,839	$ 93,713	$91,141	$85,784	$68,751	$39,240	$29,773	$22,987	$21,369	$22,584
NET EARNINGS (LOSS) FROM OPERATIONS	$14,171	$ 9,493	$(1,855)	$(4,053)	$ (667)	$ 8,176	$ 9,471	$ 8,464	$ 5,613	$ 3,714
Other Income or (Deductions) Net	(713)	(1,146)	(1,039)	(2,373)	(343)	(7)	(997)b	(1,750)b	1,013c	67
Provisions (Credits) for Income Taxes	6,175	1,826	—	3,025a	635a	(3,830)	(4,078)	(3,522)	(2,774)	(1,308)
NET INCOME (LOSS)	$ 7,284	$ 6,511	$(2,894)	$(3,401)	$ (376)	$ 4,339	$ 4,396	$ 3,193	$ 3,852	$ 2,473
NET INCOME OR (LOSS) PER SHARE:										
Preferred (e)	$ 18.21	$ 16.28	$ (7.23)	$ (8.50)	$ (0.94)	$ —	$816.07	$ 63.86	$ 77.04	$ 49.46
Common (f)	0.97	0.79	(0.67)	(0.74)	(0.17)	0.68	0.66	0.52	0.63	0.39
PRICE RANGE:										
3½% Preferred	76¾–66	70–51	68–47	80–50¾	74¾–57½	—	—	—	—	—
Common (f)	12⅜–9⅝	10–6¾	10–6⅛	11⅜–7	19⅞–9	18⅞–8⅜	9⅛–5¾	7⅝–5¼	5⅞–2½	5⅞–4
FINANCIAL POSITION—YEAR END:										
Current Assets	$51,173	$ 31,253	$29,328	$33,782	$55,340	$30,420	$32,188	$27,959	$21,845	$16,237
Current Liabilities	29,447	20,652	18,635	19,605	20,261	16,536	13,121	11,419	9,772	8,568
Net Working Capital	31,726	10,601	10,693	14,177	35,079	13,884	19,067	16,540	12,074	7,669
Aircraft and Other Property, Net	55,690	61,698	70,239	69,798	44,865	9,690	5,386	4,271	5,216	6,875
Funded Debt	35,950	36,669	40,000	40,000	40,000	—	—	—	—	—
Preferred Stock Outstanding	40,000	40,000	40,000	40,000	40,000	—	549	5,100	5,100	5,100
Common Stock Outstanding	6,453	6,453	6,453	6,453	6,453	6,453	6,386	5,748	5,748	5,748
Total Surplus	20,311	16,491	10,747	15,040	18,557	19,690	16,233	9,355	7,236	4,460

* Nine months to September 30, 1950.

NOTES: (a) Credit—Federal "carry-back" tax refund. (b) Includes provision for transition to peacetime operations, 1944—$1,000,000, 1943—$1,750,000. (c) Including $834,845 excess of proceeds over book value of flight equipment sold. (e) Based on shares outstanding at end of period. (f) Adjusted for 5-for-1 split in 1946 and 2-for-1 split in 1944.

SOURCE: CAB Reports and Moody's Industrial Manuals.

TABLE NO. IV

Comparison of Total Operating Expenses and Net Operating Income (or Loss) in Terms of Per Revenue Ton-Mile Domestic Only for Periods Indicated from January 1, 1947 to September 30, 1950

For 12 Months Period As Indicated	American		Eastern		United		TWA		NWA	
	Total	Profit Margin	Total	Profit Margin	Total	Profit Margin	Total	Profit Margin	Total	Profit Margin
Period Ended:										
March 31, 1947	48.23¢	(2.79)¢	38.25¢	8.50¢	47.97¢	(2.66)¢	60.30¢	(12.88)¢	52.69¢	(4.32)¢
June 30, 1947	48.37	(2.21)	40.31	7.81	49.86	(3.86)	61.37	(13.07)	55.27	(6.04)
Sept. 30, 1947	48.83	(1.54)	44.47	5.06	50.45	(3.65)	58.21	(8.31)	55.56	(5.11)
Dec. 31, 1947	51.05	(2.58)	48.19	2.84	51.04	(3.72)	55.32	(4.86)	56.13	(4.28)
March 31, 1948	52.43	(2.80)	50.04	3.46	51.10	(2.70)	54.46	(2.42)	57.33	(4.49)
June 30, 1948	54.49	(3.45)	52.16	2.85	51.47	(2.35)	55.46	(2.40)	59.54	(5.10)
Sept. 30, 1948	56.23	(3.94)	52.72	3.07	53.78	(3.29)	56.85	(2.78)	66.34	(10.37)
Dec. 31, 1948	54.02	(1.06)	53.96	4.80	54.83	(1.04)	57.25	0.63	68.26	(6.96)
March 31, 1949	51.57	1.68	54.54	5.28	54.91	(0.68)	58.57	(0.73)	66.98	(5.32)
June 30, 1949	49.03	3.68	54.39	5.52	54.08	0.97	56.34	1.38	61.95	(1.07)
Sept. 30, 1949	47.18	5.08	54.48	5.05	51.68	3.47	54.03	3.45	57.55	(2.50)
Dec. 31, 1949	46.84	4.92	53.76	3.27	50.38	3.06	52.73	2.24	57.46	(2.38)
March 31, 1950	51.57	1.69	54.54	5.12	54.91	(0.96)	58.57	(0.95)	66.98	(5.46)
June 30, 1950	49.03	3.75	54.37	5.38	54.08	0.61	56.34	1.16	61.95	(1.23)
Sept. 30, 1950	44.13	7.31	49.34	4.20	46.36	5.25	49.65	4.54	61.42	(9.67)

NOTE: TOTAL—Total Operating Expenses.
PROFIT MARGIN—Net Operating Income (or Loss).

SOURCE: CAB Reports.