PARTIAL VIEW OF MAIN ASSEMBLY FLOOR

NORTH AMERICAN BUILT
U. S. NAVY TRAINERS
IN ECHELON FORMATION
To the Stockholders of
NORTH AMERICAN AVIATION, INC.

March 22, 1940

On behalf of the Board of Directors, we present herewith the Company’s financial report for the year 1939, consisting of Consolidated Balance Sheet as of December 31, 1939, Summaries of Consolidated Income and Earned and Capital Surplus for the year 1939, together with the certificate of auditors, Haskins & Sells, and the following explanatory data and comments:

Earnings

Net income for the year 1939 amounted to $7,088,091.56, or the equivalent of $2.06 for each share of capital stock outstanding, of which $4,809,046.20, or $1.40 a share was distributed during the year as dividends. This result represents a substantial improvement over 1938 earnings of $1,904,085.74, or $0.55 a share, of which $1,374,013.20, or $0.40 a share was paid as dividends. These are net earnings, after all charges, including provision for Federal income taxes amounting to $1,501,000.00 for 1939, and $407,029.32 for the year 1938.

Operations during 1939 have been confined to the manufacture and sale of airplanes, parts, and related products, while the 1938 reported net income included an amount of $95,827.36, representing the net earnings of the Eastern Air Lines Division for the first three months of that year.

Sales of airplanes, parts, and related products, amounted to $27,608,651.44 during 1939, the highest in the Company’s history, compared with $10,062,345.58 during 1938, an increase of 174%. A substantial portion of the sales made during the year was to eleven foreign countries in addition to the military branches of the United States Government. The airplanes delivered during 1939 were principally basic trainer, advanced trainer, and observation types.

Net Working Capital

As indicated by the accompanying Consolidated Balance Sheet, the Company’s financial condition at December 31, 1939, was strong, current assets amounting to $20,506,945.87, an increase during the year 1939 of $11,935,509.22; and current liabilities amounting to $12,765,581.72, an increase during the year of $9,791,494.12.

Net working capital at December 31, 1939, amounted to $7,741,364.15, an increase of $2,147,015.10 over the net working capital as of December 31, 1938. While the increase in cash, $9,032,503.98, is substantial, it should be noted that a greater portion of this amount is represented by an increase of $7,043,434.39 in customers’ deposits and partial payments collected on uncompleted contracts.

Inventories at December 31, 1939, compared with inventories at December 31, 1938, increased $1,298,497.73.

The increase in current liabilities represents principally the addition of $7,557,712.99 to customers’ deposits on sales contracts, of which $7,043,434.39 was collected during 1939. The remainder, $514,278.60, was included in accounts receivable at December 31, 1939, and was collected January 8, 1940. Other increases were $1,092,298.13 in the reserve for Federal income taxes, and an increase of $1,141,483.00 in accounts payable, incentive compensation plan liability, miscellaneous taxes, etc. The ratio of current assets to current liabilities, including the customers’ deposits on sales contracts, was 1.6 to 1 at December 31, 1939. Excluding the amount of these deposits from both current assets and current liabilities, the ratio would be 3 to 1.
OPERATING REVIEW

The additional gross investment in plant and equipment at Inglewood during 1939 amounted to $473,548.51, a large portion of which represents the progress made to the end of the year in the present plant expansion program, now substantially completed. The following is presented as an indication of the rate of enlargement of plant facilities since the Company moved to California:

<table>
<thead>
<tr>
<th>Date</th>
<th>Square feet of floor space</th>
</tr>
</thead>
<tbody>
<tr>
<td>December 31, 1935</td>
<td>160,000</td>
</tr>
<tr>
<td>December 31, 1936</td>
<td>169,000</td>
</tr>
<tr>
<td>December 31, 1937</td>
<td>379,000</td>
</tr>
<tr>
<td>December 31, 1938</td>
<td>418,000</td>
</tr>
<tr>
<td>At completion of present program</td>
<td>654,000</td>
</tr>
</tbody>
</table>

The Company’s policy with respect to plant expansion is based entirely upon necessity, arising from the increased demand for our products, as commented upon hereinafter.

