

ANNUAL REPORT

Pay'n Save Corporation Annual
for the Year Ended January 31, 1981

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PAY'n SAVE Corp. 1981
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Description of Business

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

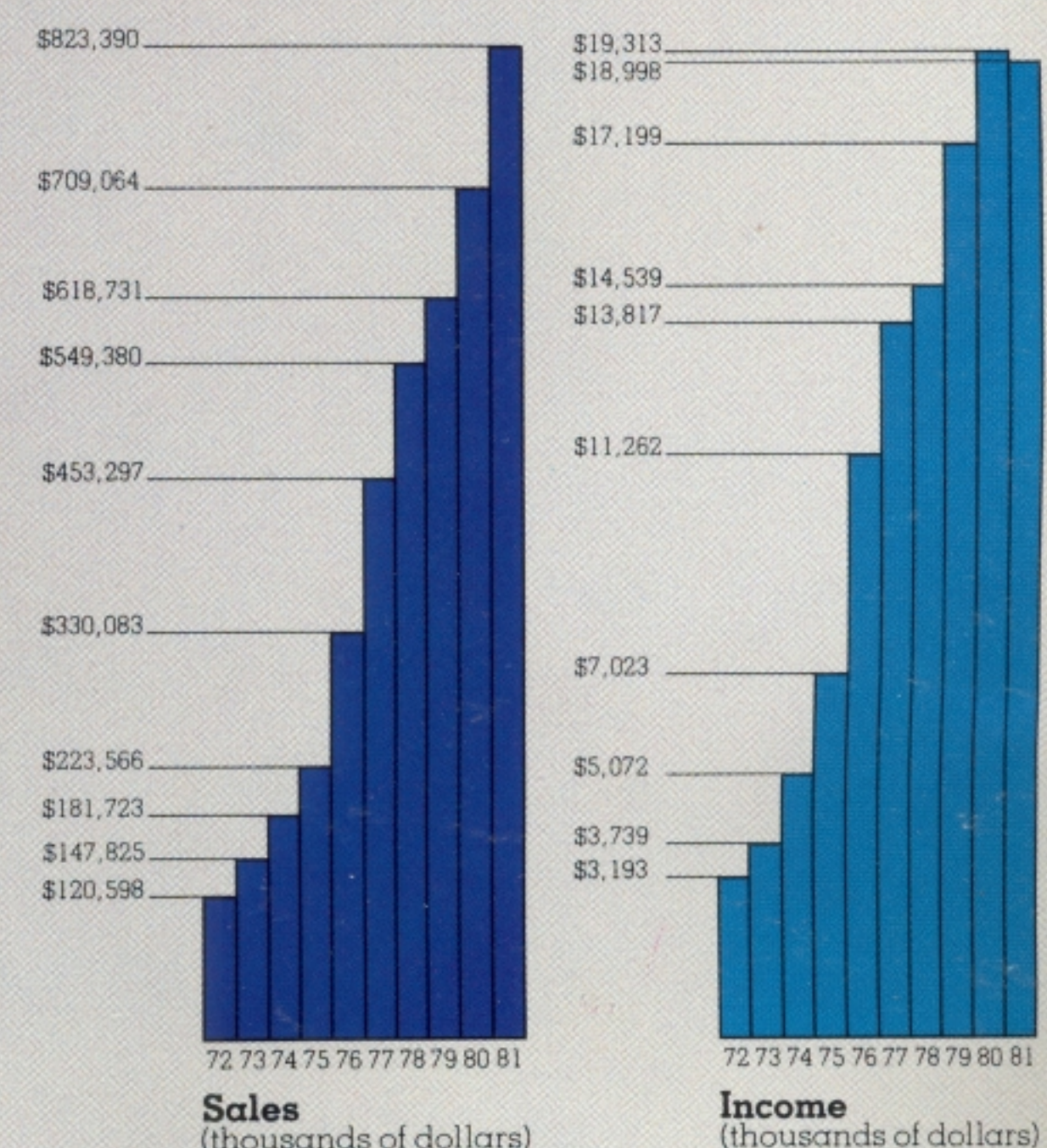
The drug operations consist of 105 Pay 'n Save and 24 Bi-Mart drug stores. Each offers a prescription department, as well as proprietary drugs, cosmetics, sporting goods, camera and sound equipment, small household appliances, automotive accessories, stationery, toys and school supplies.

The home center division has 64 Ernst stores, three Von Tobel's, three large general merchandise stores called Yard Birds, and 11 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.

