

ANNUAL REPORTS

PAY'n SAVE Corp. 1982
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Pay 'n Save Corporation Annual Report

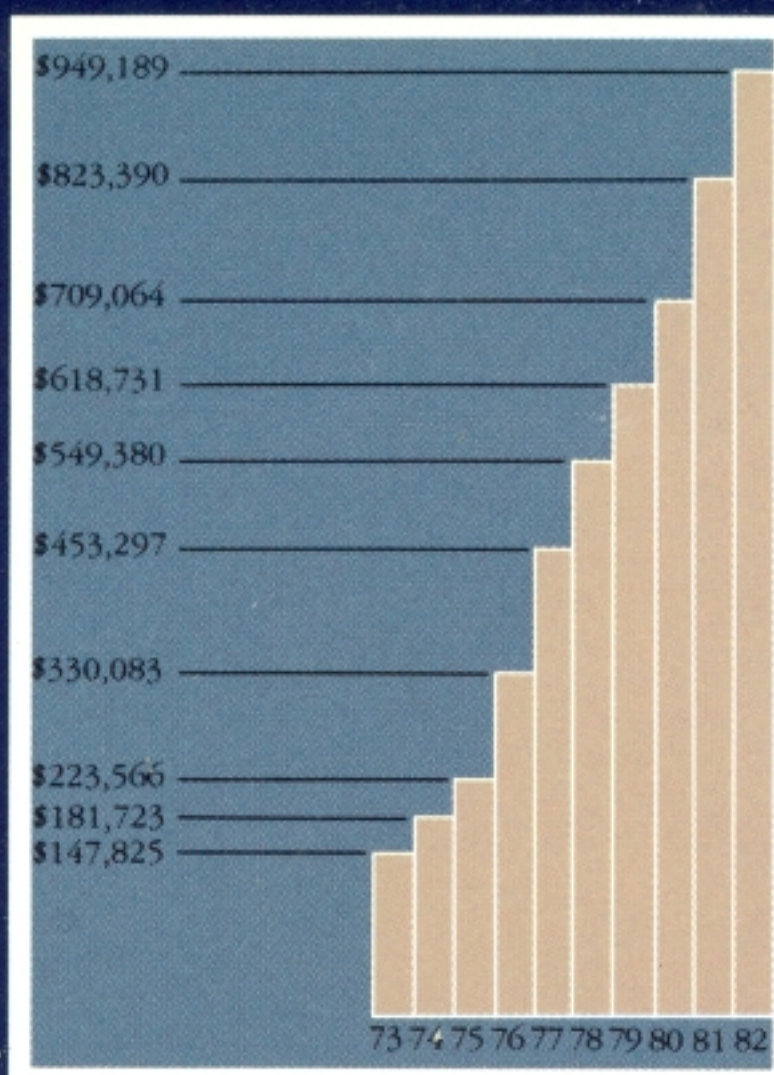
for the year ended January 30, 1982

*For 35 years
we've been
many things
to many
people*

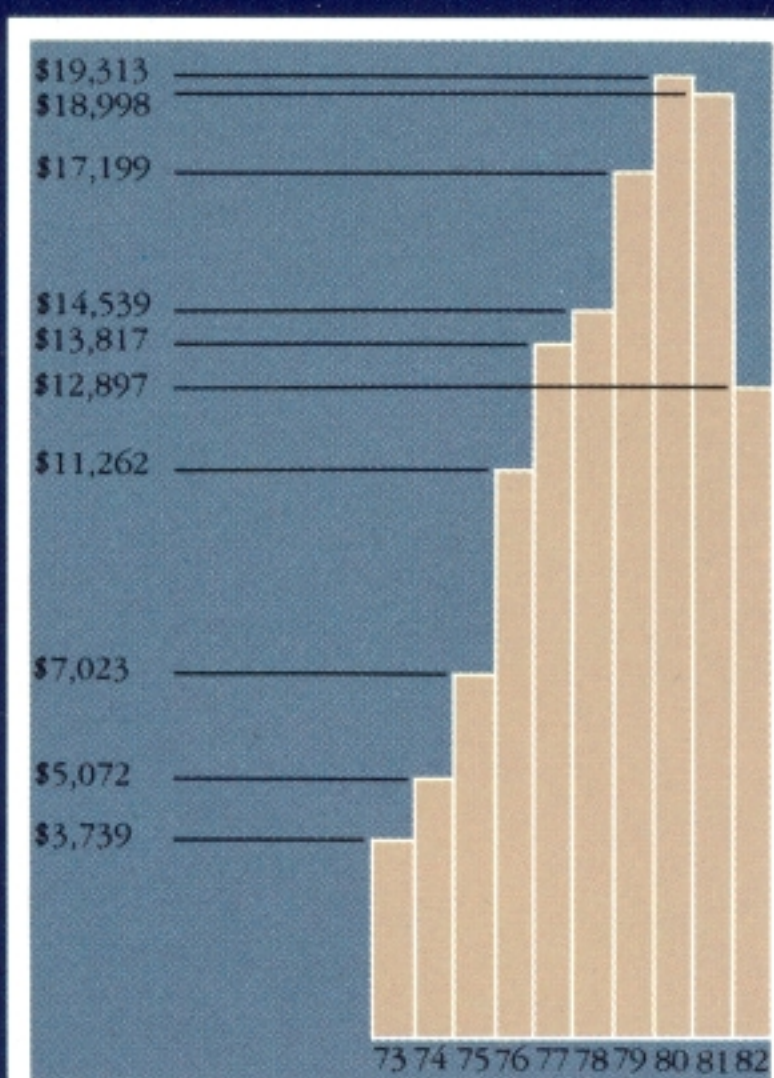
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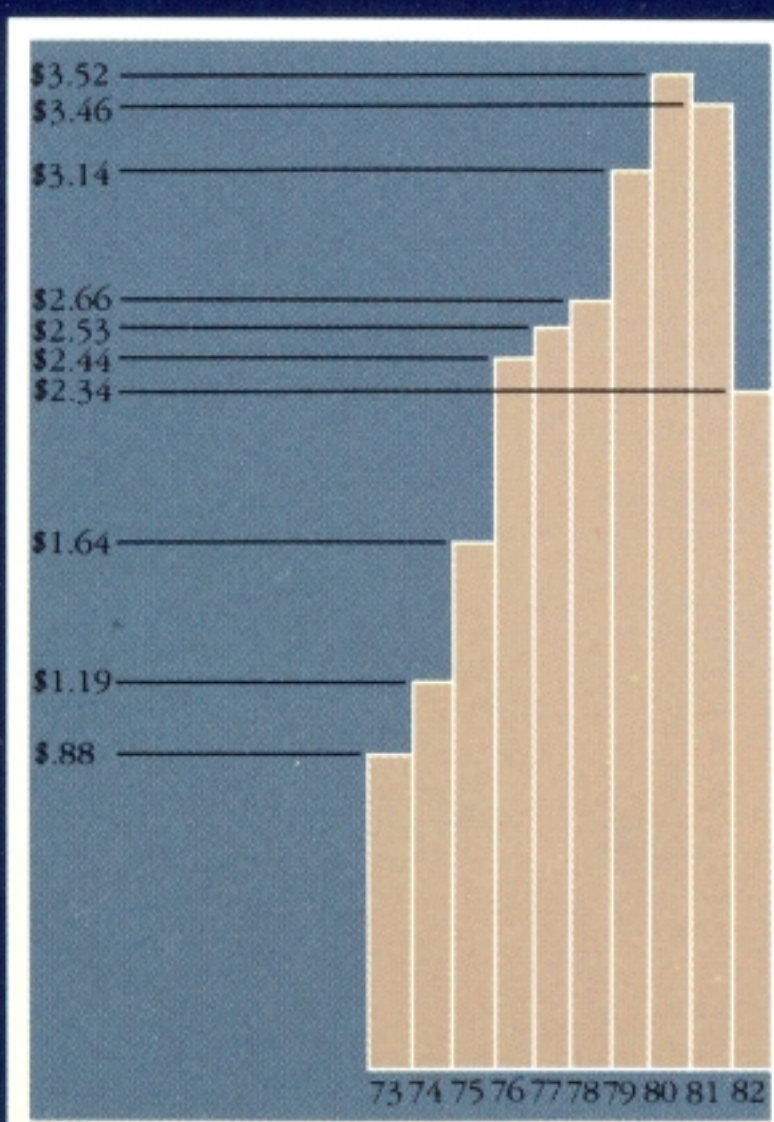
Description of Business



