

ANNUAL REPORT

ANNUAL REPORTS

PAY'n SAVE Corp. 1977

Foster Business Library
University of Washington



453297273.*
42387663.*
459684936.*

319809145.*
107656388.*
4287956.*
428744489.*

26940447.*
12602000.-
14338447.*

453297273.*
42387663.*
459684936.*

BUSINESS ADMINISTRATION
LIBRARY
UNIVERSITY OF WASHINGTON

Pay 'n Save Corporation Annual Report

For the year ended January 31, 1977

BUSINESS ADMINISTRATION
LIBRARY

Pay 'n Save Corporation and Subsidiary Companies

Financial Highlights

Year ended January 31	1977	1976		Increase
Net sales	\$453,297,273	\$330,083,444	\$123,213,829	37.3%
Net income	14,338,447	11,655,507	2,682,940	23.0%
Net income per share ...	\$2.63	\$2.53	\$.10	4.0%

Stock Price and Dividend Data

STOCK:

Traded over-the-counter NASDAQ, Symbol: PAYN

DIVIDENDS:

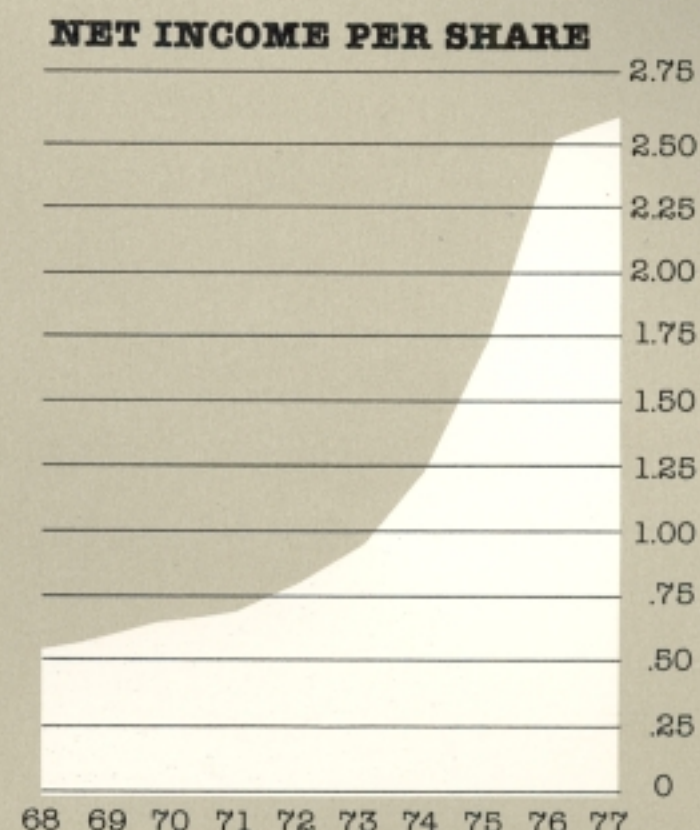
Year ended January 31	1977	1976
Cash dividend annual		
Paid quarterly	\$.40	\$.30

Quarterly High and Low Bid Prices

Year ended January 31	1977	1976
1st quarter	31¹/₈-26¹/₄	20 ¹ / ₄ -12 ¹ / ₂
2nd quarter	27 -23¹/₂	22 ³ / ₄ -17 ¹ / ₂
3rd quarter	26¹/₂-21⁵/₈	22 -16 ⁷ / ₈
4th quarter	26⁷/₈-20¹/₂	30 ⁷ / ₈ -22

Shareholders and Shares

Year ended January 31	1977	1976
Shareholders of record ..	6,141	6,033
Shares outstanding	5,434,692	5,389,575



President's Message



Monte L. Bean, Chairman of the Board

Thirty years ago M. L. Bean acquired the very first Pay 'n Save store at 4th and Pike streets in downtown Seattle. It was January of 1947. Time magazine cost 20¢ a copy, Alaska and Hawaii weren't states yet, and there was television only in New York.

M. L. chose a good location — the corner where the electric trolleys stopped on their ways to Capitol Hill and Seward Park. From inside the store you could see the people waiting at the bus stop on Pike Street.

