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31 December 1951

To: Board of Directors  
From: President  
Subject: President's Report to the Board of Directors

### SCOPE OF REPORT

This report is intended to present the salient current problems of CAT to the Board of Directors and the Bankers. At the meetings in Washington in October/November 1951 it was agreed that the President would present such reports from time to time, and it is my intention to do so quarterly.

The scope of the report has been designed with the additional consideration that it should serve as an introductory document to be used by the reconstituted Board of Directors when they take office in the early part of 1952. There is much in this report which is known to former Board members and would not be contained herein except for this latter purpose.

### HISTORICAL AND LEGAL BACKGROUND OF CAT

CAT officially came into being on 25 October 1946 as CNRRA (Chinese National Relief and Rehabilitation Administration) Air Transport. Major General C. L. Chennault, U.S. A. (Ret'd) and Mr. Whiting Willauer, formerly Far Eastern Director of United States Foreign Economic Administration left the service of the United States Government at the close of World War II and formed a partnership for the development of air transport in China as private businessmen. They were backed in this enterprise by a Panamanian corporation known as Rio Cathay, S. A. Chennault and Willauer acted as agents of this corporation. Rio Cathay remained large as an unclosed principal during CAT's operations prior to reorganization in mid 1950. Political necessities in China at the time required this type of relationship mainly because the post war Chinese Government was not

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prepared to permit any new cooperation (particularly one which was foreign owned) to ostensibly carry on an air transport business in China. In the days when Chennault and Willauer were seeking a franchise for air operations there were tremendous pressures by many interests both Chinese and foreign to form air transport corporations for China operations. The Chinese political authorities were anxious to build up the volume of air transport in China but they were not prepared to open up the field to numerous concerns. Indeed they had not even determined upon the basic question as to whether air service should be publicly owned and if so whether they would adopt a single chosen instrument or have several air organizations.

As a matter of political expediency and (to quote the franchise) because Chennault and Willauer have "rendered meritorious military service to the Chinese in the war against aggression and (had) continued to service the cause of the Chinese Government and the fight against aggression" a one year temporary franchise was granted to them on a personal basis with the primary objective of air transport by them for the distribution of relief and rehabilitation supplies furnished by UNRRA through CNRRA to China.

CNRRA Air Transport commenced operations in January 1947. The operating equipment was purchased by Chennault and Willauer from a capital grant made by UNRRA to CNRRA which in turn was loaned to Chennault and Willauer on a commercial loan basis with provisions requiring the retirement of principal within 18 months and the payment of interest during the interim. The working capital funds amounting to approximately a quarter of a million dollars and the development expenses which ran to nearly an equal amount were private funds obtained by Chennault and Willauer and their associates. The working capital came to the concern through a loan from Chinese bankers who received approximately 40% of the equity in the business plus an obligation of the business to re-pay the funds advanced. The promotional funds was furnished through Rio Cathay, S. A., together with earnings by Chennault and Willauer in other China ventures in which they were again principally acting for Rio Cathay, S. A.

During 1947 and early 1948 the equipment loan from CNRRA was paid off and full title to the equipment became vested in the private operators. During succeeding periods of operation the working capital loans were also retired, with the result that by approximately the middle of 1948 those associated with Chennault and Willauer through the partnership owned the venture free and clear.

In 1948 CAT created a wholly owned subsidiary (International Suppliers Corporation) which was used as a promotional vehicle for the generation of air cargoes for CAT. One of the major purposes of ISC was to freeze the rapidly inflating Chinese currency revenues of CAT into commodities which were usually chosen for air transportability. This company was since been liquidated after having well served its designed purposes through the years when CAT was operating on the mainland of China.

At the end of 1947 CAT's franchise with the Chinese Government through CNRRA expired and a new franchise was granted to the Chennault and Willauer partnership by the Civil Aeronautics Administration of the Chinese Ministry of Communications, and the name of the business was changed to Civil Air Transport. This franchise was on a year to year basis and has been renewed in approximately the same terms every year. The last renewal was accomplished on 1 December 1951 and covers the calendar year 1952. One of the major targets of the management of CAT for 1952 is to attempt to persuade the Chinese authorities to enter into a 5 year franchise commencing in 1953. On the working level of Chinese Government authorities there is some indication of a favorable atmosphere for the objective, but it is entirely too early to evaluate probabilities of success. Much will depend upon CAT's governmental relationships during the coming year and even more will depend on the official Chinese evaluation of the desirability of remaining in favor with the United States Government by showing favor in concrete fashion to U. S. citizens such as Chennault and Willauer.

