AMERICAN AIRLINES SYSTEM

CABLE ADDRESS AMAIR

100 EAST 42nd STREET • NEW YORK 17, NEW YORK • MURRAY HILL 3-9000

January 30, 1947

OFFICE OF
THE SECRETARY
AMERICAN AIRLINES, INC.

Mr. Amon G. Carter
Fort Worth Star Telegram
Fort Worth, Texas

Dear Mr. Carter:

The Civil Aeronautics Board requires directors of air carriers to file with the Board an annual report of their stock or other interests in air carriers and certain other companies or persons.

For your convenience, two copies of the report form are attached, the executed original to be filed by you with the Civil Aeronautics Board, Washington 25, D. C., ON OR BEFORE March 1, 1947. Detailed instructions and filing requirements are described in the form itself.

The company is required to report to the Civil Aeronautics Board the number of shares of stock owned by each of its directors as of December 31, 1946. On that date our stock record books showed that you were the beneficial owner of 92,000 shares of $1.00 par value Common Stock and 0 shares of $3.50 Cumulative Convertible Preferred Stock.

Yours very truly,

C W Jacob

C. W. Jacob

CWJ:rc
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AMERICAN AIRLINES, Inc.

Annual Report

FOR THE YEAR ENDED DECEMBER 31

1946

1946 Annual Report to the Stockholders of American Airlines, Inc.

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AMERICAN AIRLINES, Inc.

Directors

HAROLD T. AMES
HARRY E. BENEDICT
JAMES BRUCE
EDWARD H. BUTLER
AMON G. CARTER
CHARLES S. CHESTON
THOMAS M. CONROY
RALPH S. DAMON
SILLIMAN EVANS
JOHN W. FARLEY
THOMAS STEVENS HAMMOND
A. N. KEMP
WALTER SCOTT McLUCAS
O. M. MOSIER
EDGAR MONSANTO QUEENY
C. R. SMITH

Officers

C. R. SMITH,
Chairman of the Board

RALPH S. DAMON,
President

VICE PRESIDENTS

AMOS CULBERT
R. E. S. DEICHLER
L. G. FRITZ
WILLIAM LITTLEWOOD
O. M. MOSIER
REX W. D. SMITH, JR.

VICE PRESIDENT AND TREASURER

MAULSBY FORREST

VICE PRESIDENT AND SECRETARY

C. W. JACOB

WILLIS G. LIPSCOMB, Assistant Vice President
W. H. MILLER, Assistant Vice President
CARLENE ROBERTS, Assistant Vice President
M. T. STALLTER, Assistant Vice President
GEORGE C. VAN NOSTRAND, Assistant Vice President
P. G. LARIE, Comptroller and Assistant Treasurer
C. H. KIBBEE, Assistant Treasurer
T. O. ENGLISH, Assistant Treasurer
R. L. GRIFFITH, Assistant Secretary
W. L. McMILLEN, Assistant Secretary
A. A. PARADIS, Assistant Secretary
A. R. BONE, Regional Vice President
W. NELSON BUMP, Regional Vice President
L. W. KING, Regional Vice President
M. D. MILLER, Regional Vice President
C. R. SPEERS, JR., Regional Vice President
V. J. LONG, Assistant Secretary and Assistant Treasurer

OFFICES

GENERAL OFFICES: 100 East 42nd Street, New York 17, New York
CORPORATE OFFICE: 927 Market Street, Wilmington, Delaware

TRANSFER AGENT — Common Stock . . . Schroder Trust Company, New York 5, New York
TRANSFER AGENT — Preferred Stock . . . The Chase National Bank of the City of New York
REGISTRAR — Common and Preferred Stocks . . . Guaranty Trust Company of New York
TRUSTEE AND PAYING AGENT — Debentures . . . The New York Trust Company
GENERAL COUNSEL . . . Douglas and Proctor, Washington, D. C.

To the Stockholders

New York, N. Y., March 19, 1947

In 1946 the scale of operation increased substantially over previous years. Passenger miles flown increased 63% over 1945. Passenger miles for American for the year 1946 — 1,308,000,000, approximated the total revenue passenger miles for the domestic industry in 1941. Gross revenues increased 44%, from $47,416,000 in 1945 to $68,083,000 in 1946. Express and freight ton miles increased 105%, including contract freight transported by the Company's Contract Air Cargo Division.

1946 was not, however, a year of profit for a majority of the airlines, including American. Operations for the year were conducted at net loss of $252,467. Factors contributing to that result included increasing costs of doing business, a decline in load factors in the latter part of the year and a fare structure lower than in previous years. In addition, there remained many problems inherent in the transition from war and military operation to peacetime operation, augmented by diverse and unpredictable factors of economic consequence.

