North American Aviation, Inc.
(A DELAWARE CORPORATION)

ANNUAL REPORT
TO
STOCKHOLDERS
1938
To the Stockholders of
NORTH AMERICAN AVIATION, INC.:

There is submitted herewith the report of North American Aviation, Inc., for the year 1938, together with Consolidated Balance Sheet as of December 31, 1938, Summary of Consolidated Income for the year 1938 and other related statements.

SALES

The net sales of completed airplanes, parts, etc., for the year 1938, amounted to $10,062,345.58, or almost three times the sales for the year 1937, which were $3,469,735.33.

EARNINGS

Net earnings for the year 1938 amounted to $1,904,085.74 after provision for estimated Federal Income Taxes in the amount of $407,029.32. Dividends paid during the year amounted to $1,374,013.20, equivalent to 40c per share on the Common Stock outstanding.

This compared with a net profit of $496,103.26, after provision for estimated Federal Income Taxes in the amount of $220,000.00 for the year 1937. Dividends in the amount of $429,422.92 were paid in the year 1937.

In addition to the net earnings from operations for the year there was credited to Capital Surplus $998,455.70, representing the excess of proceeds of sale of assets over the book value thereof. Of this amount $985,455.70 arose from the sale of the Eastern Air Lines Division.

Net worth of your company as represented by the combined Capital Stock and Surplus increased $1,536,112.64 during the year 1938, from $5,754,888.22 at December 31, 1937 to $7,291,000.86 at the end of the year 1938.

NET WORKING CAPITAL

During the year 1938, the net working capital position of your company showed considerable improvement. The consolidated net working capital of the company increased $3,591,799.51 from $2,002,549.54 at December 31, 1937 to $5,594,349.05 at December 31, 1938.

Current assets increased $4,299,933.43 from $4,268,503.22 at December 31, 1937 to $8,568,436.65 at December 31, 1938. The principal items responsible for this improvement were cash and marketable securities, which increased $2,802,206.43 from $755,863.45 to $3,558,069.88, and inventories which showed an increase of $1,796,299.51 from $2,264,287.62 at December 31, 1937 to $4,060,587.13 at December 31, 1938.

These favorable results were made possible by the receipt of $3,500,000 from the sale of the Eastern Air Lines Division, and through additional funds representing undistributed net profits of the year. The above results were possible even after the payment of the $750,000 due banks at December 31, 1937, and after the dividend payment in the amount of $1,374,013.20.

Current liabilities increased $708,133.92 from $2,265,953.68 to $2,974,087.60. The increase in current liabilities was due mainly to additional deposits on sales contracts received during the year, the balance of which amounted to $1,475,870.32 at the end of 1938, as compared with $272,051.85 at the end of the previous year, an increase of $1,203,818.47.

OPERATING REVIEW

As indicated above, the results of the operations of your company for the year 1938 were gratifying, as reflected in the net profit of $1,904,085.74, after provision of $407,029.32 for estimated Federal Income Taxes.

The net profit of Eastern Air Lines Division for the first three months of the year, which is included in the earnings for the year 1938, was $95,827.36, after provision for estimated Federal Income Taxes of $23,027.56. During the year 1938 the sale of the Eastern Air Lines Division made it possible for the management of your company to give its undivided attention to the development and manufacture of military aircraft, which is now the only activity of the company.
The manufacturing operations for the year 1938, resulted in a net profit of $1,812,656.62 after provision for Federal Income Taxes amounting to $384,001.76. This is an improvement of $1,500,210.90 over the profit of $312,445.72 after provision for Federal Income Taxes in the amount of $147,500 reported for the year 1937.

The favorable adjustment of $7,584.40, credited to earned surplus during the year, represents the reversal of an excess provision for non-payment of airmail revenue applicable to the period prior to January 1, 1938, but subsequent to December 31, 1934, previously withheld by the Post Office Department but paid during the year 1938.