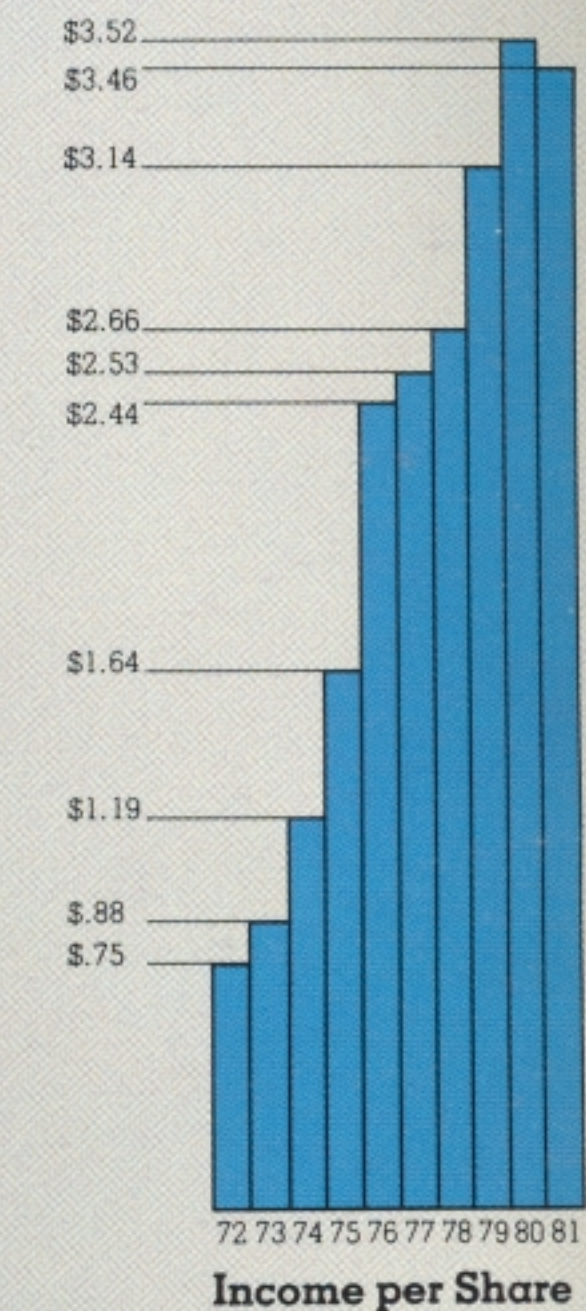
Twenty-three Lamonts stores make up the apparel division. These offer moderately priced, brand name clothing for the family, plus specialty departments with women's accessories, cosmetics, and domestics.

The company began in 1947 when Monte L. Bean, the founder, opened a single Pay 'n Save drug store in Seattle. As of January 31, 1981, the company operated 233 stores in ten western states.



Sales
(thousands of dollars)

Income
(thousands of dollars)



Income per Share

Financial Highlights

For the fiscal years	1981	1980	Change	%
Net sales (thousands of dollars)	\$823,390	\$709,064	\$114,326	16%
Net income (thousands of dollars)	18,998	19,313	-315	-2%
Net income per share	\$ 3.46	\$ 3.52	\$ -.06	-2%

Quarterly Financial Information (Unaudited)

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

For the year ended February 2, 1980	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
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(thousands of dollars)

Sales and other revenue	\$141,949	\$172,540	\$168,507	\$228,484
Gross profit	41,451	51,283	50,240	65,669
Net income	2,114	5,425	4,110	7,664
Net income per share39	.99	.75	1.39

By Lines of Business

	Drug			Home Center			Apparel		
	1981	1980	Change	1981	1980	Change	1981	1980	Change
Net sales (thousands of dollars)	\$505,915	\$433,801	17%	\$237,411	\$210,656	13%	\$ 80,064	\$ 64,607	24%
Percent of corporate total	61%	61%		29%	30%		10%	9%	
Income before income taxes (thousands of dollars) ..	\$ 17,464	\$ 17,282	1%	\$ 10,113	\$ 12,751	-21%	\$ 6,816	\$ 5,329	28%
Percent of corporate total	51%	49%		29%	36%		20%	15%	
Number of stores	129	112		81	68		23	19	

Annual Dividend Per Share

	1981	1980
	\$.86 (paid \$.215 quarterly)	\$.72 (paid \$.18 quarterly)

Quarterly Low and High Bid Prices

For the fiscal years	1981	1980
First quarter	18 — 26⁷/₈	22 ¹ / ₂ — 26 ¹ / ₂
Second quarter	19⁵/₈ — 25³/₄	22 ³ / ₄ — 26 ³ / ₈
Third quarter	25¹/₄ — 28	25 — 29 ³ / ₄
Fourth quarter	21³/₈ — 27	26 ¹ / ₄ — 29 ¹ / ₄

Shareholders and Shares

At fiscal year end	1981	1980
Shareholders of record	6,236	6,260
Shares outstanding	5,498,571	5,480,582



By M. Lamont Bean
Chairman and President

In our 34th year, we brought 34 more stores on line — making Fiscal 1981 the biggest expansion year in the history of the Corporation.

This expansion is our investment in the future, and we believe we have invested well. Your company has the right stores, in the right places, at the right time.

But expansion is always expensive, especially in these times when interest rates are high and store opening costs are inflated. So while we made satisfactory increases in sales, we had to accept a slight drop in net income — another first in our 34 years.

Sales were \$823,390,000, an increase of 16% over the previous year.

Net income was \$18,998,000, a decrease of 2%.

Income per share was \$3.46, a decrease of 2%.

Of our three areas of operation — drug stores, home centers, and apparel stores — our strongest performer was the apparel division. Consisting of 23 Lamonts stores operating in four states, this division showed a 24% increase in sales and a phenomenal 28% increase in profits. This equaled a 10% contribution to total corporate sales and 20% to corporate profits.

The drug division — made up of 105 Pay 'n Save drug stores and 24 Bi-Mart discount drug stores — showed a 17% gain in sales against a one percent profit gain.

The home center division experienced a 13% gain in sales. However, profits dropped 21%, thereby cancelling the gains made by our apparel and drug divisions. Part of this

decrease can be attributed to the comparison of this year's figures with an outstanding performance in Fiscal Year 1980. We also undertook an unusually large expansion program in this division as we positioned ourselves to take advantage of developing market areas.

Sixty-four Ernst Home Centers, 11 Sportswest stores, three Yard Birds general merchandise stores, and three Von Tobel's home centers make up our home center division. Thirteen of these outlets were opened during the year just ended.

Our corporate-wide expansion program, coupled with high interest rates, caused our short-term debt to rise to \$63,000,000 at year end, compared to \$23,000,000 a year earlier. This contributed to a \$5,000,000 increase in annual interest costs over the previous year.

We bore an extra burden during the second quarter of our Fiscal Year with the eruption of Mount St. Helens on May 18. Thirty-five of our stores in Washington, Idaho, Montana, and Oregon were closed one or more days as a result of the first eruption, and we had to contend with clean-up expenses following the first two eruptions.