One legal development which occurred in 1949 during the negotiations for the 1950 CAT operating franchise is most important. In the 1950 franchise there was for the first time included the following provision:

"21. The Operators are hereby authorized to make such changes in their operating arrangements during the period of this Agreement as may be necessary to protect their aircraft and other property from seizure by unfriendly interests in order to insure continued operation. These changes may include (a) the transfer of aircraft and any other property and assets to a corporation, foreign or domestic, (b) the transfer of any equipment to foreign registry and flag and (c) the change of the business name from Civil Air Transport to any other name that the Operators may select, provided, however, that the Operators shall promptly notify CAA in writing of any such change and further provided that any such transferee corporation may succeed to any or all of the rights and obligations of C. L. Chennault and Whiting Willauer hereunder, and further provided, that C. L. Chennault and Whiting Willauer shall remain to represent such transferee corporation as mentioned above.

Pursuant to this permission C. A. T. Inc. was formed in the last days of 1949 and all of the assets of the partnership were transferred thereto.

The Chinese Government was fully informed of this but they have never officially recognized the corporate ownership. Indeed, the Chinese Government specifically refused to issue the 1951 franchise in the corporate name and they still insist that relationships and franchise rights vis-a-vis the airline and the Chinese Government only exist through the partnership. This rather anomalous legal situation can only be fully understood in terms of Chinese politics and psychology. Suffice it to say that although peculiar to western legal concept it represents no difficulty to the Chinese mind and has always proved highly workable. One of the real reasons for this is that the corporate concept has never been fully a part of Chinese legal thinking and the responsibility of individuals is still the basic business operating concept in China in spite of the fact that the written law (largely created since World War II) contains most of the features of the New York State Corporation Law.

In November 1949 the Communist victory on the mainland of China forced a complete evacuation of CAT facilities first to the Island of Hainan, and thence to Hongkong and Formosa. CAT's business fell abruptly to about 15% of its mainland volume, i. e. from about 3000 hours a month to about 500. The management of CAT was faced in the early days of 1950 with the alternative of either liquidating or expending all of its reserves and also obtaining new financial support. The management chose to continue, having confidence that the Far Eastern political situation would ultimately result in a need for air transport along the periphery of the China mainland. Accordingly, the basic organization was kept together. For a few months this was financed by expending all of the owners' remaining reserves; and later extensive banking loans were arranged with a syndicate of venture capitalists in the United States. In July of 1950 the legal relationships were altered by a re-organization of C. A. T. Inc. into CAT Incorporated. The major features of the re-organization were the buying out of all of the former owners of C. A. T. Inc. and the placing of the bankers in a preferred position with certain vestigial rights subject to the bankers rights remaining in Willauer and James J. Brennan, CAT's Executive Vice President. This relationship was varied slightly about a year later. The details of all this are available to the Directors through our legal counsel in Washington.

The old company of C. A. T. Inc. was changed in name to Willauer Trading Company and it is now in the process of liquidation. The present active concern is CAT Incorporated working through the partnership of Chennault and Willauer who are recognized as the private firm of Civil Air Transport by the Chinese Government.

A full understanding of the historical and legal background requires a short discussion of the Delaware corporation known as Civil Air Transport, Inc. which is an entirely separate company from all others of similar name. After the Communist victory on the Chinese mainland the other two Chinese airlines, China National Aviation Corporation (CNAC) and Central Air Transport Company (CATC) attempted to desert to the Communists. The top Chinese management of these concerns flew to Peking, taking with them about 10 aircraft and leaving on the airport in Hongkong 71 additional aircraft. Chennault and Willauer as individuals were appealed to by the Chinese Government to intervene in this situation and acting as partners on 5 December 1949 bought the assets of CNAC and CATC. Immediately thereafter they formed Civil Air Transport, Inc. and transferred the 71 planes situated in Hongkong and all other assets formerly belonging to CNAC and CATC to that corporation. On 5 January 1950 the British recognized the Red Chinese Regime and there ensued a series of law suits in the courts of Hongkong and the United States to determine the ownership of the assets as between the Chinese Reds and Civil Air Transport, Inc. Civil Air Transport, Inc., representing the American side of the picture has won the case on several occasions in the United States courts in San Francisco where the issue at stake was the ownership of various bank accounts formerly belonging to CNAC and CATC. In all decisions of the British courts Civil Air Transport, Inc. has lost to date and various appeals are now pending. In the meantime the physical assets in Hongkong remain frozen. Neither CAT Incorporated nor the bankers have any direct interest in the assets of Civil Air Transport, Inc. except for a few of them which were transferred to CAT Incorporated either in fee simple or on a basis of user. However, since the Chinese authorities do not readily make legal distinctions the conduct of the affairs of Civil Air Transport, Inc. of necessity affect the relationships of CAT Incorporated with the Chinese Government. This situation is not wholly desirable but is unavoidable and it must always be recognized that there is a real difference of interest between the owners of Civil Air Transport, Inc. and those involved in CAT Incorporated. Every effort is made by both groups to keep this difference to a minimum but it exists nevertheless. No important difficulties have arisen to date but it must be constantly borne in mind that future possibilities of trouble are inherent in this situation. The officers of Civil Air Transport, Inc. have on several occasions offered to resolve this difficulty by selling out to those interested in, CAT Incorporated but the latter have not seen their way clear to this approach.