An amount of $408,379.63 has been transferred from earned surplus to capital surplus as of December 31, 1938, in order that the earned surplus account of the corporation may be adjusted so as to reflect undistributed earnings since December 31, 1934, only, as of which date the status of the corporation changed from that of a holding company to an operating company. This adjustment is subject to the approval of the stockholders and is explained in the Proxy Statement to the stockholders in connection with the Annual Meeting scheduled for March 22, 1939.

Under the Incentive Compensation Plan approved by the Stockholders at a special meeting held November 29, 1938, there was provided out of earnings a reserve in the amount of $167,000, of which amount $166,800 represents the net amount of the awards under the Plan. Awards were made by the Compensation Committee, composed of non-participating members of the Board of Directors, to eighty-eight employes entitled to receive benefits thereunder. The first payment of 50% of the amount of the awards was made to these employes during the month of February, 1939. We are confident that the operation of the Plan will serve as a stimulus to employes and will redound to the benefit of your company.

Fixed assets (net of depreciation reserves) of your company decreased $1,581,712.45 from $2,946,041.05 to $1,364,328.60. This decrease, however, is mainly due to the sale of the Eastern Air Lines Division during the year 1938. Depreciation charges during the year 1938 amounting to $95,953.48, represent only the provision of the Manufacturing Division in this respect. The decrease from the total amount reported in 1937 is due to the exclusion of depreciation of the Eastern Air Lines Division, which was sold in the early part of the year 1938.

Experimental projects in progress amounting to $299,116.26 at December 31, 1938, represent the cost of uncompleted experimental products being built at the present time, which we believe will result in additional business and, therefore, will normally be recoverable in the future.

There was deducted from the Reserve for Contingencies during the year 1938 an amount of $12,191.51, representing the final charge to this account for carrying expenses of idle leased plant. Similar charges to the Reserve for Contingencies during 1937 amounted to $26,600.04.

Deductions from earnings during the year for various taxes amounted to $746,389, or $.217 per share of capital stock outstanding. The corresponding amount for the year 1937 was $503,094, or $.146 per share.

Since the latter part of 1935 when manufacturing operations were established in our new plant at Inglewood, California, the personnel of that plant has increased from 72 employes to a peak of 3,098 in 1938. Our plant is one of the most modern in the United States and with the experience we have gained in the development of efficient manufacturing methods, made possible by the substantial orders received both from the United States and foreign governments, we are now in a strong position to participate in any increase of business caused by the contemplated expansion of the air defenses of these countries. We are quite confident of our ability to furnish trained personnel and efficient manufacturing facilities sufficient to increase our production schedule in order to fulfill our part in such programs without any material plant expansion. This has become possible due to the high degree of efficiency which has been developed during the past few years in the new plant.

Unfilled orders as of December 31, 1938, amounted to $10,914,528.66, as compared with $9,301,126.83 on December 31, 1937, an increase of $1,613,401.83, notwithstanding deliveries amounting to $10,062,345.58 during the year. Since December 31, 1938, additional orders have been received approximating $16,000,000, represented primarily by increased foreign orders.

Since 1935 your company has sold to or received orders from eleven foreign countries. A substantial portion of the sales volume for the year 1938 was represented by export sales. It is believed that a valuable reputation for reliability as to quality and performance of products, as well as ability to make prompt deliveries, has been established. This is evidenced by substantial repeat orders from important foreign countries, as well as from the United States Government.

The directors and officers wish again to record their appreciation of the loyalty and cooperation of all of the company's employes without whose untiring efforts the improvements shown for the year 1938 could not have been realized.

NORTH AMERICAN AVIATION, INC.

J. H. KINDELBERGER
President

ERNST R. BREECH
Chairman of the Board
NORTH AMERICAN AVIATION, INC., (Incorporated)

CONSOLIDATED

ASSETS

CURRENT ASSETS:
Cash ............................................. $2,060,769.54
Marketable short-term notes, at amortized values (face value, 
$1,500,000.00) .................. 1,497,300.34
Accounts receivable:
United States Government Departments ................................. 445,682.91
Other trade accounts ................................ 486,479.93
Sundry accounts receivable, accrued interest, etc., less reserve, 
$1,500.00 .................................. 17,616.80
Inventories—Contracts and work in progress, raw materials and supplies 
(at cost or less) ................................ 4,060,587.13
Total current assets ................................................................ $ 8,568,436.65