Sales
(thousands of dollars)



Net Income
(thousands of dollars)



Net Income per Share

Pay 'n Save is a Washington corporation with three basic retail operations—drug, home center and apparel.

The drug operations consist of 107 Pay 'n Save and 26 Bi-Mart drug stores. Each offers a prescription department, as well as proprietary drugs, cosmetics, sporting goods, camera and sound equipment, small household appliances, automotive accessories, stationery, toys and school supplies.

The home center division has 68 Ernst stores, three Von Tobel's, three general merchandise stores called Yard Birds and 12 Sportswest stores.

Ernst and Von Tobel's carry home improvement products for the do-it-yourself customer. Ernst stores also have large indoor and outdoor garden nurseries. Sportswest carries athletic and recreational equipment and sportswear.

Twenty-three Lamonts stores make up the apparel division. These offer moderately priced, brand name clothing for the family, plus specialty departments with women's accessories, cosmetics and domestics.

The company began in 1947 when M.L. Bean, the founder, opened a single Pay 'n Save drug store in Seattle. As of January 30, 1982, the company operated 242 stores in ten western states.

For the fiscal years	1982	1981	Change	%
Net sales (thousands of dollars)	\$949,189	\$823,390	\$125,799	15%
Net income (thousands of dollars)	12,897	18,998	-6,101	-32%
Net income per share	2.34	3.46	-1.12	-32%
Dividend per share	1.00	.86	.14	16%

Quarterly Financial Information (Unaudited)

For the year ended January 30, 1982	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
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(thousands of dollars)

Sales and other revenue	\$209,183	\$239,652	\$229,601	\$274,135
Gross profit	61,553	71,578	66,545	77,218
Net income	1,251	3,776	2,003	5,867
Net income per share23	.68	.36	1.07

For the year ended January 31, 1981	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
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(thousands of dollars)

Sales and other revenue	\$170,926	\$195,428	\$198,894	\$260,209
Gross profit	49,541	58,769	58,947	75,937
Net income	2,260	4,770	3,656	8,312
Net income per share41	.87	.67	1.51



Financial Highlights

By Lines of Business

	Drug			Home Center			Apparel		
	1982	1981	Change	1982	1981	Change	1982	1981	Change
Net sales (thousands of dollars)	\$585,449	\$505,915	16%	\$264,983	\$237,411	12%	\$98,757	\$80,064	23%
Percent of corporate total	62%	61%		28%	29%		10%	10%	
Income before income taxes (thousands of dollars)	\$ 12,003	\$ 17,464	-31%	\$ 2,504	\$ 10,113	-75%	\$ 8,722	\$ 6,816	28%
Percent of corporate total	52%	51%		11%	29%		37%	20%	
Number of stores	133	129		86	81		23	23	

Quarterly Low and High Bid Prices

For the fiscal years	1982	1981
First quarter	23 —28½	18 —26⅞
Second quarter	25½—29½	19⅞—25¾
Third quarter	19⅞—25⅞	25¼—28
Fourth quarter	20¼—26⅜	21⅜—27

Shareholders and Shares

At fiscal year end	1982	1981
Shareholders of record	5,743	6,236
Shares outstanding	5,499,921	5,498,571



Chairman's Message

One week before the close of our most recent fiscal year, your Corporation celebrated its 35th anniversary. Over the past three and one half decades of operation, your company has grown so that today we are truly many things to many people.

We began as a corner drug store in downtown Seattle in 1947 and closed the most recent year with 242 stores located in ten western states. We started with just a handful of employees and now more than 10,000 people work to serve your company.

The year recently ended has, in many ways, been the most difficult that we have ever experienced. Although sales reached an all time high, record interest rates and a weak economy combined to lead to a substantial drop in net income as compared to last year.

Sales totaled \$949,189,000, up 15% over the \$823,390,000 recorded a year ago. Net income, however, dropped a disappointing 32% compared to the previous year. Net income totaled \$12,897,000 for fiscal 1982 compared to the \$18,998,000 reported a year ago. Net income per share for the year decreased from \$3.46 to \$2.34.

High interest rates played a dual role in contributing to the decline in income.

First, interest expense totaled \$24 million, an increase of \$9 million over the previous fiscal year. Second, the effects of high interest rates and the weak national and regional economies led to less disposable income for consumers which caused shoppers to look for sales and to shy away from buying some products they would normally have purchased during better times. This, in turn, prompted a slight drop in our gross margins and a disappointing rate of sales increase which was less than the increase in operating expenses spurred on by inflation.

Among our three major divisions, the apparel operation was once again the shining star for the year, reaching new highs in both sales and net income. Although our drug and home center divisions both experienced increased sales, net income declined to disappointing levels, particularly in the home center operations.

The adverse economic conditions we have all suffered through these past months will probably continue through at least the first part of the current year. But we are confident that our results in the coming year will improve.

Two years ago, we ended the year with a gain of 34 new stores. Last year, just nine outlets were added and we expect to open a dozen more during the year currently underway. For new stores, especially those in new market areas, it often takes several years before they begin generating a profit. The stores brought on line over the past 24 months will begin to mature during the coming year, thereby

helping enhance operating profits.

We are also expecting lower average interest rates during the coming year as compared with last year. In addition, to keep interest costs down, inventories are monitored more closely now than ever before. Even with the additional stores opened during the year and the effects of inflation, inventories at year end were only six percent higher than the previous year.

Our real strength, though, lies in our most important asset—employees. The talented people that have made this company what it is today continue to determine our destiny. We are confident that through their continued dedication the difficult times will soon again become better times.

Among the many who have served with us over the past 35 years, two who have been with us since day one retired this past year and I would like to thank them for their tremendous contributions.

Joe Petrino and Ken Green were part of that handful of employees who joined the company when we began operations on January 23, 1947. Both were corporate vice presidents when they retired this year to enjoy the more leisurely lives they so richly deserve. Throughout the course of their careers, they provided guidance to literally thousands of others and played instrumental roles in the development of your company. They leave behind a legacy that will be difficult to follow and what they have taught others will, I am sure, continue to benefit the generations of retailers that follow them.