### DESCRIPTION OF CAT OPERATIONS

In the period May-November 1951 there is presented a typical cross section of CAT's present and probable future operational pattern. Attached hereto is a graph marked "A" showing the composition of flying hours during this period. Revenue from these operations follow a nearly identical pattern. Our revenue flights have made up a total of 94.1% of our total hours during this period and the percentage of 5.9% non-revenue hours has been quite low in comparison with the operational and maintenance difficulties inherent in our area and in our type of business which is mostly non-scheduled.

Contract flights marked in purple on the graph comprise 4 projects of miscellaneous contract flying and account for 34.9% of our business. [redacted] flights account for 33% and are confined to direct support of the Far East Air Force. In these two classes of flights we operate on a charter basis with a fixed hourly return of \$307 per hour for C-46's which are almost exclusively used for this business. The so-called contract flights operate on a non-scheduled basis throughout Japan, Korea and the former Japanese Islands touching occasionally Hongkong, the Philippines and Bangkok. The [redacted] flights are principally in Japan and the former Japanese Islands although from time to time much [redacted] work has been done in Korea. In the early days of the Korean War when the Air Force itself had very little transport CAT's transport furnished a major portion of all airlift to the actual combat areas.

Our scheduled flights account for only 15.8% of our total hours. We operate scheduled routes from Bangkok through Hongkong and Formosa to Tokyo, carrying passengers and cargo. We have no rights to pick up or discharge revenue business between Hongkong and Bangkok. Our charter flights have averaged 10.4% of our hours and have taken us to New Zealand, Fiji Islands, India, Burma, and Europe with several other miscellaneous points also covered.

Through a wholly owned subsidiary known as Burrige Associates, we manage the operations of Korean National Airways by supplying the maintenance, crew, and many other services for this concern which is the nationally owned chosen instrument of that country. It's present operations are domestic but international operations to Japan, Formosa and beyond are a near certainty in the next six months.

### OUTSTANDING FEATURES OF CAT'S OPERATIONS AS AFFECTING THE FINANCIAL POSITION

Due to undermanning of our Fiscal Division detailed statistical and financial analyses of the types which Management needs for its own purposes and for its reports to the Directors are in some cases non-existent and in many important categories very weak.

However, there are certain very clear general points that can be drawn from such statistics as we do have.

CAT policy as laid down by the Directors is to maintain the facilities for flying a total of 3,000 hours per month. Our break even point was formerly believed to come at about 2,400 revenue hours but recent indications are upping that figure to something closer to 2,600 hours. The Management, however, knows that at present in our profit and loss picture there are many capital charges which have not been segregated out and appear today as operating expenses (An estimate of the total effect of this appears in the section on fiscal affairs). We are now about to install a cost accounting system, having for the first time obtained a man to handle the work. Until we have cost figures we cannot tell exactly how much over 2,400 hours we require to break even.

Despite difficulties in obtaining exact figures we are confident that the following salient conclusions as to our business and the factors which cause the large fluctuations shown in the chart are correct for all practical purposes. They are as follows:

1. Our best customers, who we lump under the category of contract flights (in purple on the chart), have proved to date to be our most unreliable ones in steadiness of demand for airlift. The fluctuation of our total hours follows almost exactly the fluctuation of these contract hours. Thus it can be seen from the graph that our June peak of 2,880 hours had in it as a contribution from contract flights 1,170 hours. Our low point in August of approximately 2,100 hours had only 540 hours of contract flying. Eighty percent of the loss of 780 hours arose from the 630 hour difference flown for contract flights.

This condition of fluctuation presents no element of surprise to the Management. Indeed it was in order to take care of this type of business on a fluctuating basis that the policy of maintaining 3,000 hours available capacity was adopted by the Directors, and the choice of the particular figure of 3,000 is readily justifiable by the June peak of 2,880 hours and the present upward tendency shown by the purple line on the graph. However, some new means of compensating for this fluctuation must be sought if CAT's operations are to continue commercially sound. It is

impossible to adjust overhead to follow a fluctuating business such as is caused by the contract flights. In all other established airlines throughout the world fluctuations of this nature are taken care of by governmental subsidies which are recognized as necessary in the interest of national safety and economy. In the absence of any possibility of subsidy, consideration should be given to the desirability of placing directly on the fluctuating part of our business that part of the cost of the total operation attributable to a stand-by capacity to meet peak demands for contract flights. A fluctuating contract price decreasing in proportion to greater utilization is the most attractive solution from the Management's point of view. Whether our contract customers would go along is at present unknown. We feel that Management should be authorized to initiate negotiations along these lines.