Depreciation charges during 1939 amounted to $104,068.25 for the Inglewood plant, and $9,931.92 for the Baltimore, Maryland, plant. The latter plant is still idle. It is carried on the balance sheet at a depreciated value (based upon cost) of $175,416.58. Reserves are adequate to offset any loss on the disposal of this property.

The Company’s total investment in land, buildings, machinery and equipment, represents only 18% of the Company’s net worth. It is interesting to note that the total dollar sales amounted to seventeen times the total investment in active plant, machinery and equipment. A further indication of the progress made in quantity production is the fact that the sales value per average square foot of factory floor space used, amounted to $65.36 in 1939, compared with $24.10 during 1938.

Total compensation paid to employees in 1939 amounted to $5,689,361, compared with $3,935,058 in 1938.

In appreciation of the splendid cooperation of the entire personnel in accomplishing the record operation results of the year under review, your Directors continued the practice of making additional payments as adjusted compensation to all employees not eligible to participate in the incentive compensation plan for executives and principal employees.

The amount available for awards under the incentive compensation plan was $726,272.15, as determined by the auditors. In arriving at the amount to be awarded to the employees eligible for participation in the incentive compensation plan, the Compensation Committee of the Board of Directors accepted the recommendation of the Management, reducing the total awards under the incentive compensation plan to $675,000.00, a reduction of $51,272.15. This reduction affected only the awards made to the three principal officers of the Company. One hundred and sixty principal employees and officers of the Company received awards under the incentive compensation plan.

At December 31, 1939, the Company employed 4,639 persons, a large percentage of whom had availed themselves of the protection afforded by the Company’s group insurance plan. This protection embraces life insurance, weekly cash benefits for temporary disability, and hospital and surgical benefits.

Early in the year 1937, the Company adopted a plan of self-insurance under the Workmen’s Compensation Laws of California, and, as a result, increasingly important savings in insurance costs have been effected.

Deductions from earnings for the year 1939, to cover various direct taxes, amounted to $1,990,807.00, exclusive of state sales taxes on purchases, compared with tax charges of $746,389.00 for the year 1938, an increase of $1,244,418.00. Of this increase, $1,093,971.00, or 88%, was in Federal income taxes.

The tax expense for the year 1939 was equivalent to fifty-eight cents for each share of capital stock outstanding, compared with twenty-two cents a share for 1938. It is also interesting to note that, based upon the average personnel, these charges amount to $568.00 per employe for the year 1939, compared with $275.00 per employe for the year 1938.
At December 31, 1939, unfilled orders amounted to $50,599,802.21, compared with $10,914,528.66 at December 31, 1938. The 1939 backlog includes substantial orders from foreign governments, as well as a fair proportion of the business resulting from the defense program of the United States. This increase in assured future business is gratifying, but it must be noted that an indeterminate portion of these orders has arisen through the present disturbed foreign situation, and the proportion of this business which is of a recurring nature can hardly be estimated. Also, your attention is directed to recent legislation restricting profits on United States Army and Navy contracts to a maximum of 12%.

During 1939, the Company completed development of a twin-engine bomber, for which a substantial order was received from the United States Army. Deliveries on this contract are expected to begin during the summer of 1940.

Toward the latter part of 1939, the Company developed a primary trainer which has received favorable comment from everyone who has flown the airplane. Numerous inquiries have been received regarding this airplane, and some new business is expected to result.

Other developmental work, mostly of a confidential military nature, is in progress. In addition, current models are being improved constantly through engineering research.

The Company's sole capital obligation is represented by 3,435,033 shares of capital stock, without preferences, and the book value attaching to these shares was increased appreciably during the year 1939 by the retention in surplus of a portion of the net income for the year. The changes during 1939 in the net worth of the Company are summarized in the following:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total capital and surplus (net worth), December 31, 1938</td>
<td>$7,291,000.86</td>
</tr>
<tr>
<td>1939 earnings</td>
<td>$7,088,091.56</td>
</tr>
<tr>
<td>Less dividends paid during 1939</td>
<td>4,809,046.20</td>
</tr>
<tr>
<td>Earnings retained in the business</td>
<td>2,279,045.36</td>
</tr>
<tr>
<td>Total capital and surplus (net worth), December 31, 1939</td>
<td>$9,570,046.22</td>
</tr>
</tbody>
</table>

The average total capital employed during 1939, amounting to $9,214,940.23, was turned three times, expressed in relation to total sales, compared with 1.7 times for the average total capital employed during 1938.