If they had a few minutes, they'd come into the store to make a purchase. It was a clean, bright place to shop and the sales people were always helpful. The store attracted walk-in trade from most of downtown. In fact, business was so good,

M. L. decided to open another store in Everett. And it's been an upward curve ever since.

Last year Pay 'n Save Corporation, which now operates home centers and apparel stores in addition to drug stores, opened 26 new outlets. With the acquisition last year of the Yard Birds stores in Olympia and Chehalis, we brought our total to 166 units in seven states and two Canadian provinces.

We've come a long way from the corner where the electric trolleys still run. And that unprecedented growth has been based on the strong points of M. L.'s founding philosophy.

First — and you might call this our trademark, we provide our customers with a pleasant, convenient shopping experience in clean, uncluttered stores.

Second, we do a thorough job of training our employees in the retail business. When they show promise, we encourage them to advance, because our policy has always been to promote from within.

Then we've developed a knack for accurately reading the trends, and tailoring the product mixes in our stores to the communities we serve. Our customers have

consistently looked for quality and value at a fair price, and that's what we've given them. Through it all, our suppliers have lent their enthusiastic support.

Finally, we select each site with care. Marketing research must show not only a need for the products and services our stores offer. It must show solid growth potential for the area as well. Site research must indicate an environmentally sound as well as convenient locale.

In short, this philosophy has made Fiscal 1977 the best year we've ever had. Annual retail sales totaled \$453,297,273, an increase of 37%. Our net income increased 23% to \$14,338,447. Net income per share rose from \$2.53 last year to \$2.63 this year. This takes into account the dilution resulting from the issuance of 1,100,000 shares of common stock in October 1975. For Fiscal 1977 Pay 'n Save paid a quarterly dividend of ten cents per share, for a total of \$2,161,864.

These figures mean we've more than doubled our sales in the past two years. They also mean we have developed a solid formula that allows us to expand without slowing our profit growth.

In Fiscal 1978, we'll consolidate our gains and direct our growth at specific markets. We began a strong entry into the Nevada market the first day of Fiscal 1978 with the purchase of Von Tobel's, a highly successful home center in Las Vegas, for \$2.5 million.

We also plan an Ernst Home Center in Reno.

We'll open an additional ten stores in Alaska, Hawaii, California, and Washington. In Alaska, we'll be remodeling our Pay 'n Save drug and hardware store into a large home center in the Fairbanks market. We'll then open two standard drug stores and a Lamonts in that market.

The new stores are projected at careful intervals throughout the year.

It will be a year of balanced growth and continued progress, and we welcome you to share in it with us.