2. A possible partial means of alleviating the effect of fluctuation from contract flying has come up in the last month through the proposed contract with the Far East Air Material Command (FEAMCOM) for overhaul of their C-46 aircraft. During the period 1 July to 1 October CAT's total operating expense was \$2,756,260.08. \$1,001,508.40 of this item was cost for direct maintenance of flight equipment and ground and indirect maintenance. Thus it is to be seen that approximately 38% of our total overhead comes in our maintenance activities and if we can make this overhead into a steady revenue producer regardless of hours of flying we will have gone far towards stabilizing our financial situation. This becomes particularly apparent when we note that flying operations for the same period cost \$779,515.60. This item varies fairly constantly up to certain limits in nearly direct proportion with flying hours. It accounts in all for 29% of CAT's overhead. Thus if 38% of overhead attributable to maintenance plus 29% attributable to direct cost of flying operations could both be controlled, 67% of the problem of fluctuation would theoretically be met.

The difficulty, of course, arises in the area between theory and practice. We submit that it will be impossible as a practical matter to time things exactly enough for an ideal result because this requires a precise timing of the rapidly fluctuating needs of our contract customers with the more cumbersome problems of obtaining outside maintenance work and producing cash therefrom on schedule. Further there will be an inevitable lag in reduction of direct flying operations expenses to conform with reduction in hours flown. Nevertheless much can be done by this approach and it will be a major target of Management to cure our problems as far as possible by exploitation of this concept.



The contract with FEAMCOM represents the culmination of almost two years of work with the FEAMCOM Commander, General Doyle and his assistants. While this contract is not firm at the present moment, we have been given every possible verbal assurance.

3. Scheduled commercial flights are our greatest money losers. In fact our entire operating loss for the period July-October totalling \$222,324.24 was more than accounted for by the \$349,737.54 loss in scheduled business. The difference of \$125,413.30 which theoretically could be saved by cutting out all scheduled business would not be entirely profit since all items of overhead now charged to scheduled business could not be completely deleted. For instance, there is charged to the scheduled business 11% of the ground and indirect maintenance costs for C-46's and 43% for C-47's. It would probably be impossible to cut down the overall scope of the ground maintenance activity to make savings up to these percentages, but over a period of time such savings would show up in large measure. In the absence of a cost accounting system it is impossible to be exact on this point but it is my judgment that during the period in question our total business would have at least broken even were it not for the scheduled business.

The two major reasons for the high proportionate loss in scheduled business are the expense of the Traffic and Sales Division (and a portion of the Public Relations Office) and the low load factors. Last summer I pointed out to representatives of the Board of Directors that I personally feared that no matter how much effort was put into traffic and sales activities we can never hope to make our scheduled operations profitable. However, when Mr. Schildhauer took over responsibility for Traffic and Sales I agreed with him that he should devote more energy to organizing and increasing this activity in order to give a fair trial to the situation. We had no reliable figures available at that time and accordingly I did not wish to actively oppose increase in traffic and sales activity merely on my own business judgment. Now, however, we do have some figures and we are going to continue to watch trends carefully. There is no doubt that at present the traffic and sales activity plus the general improvement of business conditions is increasing our scheduled traffic volume, but at the present writing we do not have statistics beyond October upon which to determine financial net results. On the whole it is my opinion that prospects are bearish.

A study which I have had prepared covering the July-October results,

copy of which is attached, marked "B" gives more detail on this question. From this study it can be seen that our load factors to break even on domestic scheduled business would have to reach the impossible figure of 178.81%. The picture is better in the international business where a theoretically possible load factor of about 80% would break us even.

The question posed to Management and through Management to the Directors is a very difficult one - indeed probably the most difficult single one before the company today and for the next year. In the first place it is almost a political certainty that the Chinese Government would refuse to continue our franchise if we ceased all scheduled business. The domestic scheduled business from our Round the Island flights on Formosa, if stopped, would have a drastic effect on the morale and on the essential communications of the National Government. The problem is perhaps not so acute in our international scheduled business which connects Formosa with Tokyo, Hongkong and Bangkok because there are other carriers furnishing service. Nevertheless, I am certain, that the Government would take a very poor view of any cessation of this service.

It is my primary recommendation that we continue a careful statistical observation of this problem with a view to a decision sometime next Spring as to curative measures if the financial results remain the same unless the Board of Directors is now prepared to absorb this loss for political reasons and because of a desire to remain as broadly as possible in the straight commercial field.