WAGES, SALARIES

Wage and salary rates increased 18.1% over 1945. During the year the 40-hour week was adopted in the industry and in American. In addition to that cost, there were other wage and salary increases comparable with those instituted by other industries.

PERSONNEL

An employee group of high competence is essential in air transportation, and it has been the continuing objective of American to maintain high standards of employee ability and efficiency. Furthermore, it is our aim to maintain working conditions which will attract and hold personnel of high calibre and reduce personnel turnover. But war and post-war dislocations brought about an abnormal rate of turnover in 1946. The expense of training in 1946 was substantial but a high standard of personnel excellence has been maintained, and the organization is well trained and equipped to meet the problems of the forthcoming years.

EQUIPMENT DELIVERY

The delivery of new equipment was delayed beyond expectation and this delay had consequent effect both upon the cost of conducting the operation and upon the gross revenues that had been anticipated. It was originally planned that 50 Douglas DC-4 aircraft would be in operation by early Spring. Reconversion delays put this program back many months. Substantial expense was incurred in preparation for the contemplated expansion of operations, not immediately compensated for by increased gross revenues.

RESULTS OF OPERATIONS

Operations for 1946 after all charges, but before preferred stock dividend payments, resulted in a net loss of $252,467 including $225,672 representing the Company's proportionate interest in the net loss sustained by American Overseas Airlines, Inc. The net loss for 1946 was reduced by $635,000 as the result of the "carry-back" provisions of the Internal Revenue Code. The total Federal Tax refund receivable is $1,280,000 of which $645,000 represents the proportion that is applicable to charges to the Reserve for Transition to Peacetime Operations and has been credited thereto. During 1946 the Civil Aeronautics Board established a mail rate for American Overseas at $1.50 per ton-mile for the year 1945. American Overseas believes this to be inadequate and has requested a rehearing and reconsideration of the above rate. This request has been granted. Also in 1946 the Civil Aeronautics Board established a temporary mail rate of 75¢ per ton-mile for American Overseas' operations subsequent to January 1, 1946, pending the determination and establishment of a final rate. In a hearing, to be held later, American Overseas will seek a higher permanent rate, retroactive to January 1, 1946. Any retroactive adjustment of these mail rates will affect the operating results of this company and American Airlines' proportionate interest therein.

1947

Any prediction of operating results for the year of 1947 would be premature. Substantial losses were incurred in the early months of 1947. One of the factors contributing to this was the adverse weather conditions in January 1947; from the standpoint of the scale of air transport operation, the winter of 1946-47 was one of the most difficult in the history of the business. Based upon the 1946 level of expense, upon increased operation of the DC-4 fleet in 1947 compared with 1946, and with the forthcoming operation of the new Douglas DC-6, 1947 should witness a reduction in unit costs, with a resultant opportunity for profitable operation.

FARES

There has been widespread demand in the industry for a higher level of passenger fares. It is our belief that the future of this business can be asssured best by devotion to the principle that air transportation should be available to as many as possible of the traveling public. For that reason American will continue to advocate the establishment of fares and rates on the lowest level consistent with maintaining a high standard of operation and reasonable profit. Some fare increases above the present 4.5¢ level appear probable, but it seems assured that the 1947 level will remain below the pre-war levels and that air transportation will continue to be one necessity which can be purchased at a lower price than before the war.

NEW EQUIPMENT

It is believed that the initial units of American's fleet of DC-6's will be introduced to commercial service not later than June. Deliveries of the twin-engine Consolidated 240 will commence after the middle of the year; however, the date of inauguration of service cannot be predicted definitely at this time. The Company has on order 50 of the Douglas DC-6 four-engine type and 100 of the twin-engine Consolidated 240. We believe this fleet, when in operation, will be the most modern in the industry. Its availability for operation will permit the retirement of the Douglas DC-3 fleet in 1947 and 1948.

The Company entered an order in 1946 for 20 Republic Rainbow aircraft, a four-engine, 400 mile-an-hour transport airplane. Delivery of the first production model was expected in the latter part of 1947. It became evident in 1946 that there would be potential delays in delivery due to unavailability of materials and other factors which would change the basic premise of time on which the orders were entered. For that reason, among others, it was mutually agreed between American and the manufacturer that the contract should be cancelled, effective February 20, 1947.

THE DC-3

An airline is in the business of manufacturing and selling air transportation. As in all other forms of business, this will be attended with success only if the costs of production and sale are less than the charges therefore. In this respect, with lowered fares and increased costs of operation, the Douglas DC-3 cannot be operated profitably with attainable load factors. It is, therefore, our intention to retire that airplane as soon as possible. Following this the DC-4 passenger fleet will be gradually reduced, and either sold or converted to cargo use, leaving the passenger fleet composed of DC-6 and CV-240 airplanes.