M. Lamont Bean
Chairman of the Board and
Chief Executive Officer



Visitors to all of our stores find not only quality products at competitive prices, but friendly, helpful service from employees like Terri Rusch, a Pay 'n Save cashier.



Pharmacists like Bob Iverson are the reason our drug division maintains such an excellent reputation for personalized service.

Drug Division

The company's drug division comprised 107 Pay 'n Save stores and 26 Bi-Mart stores at the end of fiscal 1982.

Sales totaled \$585,449,000 for a 16% increase over the \$505,915,000 recorded a year ago. Income before income taxes was \$12,003,000 or 31% less than the \$17,464,000 earned a year ago. Divisional sales amounted to 62% of total corporate sales and income before taxes represented 52% of consolidated pre-tax income, in both cases about the same as last year.

Pay 'n Save drug stores continue to be popular with western consumers who have grown to appreciate their unique style of merchandising over the past 35 years. Currently Pay 'n Saves are located in Washington, California, Alaska, Hawaii, Idaho, Montana and Wyoming.

The stores are noted for their clean-cut, low counter appearance and their well-defined individually managed merchandising departments. Each offers a prescription drug department and 16 Washington State outlets now have optical departments staffed by licensed opticians.

Product lines include cameras and sound equipment, automotive accessories, sporting goods, quality health and beauty aids, photofinishing, toiletries, hardware, small appliances, records, toys, candy and tobacco, and even some food items.

Although the majority of the outlets have about 22,000 square feet of retail space, some stores in the states of Alaska, California and Hawaii are much larger and carry lumber, electrical and nursery products as well.

Pay 'n Save stores opened during fiscal 1982 included one each in Seattle; Cheyenne, Wyoming; and Santa Rosa, California. The purchase of a former Pay Less drug store in Lodi, California was also concluded. The company sold two marginal California stores.

New stores for the current

fiscal year included a Pay 'n Save in Woodinville, Washington which was greeted by large grand-opening crowds and strong sales in February. Other new Pay 'n Saves scheduled to open include a store in Laramie, Wyoming and outlets in the northern California communities of Clearlake, Rocklin and Red Bluff. All new store locations are in good areas that provide excellent potential for the Pay 'n Save drug division.

The Bi-Mart arm of the drug division was among the company's most profitable operations during fiscal 1982. Bi-Mart's low-overhead, deep discount approach to merchandising is especially popular among cost-conscious consumers during these times of economic difficulty. The division's bare-bones approach to retailing and no-frills store interiors allow the lowest possible prices on the best quality merchandise.

Stores average 30,000 square feet and, like their Pay 'n Save counterparts, each features a complete drug department and pharmacy. They also carry camera and sound equipment, sporting goods, automotive accessories, small appliances, hardware and some food items.

One of the last true membership chains in the nation, the stores offer a family membership for a one-time \$2 fee and have over 850,000 active members.

Currently 23 outlets are located in Oregon and three in the state of Washington.

During fiscal 1982, a new Bi-Mart opened in Springfield, Oregon and an Ernst Home Center in Eugene, Oregon was converted to a Bi-Mart. Eugene is the home of the division's headquarters and a particularly strong market area for the chain.

Four new Bi-Marts will open during fiscal 1983. Yakima, Washington, the city where Bi-Mart began, will greet another store and Vancouver will become the home of the first western Washington outlet. New stores also will be opened in Portland and Gresham, Oregon.

Both chains within the drug division are strong competitors within the communities where they are located. With continued

good direction from a capable employee work force, fiscal 1983 should be an improved year for the drug division.

Home Center Division

The home center division ended fiscal 1982 with 86 stores operating in six states.

Sales increased a moderate 12% from \$237,411,000 last year to \$264,983,000 in fiscal 1982. Pre-tax income totaled \$2,504,000, down 75% from the \$10,113,000 recorded a year earlier. The division was responsible for 28% of total corporate sales, approximately equal to last year, and 11% of consolidated pre-tax income, down from last year's 29%.

The slowdown in the national and Pacific Northwest

Operations





Visitors to our home center nurseries receive expert service from employees like nursery department manager April Ochoa.

economies and, most particularly, the depressed level of activity in the housing industry substantially cut into the division's annual sales and profit results. Tight money and high interest rates prompted a dramatic drop in the sale of both new and used homes which especially hurt the 68-store Ernst Home Center chain. Less movement to new homes and reduced turnover in existing homes resulted in depressed demand for many home center products which are typically purchased by a new homeowner. High interest rates and an uncertain employment outlook also curtailed purchases for home improvement projects.

Located in Washington, Idaho, Utah, Wyoming, Nevada and Montana, Ernst Home Centers carry a wide assortment of products designed to help consumers repair and modernize their homes. The stores generally average 36,000 square feet, and product lines include tools, paint and related supplies, small appliances, electrical, plumbing, and building supplies and sporting goods. Each outlet also has a nursery featuring indoor and outdoor plants as well as lawn and garden equipment and supplies.

Ernst Home Centers opened during the year in the Washington cities of Seattle, Port Orchard, Silverdale and Richland and in Boise, Idaho and Cheyenne, Wyoming. The division transferred its only Oregon outlet, located in Eugene, to the company's Bi-Mart division to take advantage of the latter's name familiarity in that market area.

The downtown Seattle Ernst was also closed to make way for



a new high-rise office building to be constructed by the building's owner. This outlet was one of the original Ernst stores with a history dating back to the 1900's.

The three Von Tobel's home improvement centers, all located in Las Vegas, are about 65,000 square feet in size and carry a product mix similar to Ernst but with a greater emphasis on lumber goods. The Von Tobel's name is firmly established in the Las Vegas market with a history that dates back to 1905.

The company's three Yard Birds general merchandise stores are located in the western Washington towns of Chehalis, Olympia and Shelton.

Sportswest, the company's sporting goods chain, now comprises 12 stores with the opening of a new outlet near Seattle during fiscal 1982.

Each store averages about 12,000 square feet and caters to the sports enthusiast and the recreation minded with extensive lines of snow and water skiing equipment as well as camping, hunting, fishing, hiking, golf, tennis and exercise products. The stores also stock sportswear and contain a complete sports shoe department.

Sportswest will move north to Alaska during the current fiscal year with two outlets scheduled to open in Anchorage. This market offers excellent potential for the chain with its full service approach to merchandising.

Although fiscal 1982 was a poor year for the home center division, we expect improved results as interest rates decline



and the housing industry improves. Our stores are located both in well established markets and in new areas with strong potential for long-term growth.

Apparel Division

For the second consecutive year, our apparel division, consisting of 23 Lamonts stores in Washington, Alaska, Idaho and Oregon, led the company both in increased sales and pre-tax income percentage gains.

Sales of \$98,757,000 were 23% over the \$80,064,000 figure recorded last year. Pre-tax income totaled \$8,722,000 or 28% more than last year's \$6,816,000. The division was responsible for just 10% of total corporate sales, the same as last year, yet contributed 37% of the company's pre-tax profits.

Some of the year's achievements for Lamonts can be attributed to aggressive and coordinated advertising campaigns that tied in print media with electronic media, as well as improved merchandising and buying.