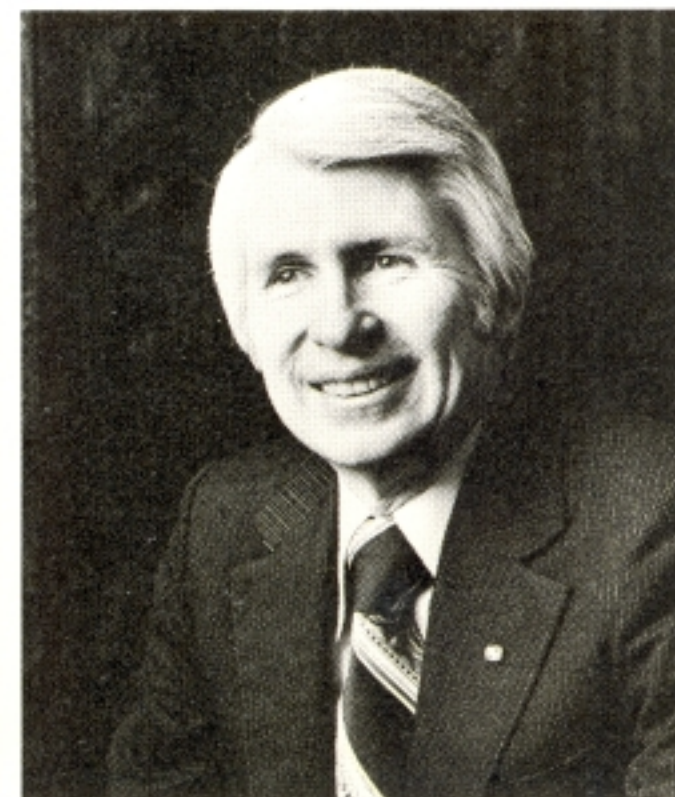
M. Lamont Bean, President



Calvin Hendricks,
Executive Vice President,
Administration



M. Lamont Bean,
President



E. R. Erickson,
Executive Vice President,
Operations

Pay 'n Save drug store operations began thirty years ago with one drug store in downtown Seattle. We offered the public fine values in housewares, drugs, and sundries. And just like today, we took a lot of care to train our staff, to listen to our customers, to keep abreast of the trends, and to constantly improve our product mix. In other words, we made it a policy from "Day One" to never stop learning. That's one of the secrets to our success.

We've come a long way since 1947. By the close of Fiscal 1977 our drug operations had expanded into 104 stores in six states and two provinces, and included three divisions: Pay 'n Save North, Pay 'n Save South, and Bi-Mart.

It was a record sales year for Pay 'n Save North, and another very profitable one—even though we opened ten new stores and remodeled three, factors which normally slow profit growth.

We opened new Pay 'n Saves in Hawaii at Temple Valley and Mililani; in Washington at Pasco, Moses Lake, Redmond, Seattle, and Aberdeen; and in Moscow, Idaho. We remodeled two stores in Anchorage and one in Seattle's Westwood Village. Plans for Fiscal 1978 call for slower expansion—the opening of three stores in Alaska, one in Seattle, and one in Tacoma—and a consolidation of gains and personnel added this past year.

Pay 'n Save South continues to edge toward solid profitability, and showed a highly profitable fourth quarter for the first time since we opened this market area by acquiring a block of 14 stores from the Safeway Corporation in 1971. In the words of our division manager, "Mac" McKerney, "we may have turned the corner!"

Northern California has been an extremely competitive market. Our stores there are spread over a large area and corporate identity has been difficult to establish. But our people have responded with enthusiasm, confidence is high, and plans for the future include two new stores at Paradise and Sonoma. Operations were tightened during the past year, and one of the old stores, located in a poor market area, was sold.

Drug Divisions

(Pay 'n Save, Bi-Mart)