EXPERIMENTAL PROJECTS IN PROGRESS .......................................................... 299,116.26
DUE FROM UNITED STATES GOVERNMENT FOR SERVICES RENDERED UNDER 
AIR MAIL CONTRACT ABROGATED ON FEBRUARY 19, 1934 .............................. 86,707.21
INVESTMENTS (including government and municipal bonds deposited as surety 
for performance of obligations, $113,377.76) ........................................... 115,122.41

FIXED ASSETS:
California plant—Buildings, machinery, and equipment, at cost, 
$1,504,719.74, less depreciation reserve of $325,739.64 ........ $1,178,980.10
Maryland plant (not used in business)—Land, buildings, and equipment 
at cost, $277,055.66, less depreciation reserve of $91,707.16 .......... 185,348.50
Total fixed assets, depreciated value ................................................. 1,364,328.60

DEFERRED CHARGES—Prepaid taxes, insurance, etc. .......................... 97,197.60

TOTAL .................................................. $10,530,908.73

NOTE: There are various claims and suits pending against the compani

ACCOUNT

NORTH AMERICAN AVIATION, INC.:

We have made an examination of the consolidated balance sheet of North 
summaries of consolidated income, earned surplus, capital surplus, and reserve for conti 
and examined or tested accounting records of the companies and other supporting ev 
internal accounting control.

In our opinion, based upon our examination, the accompanying consolida 
reserve for contingencies fairly present, in accordance with accepted principles of acco 1938 and the results of operations for the year ended that date.

Los Angeles,
February 20, 1939.
BALANCE SHEET

1938

L I A B I L I T I E S

CURRENT LIABILITIES:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accounts payable</td>
<td>$ 605,167.12</td>
</tr>
<tr>
<td>Taxes payable and accrued (including estimated Federal income tax, $487,200.00)</td>
<td>604,044.40</td>
</tr>
<tr>
<td>Estimated liability under Incentive Compensation Plan</td>
<td>167,000.00</td>
</tr>
<tr>
<td>Other accrued liabilities</td>
<td>122,005.76</td>
</tr>
<tr>
<td>Deposits on sales contracts</td>
<td>1,475,870.32</td>
</tr>
</tbody>
</table>

Total current liabilities $ 2,974,087.60

RESERVE FOR CONTINGENCIES                           265,820.27

CAPITAL STOCK AND SURPLUS:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Capital stock—Authorized, 6,000,000 shares of the par value of $1.00 per share; issued and outstanding, 3,435,033 shares</td>
<td>$3,435,033.00</td>
</tr>
<tr>
<td>Capital surplus</td>
<td>3,140,718.50</td>
</tr>
<tr>
<td>Earned surplus since December 31, 1934</td>
<td>715,249.36</td>
</tr>
</tbody>
</table>

Total capital stock and surplus 7,291,000.86

TOTAL                                           $10,530,908.73

Of which in the opinion of their counsel will result in any substantial loss.

CERTIFICATE

Aviation, Inc. and its wholly-owned subsidiaries as of December 31, 1938 and of the related statements for the year 1938. In connection therewith, we made a review of the accounting methods and to the extent which we considered appropriate in view of the systems of consistently followed by the companies, the consolidated financial condition at December 31,