Customers have come to rely on Lamonts to provide quality brand name clothing at attractive prices plus first class service from fashion-conscious sales people. The stores offer complete selections of casual fashions for all ages as well as shoes, domestics and cosmetics. Averaging 50,000 square feet, most Lamonts outlets are located in neighborhood shopping centers or regional malls with plenty



of free parking.

The division reached a hall-mark on the day after Thanksgiving last year when combined sales volume for one day topped the \$1 million mark.

During the year, the chain installed point of sale terminal registers at all stores which has resulted in improved information for better merchandising decisions and inventory control. Each time a transaction is completed, information on the department, style, color, vendor, fashion and price is relayed on line to the division's corporate headquarters in Seattle. This timely data helps the management team, both at corporate headquarters and in the stores, make faster and better operating decisions.

No new outlets were added to the Lamonts division during fiscal 1982. One store is scheduled to join two existing Lamonts in Anchorage during the current year.

Lamonts expects to continue to enhance its competitive stance among apparel retailers in the years ahead as it refines its current successful merchandising techniques to the benefit of its customers and the company alike.

Corporate Headquarters

Individual stores receive vital support services from the staff working at corporate headquarters in downtown Seattle. Although the company does have regional offices in some locations, most of the

decisions regarding overall operating strategies are formulated at corporate headquarters with input from employees at all levels of the organization.

Early in the fiscal year, the company reorganized by placing responsibility for merchandising of promotional items, distribution and advertising for most divisions under one corporate entity. After a year of fine-tuning, the new organizational structure is beginning to pay off. Decisions are made faster and, through centralized purchasing of promotional goods, more economical merchandise buys are being made. A key to any organization's success is close coordination between those at corporate headquarters and those in the field and this organizational change has provided more time for district managers to work directly with employees at the store level.

Training for both new employees and those interested in moving up the corporate ladder has been enhanced during the past year through ongoing and new programs. Programs, such as the company's management review program, helped identify those employees with management potential and provide a structured way for them to move ahead.

Special promotions and community involvement have always played an important role within the Pay 'n Save Corporation. Many, of course, are part of our merchandising technique, but others are done because we feel that we have a vested interest as corporate citizens in the welfare of the communities we serve.

In addition to the time generously given by Corporation employees to public service agencies, the company helps support such charitable organizations as United Way and its affiliated agencies, March of Dimes, the Variety Club and Camp Fire. Last year, we also put together and sponsored programs to enhance salt and fresh water fishing and helped local communities with health fairs. The year also saw the company sponsor photo contests and athletic events, such as women's runs.

Our biggest effort in the area of community relations remains our tremendously successful Show-Me-How and Do-It-Yourself Fairs. Literally hundreds of thousands of cost-conscious consumers attend these annual events to learn the latest in do-it-yourself techniques. Two fairs are held annually in Seattle and others occur in Sacramento, Salt Lake City and Spokane. Each year the crowds attending these events grow larger and larger.

Over the years, we have become many things to many people. To our customers, we offer a style of merchandising that they have come to accept and value. The communities where we are located view us as partners in their futures, as we are a company that recognizes the responsibilities that come with corporate citizenship. Many of our employees took *jobs* that quickly became *careers* as they learned that they could go as far as their ambition and talent allowed them. And the owners of our company—our shareholders—have come to know us as an organization that will wisely invest their money for future benefit.

We enter our 36th year with renewed enthusiasm and dedication. We are confident that the corner drug store that grew into a company that today serves nearly a half million people on a given day has a future of continued prosperity ahead of it.





Lamonts shoppers looking for quality name brand apparel also find quality service from fashion-conscious employees like store manager Larry Lee.

Management's Discussion

Management's Discussion and Analysis of Financial Condition and Results of Operations

Sales increased 15% in the current year as compared to the year ended January 31, 1981. Sales for the year ended January 31, 1981 increased 16% as compared to the year ended February 2, 1980. These increases reflect the addition of new stores and increased sales in existing stores. The net increase in stores was nine in 1982, 34 in 1981 and 16 in 1980. Sales increases include inflation-related price increases, an amount which cannot be determined.

Other income consists primarily of rental income from leased departments, interest income and customer service charges. Other income increased substantially in 1982 as compared with 1981 primarily as a result of interest income earned on temporary investment of proceeds from Industrial Development Revenue Bonds during the construction period, the sale of a leasehold interest prior to the expiration of the lease term and increased rental income. Other income decreased moderately in 1981 as compared with 1980 due primarily to a decline in interest income and a modest decline in customer service charges.

Cost of merchandise sold was 70.8% of sales for 1982, 70.5% of sales for 1981 and 70.6% of sales for 1980. The increase in 1982 as compared with 1981 is primarily attributable to selective purchasing by consumers of greater amounts of promotional merchandise as a percentage of their total purchases, particularly in the third and fourth quarters of the fiscal year. Variations during each of the periods presented are also attributable to changes in merchandise mix.

Operating and administrative expenses reflect growth in occupancy and personnel related costs. As a percentage of net sales, operating and administrative expenses increased to 24.5% in 1982 as compared with 23.8% in 1981 and 23.3% in 1980. The increase in 1982 is primarily attributable to sales increasing at a slower rate than certain operating expenses, particularly during the latter half of the year, as a result of the current national recession. The increase is also partially attributable in 1982, as well as in 1981 compared with 1980, to higher than normal occupancy and start-up costs as a percentage of sales relating to new stores opened in 1981 and 1982.

Interest expense results from obligations under capital leases, long-term debt and bank borrowings used to finance seasonal inventory fluctuations as well as for interim financing of some of the company's expansion during 1982 and 1981. Interest expense relating to capital leases amounted to \$11,768,000 in 1982, \$9,989,000 in 1981 and \$8,169,000 in 1980. Interest expense on

all other debt aggregated \$12,274,000 in 1982, \$5,117,000 in 1981 and \$2,013,000 in 1980.

Income taxes as a percentage of income before income taxes amounted to 44.5% in 1982 as compared to 44.8% in 1981 and 45.4% in 1980. The decrease in the income tax rate resulted from changes in federal income tax rates and in investment credit as a percentage of income before income taxes.

Net income as a percentage of net sales was 1.4% in 1982, 2.3% in 1981 and 2.7% in 1980.

During fiscal year 1982, the company generated working capital from operations of \$26,083,000 which, together with new obligations under capital leases of \$10,053,000, was sufficient to finance property and equipment additions of \$36,360,000. Cash was provided from the reduction of recoverable store locations (\$7,401,000) resulting from the sale of a shopping center under development. This, together with the reduction in cash balances made available by more timely availability and more efficient use of cash receipts, was sufficient to finance modest inventory growth of \$10,559,000, which resulted exclusively from the addition of new stores during fiscal 1982 and inflation, as well as the payment of cash dividends and current maturities of long-term liabilities.

In addition, during the year the company generated working capital of \$61,962,000 through the refinancing of short-term indebtedness into a seven-year \$100,000,000 revolving loan agreement with a group of banks. The company's maximum borrowings (including commercial paper) at the end of any month during the fiscal years ended January 30, 1982 and January 31, 1981 were approximately \$90,000,000 and \$73,000,000, respectively. Average borrowings outstanding during fiscal years 1982 and 1981 were approximately \$69,000,000 and \$40,000,000, respectively. The approximate weighted average interest rate on these borrowings was 16.68% during 1982 and 14.10% during 1981.