Twenty-seven new stores came on line last year, some of which had been on the drawing boards since 1977 and were negotiated under lease terms more favorable than those available today.

In addition, we acquired nine stores — seven Pay Less drug stores in Hawaii and one in California, and Odegard's, a combination drug and home center in Montana. We closed two marginal Pay 'n Saves in Portland, Oregon, when their leases expired.

Six Pay 'n Saves were opened in the state of Washington, two in Montana, and one each in California and Hawaii. We also opened a replacement unit in Alaska.

Three Ernst Home Centers came on line in Washington, two each in Idaho, Utah, and Montana and one in Nevada.

A Von Tobel's opened in Nevada, a Bi-Mart in Oregon, and a Sportswest in the Puget Sound area. A Lamonts store opened in Alaska and Idaho, and two in Washington.

This brought us to a net gain of 34 stores.

We are excited about this expansion because we believe it lays important groundwork for the future. These market areas are either already thriving or on the verge of heavy growth.

Economists across the country have been optimistic about the ability of the Intermountain and Pacific Coast states to weather recessionary trends, and a closer look at what is happening in these market areas not only supports this viewpoint, but also indicates their future potential.

The states of Wyoming, Nevada, Montana, Idaho, and Utah have been gearing up for what TIME Magazine has tagged as a "Rocky Mountain High." Vast coal, natural gas, oil, shale, and uranium reserves promise an energy boom in all five states unparalleled in this country since the development of Alaska's North Slope.

As these resources are developed, a flood of people will come with the energy fields to live and work in the mountains and deserts of these now sparsely populated states. The energy fields will be bordered by electronic plants, schools, shopping malls, and acre after acre of ranch houses, condominiums, and apartment buildings. And the occupants are targeted to be our future customers.

We are also optimistic about our future in Alaska and expect the Alaskan economy to expand in the year ahead, reversing the period of stabilization that followed the completion of the pipeline. A major factor in the upswing is increased activity by the petroleum industry on Alaska's North Slope.

According to a report issued by the National Bank of Alaska, several exploratory and follow-up wells are scheduled to be drilled in the Beaufort Sea during the winter drilling season. The Kuparuk field, west of Prudhoe Bay, also is the site of much activity and the Bank expects oil from the field to be pumped down the pipeline by the Spring of 1982.





Petroleum-related projects, coupled with \$250 million in programs approved by the State Legislature in 1980, are contributing to an upswing in commercial construction. And 1981 should also be a good year for mineral exploration in Alaska, as large corporations express renewed interest in exploration and development in the state following passage of the Alaska Lands Bill.

Although tourism in Hawaii has been down, the Islands nonetheless are maintaining a stable economy. When we acquired seven Pay Less drug stores on Oahu this past year, we became the largest super drug retailer in Hawaii in terms of number of stores. By doubling our impact, we are also able to operate more efficiently in this market in regard to merchandising, distribution, and advertising.

The former Pay Less stores are a fairly good match to our own drug outlets, in terms of location and merchandise mix.

We acquired some talented Pay Less retailers along with the stores and we've mixed these with some seasoned retailers of our own to form a dynamic Pay 'n Save team in the Islands.

Washington, northern California, and Oregon — like Hawaii — also have remained stable markets.

The local economy in Seattle (our corporate base) and the greater Puget Sound area is being invigorated by the surge of commercial and government contracts to Boeing, the region's major employer. We're deeply rooted in Western Washington in all three of our retailing specialties, with 107 drug, home center, and apparel outlets here, and 134 throughout the state as of year end.

We have continued expansion of our Bi-Mart discount drug chain, which is headquartered in Eugene, Oregon. We now have a total of 24 Bi-Marts — 21 in Oregon and three in Washington.

Our Pay Less acquisition included two stores in northern California, one in Lodi and the other in Yuba City. Although the Yuba City store has been on board since October, the purchase of the Lodi store is awaiting FTC approval.

In the year ahead, we plan to reduce our expansion program to twelve stores, in five states.

Pay 'n Saves will open in Washington, California, and Wyoming, and we expect FTC approval of our purchase of the Pay Less store in Lodi, for a total of four.

We will open four Ernst stores in Washington and one each in Idaho and Wyoming. Another Sportswest will be added in Washington and a Bi-Mart in Oregon.

Seven of these stores will be open before we close the first quarter. With the continuation of high interest rates and inflated start-up costs, we no doubt will see the impact of this growth in our first quarter profits. On top of this, the first quarter is always our lowest volume period and we also will be carrying the weight of stores opened last year that have not yet reached the point of profitability.



The pay-off should come later in the year as our expansion thrust slows dramatically and some of the new stores begin to mature.

By slowing down expansion, we will gain an opportunity to streamline our operations and make our support services more efficient and responsive. Toward this end, we have created a new arm in our company to improve our merchandising, advertising, and distribution functions. Planned as a lean, tight-knit division, its three key functions will be headed by a vice president of merchandising and distribution, who will report to our executive vice president of operations. Basically, this is a move toward more centralized buying and more efficient advertising and distribution of goods. And we expect profitable results.

Joe Christy, who previously served as our treasurer and controller, has been appointed as the vice president in charge of this new division.

We also have named Bill Boston, who is general manager of our home center operations, and Vern Stigge, who is president of our Lamonts chain, as vice presidents of the Corporation. These three appointments were made shortly after the close of our Fiscal Year.

In addition, we stepped into the 1982 Fiscal Year with two new directors on our corporate board — Fenwick Crane, president and chairman of Family Life Insurance Company, and Earl Smith, former president and chairman of Allied Supermarkets, which are

based in Livonia, Michigan. Fen and Earl are highly respected executives and we are pleased to have them with us. Their photos and brief biographies are included on the inside back cover of this Annual Report.