Curative measures which I am now studying are as follows:

Domestic Scheduled Business - If the present 48.78% load factor can be markedly improved we should consider increasing our domestic schedules. If not we must either have a drastic increase in rates on all our schedules or bear the loss. There is nothing we can do on the Island of Formosa by way of increasing the revenue by increasing the carrying capacity of equipment used and thus reducing the overhead. This is because of airport limitations which restricts us to C-47 operations.

International Scheduled Business - Here we cannot consider any further substantial increase of schedules because of international restrictions on the number of flights. However, I would have real hope to break this business even by a C-54 operation as distinguished from the present C-46 service. The load factor of nearly 80% on C-46's required to

break even is almost an impossible target on our particular routes. However, with a C-54 service the load factor to yield break even revenue would probably come closer to practical possibilities and be in the range of 65 to 70%. If the average monthly loss from international scheduled service of about \$45,000 could be wiped out with C-54 equipment we would be gaining against the purchase price of this equipment \$540,000 a year, a figure which I understand to be somewhat near the cost of such an aircraft, although there have been isolated sales at even higher figures.

If we can ever succeed in obtaining commercial landing rights in Okinawa we should be greatly aided, and some help would come from rights to pick up passengers at Hongkong for Bangkok. The first question is before the U.S. high authorities in Washington; the other requires very difficult negotiations with the British with very little hope of success.

4. In the commercial field our greatest present weakness seems to me to be in lack of emphasis upon the support of our long range charter business. Since my recent return at which time I resumed direct responsibility for financial matters, I have devoted much time to study of this potentiality. This business does not suffer from the same limitations preventing it from making money as our scheduled business. Since our first long range charter flight on 5 March 1951 to Wellington, New Zealand, we have flown ten of these charters which earned a total of \$120,000 of revenue and so far as can be determined from available statistics all of this business has been at a good profit. As part of this business we are carrying on a fairly extensive brokerage service and the earnings from brokerage appear to be paying for the overhead of maintaining our long range charter negotiations and contacts. Through this long range charter business CAT has flown the Chinese flag in twenty-two countries and we have never been refused a clearance on the basis of the nationality of our flag. We have developed aggressive agents of integrity throughout the world which are particularly strong in India, the Mid-East and in Europe. During the last quarter of 1951 our revenue per hour averaged \$330.30 which is almost 10% better than our contract flights. Since all business is on a full plane basis the load factor problem of scheduled operations does not arise.

From a very carefully reasoned report submitted by those in charge of long range charters, it seems to me that it would be a good business risk to free them from certain restrictions in their activities. Through the Traffic & Sales Division regulations arbitrary per hour price limitations with

which long range charters can be bid have been imposed, and apparently much business has been lost through this policy. Subject to a little more investigation based on figures not available at the time of this writing I propose to permit more latitude on price for these charters in order to experiment further in this field. Final policy can probably be firmed up by the time of my next report.

5. Our past deficit also could have been cured by a 10% increase in all our rates. This would have increased our income in the July/October period by \$248,898.32, more than offsetting the loss therein. There is justification for this in the overall price structure increase since the beginning of the Korean War. The increase in general cost of living has now exceeded 10% in the United States and has been more than that in this part of the world. All aviation supplies have gone up an average of more than 25% and many critical items have more than doubled in price. We have already applied for a 33-1/3 increase through the Chinese Civil Aeronautics Administration on our scheduled domestic routes. Increases in our international scheduled rates are probably not practical for the moment because the only reason we can compete at all today with our C-46's against C-54's is on a cut rate basis.
6. The location of our Head Office and of the major work of operations and maintenance in Formosa poses a very difficult fiscal problem which cost us a great deal of money which we would not otherwise have to expend. This is one of the reasons why I have opposed too much concentration in Formosa. (There are other political reasons besides the financial ones which need not be discussed at this point.)

The present situation is that due to high expenses in Formosa and low earnings there in local currency we have to remit to Formosa for payroll and other local expenses every month approximately US\$90,000. This remittance has to be made at the official rate of 15.65 New Taiwan Dollars to one U.S. dollar. Actually the realistic rate which prevails as to cost of most commodities and which affects our general expenses in Formosa is closer to 25 New Taiwan Dollars to one U.S. dollar, Thus if we could remit at 25, we would be saving approximately US\$30,000 a month. To make a direct remittance at a rate of 25 would be a black market transaction and therefore something we should not enter into. Even if we

were willing to use the black market, it is too thin to accommodate us for a substantial amount of money. I am now intensively studying another possible alternative. This involves the financing of commodities for import to Taiwan and local currency sale through established import firms such as Taiwan Trading Company (a subsidiary of Henningsen & Co., Ltd.). A full report on this possibility will be submitted before any action is taken. I do not believe that this device, if used, will solve all of our problems, nor will it reach full effectiveness except on a gradual basis. However, it might prove to be an important step in the right direction.