INCREASED SERVICE

The demand for air transportation will continue to increase, and the Company is preparing to meet this demand for additional services. In 1947 and 1948 the trend will be to serve the cities on the routes of American with an adequate number of frequent, convenient, time-saving schedules. The strength of American's position in the industry is shown in comparative statistics, and the aggressive service and sales program of the Company should permit further progress. The Company will continue an aggressive policy in the development of cargo by air.

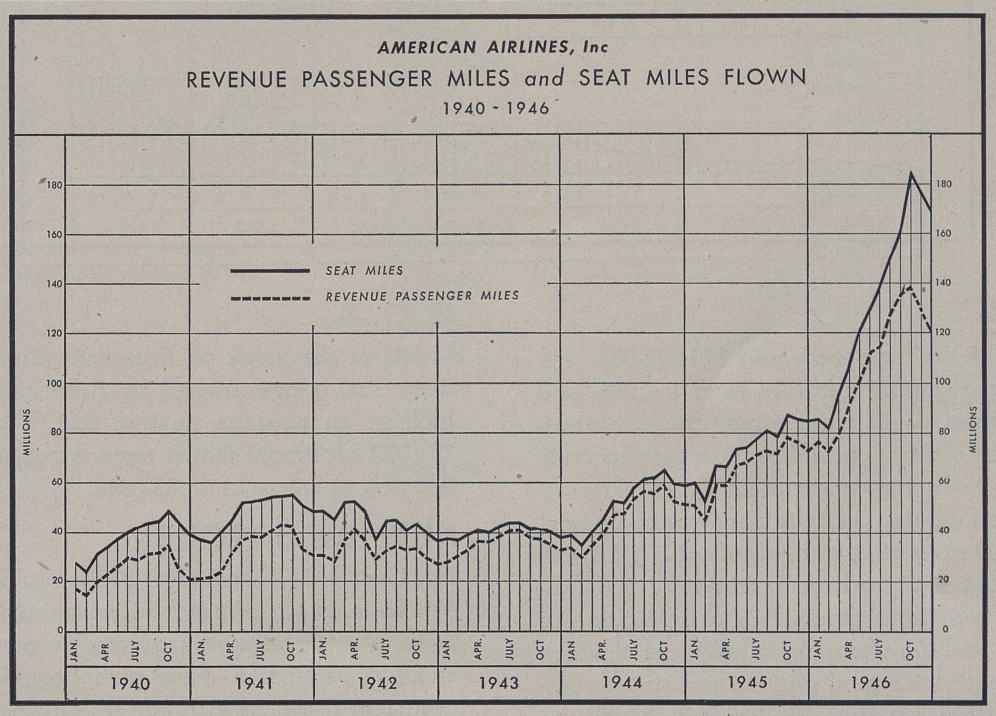
COMBINED OPERATION

An increasing factor in total operating costs is ground costs. Where several air carriers operate from the same location there is possibility for increased economy of operation by pooled ground services and by the elimination of duplicating effort and expense. American participated with the industry in 1946 in the formation of Airlines Terminal Corporation, a joint terminal serv-

ice company, to be wholly owned by the participating air carriers. This company began operation, on limited basis, in early 1947. The basic premise of its formation is sound and its opportunity to contribute substantial economies seems reasonably assured.

RESEARCH

In addition to the requirement of safety, there is the transportation requirement of dependability—on-time departure and on-time arrival. The year of 1946 has been one of intensive research in the development of instruments and facilities which will permit additional gains in the field of safety and dependability. American has participated substantially in the industry program and has, in addition, conducted an individual company program relating to the continued development and utilization of radar and other electronic devices intended to provide more effective methods of operation. The installation and utilization of these devices will take time, but the program is an intelligent, intensive one, and the trend is constructive. Each succeeding year should find us equipped with a larger number of proven devices and equipment.