Fen and Earl replace Joshua Green, Jr., chairman of the board of Peoples National Bank of Washington and a director and president of the Joshua Green Corporation, and James H. Clausen, retired president and chairman of the board of Puget Sound Power and Light Company. These two men, noted for their long and distinguished careers, have elected to retire from our board after many years of dedicated service. We appreciate what they have done for us and wish them the very best in the future.

We also want to make two other expressions of appreciation. One to you, our loyal shareholders. The other is to our employees — the 10,000 people who back up each dollar you have invested in the company.

I'm sure you know, this Corporation's success does not stem from a CEO sitting in his office, thinking deep thoughts. A profitable retail operation — which in your language means a profitable stock investment — happens because the people in our stores make it happen.

Our people are the best in retailing. And I've asked them for special dedication as we move ahead in these unpredictable times.

M. Lamont Bean

M. Lamont Bean
Chairman of the Board and President





Management's Discussion

Management's Discussion and Analysis of financial condition and results of operations.

Sales volume increased 16% in the current year as compared to the year ended February 2, 1980. Increase for the prior year amounted to 15% compared to the year ended January 31, 1979. These figures reflect the addition of new stores and increased sales in existing stores. The net increase in new stores was thirty-four in 1981, sixteen in 1980, and seven in 1979. Sales volume gains also include inflation-related price increases, an amount which cannot be determined.

Interest and other income consists of income from leased departments, investments, and customer service charges. Customer service charges decreased slightly in 1981 as compared to 1980 and 1979. Interest income amounted to approximately \$404,000 in 1981, \$629,000 in 1980 and \$545,000 in 1979.

Cost of merchandise sold was 70.5% of sales for 1981, 70.6% of sales for 1980, and 70.2% for 1979. The variations are attributed to changes in merchandise mix.

Operating and administrative expenses reflect growth in personnel, personnel-related costs, and occupancy costs. As a percentage of net sales, operating and administrative expenses increased to 23.8% (1981) as compared to 23.3% (1980), and 23.3% (1979). The increase in 1981 can be attributed mainly to higher occupancy and start-up costs related to the accelerated expansion program in fiscal year 1981.

Interest expense results from seasonal inventory loans, long-term debt, and the capitalization of leases. The latter item amounted to \$9,989,000 (1981), \$8,169,000 (1980), and \$7,378,000 (1979). Outstanding long-term debt and interest rate averages for the last three years were approximately \$11,645,000 at 8.05% (1981), \$11,843,000 at 8.05% (1980), and \$12,636,000 at 7.86% (1979).

The tax rate decreased to 44.8% in 1981, as compared to 45.4% in 1980 and 48.6% in 1979. The fluctuations result from changes in federal tax rates and tax credits used.

Net income as a percentage of net sales was 2.3% (1981), 2.7% (1980), and 2.8% (1979).

During fiscal year 1981 the company generated working capital from operations of \$30,596,000, received \$4,945,000 from the sale of fixed assets and increased short-term debt by \$39,772,000. Long-term debt remained relatively constant. These funds were used primarily to finance increased inventories in new and existing stores amounting to \$30,215,000, the purchase of land and buildings amounting to \$39,210,000 and the development of an \$8,500,000 shopping center which is included as recoverable store location expenditure.

Short-term indebtedness at January 31, 1981, consisted of bank notes of \$28,000,000 and commercial paper of \$34,534,000. Corporate policy is to maintain bank lines of credit at least equal to outstanding commercial paper. The company had unused lines totaling \$35,000,000 at January 31, 1981. Commitment fees ranged up to $\frac{1}{4}$ of 1% of the unused portion.

The company's maximum short-term obligations (including commercial paper) at the end of any month during the years ended January 31, 1981, and February 2, 1980, respectively, were \$73,000,000 and \$26,000,000. Average amounts outstanding during each year were approximately \$39,600,000 and \$9,700,000. Interest rates on short-term obligations at January 31, 1981, and February 2, 1980, averaged 18.99% and 13.85% respectively. Approximate weighted average interest was 14.10% during the year and 12.45% the preceding year (computed by number of days each interest rate was in effect).

Fiscal years 1981 and 1980 included aggressive expansion programs and the number of stores increased 34 and 16 respectively. Current expansion plans for fiscal year 1982 include the addition of twelve stores. It is anticipated that cash flow from continuing operations will be adequate to provide funding for capital expenditures in fiscal years 1982 and 1983. Capital leases are accounted for as assets financed by related debt.



Consolidated Statement of Income and Retained Earnings

For the fiscal years

	1981	1980	1979
	(thousands of dollars)		
SALES AND OTHER REVENUE			
Net sales	\$823,390	\$709,064	\$618,731
Interest and other income	2,067	2,416	2,466
	825,457	711,480	621,197
COSTS AND EXPENSES			
Cost of merchandise sold	580,196	500,421	434,439
Operating and administrative expenses	195,762	165,515	144,287
Interest	15,106	10,182	8,992
	791,064	676,118	587,718
Income before federal and state income taxes	34,393	35,362	33,479
Provision for federal and state income taxes	15,395	16,049	16,280
Net income for the year	18,998	19,313	17,199
Retained earnings at beginning of year	88,430	73,062	59,133
Cash dividends — \$.86 (1981), \$.72 (1980) and \$.60 (1979)	(4,729)	(3,945)	(3,270)
Retained earnings at end of year	\$102,699	\$ 88,430	\$ 73,062
Net income per common and common equivalent share	\$3.46	\$3.52	\$3.14

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

Income By Lines of Business

PERCENTAGE OF SALES BY DIVISIONS

For the fiscal years

	1981	1980	1979	1978	1977
Drug Division	61.44	61.18	62.64	64.32	68.90
Home Center Division	28.83	29.71	28.09	27.53	23.24
Apparel Division	9.73	9.11	9.27	8.15	7.86

PERCENTAGE OF INCOME BEFORE INCOME TAXES BY DIVISIONS

For the fiscal years

	1981	1980	1979	1978	1977
Drug Division	50.78	48.87	51.26	50.36	55.87
Home Center Division	29.40	36.06	33.81	36.95	27.76
Apparel Division	19.82	15.07	14.93	12.69	16.37

See page 17 for Segment Financial Data for 1981, 1980, and 1979.