Solutions to these currency problems used to be absolutely vital to the existence of CAT and they will probably prove to be so again as continued inflation and monetary controls more and more affect our business in the future. It is probable that a similar problem will arise soon in Japan.

#### ORGANIZATIONAL PROBLEMS

The calendar year 1951 has been the first year in CAT's history where anything like stability can be said to have prevailed in the business, operating and political conditions applicable to CAT's operations. In CAT's previous history major dislocations involving over 50 evacuations, terrific up and down swings in business covering a range between 4000 hours a month and 500, operations conducted almost entirely under combat conditions and drastic changes in location of business have been the rule. Despite all this CAT entered the calendar year 1951 with a reasonably sound organizational structure which was codified in Organizational Memorandum No. 2. Experiences during the year have caused some slight modifications in the top managerial structure. Finalization of the top managerial structure awaits the reconstitution of the Board of Directors and the receipt of directives from them. All important relocation of responsibilities and duties which were needed to introduce Mr. Schildhauer into the management have been completed and he now has administrative direction of the 5 operating divisions.

At the Board's request I have as of my return on 28 November 1951 resumed direct responsibility for the fiscal affairs of the company subject to the concurrence of the Treasurer. It is recognized by all that the build-up of our

fiscal organization is the major target for the next year. Unfortunately, however, we are still suffering from a drastic dearth of personnel. The man chosen for Comptroller to replace Mr. Terhaar has become unavailable because of passport restrictions. The Chief of our Fiscal Division, who is concurrently in charge of our accounts, Mr. Brunner, has submitted his resignation. Other men needed have not been found.

If we can solve the fiscal organizational problem during this year, we feel that with the completion of that we will then have all departments of CAT at a higher than average efficiency level. The problems of organization in the Fiscal Division are treated in greater detail in the next section of this report.

We are particularly proud of the build up which has taken place last year in our engineering department, notably on the LST, which is now practically complete. Outsiders who are technically qualified have stated that our shops are of excellent quality. This is reflected in the appearance and performance of our fleet. Out Operations have always been rated as outstanding, and the lack of labor trouble and the high level of morale speak well for the Personnel Division.

### FINANCIAL SITUATION AND FISCAL PROBLEMS

#### Balance Sheet

As of June 30, 1951 Current Liabilities exceeded Current Assets by \$79,401.00. This has increased to \$293,404.00 as of 30 November 1951. The principle reason being Notes Payable to Airdale Corporation which is up US\$250,000.00.

The Operating Property and Equipment as of November 30 shows a total of \$1,420,752.42 as Valuation and Depreciation Reserve. Of this figure \$500,000.00 represents Valuation reserve. This was set up by the auditors and was to have the approval of the Board of Directors.

I wish to point out that \$200,000. of increase has been made in the Operating Property and Equipment. This expenditure came from operating capital, thus affecting our cash position.

Profit and Loss Statements

Our accumulated loss reflects \$317,351.25. I would estimate this figure to be in excess by at least \$200,000.00 the reasons being:

1. Facility Developments, such as the work done on the LST, buildings and equipment at Tainan Air Base, were charged into operating expense.
2. Plushing and rebuilding aircraft, such as B-801 and B-848 were charged into operating expense.
3. Repairs and maintenance charged for overhaul of aircraft, aircraft engines, component parts, etc. at the time work was done. We would receive delivery and have to pay for 10 or 20 engines in one month and operating expenses were charged for this cost. This should have been on a reserve so as to spread the expenses over the hours flown.

All of this was necessary because of lack of a cost accounting system. Since we have been able to start a cost system as of January, this will be eliminated as soon as the system functions, but the fact still remains that the expenses are now being over-stated.

Highlights on Operations of the Fiscal Division

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It was not until December of 1950/the accounting for CAT Incorporated was started. The responsibility for this phase of CAT's activities had been assumed by the Bankers in July 1950, but they were first unable to find staff, and have not to date furnished sufficient. The staff, in December consisted of four foreigners and fourteen Chinese. This included our accountants in all stations and booking offices. Working conditions were poor as there was not sufficient office space, nor desks at which the men could work. It was necessary to start the books as of July 1, 1950. This was a tremendous task in itself, but besides this we had the problem of keeping current with as much daily work as possible. On top of all that the entire crew had to be taught American Accounting as only the Treasurer and Brunner had any previous experience. In January, 1951, the Accounting Office was moved from Taipei to Hongkong, thus enabling us to obtain more office space and much better working conditions. By March, 1951, we were able to increase our staff to a total of twenty-five. The back work was being posted more rapidly and the daily work had let up a little and progress was then beginning to show. By the end of May most all the entries were put on the books, but time and the lack of help did not allow for the reviewing and the making of necessary adjustments. Cash was the principle item of immediate concern, together with Accounts Receivable