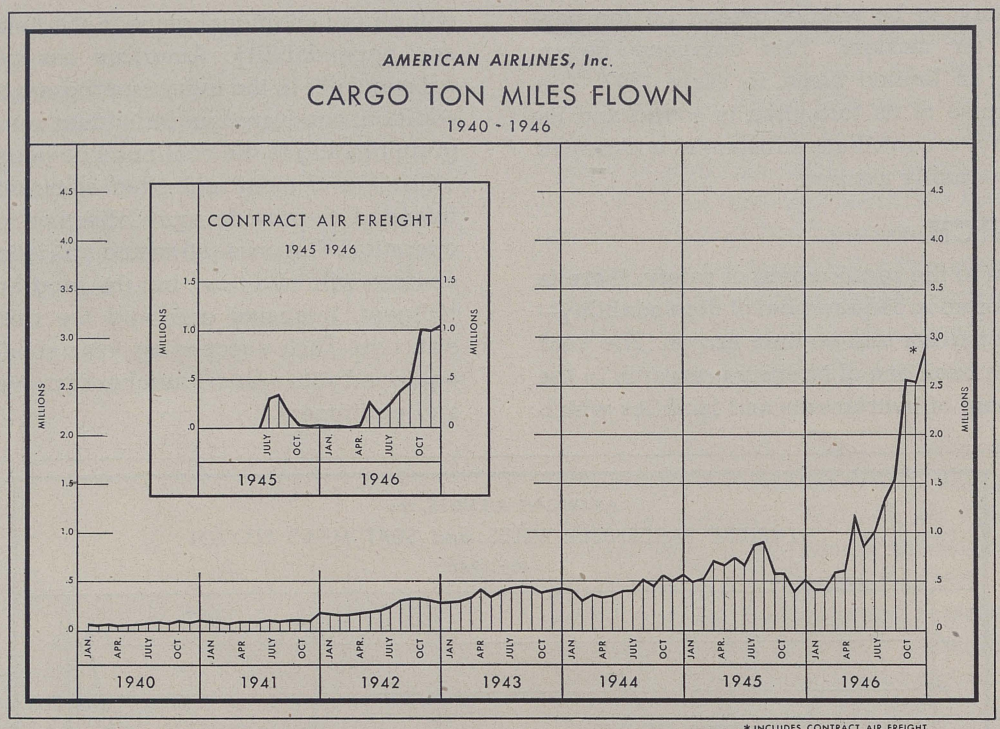


TRAFFIC

Air transportation will continue to be a growth industry. Its potential market is a broad one, with opportunity for continued growth and development. The innate growth factor is illustrated by the charts on this and the following page.

There has been gratifying increase in the volume of air cargo. Ton miles increased from 7,903,845 in 1945 to 16,239,844 in 1946. Transportation of cargo by air is still a pioneering endeavor, with many problems yet to be solved, but the trend is a highly encouraging one and the field shows promise of good profit potentialities.

American is a stockholder in Air Cargo, Inc., an inter-line company intended to foster the development and facilitate the handling of cargo traffic. Immediate objectives will be the standardization of forms and procedures and the maximum possible consolidation of services and employment of joint facilities. Nation wide pick-up and delivery service on a uniform basis should be among the first of the desired results.



* INCLUDES CONTRACT AIR FREIGHT

FINANCE

In June 1946 the Company sold $40,000,000 3% sinking fund debentures due June 1, 1966, and 400,000 shares 3½% cumulative convertible preferred stock of $100 par value. The net proceeds from this financing were $79,270,726. The attached consolidated balance sheet as of December 31, 1946 reveals current assets of $55,340,431 as compared with current liabilities of $20,261,437. Cash on hand or in banks amounted to $7,998,019 and the Company's holdings of short-term U. S. Government and Canadian Government securities totaled $31,850,899. Based on present expectancies, it is believed that these cash resources will be sufficient to finance the completion of the expansion program without resort to other than possible temporary borrowing.

On April 22, 1946, the par value of common stock was reduced to $1.00 per share and five shares of new stock were exchanged for each previous share. Common stockholders of American now number 34,352, averaging 188 shares each. No dividends were paid on the common stock during the year.

A. O. A.

61.8% of the stock of American Overseas Airlines, Inc. is now owned by American Airlines, Inc., at an average cost of $10.77 per share. 721,079 additional shares were purchased during the year at a cost of $8,652,948.

NEW DIRECTORS

Mr. Charles S. Cheston of Philadelphia, Pa. and Mr. Thomas M. Conroy of Cincinnati, Ohio have been elected directors of the Company to fill existing vacancies. Your management is confident that these new directors will make worthwhile contributions to the policy direction of the Company's business.

Respectfully submitted,

R S Damon
President

C R Smith
Chairman of the Board

Cities Authorized for Service on the American Airlines System

UNITED STATES

Abilene
Akron
Albany
Ann Arbor
Baltimore
Battle Creek
Big Spring
Binghamton
Boston
Bridgeport
Bristol
Buffalo
Charleston-Dunbar
Chicago
Cincinnati
Clarksburg
Cleveland
Columbus
Corning
Dallas
Dayton
Detroit
Douglas
El Paso
Elkins
Elmira
Erie
Fort Worth
Hartford
Huntington
Indianapolis
Jackson
Joplin
Kalamazoo
Knoxville
Little Rock
Los Angeles
Louisville
Lynchburg
Memphis
Midland-Odessa
Milwaukee
Nashville
Newark
New Haven
New York
Niagara Falls
Oklahoma City
Parkersburg
Peoria
Philadelphia
Phoenix
Providence
Roanoke
Rochester
St. Louis
San Antonio
San Diego
Scranton—Wilkes Barre
South Bend
Springfield, Ill.
Springfield, Mass.
Springfield, Mo.
Syracuse
Texarkana
Tucson
Tulsa
Utica
Washington