Consolidated Balance Sheet

Assets

January 31, 1981 February 2, 1980

(thousands of dollars)

CURRENT ASSETS

Cash and temporary investments	\$ 4,555	\$ 3,525
Notes receivable	1,809	1,041
Accounts receivable	6,132	4,644
Recoverable store location expenditures	8,485	1,868
Inventories	171,460	141,245
Prepaid insurance and miscellaneous	1,861	1,095
Total current assets	<u>194,302</u>	<u>153,418</u>

PROPERTY, PLANT, AND EQUIPMENT, at cost

Buildings and land improvements	27,749	11,345
Furniture, fixtures, and equipment	65,669	50,757
Leasehold improvements	15,311	13,515
	<u>108,729</u>	<u>75,617</u>

Less — Accumulated depreciation and amortization	39,097	31,882
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Land	69,632	43,735
Construction in progress	10,977	9,848
	2,638	3,440

Buildings under capital leases, less accumulated amortization of \$20,640,000 (1981) and \$17,171,000 (1980)	89,861	69,713
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Total property, plant, and equipment	<u>173,108</u>	<u>126,736</u>
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OTHER ASSETS

Notes receivable	3,038	3,926
Investment in common stock	755	687
Deferred income taxes	5,205	4,435
Cash value of life insurance and other	367	461
Total other assets	<u>9,365</u>	<u>9,509</u>

EXCESS OF COST OVER NET ASSETS OF ACQUIRED COMPANIES	3,593	3,703
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	<u>\$380,368</u>	<u>\$293,366</u>
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The accompanying notes are an integral part of these financial statements.



Liabilities

January 31,
1981

February 2,
1980

(thousands of dollars)

CURRENT LIABILITIES

Short-term indebtedness	\$62,534	\$22,762
Accounts payable	41,190	34,176
Withheld and accrued taxes	4,539	4,498
Accrued salaries and bonuses	5,991	4,803
Accrued rent, pension, and other expenses	7,129	6,061
Federal and state income taxes	5,873	5,404
Current maturities of long-term indebtedness	1,145	868
Current maturities of obligations under capital leases	1,836	1,500
Total current liabilities	130,237	80,072

NON-CURRENT LIABILITIES

Long-term indebtedness, less current maturities	10,645	10,770
Obligations under capital leases, less current maturities	100,779	78,333
Total non-current liabilities	111,424	89,103

STOCKHOLDERS' EQUITY

Capital stock — authorized 10,000,000 shares without par value, outstanding 5,498,571 (1981) and 5,480,582 (1980)	36,008	35,761
Retained earnings	102,699	88,430
Total stockholders' equity	138,707	124,191
	\$380,368	\$293,366

Lease commitments — page 16



Consolidated Statement of Changes in Financial Position

For the fiscal years

January 31, 1981 February 2, 1980 January 31, 1979

(thousands of dollars)

Financial resources were provided by:

Net income	\$18,998	\$19,313	\$17,199
Add (deduct) income charges not affecting working capital in the period —			
Depreciation and amortization including capital leases	12,253	9,457	8,807
Amortization of excess of cost over net assets of acquired companies and other assets	115	114	122
Deferred income taxes	(770)	(864)	(699)
Working capital provided by operations for the year	30,596	28,020	25,429
Increase in long-term debt	2,094	1,249	96
Reduction of fixed and other assets resulting from the sale of Pay 'n Save, Ltd.			1,691
Obligations under capitalized leases	24,360	11,015	8,235
Proceeds from sale of capital assets	4,945	3,699	257
Proceeds from stock options	247	255	373
Decrease in non-current notes receivable	939	482	92
Total	63,181	44,720	36,173

Financial resources were used for:

Acquisition of property and equipment	39,210	23,422	11,892
Leased buildings under capital leases	24,360	11,015	8,235
Long-term debt paid or coming due currently	2,219	1,159	523
Obligations under capital leases coming due currently	1,915	1,447	2,285
Cash dividends	4,729	3,945	3,270
Increase in non-current notes receivable	51	1,416	1,937
Miscellaneous, net	(22)	188	121
Total	72,462	42,592	28,263

Increase (decrease) in working capital	\$ (9,281)	\$ 2,128	\$ 7,910
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ANALYSIS OF CHANGES IN WORKING CAPITAL

Increase (decrease) in current assets:

Cash and temporary investments	\$ 1,030	\$ 946	\$ (369)
Receivables	2,256	217	(16,927)
Recoverable store location expenditures	6,617	1,868	
Inventories	30,215	21,580	14,498
Other	766	326	(60)
	40,884	24,937	(2,858)

Increase (decrease) in current liabilities:

Short-term indebtedness	39,772	17,762	(14,920)
Accounts payable and accrued expenses	9,311	6,950	6,982
Current maturities of long-term debt and obligations under capital leases ..	613	285	(5,742)
Federal and state income taxes	469	(2,188)	2,912
	50,165	22,809	(10,768)

Increase (decrease) in working capital	\$ (9,281)	\$ 2,128	\$ 7,910
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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 the 150% declining balance or straight line method, over an estimated 15- to 40-year useful life range. Depreciation of furniture, fixtures, and equipment is determined using predominantly the double declining method, over an estimated 8- to 10-year useful life range. Leasehold improvements are amortized on the straight line method, over lease period or useful life of improvement, whichever is shorter. Maintenance and repairs are charged to income. Major renewals and improvements are capitalized. Interest costs on projects constructed by Pay 'n Save were capitalized as part of the historical cost of the assets (\$1,354,000 in 1981 and \$263,000 in 1980). When assets are retired or disposed, cost and accumulated depreciation of assets are eliminated from the property accounts. The resulting gains and losses are applied to income. The accompanying consolidated balance sheet includes assets and liabilities for stores under capital leases, as defined by financial accounting standards.