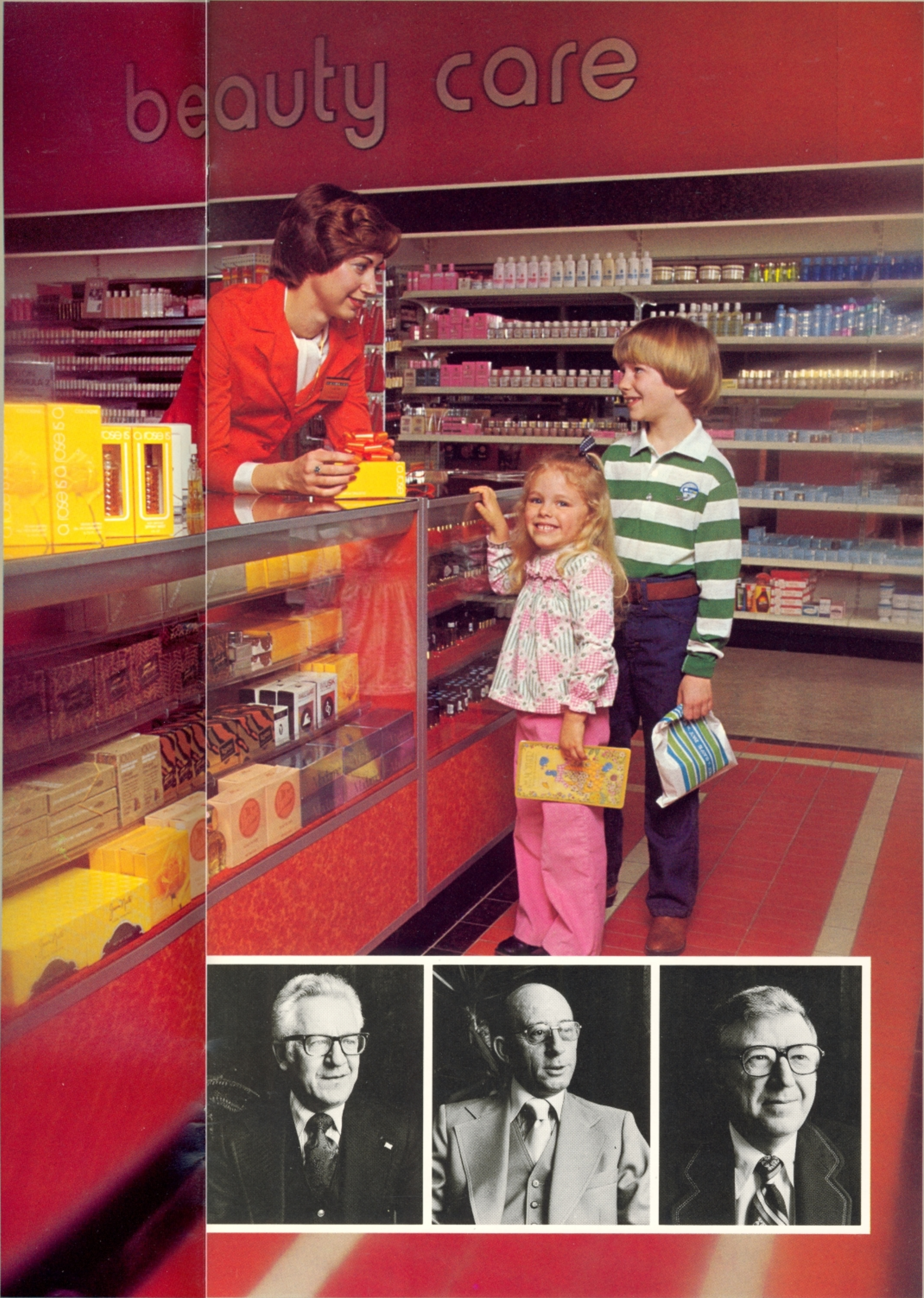
	Year ended January 31	
	1977	1976
Sales	\$312,309,255	\$230,079,551
% Corporate sales	69%	69%
Income before income taxes	\$15,025,245	\$11,788,372
% Corporate income	56%	54%
Stores in operation	104	94

Fiscal 1977 was an excellent year for our 15-store Bi-Mart division. Several of these high volume stores recorded sales exceeding \$250 per square foot of selling space, an astounding ratio by anyone's standards.

The Bi-Mart stores, acquired in 1975, are Pay 'n Save's discount division. Although the appearance of the stores differs greatly from our other stores—let's call it a "low overhead decor"—the product fit is an almost perfect match.

This past year, we went to a district manager system consistent with Pay 'n Save to streamline administrative operations.

We opened two new stores in Pendleton and McMinnville, we have a signed lease for a store in Medford, and several other locations are under investigation.■



In a Pay 'n Save drug store you'll find wide aisles, bright lights, and shelves stocked with thousands of quality items—housewares, stereo and camera equipment, sundries, drugs, and cosmetics.

You'll also find friendly salespeople, ready to help you or offer advice. One of these people is Linda Palin.

Linda started with us as a clerk and stocker, but she soon showed a flair for the drug business. She also showed a willingness to assume bigger responsibilities, and her genuine interest in her customers was impressive. Because of these qualities, Linda was selected for management training last year. And this year, she was promoted to department manager—the first step on the management ladder.

We're on the lookout for employees like Linda. They work hard for us, and for our customers, and they form the backbone of our operations. They're also the ones who may someday develop into the resourceful store managers that keep Pay 'n Save successful.■

Left to right:
Joseph J. Petrino,
Vice President,
Pay 'n Save
Northern Division Manager