The company's expansion program in fiscal 1982 was moderated substantially as compared to fiscal 1981 and 1980. The company plans to add 12 new stores in fiscal 1983 and expects that cash flow from operations will be adequate to fund the level of capital expenditures necessary to provide for this level of planned growth.

Consolidated Statement of Income and Retained Earnings

For the fiscal years

1982

1981

1980

(thousands of dollars)

SALES AND OTHER REVENUE

Net sales	\$949,189	\$823,390	\$709,064
Other income	3,382	2,067	2,416
	952,571	825,457	711,480

COSTS AND EXPENSES

Cost of merchandise sold	672,295	580,196	500,421
Operating and administrative expenses	233,005	195,762	165,515
Interest	24,042	15,106	10,182
	929,342	791,064	676,118

Income before income taxes	23,229	34,393	35,362
Provision for income taxes	10,332	15,395	16,049
Net income for the year	12,897	18,998	19,313
Retained earnings at beginning of year	102,699	88,430	73,062
Cash dividends—\$1.00 (1982), \$.86 (1981) and \$.72 (1980) . . .	(5,499)	(4,729)	(3,945)
Retained earnings at end of year	\$110,097	\$102,699	\$ 88,430
Net income per share	\$2.34	\$3.46	\$3.52

The accompanying notes are an integral part of these financial statements.

Consolidated Balance Sheet

Assets

January 30,
1982

January 31,
1981

(thousands of dollars)

CURRENT ASSETS

Cash	\$ 11,854	\$ 29,640
Receivables, less allowance for doubtful accounts of \$160,000 (1982) and \$111,000 (1981)	8,448	7,941
Recoverable store location expenditures	1,084	8,485
Inventories	182,019	171,460
Prepaid expenses	1,512	1,861
Total current assets	<u>204,917</u>	<u>219,387</u>

PROPERTY AND EQUIPMENT, at cost

Land	14,075	10,977
Buildings and improvements	34,446	27,749
Furniture, fixtures and equipment	74,127	65,669
Leasehold improvements	18,012	15,311
Buildings under capital leases	120,379	110,501
Construction in progress	6,427	2,638
	<u>267,466</u>	<u>232,845</u>
Less—Accumulated depreciation and amortization	73,357	59,737
Total property and equipment	<u>194,109</u>	<u>173,108</u>

OTHER ASSETS

Deferred income taxes	6,605	5,205
Excess of cost over net assets of acquired companies	3,482	3,593
Notes receivable and other	5,650	4,160
Total other assets	<u>15,737</u>	<u>12,958</u>
	<u>\$414,763</u>	<u>\$405,453</u>

The accompanying notes are an integral part of these financial statements.

Liabilities and Stockholders' Equity

January 30,
1982

January 31,
1981

(thousands of dollars)

CURRENT LIABILITIES

Short-term indebtedness	\$ —	\$ 62,534
Accounts payable	51,790	66,275
Accrued expenses	20,704	17,659
Income taxes	4,283	5,873
Current maturities of long-term liabilities	3,284	2,981
Total current liabilities	80,061	155,322

LONG-TERM LIABILITIES

Long-term debt	79,486	10,645
Obligations under capital leases	109,077	100,779
Total long-term liabilities	188,563	111,424

STOCKHOLDERS' EQUITY

Capital stock—authorized 10,000,000 shares without par value, outstanding 5,499,921 (1982) and 5,498,571 (1981)	36,042	36,008
Retained earnings	110,097	102,699
Total stockholders' equity	146,139	138,707
	\$414,763	\$405,453

Consolidated Statement of Changes in Financial Position

For the fiscal years ended

	January 30, 1982	January 31, 1981	February 2, 1980
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(thousands of dollars)

Financial resources were provided by:

Net income	\$ 12,897	\$18,998	\$19,313
Charges (credits) not affecting working capital:			
Depreciation and amortization	14,586	12,368	9,571
Deferred income taxes	(1,400)	(770)	(864)
Working capital provided by operations	26,083	30,596	28,020
Increase in long-term debt	70,370	2,094	1,249
Obligations under capital leases	10,053	24,360	11,015
Proceeds from sale of property and equipment	969	4,945	3,699
Other	88	1,157	255
	<u>107,563</u>	<u>63,152</u>	<u>44,238</u>

Financial resources were used for:

Additions to property and equipment	36,360	63,570	34,437
Current maturities of long-term liabilities	3,284	4,134	2,606
Cash dividends	5,499	4,729	3,945
Other	1,629		1,122
	<u>46,772</u>	<u>72,433</u>	<u>42,110</u>

Increase (decrease) in working capital	\$ 60,791	\$ (9,281)	\$ 2,128
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ANALYSIS OF CHANGES IN WORKING CAPITAL

Increase (decrease) in current assets:

Cash	\$ (17,786)	\$15,382	\$ 1,414
Receivables	507	2,256	217
Recoverable store location expenditures	(7,401)	6,617	1,868
Inventories	10,559	30,215	21,580
Prepaid expenses	(349)	766	326
	<u>(14,470)</u>	<u>55,236</u>	<u>25,405</u>

(Increase) decrease in current liabilities:

Short-term indebtedness	62,534	(39,772)	(17,762)
Accounts payable and accrued expenses	11,440	(23,663)	(7,418)
Income taxes	1,590	(469)	2,188
Current maturities of long-term liabilities	(303)	(613)	(285)
	<u>75,261</u>	<u>(64,517)</u>	<u>(23,277)</u>

Increase (decrease) in working capital	\$ 60,791	\$ (9,281)	\$ 2,128
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The accompanying notes are an integral part of these financial statements.

Notes to Financial Statements

Summary of Accounting Policies

Fiscal Year — The Pay 'n Save Corporation fiscal year-end is on the Saturday nearest January 31.

Basis of Consolidation — Financial statements include the accounts of Pay 'n Save Corporation and its wholly-owned subsidiaries. All material intercompany transactions have been eliminated.

Inventories — Company inventories, valued at the lower of cost or market, comprise merchandise held for sale. Inventory values for Lamonts, Bi-Mart and Yard Birds are determined by the retail inventory method. Cost for all other inventories is determined on an identified item basis.

Recoverable Store Location Expenditures —

Recoverable store location expenditures result from construction and development costs which are paid by the company. These stores are subsequently sold and leased back, resulting in no material gain or loss to the company.

Property and Equipment — Depreciation of buildings is determined using accelerated and straight line methods over an estimated 10- to 40-year useful life. Depreciation of furniture, fixtures and equipment is determined using accelerated and straight line methods over an estimated 8- to 10-year useful life. Leasehold improvements are amortized on the straight line method over the lease period or useful life of

improvement, whichever is shorter. Maintenance and repairs are charged to income. Major renewals and improvements are capitalized. When assets are retired or disposed of, cost and accumulated depreciation of assets are eliminated from the property accounts. The resulting gains and losses are applied to income.

Accumulated amortization of buildings under capital leases was \$25,295,000 in 1982 and \$20,640,000 in 1981.

Interest costs on projects constructed by Pay 'n Save are capitalized as part of the historical cost of assets (\$809,000 in 1982, \$1,354,000 in 1981, and \$263,000 in 1980).

Excess of Cost Over Net Assets of Acquired Companies — Excess of cost over value of tangible net assets acquired is being amortized over a 40-year period and results primarily from the acquisition of the Bi-Mart Company and Von Tobel's (\$4,167,000 less accumulated amortization of \$685,000).