CANADA
Toronto
Windsor

MEXICO
Mexico City
Monterrey

DENMARK
Copenhagen

EIRE
Shannon

FINLAND
Helsinki

GERMANY
Berlin
Frankfurt

GREAT BRITAIN
Glasgow
London

GREENLAND
Bluie West 1

ICELAND
Reykjavik

LABRADOR
Goose Bay

NETHERLANDS
Amsterdam

NEWFOUNDLAND
Gander

NORWAY
Oslo

POLAND
Warsaw

RUSSIA
Leningrad
Moscow

SWEDEN
Stockholm

AMERICAN AIRLINES

AMERICAN AIRLINES, Inc. – AMERICAN OVERSEAS AIRLINES, Inc.

AMERICAN AIRLINES, INC. AND CONSOLIDATED SUBSIDIARY

Consolidated Balance Sheets

AT DECEMBER 31, 1946 AND DECEMBER 31, 1945

Assets

CURRENT ASSETS:	Dec. 31, 1946	Dec. 31, 1945
Cash on hand and demand deposits	$ 7,998,019	$11,993,858
Marketable securities, at amortized cost (approximately market):		
U. S. Government	$ 31,624,649	$ 7,191,128
Canadian Government	226,250	226,250
	$ 31,850,899	$ 7,417,378
Accounts receivable:		
U. S. Government:		
For services performed at cost under war contracts (terminated in 1946)	$ 275,205	$ 2,858,955
For the transportation of air mail	1,002,941	1,448,850
For air travel, etc.	849,005	1,128,572
Air travel plan subscribers	2,579,951	1,390,629
Other airline companies and agents—traffic and express balances	4,588,666	1,532,715
Other trade accounts	2,878,211	770,333
Indebtedness of employees	180,830	114,436
	$ 12,354,809	$ 9,244,490
Less: Reserve for doubtful accounts receivable	39,077	133,227
	$ 12,315,732	$ 9,111,263
Federal tax refund receivable under "carry-back" provisions of the tax law	$ 1,280,000	$ —
Advance to American Overseas Airlines, Inc. (repaid March 8, 1946)	$ —	$ 1,000,000
Inventories of materials and supplies, at the lower of cost or market	$ 1,895,781	$ 897,921
TOTAL CURRENT ASSETS	$ 55,340,431	$30,420,420
INVESTMENTS AND SPECIAL FUNDS:		
Investments in subsidiaries not consolidated (Note 1):		
American Overseas Airlines, Inc., at cost less reserve of $225,672 at Dec. 31, 1946	$ 11,427,276	$ 3,000,000
Other, at cost	1,351,000	651,000
Miscellaneous investments in connection with operations, at cost	325,269	118,721
Deposits in connection with acquisition of airplanes and engines:		
Cash (Note 6)	9,432,626	894,000
U. S. Government securities, at amortized cost (approximately market)	2,406,104	—
Other special deposits	228,804	110,837
	$ 25,171,079	$ 4,774,558
FLIGHT EQUIPMENT (INCLUDING SPARE PARTS AND ASSEMBLIES) AT COST	$ 46,186,432	$13,645,586
Less: Reserve for obsolescence and depreciation	12,400,162	7,753,720
	$ 33,786,270	$ 5,891,866
LAND, BUILDINGS AND OTHER EQUIPMENT, AT COST	$ 14,851,321	$ 6,842,979
Less: Reserve for depreciation	3,772,270	3,045,297
	$ 11,079,051	$ 3,797,682
NON-OPERATING PROPERTY AND EQUIPMENT, AT ESTIMATED REALIZABLE VALUE	$ —	$ 21,320
LONG TERM OPERATING PROPERTY PREPAYMENTS, LESS AMORTIZATION	$ 933,797	$ 613,938
DEFERRED CHARGES:		
Prepaid rents, insurance and other expenses	$ 231,617	$ 212,936
Unamortized debenture discount and expense	599,283	—
Other deferred charges (Note 2)	911,999	125,103
	$ 1,742,899	$ 338,039
	$128,053,527	$45,857,823