and Working Funds. Consequently these were put under control first. Other controls which were necessary, such as inventory and property control, were left for a later date. In June, four auditors from Lybrand, Ross Bros. & Montgomery arrived from the States. With their help we were able to get much more work accomplished. Due to our lack of experienced personnel, the auditors were required to go into our stations and assist with the Branch Accounting. This had been prepared for in March together with printed forms, etc., but we had never had the time nor staff to install the system properly. With the help of the auditors we accomplished about six months' work in three months. When they left in September we had the books posted and ready for closing as of June 30 which ended our first fiscal year. After that the work went along much smoother, and by the end of December 1951 the monthly statements through November have been completed.

Progress made since the departure of the Stateside auditors is as follows:

1. Payroll Department has been transferred from the Personnel Division to the Fiscal Division. This will enable better control because the Payroll Division performs fiscal functions and the responsibility for these functions should reside within the Fiscal Division.
2. We have established a Budget Office within the Fiscal Division; however, this is new and staffed with only one person. It should consist of two persons due to the travelling and the amount of detailed work involved to keep the planning and projection of revenues, costs and working capital, the use of budgets for control of actual expenditures, and the reporting of events causing deviation from plans.
3. All accounting has been changed to fully meet with the CAB Uniform System of Accounts for Air Carriers and required in CAB Form 41 manual.
4. Inventory stock control has been installed. Carddax is now used showing unit cost and issues and perpetual inventory on hand. Issuance slips are now used, showing the quantity and price of all items removed from stock for repairs and maintenance to aircraft and ground equipment.
5. A complete investigation of all disbursement made by Slick Airways Inc. has been made. Our purchase requisitions together with Slick's invoices and duplicate checks have been matched with our receiving reports in



order to determine the correct amount by items of merchandise in transit and whether or not sufficient funds are on hand to cover all purchase orders issued.

6. A follow-up system has been installed on all accounts receivable and payable within each branch office. This has enabled us to get our revenue in more promptly so as to maintain an adequate amount of working capital on hand.
7. The Research Statistics Department is being transferred to the Fiscal Division. It is and will be the responsibility of the Director of the Fiscal Division to prepare and present statistics and reports covering hours flown versus cost of operations versus revenue, etc.
8. Work on the Fiscal Division organizational chart together with an accounting manual was started December 26 and it is anticipated it will be completed by the end of January.

#### Fiscal Program for 1952

Cost Section - Further improvement in fiscal administration and control will result from a program of cost findings and cost reports which will supplement the reports now prepared from book accounts. Mr. Malloy, who recently joined the Fiscal Division as Assistant to the Treasurer, will proceed to install the cost system for this company. The steps outlined for Mr. Malloy are as follows:

1. Determine costs and expenses by areas, stations, offices and departments for use in preparing budgets.
2. Analyze and reclassify certain expense elements for the purpose of preparing reports on the standard CAB Forms.
3. Prepare cost data on maintenance and overhaul work on aircraft.
4. Accumulate the cost of manufacturing equipment and the repairs to aircraft component parts in our shops on the LST and Tainan Base.
5. Complete analysis of cost on all customer maintenance projects; such as USAF, etc.

6. Accumulate the costs of special services and activities, such as will be related to development of business, furtherance of contract relationships, special charter flights, etc.

Internal Auditing - The position of internal auditor is a significant one in the new regional plan of branch accounting. He will serve as one of the principal assistants in the administration of the Fiscal Division. It will be necessary for the auditor to visit and check the performance of the branch offices, coordinate their efforts, help to standardize their methods and independently audit the handling and disbursements of funds. We do not have the personnel for this as yet.

New Accounting Office - We propose to install an accounting office in Tainan to transfer certain accounting functions from the Supply Division to the Fiscal Division. This move will build a strong effective fiscal control on all supplies, such as the following:

1. Handle the receiving reports and see that what we are getting is properly charged and accounted for in the property control ledger or the stock record control.
2. Establish a tie-up between receiving reports and purchase orders versus invoices, to assure proper payment.
3. Take physical inventory on a cycle basis.
4. Account for all issuance of materials, parts and assemblies, and see that proper prices are used from the stock cards which we now have on a first in-first out basis.