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 \$574,000).

Earnings Per Share — Earnings per share have been 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 earnings per share are not materially different from primary earnings per share.

Income Taxes

	(thousands of dollars)		
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>
Year ended January 31, 1979	Federal	State	Total
Current	\$18,858	\$1,352	\$20,210
Deferred	(3,165)	(150)	(3,315)
Investment credit (Flow-through method)	(515)		(515)
Employment credit	(100)		(100)
	<u>\$15,078</u>	<u>\$1,202</u>	<u>\$16,280</u>

Deferred income tax expense results from the capitalization of store leases, and, in 1979, included \$2,377,000 from the use of the installment method of reporting sales.

Long-Term Indebtedness

For the fiscal years	1981	1980
	(thousands of dollars)	
Former stockholders of Yard Birds	\$ 5,069	\$ 5,529
Insurance companies	4,831	4,907
Others	1,890	1,202
	<u>11,790</u>	<u>11,638</u>
Less current maturities	<u>1,145</u>	<u>868</u>
	<u>\$10,645</u>	<u>\$10,770</u>

The notes payable to former stockholders of Yard Birds bear interest at 7%, and are due in annual installments to 1991.

Notes payable to insurance companies are secured by real property. Annual installments are payable through 1997 at 8.825% interest.

Long-term indebtedness maturities over a five year period are \$1,145,000 (1982), \$1,077,000 (1983), \$1,056,000 (1984), \$950,000 (1985) and \$774,000 (1986).

Short-term Indebtedness — Short-term indebtedness at year end consisted of bank notes of \$28,000,000 (1981) and \$4,000,000 (1980) and commercial paper of \$34,534,000 (1981) and \$18,762,000 (1980). Company policy is to maintain bank credit lines at least equal to outstanding commercial paper and there were unused bank credit lines of \$35,000,000 at January 31, 1981. Interest rates on short-term indebtedness averaged 18.99% at January 31, 1981 and 13.85% at February 2, 1980.



Employee Stock Options

A qualified stock option plan, reserving 150,000 shares of the company's capital stock, was adopted March 2, 1973. No options were granted during the year and no further options will be granted under this plan.

According to this plan, option prices may not be less than the market value of the shares at the date of grant. Options may not be granted to one employee in excess of 7,499 shares, may not be exercised for a minimum of two years, and expire after five years. Options for 17,989 shares were exercised during the year at an average price of \$13.75, or a total of \$247,350. Options for 4,911 shares were cancelled or expired. Options outstanding and exercisable at January 31, 1981, were as follows:

Granted during years ended January 31	Number of shares	Option price per share	Total
			(thousands of dollars)
1977	26,850	\$27.125	\$728
1978	34,350	25.50	876

The president does not participate in the qualified stock option plan and has been granted options for 8,000 shares. During the year, the president did not exercise any options. Options for 4,000 shares remain outstanding as of January 31, 1981, at the following prices (2,000 shares per year): 1977, \$27.125; 1978, \$25.50.

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 and expire after eight years. During the year, options for 72,400 shares at \$1.00 each were granted and 700 shares were cancelled. The total options outstanding at January 31, 1981 was 71,700.

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 1981, 1980, and 1979 was \$2,300,000, \$1,700,000, and \$1,600,000 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:

	1980	1979
	(thousands of dollars)	
Actuarial present value of accumulated plan benefits:		
Vested	\$10,865	\$ 8,429
Nonvested	598	481
	<u>\$11,463</u>	<u>\$ 8,910</u>
Net assets available for benefits ..	<u>\$13,542</u>	<u>\$11,041</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, 1980 and 1979.

Leased Property

The company leases a majority of its stores, as well as transportation 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 \$2,769,000 in 1981, \$2,794,000 in 1980 and \$2,575,000 in 1979. Sublease rental income received from buildings under capital leases was \$846,000 in 1981, \$782,000 in 1980 and \$776,000 in 1979.

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

For the fiscal years	Amount
	(thousands of dollars)
1982	\$ 12,945
1983	12,967
1984	12,988
1985	12,942
1986	12,726
Thereafter	<u>206,428</u>
Total minimum rental payments	270,996
Less estimated executory costs (primarily taxes and insurance)	(5,242)
Less amount representing interest	<u>(163,139)</u>
Present value of obligations under capital leases at January 31, 1981	102,615
Less current portion	<u>(1,836)</u>
Long-term obligations under capital leases	<u>\$100,779</u>
Future sublease rentals	<u>\$ 1,992</u>

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

Future Minimum Rentals

For the fiscal years	1981	1980	1979
	(thousands of dollars)		
1982	\$ 8,604		
1983	8,190		
1984	8,063		
1985	7,784		
1986	7,492		
Thereafter	<u>111,703</u>		
Total minimum rental payments	<u>\$151,836</u>		
Future sublease rentals	<u>\$ 663</u>		
Rental Expense			
For the fiscal years			
Minimum rentals	<u>\$ 8,709</u>	\$6,861	\$5,954
Contingent rentals	<u>1,668</u>	1,707	1,303
Sublease rentals	<u>(353)</u>	(301)	(249)
	<u>\$10,024</u>	<u>\$8,267</u>	<u>\$7,008</u>