Reference is made to the accompanying notes

Liabilities, Capital Stock and Surplus

CURRENT LIABILITIES:	Number of Shares		Dec. 31, 1946	Dec. 31, 1945
Accounts payable			$ 7,126,677	$ 4,291,957
Other airline companies—traffic balances payable			5,427,790	2,416,542
Air travel plan subscribers' deposits			5,307,825	4,277,198
Accrued salaries and wages			618,623	618,695
Accrued Federal income taxes (1945 and prior years)			389,224	4,064,889
Other accrued taxes			384,276	252,870
Accrued interest on debentures			100,000	—
Other accrued liabilities			907,022	614,117
TOTAL CURRENT LIABILITIES			$ 20,261,437	$16,536,268
UNEARNED TRANSPORTATION REVENUE			$ 699,664	$ 428,980
3% SINKING FUND DEBENTURES, DUE JUNE 1, 1966			$ 40,000,000	$ —
RESERVE FOR TRANSITION TO PEACETIME OPERATIONS (NOTES 3 AND 6)			$ 1,959,544	$ 2,750,000
CAPITAL STOCK:				
At December 31, 1946:				
Preferred stock, par value $100 per share:				
Authorized	600,000			
Issued and outstanding (3½% Cumulative Convertible)	400,000	$ 40,000,000		
Common stock, par value $1 per share:				
Authorized	12,000,000			
Issued and outstanding	6,452,835.85	6,452,836		
Reserved:				
For conversion of 3½% Cumulative Convertible Preferred stock at $21 per share	1,904,762			
For exercise of option expiring June 1, 1950 at $11.70 per share	250,000			
Employees' stock, par value $1 per share:				
Authorized	500,000			
Issued and outstanding	None			
		$ 46,452,836		
At December 31, 1945:				
Preferred stock, par value $100 per share:				
Authorized	200,000			
Issued and outstanding	None			
Common stock, par value $5 per share:				
Authorized	2,400,000			
Issued and outstanding	1,290,567.69			$ 6,452,838
Reserved for exercise of option expiring June 1, 1950 at $58.50 per share	50,000			
Employees' stock, par value $5 per share:				
Authorized	100,000			
Issued and outstanding	None			
SURPLUS (per attached statement):				
Paid-in surplus			$ 6,159,654	$ 6,267,434
Earned surplus (Note 4)			$ 12,520,392	13,422,303
			$ 18,680,046	$19,689,737
COMMITMENTS AND CONTINGENT LIABILITIES (NOTE 5)			$128,053,527	$45,857,823

Reference is made to the accompanying notes

Consolidated Statements of Profit and Loss

FOR THE YEARS ENDED DECEMBER 31, 1946 AND 1945

	Year Ended Dec. 31, 1946	Year Ended Dec. 31, 1945
OPERATING REVENUES:		
Passenger	$58,746,001	$37,317,430
Mail	3,269,052	5,981,051
Express	2,083,367	2,417,105
Freight	2,860,460	967,468
Other	1,124,554	732,946
	$68,083,434	$47,416,000
OPERATING EXPENSES (NOTE 2):		
Flying operations	$14,215,942	$ 9,505,913
Ground operations	12,887,143	6,984,297
Maintenance and repairs	14,501,073	7,326,852
Passenger service	5,451,686	3,417,191
Traffic and sales	7,455,627	4,494,019
Advertising and publicity	2,156,229	1,592,955
Retirement Benefit Plan and other employee welfare (Note 7)	495,517	627,558
Social security taxes	768,160	438,561
General and administrative	4,621,348	2,927,363
Provision for obsolescence and depreciation of property and equipment	5,849,024	1,925,182
	$68,401,749	$39,239,891
	$ (318,315)	$ 8,176,109
OTHER INCOME:		
Interest earned	$ 259,863	$ 110,592
Cash discounts on purchases, etc.	131,767	74,280
	$ 391,630	$ 184,872
	$ 73,315	$ 8,360,981
DEDUCTIONS FROM INCOME:		
Interest on debentures and bank loans (Note 2)	$ 428,521	$ —
Amortization of debenture discount and expense	22,211	—
Loss on sale and retirement of property and equipment	100,250	99,903
Other	184,128	121,620
	$ 735,110	$ 221,523
	$ (661,795)	$ 8,139,458
PROVISION FOR FEDERAL INCOME TAXES	—	3,800,000
FEDERAL TAX REFUND RESULTING FROM "CARRY-BACK" PROVISIONS OF THE TAX LAW ($1,280,000) LESS PORTION THEREOF ($645,000) CREDITED TO RESERVE FOR TRANSITION TO PEACETIME OPERATIONS (NOTES 2 AND 3)	635,000	—
	$ (26,795)	$ 4,339,458
PROPORTIONATE INTEREST IN NET LOSS OF AMERICAN OVERSEAS AIRLINES, INC. (NOTE 1)	$ 225,672	—
NET PROFIT (LOSS) CARRIED TO EARNED SURPLUS (NOTE 2)	$ (252,467)	$ 4,339,458