It is extremely difficult to forecast the trend of certain conditions which have augmented so remarkably the activity in all branches of this industry, and, accordingly, the Board of Directors has felt it wise to conserve a reasonable portion of the Company's earnings for future developments.

Eighty-one percentum of the Company's net worth at December 31, 1939, was represented by the excess of current assets over current liabilities.

At December 31, 1939, the Company's stockholders numbered 28,023.

CONCLUSION

In presenting this report, it has been our desire to give our stockholders all vital information concerning the operations and the financial condition of the Company, without conflicting in any way with the policy of the Government of the United States of America with reference to releasing information of a confidential nature.

It is our wish to express again to our stockholders and to our employees, on behalf of the Board of Directors and the Management, our appreciation for their cooperation, loyalty and efficiency, which have contributed in such great measure to the record achievement of 1939.

NORTH AMERICAN AVIATION, INC.
J. H. Kindelberger  
President

Ernest K. Breech  
Chairman of the Board
NORTH AMERICAN AVIATION, INC. (Incorporated)

CONSOLIDATED

ASSETS

CURRENT ASSETS:

Cash (including $2,782,015.88 deposited in escrow in connection with sales contracts) $11,093,273.52

 Marketable short term notes, at amortized values (face value, $1,300,000.00) 1,298,154.16

Accounts receivable:
United States Government Departments 1,131,666.60
Other trade accounts 601,286.78
Sundry accounts receivable, accrued interest, etc. 29,100.11

Inventories (at cost)—Contracts and work in progress (less cost of partial deliveries) and raw materials and supplies 5,359,084.86

Deposits on contracts for purchase of airplane engines, etc. 994,379.84

Total current assets $20,506,945.87

EXPERIMENTAL PROJECTS IN PROGRESS 36,230.69

DUE FROM UNITED STATES GOVERNMENT FOR SERVICES RENDERED UNDER AIR MAIL CONTRACT ABROGATED ON FEBRUARY 19, 1939 86,707.21

INVESTMENTS (including government and municipal bonds deposited as surety for performance of obligations, $112,967.12) 114,711.77

FIXED ASSETS:

California plant—Buildings, improvements, machinery, and equipment, at cost, $1,978,268.25, less depreciation reserve of $409,092.94 $ 1,569,175.31

Maryland plant (not used in business)—Land, buildings, and equipment, at cost, $277,055.66, less depreciation reserve of $101,639.08 175,416.58

Total fixed assets, depreciated value 1,744,591.89

DEFERRED CHARGES—Prepaid taxes, commissions, etc. 112,260.78

Total $22,601,448.21

NOTE: There are various claims and suits pending against the companies.

ACCOUNTANT:

NORTH AMERICAN AVIATION, INC.:

We have examined the consolidated balance sheet of North American Aviation, Inc., earned surplus, and capital surplus for the year ended that date, have reviewed the said records, and other supporting evidence, by methods and to the extent usual in the circumstances.

In our opinion, the accompanying consolidated balance sheet and related statements of financial condition of the companies at December 31, 1939 and the results of their operations by the companies on a basis consistent with that of the preceding year.

Los Angeles,
February 8, 1940.
LIABILITIES

CURRENT LIABILITIES:

Accounts payable .......................................................... $1,033,476.73
Taxes payable and accrued:
Federal income tax (estimated) .......................................... 1,579,498.13
Other taxes ........................................................................ 215,050.82
Estimated liability under incentive compensation plan (including
$12,250.00 from prior year) ............................................... 717,250.00
Other accrued liabilities ...................................................... 186,722.73
Deposits and progress billings on sales contracts ..................... 9,033,583.31

Total current liabilities ......................................................... $12,765,581.72

RESERVE FOR CONTINGENCIES ............................................. 265,820.27

CAPITAL STOCK AND SURPLUS:

Capital stock—Authorized, 6,000,000 shares of the par value of $1.00 a
share; issued and outstanding, 3,435,033 shares .......................... $3,435,033.00
Capital surplus ....................................................................... 3,109,938.01
Earned surplus (since December 31, 1934) ................................. 3,025,075.21

Total capital stock and surplus ................................................. 9,570,046.22