C. B. McKerney
Pay 'n Save
Southern Division Manager

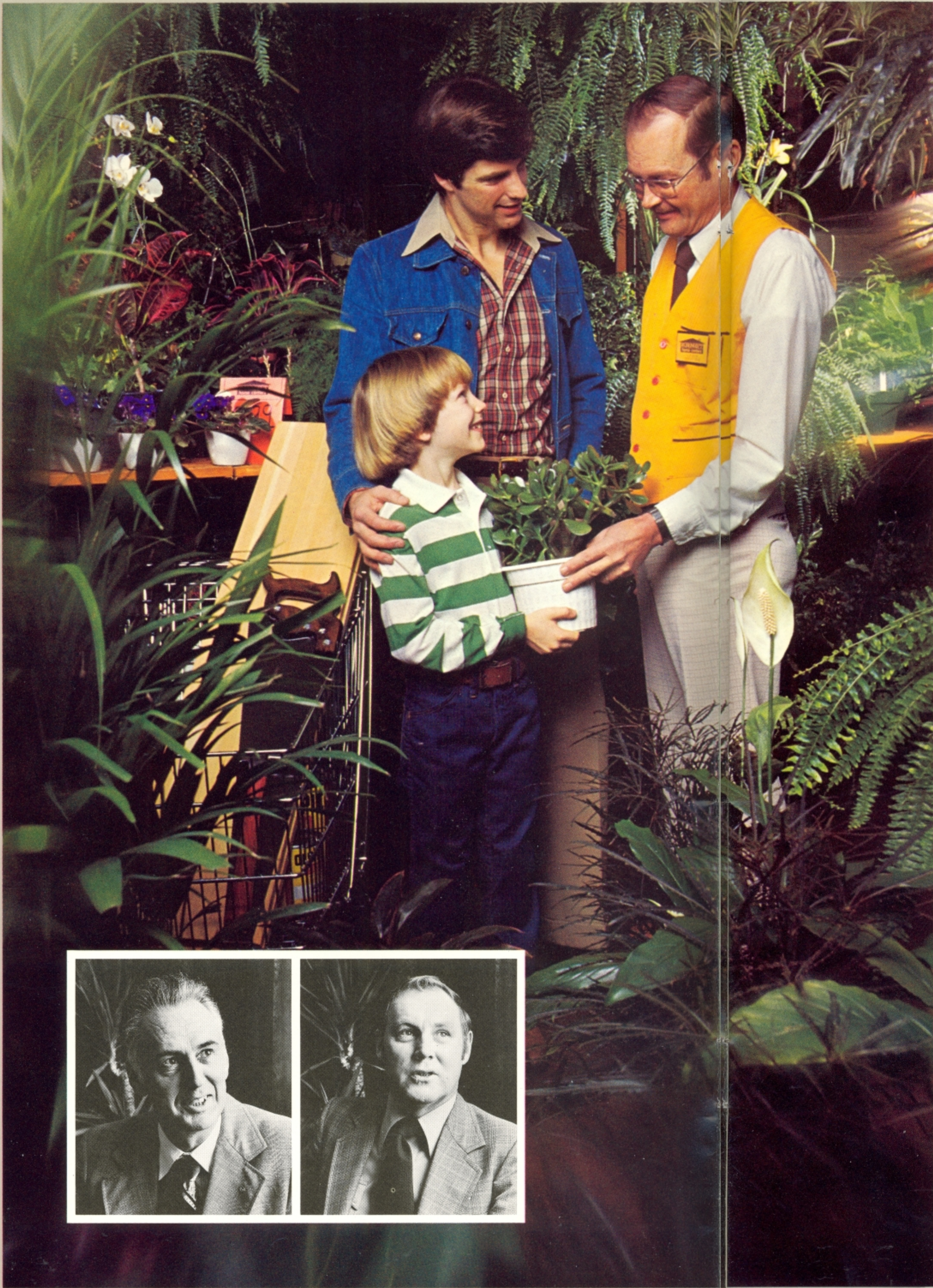
Jack Phelan,
Vice President,
Bi-Mart Division Manager

Cliff Nelson is one of the seasoned retailers who are assistant managers in our home center operations.

For 14 years, Cliff has consistently directed himself to keeping Ernst customers satisfied. His marketing decisions, and his share of the profits reflect that.

By the time employees achieve the assistant manager level, they've worked in several departments and had an average of seven years' experience with the home center operations. They've come to assume responsibility for many of the retailing decisions at their store.

As our new stores open, we'll be drawing heavily on the knowledge and experience of these assistant managers. Many will move on to bigger and better assignments. Some will take over stores of their own. It's our policy to promote from within, tapping developed talent and rewarding the people who work hardest for us. ■



Left to right:
Thomas R. Lawrenson,
Vice President,
Ernst-Malmo Division Manager

Paul R. Ross,
Vice President,
Yard Birds General Manager



Our home center operations accomplished more expansion last year than any other division. Between Ernst and Sportswest we opened 12 new stores and purchased two successful stores in Southwestern Washington called Yard Birds. This brings our total stores in the division to 50, up from 36 in 1975.