HASKINS & SELLS.
NORTH AMERICAN AVIATION, INC.
and wholly-owned subsidiaries

**SUMMARY OF CONSOLIDATED INCOME**
for the year ended December 31, 1938

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>SALES OF AIRPLANES, PARTS, ETC.</strong></td>
<td>$10,062,345.58</td>
</tr>
<tr>
<td><strong>COST OF SALES</strong></td>
<td>$7,437,857.03</td>
</tr>
<tr>
<td><strong>GROSS PROFIT FROM SALES</strong></td>
<td>$2,624,488.55</td>
</tr>
<tr>
<td><strong>GENERAL ADMINISTRATIVE AND SELLING EXPENSES</strong></td>
<td>$304,800.41</td>
</tr>
<tr>
<td><strong>PROFIT FROM MANUFACTURING OPERATIONS (after providing $95,953.48 for depreciation)</strong></td>
<td>$2,319,688.14</td>
</tr>
<tr>
<td><strong>OTHER INCOME:</strong></td>
<td></td>
</tr>
<tr>
<td>Profit of Eastern Air Lines Division (January 1 to March 31, 1938, date of sale) before provision for Federal income tax</td>
<td>$118,854.92</td>
</tr>
<tr>
<td>Interest, discount, scrap sales, etc.</td>
<td>$68,184.09</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>$187,039.01</td>
</tr>
<tr>
<td><strong>GROSS INCOME</strong></td>
<td>$2,506,727.15</td>
</tr>
<tr>
<td><strong>INCOME CHARGES:</strong></td>
<td></td>
</tr>
<tr>
<td>Provision for payments under Incentive Compensation Plan</td>
<td>$167,000.00</td>
</tr>
<tr>
<td>Idle plant expenses, etc.</td>
<td>$28,612.09</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>$195,612.09</td>
</tr>
<tr>
<td><strong>NET INCOME BEFORE PROVISION FOR FEDERAL INCOME TAX</strong></td>
<td>$2,311,115.06</td>
</tr>
<tr>
<td><strong>PROVISION FOR FEDERAL INCOME TAX</strong></td>
<td>$407,029.32</td>
</tr>
<tr>
<td><strong>NET INCOME</strong></td>
<td>$1,904,085.74</td>
</tr>
</tbody>
</table>
NORTH AMERICAN AVIATION, INC.
and wholly-owned subsidiaries

SUMMARIES OF CONSOLIDATED EARNED SURPLUS,
CAPITAL SURPLUS, AND RESERVE FOR CONTINGENCIES
for the year ended December 31, 1938

## EARNED SURPLUS

**Balance, January 1, 1938** ........................................................................................................... $ 585,972.05

**Add:**

- Net income for the year ........................................... $1,904,085.74
- Adjustment of mail revenue applicable to prior year ........ 7,584.40 1,911,670.14

**Total** ................................................................................................................................. $2,497,642.19

**Less:**

- Dividend paid ............................................................... $1,374,013.20
- Earned surplus as of December 31, 1934 (as adjusted) and excess of proceeds over book values of certain securities sold subsequent to December 31, 1934 transferred to capital surplus in accordance with resolution of the Board of Directors (subject to approval by the stockholders) 408,379.63 1,782,392.83

**Balance, December 31, 1938 (earned surplus since December 31, 1934)** .................... $ 715,249.36

## CAPITAL SURPLUS

**Balance, January 1, 1938** ........................................................................................................... $1,733,883.17

**Add:**

- Amount transferred from earned surplus (see above) ........................................ 408,379.63
- Excess of sales proceeds over book value of assets previously written down by charges against capital surplus (including amount from sale of Eastern Air Lines Division, $985,455.70) ........................................ 998,455.70

**Balance, December 31, 1938** .................................................................................................. $3,140,718.50

## RESERVE FOR CONTINGENCIES

**Balance, January 1, 1938** ........................................................................................................... $ 278,011.78

**Rent of Idle Plant** .................................................................................................................. 12,191.51

**Balance, December 31, 1938** .................................................................................................. $ 265,820.27
NORTH AMERICAN AVIATION, INC.

BOARD OF DIRECTORS
Ernest R. Breech, Chairman

J. Lee Atwood                Henry B. du Pont
Lisle R. Beardslee          Henry M. Hogan
Frederic G. Donner          James H. Kindelberger

OFFICERS

James H. Kindelberger .......... President
Henry M. Hogan ................ Vice President
J. Lee Atwood .................. Vice President
Lisle R. Beardslee ............ Secretary
R. A. Lambeth .................. Treasurer
Harvey C. Tafe ................ Assistant Secretary
Andres J. du Bouchet, Jr. ...... Assistant Secretary
Frank Beranek ................. Assistant Treasurer

Office of the Secretary
1775 Broadway
New York, N. Y.

Office of Transfer Agent
1775 Broadway
New York, N. Y.