Reference is made to the accompanying notes

Consolidated Statements of Surplus

FOR THE YEARS ENDED DECEMBER 31, 1946 AND 1945

PAID-IN SURPLUS	Year Ended Dec. 31, 1946	Year Ended Dec. 31, 1945
Balance at beginning of year	$ 6,267,434	$ 5,855,878
Add:		
Arising from conversion of 4,692 shares of $4.25 Cumulative Convertible Preferred Stock into 13,405.53 shares of Common Stock	—	411,556
	$ 6,267,434	$ 6,267,434
Deduct:		
Expenses in connection with sale of 400,000 shares of 3½% Cumulative Convertible Preferred Stock (charged to paid-in surplus to conform to the accounting requirements of the Civil Aeronautics Board)	107,780	—
Balance at end of year	$ 6,159,654	$ 6,267,434

EARNED SURPLUS			
Balance at beginning of year		$13,422,303	$10,376,858
Net profit (loss) for year (Note 2)		(252,467)	4,339,458
		$13,169,836	$14,716,316
Deduct:			
Dividends paid:			
On 3½% Cumulative Convertible Preferred Stock—$1.75 per share (covering period from June 1 to December 1, 1946)	$700,000		
Less: Accrued at date sold — collected from purchasers	50,556	$ 649,444	$ —
On Common Stock—$1.00 per share		—	1,290,495
Redemption premium on 695 shares of $4.25 Cumulative Convertible Preferred Stock redeemed on January 15, 1945		—	3,518
		$ 649,444	$ 1,294,013
Balance at end of year (Note 4)		$12,520,392	$13,422,303

Reference is made to the accompanying notes

Notes to Financial Statements

NOTE 1:

The accompanying financial statements include in consolidation the Company's wholly-owned subsidiary, American Airlines de Mexico, S. A. The assets and operations of this subsidiary are not material in relation to those of the Company.

American Overseas Airlines, Inc. (61.8% owned at December 31, 1946 and 51.4% owned at December 31, 1945) is not included in consolidation. The Company's proportionate interest in the net loss of this subsidiary from date of acquisition (July 1945) to December 31, 1946 amounted to $225,672 and the Company has provided a reserve of this amount by charge to profit and loss in 1946. Of this amount $201,548 is applicable to the year 1946 and $24,124 to the six months ended December 31, 1945 after giving effect to retroactive adjustments of 1945 results. Revenue for the transportation of air mail during 1945 and 1946 has been accrued by the subsidiary on the basis of rates established by the Civil Aeronautics Board. The subsidiary has been granted reconsideration of the Board's order establishing the 1945 rate and will seek an increase in the temporary rate established by the Board for 1946. Any retroactive adjustments of mail rates will affect the subsidiary's operating results and the Company's proportionate interest therein.

After deduction of the aforementioned reserve of $225,672 the Company's investment in American Overseas Airlines, Inc. exceeds the Company's equity in the net assets shown by the subsidiary's books by $1,418,591 at December 31, 1946 which represents excess of cost of the investment over equity at dates of acquisition. The Company's equity in the net assets of the subsidiary includes $658,530 in respect of deferred experimental and development costs being amortized on the subsidiary's books over the term of the Certificate of Public Convenience and Necessity covering its present Trans-Atlantic operations, such Certificate expiring July 4, 1952.

The Company's equity in the net assets shown by the books of the other subsidiaries not consolidated (which are wholly-owned) exceeds the Company's investment therein by $91,431 at December 31, 1946 which represents accumulated profits of these subsidiaries since dates of acquisition. The net profits of these subsidiaries, amounting to $17,840 for the year 1946 and $43,054 for the year 1945, are not reflected in the Company's accounts. No dividends have been paid by the subsidiaries since dates of acquisition.

NOTE 2:

During 1946 the Company deferred $343,770 representing interest paid on debentures and bank loans to the extent the proceeds therefrom were used for financing the acquisition of equipment and facilities prior to the date of their actual utilization in operations. As of December 31, 1946, $57,039 of the deferred interest has been capitalized and included in the cost of equipment or facilities completed and placed in operation, and the balance of $286,731 is included in deferred charges.

During 1946 the Company also deferred $388,057 representing the estimated cost of training personnel for operation of aircraft of types not previously flown in commercial operations. The portion of the deferred training expenses applicable to DC-4 airplanes is being amortized from dates incurred to December 31, 1948 and the portion applicable to DC-6 airplanes will be amortized over a period of four years from the dates such airplanes are placed in commercial operation. As of December 31, 1946, $38,909 of the deferred training expense has been amor-

tized by charge to profit and loss and the balance of $349,148 is included in deferred charges.