Accounts Payable — Checks outstanding in excess of certain cash balances of \$15,921,000 in 1982 and \$25,085,000 in 1981 (as restated) are included in accounts payable.

Net Income Per Share — Net income per share is based on (1) the weighted average number of shares outstanding during each year and (2) the assumption that all dilutive stock options have been exercised at the beginning of the year (or on date of grant, if granted during the year), and the proceeds used to purchase shares of the company's stock at the average market price during the year. Fully diluted net income per share is not materially different from primary net income per share.

Income Taxes (thousands of dollars)			
Year ended			
January 30, 1982	Federal	State	Total
Current	\$11,926	\$ 925	\$12,851
Deferred	(1,636)		(1,636)
Investment credit (Flow-through method)	(773)		(773)
Employment credit . . .	(110)		(110)
	<u>\$ 9,407</u>	<u>\$ 925</u>	<u>\$10,332</u>
Year ended			
January 31, 1981	Federal	State	Total
Current	\$16,467	\$1,301	\$17,768
Deferred	(961)		(961)
Investment credit (Flow-through method)	(1,314)		(1,314)
Employment credit . . .	(98)		(98)
	<u>\$14,094</u>	<u>\$1,301</u>	<u>\$15,395</u>
Year ended			
February 2, 1980	Federal	State	Total
Current	\$16,756	\$1,158	\$17,914
Deferred	(984)		(984)
Investment credit (Flow-through method)	(841)		(841)
Employment credit . . .	(40)		(40)
	<u>\$14,891</u>	<u>\$1,158</u>	<u>\$16,049</u>

Deferred income tax expense results primarily from the capitalization of store leases for financial reporting purposes and in 1982 included approximately \$500,000 from the use of accelerated depreciation methods for income tax purposes.

Long-Term Debt

Long-term debt is summarized as follows:

	1982	1981
	(thousands of dollars)	
Notes payable to banks under \$100,000,000 revolving credit agreement, in accordance with terms described below	\$52,000	
Commercial paper	9,962	
Industrial Development Revenue Bonds, interest at 8 5/8%, secured by certain real property, due in 1984 . . .	7,200	
Industrial Development Revenue Bonds, interest at 67% to 68% of prime, secured by certain real property, due in 1996	11,250	
Notes payable to former stock- holders of Yard Birds, inter- est at 7%, due in annual installments through 1991 . . .	4,578	\$ 5,069
Notes payable to insurance companies, interest at 8.825%, secured by certain real property, due in annual installments through 1997 . . .	4,746	4,831
Other	1,717	1,890
	<u>91,453</u>	<u>11,790</u>
Current maturities of long- term debt	(1,264)	(1,145)
Industrial Development Revenue Bond funds held by Trustees	(10,703)	
	<u>\$79,486</u>	<u>\$10,645</u>

On September 16, 1981, the company entered into a revolving credit agreement with a group of banks. The agreement provides that the company may borrow up to \$100,000,000 (including commercial paper backed under the agreement) until September 15, 1984, at which time any outstanding borrowings may be converted into a term loan with annual principal payments equal to one-sixth of such outstanding borrowings due in 1985 through 1987 and the remaining one-half of such outstanding borrowings due September 15, 1988. Interest on outstanding borrowings is computed at the lesser of the prime rate or certain rate options based upon the cost of funds available to the various participating banks. A commitment fee of 3/8% of the daily average unused portion of the revolving credit is payable quarterly through September 15, 1984. Prepayments on amounts borrowed prior to September 15, 1984 are generally permitted without penalty. The agreement contains certain restrictive covenants, including the maintenance of a minimum current ratio and tangible net worth. For the fiscal year ended January 30, 1982, the company was in compliance with all covenants. Under the most restrictive of these

covenants, approximately \$6,209,000 of retained earnings were not restricted as to payment of dividends at January 30, 1982. The weighted average interest rate of borrowings (including commercial paper) outstanding at January 30, 1982 was 14.17%.

The weighted average interest rate on short-term indebtedness outstanding at January 31, 1981 was 18.99%.

The \$11,250,000 of Industrial Development Revenue Bonds due in 1996 provide for put options in fiscal years 1987 and 1992 under which the company can be required by the bondholders to redeem all or part of the outstanding bonds. The company may prepay the bonds at any time at par.

Long-term debt maturities for the five years subsequent to January 30, 1982, assuming the put options on the aforementioned Industrial Development Revenue Bonds are fully exercised in fiscal 1987, are \$1,264,000 (1983); \$1,210,000 (1984); \$8,188,000 (1985); \$11,121,000 (1986); and \$22,430,000 (1987).

Employee Stock Options

During 1982, options for 550 shares were exercised at an average price of \$25.50 under two stock option plans established in 1974. Options for 32,250 shares were cancelled or expired. Options for 32,400 shares were outstanding and exercisable at January 30, 1982. These options expired in February 1982.

A non-qualified stock option plan, reserving 300,000 shares of the company's capital stock, was adopted March 10, 1980. Under this plan, the option price is to be a nominal amount determined by the Board of Directors. Options may not be exercised for a minimum of five years, except in the case of death, disability or retirement, and expire after eight years. During the year, options for 800 shares were exercised at \$1 each and options for 5,500 shares were cancelled. Options for 73,200 shares and 67,500 shares granted for \$1 each in years 1982 and 1981, respectively, remained outstanding at January 30, 1982.

Pension Plan

A defined benefit pension plan, funded solely by the company, covers employees who are not eligible for union pension benefits. The company makes annual contributions to the plan equal to the amounts accrued for pension expense. Pension expense for 1982, 1981, and 1980 was \$2,115,000, \$2,300,000 and \$1,700,000, respectively, which includes amortization of prior service costs over periods ranging from 15 to 40 years. A comparison of accumulated plan benefits and plan net assets for the company's pension plan as of April 30 is presented below:

	1981	1980
Actuarial present value of accumulated plan benefits:	<i>(thousands of dollars)</i>	
Vested	\$14,598	\$10,865
Nonvested	1,068	598
	<u>\$15,666</u>	<u>\$11,463</u>
Net assets available for benefits	<u>\$18,523</u>	<u>\$13,542</u>

The average rate of return used in determining the actuarial present value of accumulated plan benefits was six percent for the plan years ended April 30, 1981 and 1980.

Leased Property

The company leases a majority of its stores and data processing equipment. Generally, the store leases provide for minimum rentals (which, in some cases, include payment of taxes and insurance), plus contingent rentals (based upon a percentage of the stores' sales in excess of a stipulated minimum). The majority of lease agreements cover periods from 20 to 30 years, with three to five renewal options of five years each. However, the company has a number of leases covering shorter periods, with fewer renewal options.

Contingent rentals including taxes and insurance paid on capital leases were \$3,835,000 in 1982, \$2,769,000 in 1981 and \$2,794,000 in 1980. Sublease rental income received from buildings under capital leases was \$1,048,000 in 1982, \$846,000 in 1981 and \$782,000 in 1980.