Transactions in Capital Stock

	Shares	Amount (thousands of dollars)
Balance, January 31, 1978	5,435,892	\$35,133
Exercise of employee stock options	26,090	373
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

Segment Financial Data

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

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	179,311	132,501	48,192	20,364	380,368
Additions to property, plant, and equipment	18,324	17,673	3,174	39	39,210
Additions to buildings under capital leases	11,168	8,480	4,712		24,360
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	136,108	92,647	47,825	16,786	293,366
Additions to property, plant, and equipment	10,803	7,571	4,664	384	23,422
Additions to buildings under capital leases	3,733	7,282			11,015
Depreciation and amortization	4,060	2,990	2,349	58	9,457
For the year ended January 31, 1979	Drug	Home Center	Apparel	Corporate	Consolidated
	(thousands of dollars)				
Sales and other revenue	\$388,055	\$174,485	\$58,102	\$ 555	\$621,197
Operating profit	21,903	14,408	6,924	555	43,790
General corporate expense (net)				1,319	1,319
Interest expense					8,992
Income before income taxes					33,479
Identifiable assets	118,818	77,351	37,581	11,526	245,276
Additions to property, plant, and equipment	4,524	3,608	1,453	2,307	11,892
Additions to buildings under capital leases	1,933	4,248	2,054		8,235
Depreciation and amortization	3,875	2,485	2,389	58	8,807



Financial Reporting for the Effects of Changing Prices (Unaudited)

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 indexation.

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, plant, and equipment and the related depreciation and amortization expense are estimates of what the company's existing assets would cost at January 31, 1981. 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 five-year comparison shows the effect of adjusting historical net sales, cash dividends declared per common share, and the market price per common share to dollar amounts expressed in terms of average fiscal 1981 dollars as measured by the CPI-U. Fiscal 1980 figures also have been adjusted to average fiscal 1981 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)
<i>(thousands of dollars)</i>			
For the year ended January 31, 1981			
Net sales	\$823,390	\$823,390	\$823,390
Cost of goods sold, <i>excluding</i> depreciation and amortization	580,069	597,690	596,630
Gross profit	243,321	225,700	226,760
Other operating expenses, <i>excluding</i> depreciation and amortization	183,661	183,661	183,661
Depreciation and amortization	12,228	16,574	16,798
Total operating expenses	195,889	200,235	200,459
Operating income	47,432	25,465	26,301
Other (income) or expense — Net	13,039	13,039	13,039
Earnings before income taxes	34,393	12,426	13,262
Provision for income taxes	15,395	15,395	15,395
Net income (loss)	\$ 18,998	\$ (2,969)	\$ (2,133)
Gain from decline in purchasing power of net amounts owed		\$ 19,046	\$ 19,046
Increase in current cost of inventories, and property, plant, and equipment held during the year			\$ 40,096
Less effects of changes in current cost levels			20,078
Increase in current cost of inventories, and property, plant, and equipment net of changes in current cost levels ..			\$ 20,018

At January 31, 1981, current cost of inventory was \$173,427,000 and current cost of property, plant, and equipment, net of accumulated depreciation, was \$247,142,000.



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

For the fiscal years

	1981	1980	1979	1978	1977
Historical cost information adjusted for general inflation:	<i>(Thousands of average fiscal 1981 dollars except per share figures)</i>				
Net sales	\$823,390	\$803,584	\$782,762	\$749,866	\$659,558
Net income (loss)	(2,969)	561			
Net income (loss) per common and common equivalent share	(.54)	.10			
Net assets at year end	204,891	190,551			
Gain from decline in purchasing power of net amounts owed ..	19,046	18,778			
Cash dividends declared per common share86	.82	.76	.68	.58
Market price per common share at year end	\$ 23.63	\$ 28.31	\$ 28.29	\$ 31.60	\$ 35.88
Average consumer price index (1967 = 100)	249.1	219.8	196.9	182.5	171.2
Current cost information:					
Net income (loss)	\$ (2,133)	\$ 3,228			
Net income (loss) per common and common equivalent share	(.39)	.59			
Increase in current cost of inventories, and property, plant, and equipment net of changes in current cost levels	20,018	12,376			
Net assets at year end	\$209,334	\$194,256			

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 31, 1981 and February 2, 1980, and the results of their operations and the changes in their financial position for each of the three years in the period ended January 31, 1981, 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 & CO.

Seattle, Washington
March 9, 1981



Ten-Year Summary

For the fiscal years	1981	1980	1979	1978
OPERATING RESULTS				
Net sales*	\$823,390	\$709,064	\$618,731	\$549,380
Net income*†	18,998	19,313	17,199	14,539
Net income as percentage of sales	2.31%	2.72%	2.78%	2.65%
Earnings on equity at beginning of year	15.30%	17.79%	18.24%	17.64%
COMMON STOCK				
Net income per common and common equivalent share†	\$ 3.46	\$ 3.52	\$ 3.14	\$ 2.66
Book value per share	25.22	22.66	19.88	17.34
Approximate price range of common stock	28-18	30-23	29-21	26-21
Shares outstanding (end of year)†	5,499	5,481	5,462	5,436
Cash dividends	\$.86	\$.72	\$.60	\$.50
FINANCIAL POSITION				
Total assets*	\$380,368	\$293,366	\$245,276	\$236,220
Working capital*	64,065	73,346	71,218	63,308
Current ratio	1.49	1.92	2.24	1.93
Long-term debt*	10,645	10,770	10,680	11,108
Obligations under capital leases*	100,779	78,333	68,765	62,815
Stockholders' equity*	138,707	124,191	108,568	94,266
CAPITALIZATION PERCENTAGE				
Long-term debt	4.2	5.1	5.7	6.6
Obligations under capital leases	40.3	36.7	36.6	37.4
Stockholders' equity	55.5	58.2	57.7	56.0
STORES IN OPERATION				
Pay 'n Save	105	89	89	90
Bi-Mart	24	23	18	17
Ernst	64	53	47	42
Sportswest	11	10	9	9
Yard Birds	3	3	2	2
Lamonts	23	19	17	15
Von Tobel's	3	2	1	1
	233	199	183	176
AVERAGE SALES PER STORE				
(based upon number of stores at end of the year)	\$ 3,534	\$ 3,563	\$ 3,381	\$ 3,121

* Amounts in thousands of dollars.
† Thousands of shares outstanding, adjusted to give effect to stock splits in 1973.
‡ Includes unusual gain of \$259,624 or \$.06 per share in 1974.