TOTAL ........................................................................... $22,601,448.21

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

CERTIFICATE

and its subsidiaries as of December 31, 1939 and the summaries of consolidated income,
internal control and the accounting procedures of the companies, and have examined or
believed appropriate. Our examination of inventories included physical tests of quantities.
consolidated income, earned surplus, and capital surplus fairly present the consolidated
year ended that date, in conformity with generally accepted accounting principles followed

HASKINS & SELLS.
NORTH AMERICAN AVIATION, INC.
and subsidiary companies

Summary of Consolidated Income
for the year ended December 31, 1939

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales of Airplanes, Parts, Etc.</td>
<td>$27,608,651.44</td>
</tr>
<tr>
<td>Cost of Sales</td>
<td>$17,862,268.94</td>
</tr>
<tr>
<td>Gross Profit from Sales</td>
<td>$9,746,382.50</td>
</tr>
<tr>
<td>General Administrative and Selling Expenses</td>
<td>$636,861.43</td>
</tr>
<tr>
<td>Profit from Operations (after providing $104,068.25 for depreciation)</td>
<td>$9,109,521.07</td>
</tr>
<tr>
<td>Other Income:</td>
<td></td>
</tr>
<tr>
<td>Royalty and license agreements</td>
<td>$74,806.81</td>
</tr>
<tr>
<td>Interest and discounts</td>
<td>$63,678.38</td>
</tr>
<tr>
<td>Scrap sales, etc.</td>
<td>$39,995.84</td>
</tr>
<tr>
<td>Total</td>
<td>$178,481.03</td>
</tr>
<tr>
<td>Gross Income</td>
<td>$9,288,002.10</td>
</tr>
<tr>
<td>Income Charges:</td>
<td></td>
</tr>
<tr>
<td>Provision for payments under incentive compensation plan</td>
<td>$675,000.00</td>
</tr>
<tr>
<td>Idle plant expenses (including depreciation, $9,931.92), etc.</td>
<td>$23,910.54</td>
</tr>
<tr>
<td>Total</td>
<td>$698,910.54</td>
</tr>
<tr>
<td>Net Income Before Provision for Federal Income Tax</td>
<td>$8,589,091.56</td>
</tr>
<tr>
<td>Provision for Federal Income Tax</td>
<td>$1,501,000.00</td>
</tr>
<tr>
<td>Net Income</td>
<td>$7,088,091.56</td>
</tr>
</tbody>
</table>
NORTH AMERICAN AVIATION, INC.
and subsidiary companies

SUMMARIES OF CONSOLIDATED EARNED SURPLUS AND CAPITAL SURPLUS
for the year ended December 31, 1939

EARNED SURPLUS (since December 31, 1934)

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Balance, January 1, 1939</td>
<td>$715,249.36</td>
</tr>
<tr>
<td>Add:</td>
<td></td>
</tr>
<tr>
<td>Net income for the year</td>
<td>$7,088,091.56</td>
</tr>
<tr>
<td>Amount transferred from capital surplus—Adjustment resulting from a</td>
<td>30,780.49</td>
</tr>
<tr>
<td>re-determination of the profit arising from the sale of Eastern Air</td>
<td></td>
</tr>
<tr>
<td>Lines Division in 1938</td>
<td>7,118,872.05</td>
</tr>
<tr>
<td>Total</td>
<td>$7,834,121.41</td>
</tr>
<tr>
<td>Less Dividends Paid—$1.40 per share</td>
<td>4,809,046.20</td>
</tr>
<tr>
<td>Balance, December 31, 1939</td>
<td>$3,025,075.21</td>
</tr>
</tbody>
</table>

CAPITAL SURPLUS

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Balance, January 1, 1939</td>
<td>$3,140,718.50</td>
</tr>
<tr>
<td>Less Amount Transferred to Earned Surplus (see above)</td>
<td>30,780.49</td>
</tr>
<tr>
<td>Balance, December 31, 1939</td>
<td>$3,109,938.01</td>
</tr>
</tbody>
</table>
NORTH AMERICAN AVIATION, INC.

BOARD OF DIRECTORS
Ernest R. Breech, Chairman

J. L. Atwood
Henry B. du Pont
Herbert G. Fales
Henry M. Hogan
James H. Kindelberger
John L. Pratt

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

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