Future minimum rental payments under capital leases together with present value of net minimum lease payments are as follows:

For the fiscal years	Amount
	<i>(thousands of dollars)</i>
1983	\$ 13,863
1984	14,033
1985	14,056
1986	13,969
1987	14,001
Thereafter	219,276
Total minimum rental payments	289,198
Less estimated executory costs (primarily taxes and insurance)	(5,147)
Less amount representing interest	(172,954)
Present value of obligations under capital leases at January 30, 1982	111,097
Less current portion	(2,020)
Long-term obligations under capital leases	<u>\$109,077</u>
Future sublease rentals	<u>\$ 3,393</u>

Future minimum rental payments and rental expense under operating leases are as follows:

Future Minimum Rentals			
For the fiscal years		Amount	
		<i>(thousands of dollars)</i>	
1983	\$ 9,220		
1984	8,840		
1985	8,456		
1986	8,110		
1987	7,944		
Thereafter	114,112		
Total minimum rental payments	<u>\$156,682</u>		
Future sublease rentals	<u>\$ 1,512</u>		
Rental Expense			
For the fiscal years	1982	1981	1980
	<i>(thousands of dollars)</i>		
Minimum rentals	\$ 9,700	\$ 8,709	\$6,861
Contingent rentals ...	1,914	1,668	1,707
Sublease rentals	(614)	(353)	(301)
	<u>\$11,000</u>	<u>\$10,024</u>	<u>\$8,267</u>

Transactions in Capital Stock	Shares	Amount
		(thousands of dollars)
Balance, January 31, 1979	5,461,982	\$35,506
Exercise of employee stock options	18,600	255
Balance, February 2, 1980	5,480,582	35,761
Exercise of employee stock options	17,989	247
Balance, January 31, 1981	5,498,571	36,008
Exercise of employee stock options	1,350	34
Balance, January 30, 1982	5,499,921	\$36,042

Segment Financial Data

Segment financial data, in accordance with a financial accounting standard, are as follows:

For the year ended January 30, 1982	Drug	Home Center	Apparel	Corporate	Consolidated
	(thousands of dollars)				
Sales and other revenue	\$586,490	\$265,494	\$99,974	\$ 613	\$952,571
Operating profit	25,150	12,783	11,726	613	50,272
General corporate expense (net)				3,001	3,001
Interest expense					24,042
Income before income taxes					23,229
Identifiable assets	204,375	142,886	52,615	14,887	414,763
Additions to property and equipment ...	18,370	12,502	5,272	216	36,360
Depreciation and amortization	6,318	4,886	3,128	57	14,389
For the year ended January 31, 1981	Drug	Home Center	Apparel	Corporate	Consolidated
	(thousands of dollars)				
Sales and other revenue	\$506,147	\$237,918	\$81,080	\$ 312	\$825,457
Operating profit	25,793	16,676	9,097	312	51,878
General corporate expense (net)				2,379	2,379
Interest expense					15,106
Income before income taxes					34,393
Identifiable assets	194,723	139,733	50,633	20,364	405,453
Additions to property and equipment ...	29,492	26,153	7,886	39	63,570
Depreciation and amortization	5,351	3,975	2,867	60	12,253
For the year ended February 2, 1980	Drug	Home Center	Apparel	Corporate	Consolidated
	(thousands of dollars)				
Sales and other revenue	\$434,082	\$211,302	\$65,470	\$ 626	\$711,480
Operating profit	22,785	16,798	7,318	626	47,527
General corporate expense (net)				1,983	1,983
Interest expense					10,182
Income before income taxes					35,362
Identifiable assets	142,674	95,836	48,802	16,786	304,098
Additions to property and equipment ...	14,536	14,853	4,664	384	34,437
Depreciation and amortization	4,060	2,990	2,349	58	9,457

Financial Reporting for the Effects of Changing Prices

The following supplemental financial information is presented in accordance with Financial Accounting Standards Board Statement 33, Financial Reporting and Changing Prices. An effort has been made to produce restated financial information that discloses the effects of inflation utilizing the Consumer Price Index for All Urban Consumers (CPI-U) and the effects of changes in specific prices (current cost) utilizing methods of indexing.

Income adjusted for general inflation reflects the impact from restating the historical cost of goods sold and depreciation and amortization expense as measured by the CPI-U. All other revenue and expense transactions are assumed to have occurred proportionately during the year.

The gain in purchasing power of net amounts owed is derived from the concept that net monetary liabilities decrease in value with inflation. The gain is calculated by measuring the increase in purchasing power for the year attributable to general inflation. Because the company's monetary liabilities were substantially in excess of its monetary assets for the year, there was a purchasing power gain in net amounts owed.

The current cost of inventories represents the cost of purchasing the goods at year-end prices. The cost of goods sold reflects prices in effect on the date of sale.

The current cost of property and equipment and the related depreciation and amortization expense are estimates of what the company's existing assets would cost at January 30, 1982. These values represent the estimated current costs of existing assets and do not consider technological improvements and efficiencies related with the normal replacement of productive capacity.

The provision for income taxes included in the supplemental financial information is the same as reported in the primary financial statements. Present regulations do not allow income tax provisions based on earnings after adjustments for effects of inflation. Thus, income taxes as reported reflect effective rates which in real terms exceed established statutory rates.

The five-year comparison shows the effect of adjusting historical net sales, cash dividends declared per share, and the market price per share to dollar amounts expressed in terms of average fiscal 1982 dollars as measured by the CPI-U. Fiscal 1980 and 1981 figures also have been adjusted to average fiscal 1982 dollars.

The information should be viewed as an experimental attempt to estimate the approximate effects of inflation rather than as a precise measure of the actual effects upon the company. It does not reflect the results of actual inflated dollar transactions.

Statement of Earnings Adjusted for Changing Prices (Unaudited)

	As reported in the Primary Financial Statements	Adjusted for General Inflation	Adjusted for Changes in Specific Prices (Current Costs)
For the year ended January 30, 1982			
		<i>(thousands of dollars)</i>	
Net sales	\$949,189	\$949,189	\$949,189
Cost of goods sold, excluding depreciation and amortization	672,147	687,641	678,916
Gross profit	277,042	261,548	270,273
Other operating expenses, excluding depreciation and amortization	218,567	218,567	218,567
* Depreciation and amortization	14,586	20,164	19,264
Total operating expenses	233,153	238,731	237,831
Operating income	43,889	22,817	32,442
Other income and expense—net	20,660	20,660	20,660
Income before income taxes	23,229	2,157	11,782
Provision for income taxes	10,332	10,332	10,332
Net income (loss)	\$ 12,897	\$ (8,175)	\$ 1,450
Gain from decline in purchasing power of net amounts owed		\$ 17,135	\$ 17,135
Increase in current cost of inventories and property and equipment held during the year			\$ 22,784
Less effects of changes in general price levels			35,504
Increase in current cost of inventories and property and equipment, net of changes in general price levels . .			\$ (12,720)

At January 30, 1982, current cost of inventory was \$183,677,000 and current cost of property and equipment, net of accumulated depreciation, was \$277,951,000.