	1977	1976	1975	1974	1973	1972
Net sales	\$453,297	\$330,083	\$223,566	\$181,723	\$147,825	\$120,598
Net income	13,817	11,262	7,023	5,072	3,739	3,193
Net income as percentage of sales	3.05%	3.41%	3.14%	2.79%	2.53%	2.65%
Earnings on equity	19.69%	29.52%	22.02%	18.78%	15.77%	15.03%
Net income per common and common equivalent share	\$ 2.53	\$ 2.44	\$ 1.64	\$ 1.19	\$.88	\$.75
Book value per share	15.17	13.02	8.92	7.52	6.43	5.71
Approximate price range of common stock	31-21	31-12	14-9	18-12	22-17	18-8
Shares outstanding (end of year)	5,435	5,390	4,274	4,242	4,202	4,156
Cash dividends	\$.40	\$.30	\$.25	\$.20	\$.18	\$.175
Total assets	\$191,833	\$142,177	\$ 88,414	\$ 73,705	\$ 58,416	\$ 48,151
Working capital	64,715	52,287	32,244	28,338	20,347	19,260
Current ratio	2.33	2.50	2.53	2.68	2.30	2.63
Long-term debt	17,719	7,652	9,648	8,387	1,633	1,907
Obligations under capital leases	42,781	29,479	19,541	16,527	14,107	10,603
Stockholders' equity	82,429	70,159	38,144	31,889	27,012	23,716
Long-term debt	12.4	7.1	14.3	14.8	3.8	5.3
Obligations under capital leases	29.9	27.5	29.0	29.1	33.0	29.3
Stockholders' equity	57.7	65.4	56.7	56.1	63.2	65.4
Pay 'n Save	89	81	71	66	61	55
Bi-Mart	15	13				
Ernst	39	28	25	26	23	21
Sportswest	9	8	7	5		
Yard Birds	2					
Lamonts	12	10	7	6	5	5
Von Tobel's						
	166	140	110	103	89	81
Average sales per store	\$ 2,731	\$ 2,357	\$ 2,032	\$ 1,764	\$ 1,661	\$ 1,489

Pay'n Save Corporation



Store Count by State and Division	Washington	California	Alaska	Oregon	Hawaii	Idaho	Utah	Montana	Nevada	Wyoming	Total
Pay 'n Save Drug Stores	60	18	9		14	2		2			105
Bi-Mart Drug Stores	3			21							24
Ernst Home Centers	41			1		6	10	3	2	1	64
Lamonts	16		3	1		3					23
Sportswest	11										11
Yard Birds	3										3
Von Tobel's									3		3
Totals	134	18	12	23	14	11	10	5	5	1	233

Corporate Headquarters

Pay 'n Save Corporation, 1511 Sixth Avenue, Seattle, Washington 98101

Annual Meeting

April 30, 1981, at 11 a.m., Washington Athletic Club, 1325 Sixth Avenue, Seattle, Washington

Transfer Agents

Corporate Trust Department, Peoples National Bank, Seattle, Washington 98101

Bradford Trust Company, New York, New York

Independent Accountants

Price Waterhouse & Co., Seattle, Washington 98161

O-T-C Market

Pay 'n Save Corporation Common Stock is traded Over-the-Counter and quoted daily in leading financial publications. NASDAQ Symbol: PAYN

SEC Form 10-K

For copies of the Annual Report to the Securities and Exchange Commission on Form 10-K and other financial information about Pay 'n Save Corporation, please contact: Calvin Hendricks, Executive Vice President, Administration.

General Information

For general information about Pay 'n Save Corporation, please contact Jim Konschuh, Public Relations Director.





Directors

M. Lamont Bean (center)

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.



E. Ronald Erickson (left)

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 (right)

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.



Monte L. Bean

Founded the Pay 'n Save Corporation in 1947. Former President and Chairman of the Board for Pay 'n Save. Named Founding Chairman of the Pay 'n Save Corporation in 1980.

Earl W. Smith

Elected to the Board in January, 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.

Fenwick J. Crane

Elected to the Board in January, 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.

Officers

M. Lamont Bean*

President,
Chief Executive Officer and
Chairman of the Board

Monte L. Bean
Founder

E. Ronald Erickson*
Executive Vice President,
Operations

Calvin Hendricks*
Executive Vice President,
Administration

Thomas R. Lawrenson
Senior Vice President

Joseph J. Petrino
Vice President

J. Kenneth Green
Vice President

Walter R. Guidinger
Vice President

Jack Phelan
Vice President

Gordon Lee Smith
Vice President

Raymond C. Swanson
Secretary

Joseph Christy
Treasurer and
Assistant Secretary

Jennie K. Hauge
Assistant Treasurer

*Executive Committee

~~UNCL RET'D~~
JUN 7 1982
JUN 10 1982
SEP 20 1985
DEC 6 1985
JAN 26 1983
DEC 11 1985 RETD
FEB 4 1983
MAR 16 1988
FEB 23 1983
MAY 13 1986
NOV 29 1984
MAY 13 1986 RETD
DEC 7 1984
FEB 6 1985