Of the "carry-back" Federal tax refund credited to profit and loss for 1946 $330,000 results from the aforementioned deferred interest and training expenses being deductible for tax purposes in 1946 rather than in future years when the expenses will be charged to profit and loss.

NOTE 3:

The estimated expenses during 1946 resulting from delays in reassigning personnel from military contract to commercial operations, and from retraining personnel returning from military service have been charged in the amount of $1,435,456 to the Reserve for Transition to Peacetime Operations and the reserve has been credited with $645,000 representing the portion of the "carry-back" Federal tax refund resulting from these expenses being deductible for tax purposes.

NOTE 4:

The terms of the outstanding debentures and preferred stock provide certain restrictions on the payment of dividends on the common stock. The portion of the Company's earned surplus at December 31, 1946 not subject to such restrictions amounted to $3,057,929.

NOTE 5:

At December 31, 1946 the Company had various commitments for the purchase of flight equipment and major items of other property and equipment. It is estimated that, exclusive of the terminated contract mentioned in Note 6, such commitments will involve an aggregate expenditure, in addition to deposits and payments made during 1946, of approximately $51,000,000 of which, it is anticipated, approximately $35,000,000 will be expended in 1947 and approximately $16,000,000 in 1948.

At December 31, 1946 the Company was guarantor of a bank loan payable by American Overseas Airlines, Inc. in the amount of $5,000,000. This loan matured March 3, 1947 on which date the Company loaned $3,000,000 to the subsidiary to enable the latter to repay the bank loan. The Company has also guaranteed the subsidiary's performance of its obligations under an airplane purchase agreement involving a maximum contingent liability of $9,600,000 at December 31, 1946.

NOTE 6:

In February 1947 the Company entered into an agreement with Republic Aviation Corporation terminating a contract entered into in 1946 for the purchase of Republic Rainbow airplanes. Pursuant to the settlement agreement, the Company accepts in lieu of the return of the $2,433,333 cash deposits made with Republic (of which $2,129,167 were made in 1946 and are carried as an asset on the accompanying balance sheet), certain notes of Republic in the principal amount of $1,700,000 and participates at an estimated cost of $750,000 in settlement of sub-contract claims against Republic. The resulting loss to the Company, estimated at approximately $925,000 after taking into consideration anticipated 1947 Federal income tax credit, is not reflected in the accompanying financial statements, but will be charged in 1947 to the Reserve for Transition to Peacetime Operations.

NOTE 7:

Under the Employees Retirement Benefit Plan established as of December 31, 1941 the Company pays the entire cost of annuities covering past services rendered by employees prior to December 31, 1941. The payments, which have been charged to profit and loss in the years in which paid, amounted to $375,000 in 1945 and an aggregate of $1,000,000 in prior years. No purchases of past service annuities were made by the Company in 1946. The remaining cost of past service annuities not yet purchased as of December 31, 1946 is estimated at approximately $100,000.

The cost of the Plan for services rendered since January 1, 1942 is paid currently in part by the participating employees and in part by the Company.

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ARTHUR YOUNG & COMPANY
ACCOUNTANTS AND AUDITORS
1 CEDAR STREET
NEW YORK 5, N. Y.

TORONTO
MONTREAL
LONDON
PARIS

To the Board of Directors and Stockholders
American Airlines, Inc.:

We have examined the consolidated balance sheet of AMERICAN AIRLINES, INC. AND CONSOLIDATED SUBSIDIARY at December 31, 1946 and the consolidated statements of profit and loss and surplus for the year then ended, have reviewed the system of internal control and the accounting procedures of the Companies and, without making a detailed audit of the transactions, have examined or tested accounting records of the Companies and other supporting evidence, by methods and to the extent we deemed appropriate. Our examination was made in accordance with generally accepted auditing standards applicable in the circumstances and included all procedures which we considered necessary.

We have made similar examinations of the balance sheets at December 31, 1946 and the statements of profit and loss and surplus for the year then ended of subsidiaries not consolidated other than American Overseas Airlines, Inc. The consolidated balance sheet at December 31, 1946 and the statements of consolidated income and surplus for the year then ended of American Overseas Airlines, Inc. and its subsidiary company have been examined by other independent accountants, whose audit report has been furnished to us.

In our opinion, the accompanying consolidated balance sheet and consolidated statements of profit and loss and surplus present fairly the position of American Airlines, Inc. and Consolidated Subsidiary at December 31, 1946, and the results of their operations for the year then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

ARTHUR YOUNG & COMPANY

New York, N. Y.
March 18, 1947