Five-Year Comparison of Selected Supplementary Financial Data Adjusted for Effects of Changing Prices (Unaudited)

For the fiscal years

1982 1981 1980 1979 1978

(Thousands of average fiscal 1982 dollars except per share figures)

Historical cost information adjusted for general inflation:

Net sales	\$949,189	\$906,357	\$884,556	\$861,636	\$825,425
Net income (loss)	(8,175)	(3,268)	618		
Net income (loss) per share	(1.49)	(.59)	.11		
Net assets at year end	234,066	225,536	209,752		
Gain from decline in purchasing power of net amounts owed	17,135	20,965	20,670		
Cash dividends declared per share	1.00	.95	.90	.84	.75
Market price per share at year end	22.19	24.87	31.16	31.14	34.79
Average consumer price index (1967 = 100)	274.2	249.1	219.8	196.9	182.5

Current cost information:

Net income (loss)	\$ 1,450	\$ (827)	\$ 4,519		
Net income (loss) per share26	(.15)	.82		
Increase in current cost of inventories and property and equipment, net of changes in general price levels	(12,720)	(4,149)	(4,346)		
Net assets at year end	227,865	220,873	203,916		

Report of Independent Accountants

TO THE STOCKHOLDERS OF PAY 'N SAVE CORPORATION:

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of income and retained earnings and of changes in financial position present fairly the financial position of Pay 'n Save Corporation and its subsidiaries at January 30, 1982 and January 31, 1981 and the results of their operations and the changes in their financial position for each of the three years in the period ended January 30, 1982, in conformity with generally accepted accounting principles consistently applied. Our examinations of these statements were made in accordance with generally accepted auditing standards and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

PRICE WATERHOUSE

Seattle, Washington
March 12, 1982

Ten-Year Summary

For the fiscal years	1982	1981	1980	1979	1978	1977	1976	1975	1974	1973
OPERATING RESULTS										
Net sales*	\$949,189	\$823,390	\$709,064	\$618,731	\$549,380	\$453,297	\$330,083	\$223,566	\$181,723	\$147,825
Net income*	12,897	18,998	19,313	17,199	14,539	13,817	11,262	7,023	5,072	3,739
Net income as percentage of sales	1.36%	2.31%	2.72%	2.78%	2.65%	3.05%	3.41%	3.14%	2.79%	2.53%
Earnings on equity at beginning of year	9.30%	15.30%	17.79%	18.24%	17.64%	19.69%	29.52%	22.02%	18.78%	15.77%
COMMON STOCK										
Net income per common and common equivalent share†	\$ 2.34	\$ 3.46	\$ 3.52	\$ 3.14	\$ 2.66	\$ 2.53	\$ 2.44	\$ 1.64	\$ 1.19	\$.88
Book value per share	26.57	25.22	22.66	19.88	17.34	15.17	13.02	8.92	7.52	6.43
Approximate price range of common stock	30-19	28-18	30-23	29-21	26-21	31-21	31-12	14-9	18-12	22-17
Shares outstanding (end of year)†	5,500	5,499	5,481	5,462	5,436	5,435	5,390	4,274	4,242	4,202
Cash dividends	\$ 1.00	\$.86	\$.72	\$.60	\$.50	\$.40	\$.30	\$.25	\$.20	\$.18
FINANCIAL POSITION										
Total assets*	\$414,763	\$405,453	\$304,098	\$255,541	\$236,220	\$191,833	\$142,177	\$ 88,414	\$ 73,705	\$ 58,416
Working capital*	124,856	64,065	73,346	71,218	63,308	64,715	52,287	32,244	28,338	20,347
Current ratio	2.56	1.41	1.81	2.05	1.93	2.33	2.50	2.53	2.68	2.30
Long-term debt*	79,486	10,645	10,770	10,680	11,108	17,719	7,652	9,648	8,387	1,633
Obligations under capital leases*	109,077	100,779	78,333	68,765	62,815	42,781	29,479	19,541	16,527	14,107
Stockholders' equity*	146,139	138,707	124,191	108,568	94,266	82,429	70,159	38,144	31,889	27,012
CAPITALIZATION PERCENTAGE										
Long-term debt	23.7	4.2	5.1	5.7	6.6	12.4	7.1	14.3	14.8	3.8
Obligations under capital leases	32.6	40.3	36.7	36.6	37.4	29.9	27.5	29.0	29.1	33.0
Stockholders' equity	43.7	55.5	58.2	57.7	56.0	57.7	65.4	56.7	56.1	63.2
STORES IN OPERATION										
Pay 'n Save	107	105	89	89	90	89	81	71	66	61
Bi-Mart	26	24	23	18	17	15	13			
Ernst	68	64	53	47	42	39	28	25	26	23
Sportswest	12	11	10	9	9	9	8	7	5	
Yard Birds	3	3	3	2	2	2				
Lamonts	23	23	19	17	15	12	10	7	6	5
Von Tobel's	3	3	2	1	1					
	242	233	199	183	176	166	140	110	103	89
AVERAGE SALES PER STORE*										
(based upon number of stores at end of the year)	\$ 3,922	\$ 3,534	\$ 3,563	\$ 3,381	\$ 3,121	\$ 2,731	\$ 2,357	\$ 2,032	\$ 1,764	\$ 1,661

*Amounts in thousands of dollars.

†Thousands of shares outstanding, adjusted to give effect to stock splits in 1973.



Monte L. Bean

Founder of the Pay 'n Save Corporation in 1947.

Pay'n Save Corporation

Directors

M. Lamont Bean

Elected to the Board in 1952. Began working for the company in 1948 and named General Manager of the Corporation in 1953. Appointed President in 1959 and elected to the Executive Committee in 1972. Named Chairman of the Board in 1980.

Fenwick J. Crane

Elected to the Board in 1981. President and Chairman of the Board for Family Life Insurance Company headquartered in Seattle, a subsidiary of Merrill Lynch & Co., Inc. He is a Director of Merrill Lynch & Co., Inc. and also a Trustee for Prudential Mutual Savings Bank of Seattle.

E. Ronald Erickson

Elected to the Board in 1967. Began working for the Corporation in 1954 and was assigned to Ernst Home Center division as Assistant General Manager in 1960 and named General Manager in 1965. Elected a Vice President in 1967 and a member of the Executive Committee in 1972. Named Executive Vice President of Operations in 1975.

Calvin Hendricks

Elected to the Board in 1967. Joined the company in 1962 as Controller and the following year was appointed Treasurer/Controller. Elected a Vice President and a member of the Executive Committee in 1972. Appointed Executive Vice President of Administration in 1975.

Earl W. Smith

Elected to the Board in 1981. A Seattle management consultant, retired Chairman, President and, currently, a member of the Board of Allied Supermarkets, Inc., based in Livonia, Michigan. Previously served as Vice President and Regional Manager for Safeway Stores, Inc.

Raymond C. Swanson

Elected to the Board in 1974. Partner in the Seattle law firm of Ryan, Swanson, Hendel & Cleveland.

Officers

M. Lamont Bean*

Chairman of the Board, President and Chief Executive Officer

Monte L. Bean

Founding Chairman

E. Ronald Erickson*

Executive Vice President, Operations

Calvin Hendricks*

Executive Vice President, Administration

Thomas R. Lawrenson

Senior Vice President

Bill Boston

Vice President

Joseph Christy

Vice President

Walter R. Guidinger

Vice President

Jack Phelan

Vice President

Gordon Lee Smith

Vice President

Vern Stigge

Vice President

Raymond C. Swanson

Secretary

Barry D. Weston

Treasurer/Controller and Assistant Secretary

Jennie K. Hauge

Assistant Treasurer

*Executive Committee



Pay 'n Save Corporation's Executive Committee (from left) E. Ronald Erickson, M. Lamont Bean, Calvin Hendricks.