Lack of additional foreign personnel for the Fiscal Division still remains the cardinal problem facing CAT Management. During the recent Stateside visit I had hoped we had gone a long ways towards a solution by the hiring of Mr. Hall, who in turn was quite confident that he could obtain additional personnel through his own contacts as soon as he had visited the Far East and ascertained the needs. The fact that Mr. Hall will not be available is a very severe blow to our plans and if Mr. Brunner's proposed resignation becomes final we will continue to be as badly off as before until new men

arrive. We understand that the Directors have assumed the responsibilities for obtaining this personnel and are exerting every effort to find these men. We believe our requirements are fully known to our Stateside Office.

### DEPRECIATION AND CAPITAL EXPENDITURES

A major managerial undertaking for the next year should be to work out with the Directors the policy for maintaining CAT's level of plant efficiency and value.

It is especially true of the aviation business that the setting of proper standards of depreciation and capital replacements is a most troublesome problem and cuts across the most important items of major policy. Because of CAT's locality, its mobility, and many special factors in its business I feel that before too long I should discuss this whole question personally with the Directors. That time will probably come when we have accomplished the present work which the Fiscal Division is undertaking to segregate out true capital expenditures on our budget from things which have been called capital budget in the past, but which are in reality simply working capital expenditures ultimately to be charged off to expense.

We are presently depreciating our aircraft on a three year basis and most other major equipment in five. The reserves thus created, or some of them, will have to be invested in new acquisitions to keep up the efficiency of the plant. We have been working under such close financial margins in the past that we have not evolved any policy or long range plan to keep up the plant on a carefully budgeted basis in order that capital expenditures for replacement of some items will not be disproportionate to others.

Even before we reach this problem, we will have to determine in the light of political factors in our area, and of other considerations peculiar to CAT whether the policy is to end up with as good a plant as we began, or with more cash and an inferior plant, or whether perhaps we may even wish to improve the value. A great deal of this in turn will depend upon the long range plans for disposition of assets, reorganization of financial interests and the like.

THE FUTURE

CAT's business of operating a major airline based in the Far East is directly dependent upon the political future of that area to an exceptional degree. There is clearly insufficient business of an ordinary commercial nature to warrant any kind of operation were it not for the large volume of business related to the hot war in Korea and the cold war throughout our area.

On the other hand CAT has a high degree of physical mobility. Granted the necessary political clearances to leave the area and set up some place else, CAT's mobility is a unique form of insurance against loss of the investment. Through CAT's floating maintenance and supply fleet and the mobile design of most of CAT's equipment it is physically possible to commence a major move of all CAT within 24 hours and to complete within less than a week the dispatch of CAT as an entire going concern to a new location anywhere in the world.

The best political thinking available to us does not indicate the need for such a move in the near future, but a rapid reversal of the entire situation could obviously occur almost instantaneously.

I feel that it would be a wise precautionary move to make investigations and lay at least general plans for utilizing CAT elsewhere in the event of a major crisis. Such a crisis could among other things occur in case of a large scale attack on Formosa which is of course an avowed Communist objective. Another reason for a large scale move might be the outbreak of hostilities somewhere else in Southeast Asia and the need for CAT operations to assist in defense of that area. Such possibilities exist in Siam, Burma and Indo-China. If CAT were required to operate extensively in these areas it might be necessary under certain circumstances to consider transferring our maintenance base from Formosa. This might be particularly necessary if the Red Chinese Air Force came into activity to stop air traffic between Formosa and Japan on the one hand and Southeast Asia on the other.


Of very high importance in any consideration of the future is the morale factor among CAT's staff. It has been largely CAT's high morale which has allowed it to perform its very exceptional operations under extremely difficult conditions throughout its past history. The staff and management have been closely knit together through years of fighting the same battles together and a spirit of team work has grown up which, if lost, would be well nigh fatal to the essential value of CAT. I have been much concerned about this morale factor during the past year. In the first place things have been quieter and

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there has not therefore been the day to day struggle for existence which kept staff and management together in the past. Secondly there have been certain changes in the structure of management which today have left some confusion as to the future in the minds of many key men in the principal departments. Our better men have been with us long enough so that they have become financially independent through their savings and it is a certainty that many of them are only interested in staying because they like the organization, its management, and the kind of work CAT does. In talking to some of our employees lately I have found that they feel that at present the improvement in equipment indicates that the company is still dynamic. This psychological element from physical improvement will not, however, continue for ever.

In CAT's morale, as in the morale of similar organizations, which are required to live dangerously the quality and permanence of leadership is probably the first and foremost element in the minds of key employees. Secondly, of almost equal importance in the case of individual employees comes the hope that he may himself grow in the organization. Thirdly, is the conviction of individual employees that CAT is a permanent structure substantially backed with a long range future as a free enterprise which can and will continue to grow and to do interesting things.

Respectfully submitted,

  
Whiting Willauer  
President

Attachments