It's been a year of innovation for our Ernst-Malmo division—like the 1200-square-foot plant solarium we introduced at our Bellevue, Washington, store, which represents a new concept in houseplant marketing. We also added a fourth district manager to the division to make the district administration more responsive. And to solidly sustain last year's massive expansion, we moved a great number of people up the ladder of responsibility to maintain the depth of management that makes our operations strong.

Just as we thoroughly train our people in every department, so do we closely observe the public to better serve their needs. We attract customers who take pride in their homes and develop useful skills for

their leisure time. They're cost-conscious people, who do projects and repairs themselves rather than paying the high cost of professional labor. And they shop for good values at fair prices.

To serve these people, we tend to establish our home centers in the smaller communities which draw shoppers from several miles around. We cater to their interests by staging our popular Do-It-Yourself and Show-Me-How Fairs, as well as special clinics, to keep them informed of new products and techniques they can put to use in their daily lives. We have responded to the energy crunch by offering an increasing variety of energy-saving products and clinics to help the public conserve and still remain comfortable.

After such a big year in Fiscal 1977 we're looking forward to the one ahead as a period of consolidation for our personnel and our new stores. Although we are entering one new market area, we plan to open only four new stores.

Plans for our entry into Nevada became a reality just after the fiscal year ended with the purchase of Von Tobel's, a highly successful home center store in Las Vegas. A second Von Tobel's will be opened in Las Vegas later this year or early next year, as well as an Ernst in Reno. We also will open Ernst stores

in Wenatchee and Seattle, Washington.

Sportswest continues to be an exciting merchandising concept. In Fiscal 1977, we opened two new Seattle stores, and closed a Sportsland in a market area already covered. As people turn more to sports and the outdoors in their leisure time, we expect these stores to prosper increasingly. And to keep up with trends, we'll expand our clinics beyond hunting and fishing to other sports.

The two Yard Birds stores were purchased in July 1976, for \$8 million, which will be paid over a period of 15 years. The corporation named Paul R. Ross, former Pay 'n Save southern division manager, to head the new operation. Yard Birds are home center and general stores with annual sales volume of approximately \$20 million. An excellent addition to our marketing mix, Yard Birds employs over 350 people in Southwestern Washington. ■

Home Center Division

(Ernst-Malmo, Sportswest/Sportsland, Yard Birds)

	Year ended January 31 1977	1976
Sales	\$108,340,280	\$71,598,948
% Corporate sales	23%	22%
Income before income taxes	\$7,453,542	\$6,434,026
% Corporate income	28%	29%
Stores in operation	50	36

LIn the apparel store business, where low earnings are the rule, Lamonts has become the exception. In more ways than one.

Unlike most other apparel stores, whose profits fluctuate with seasonal trends, the Lamonts division hasn't had an unprofitable quarter since spring of 1968.

Our explanation is we know what we're doing. Lamonts is geared to the family shopper and positioned as the only major apparel store in most of the communities where we operate. This means we carry a broad range of merchandise to satisfy customer needs.

But we also avoid getting locked into particular styles or trends. On the contrary. We've established an operating formula that is continually responsive to the public we serve.

By eliminating from our stock low profit and poor performance classifications, and introducing new apparel and accessory items, we gear our inventory for quick movement out to the public.

We give our managers the autonomy to run their stores on their own. They've each had solid training in the business. And they've shown the mature retailing judgment

that sets them apart as store managers.

Our buyers have comparable responsibility. They can make their own buys, but it's their job to make those buys move. We feel that's the fastest way to develop their talents.

We're constantly increasing the depth of our name brand, leisure wear, family apparel. Our major customers are families, and today's look is casual.

But before we add, we test. Each of our departments has a "want list" on which customer requests for the same item will often lead buyers to test it in the store. If it's successful, they may make a major buy.

Lamonts Division has spent the past ten years developing this successful operating formula, remodeling the original stores, and slowly opening eight new ones, expanding as the division could afford it.

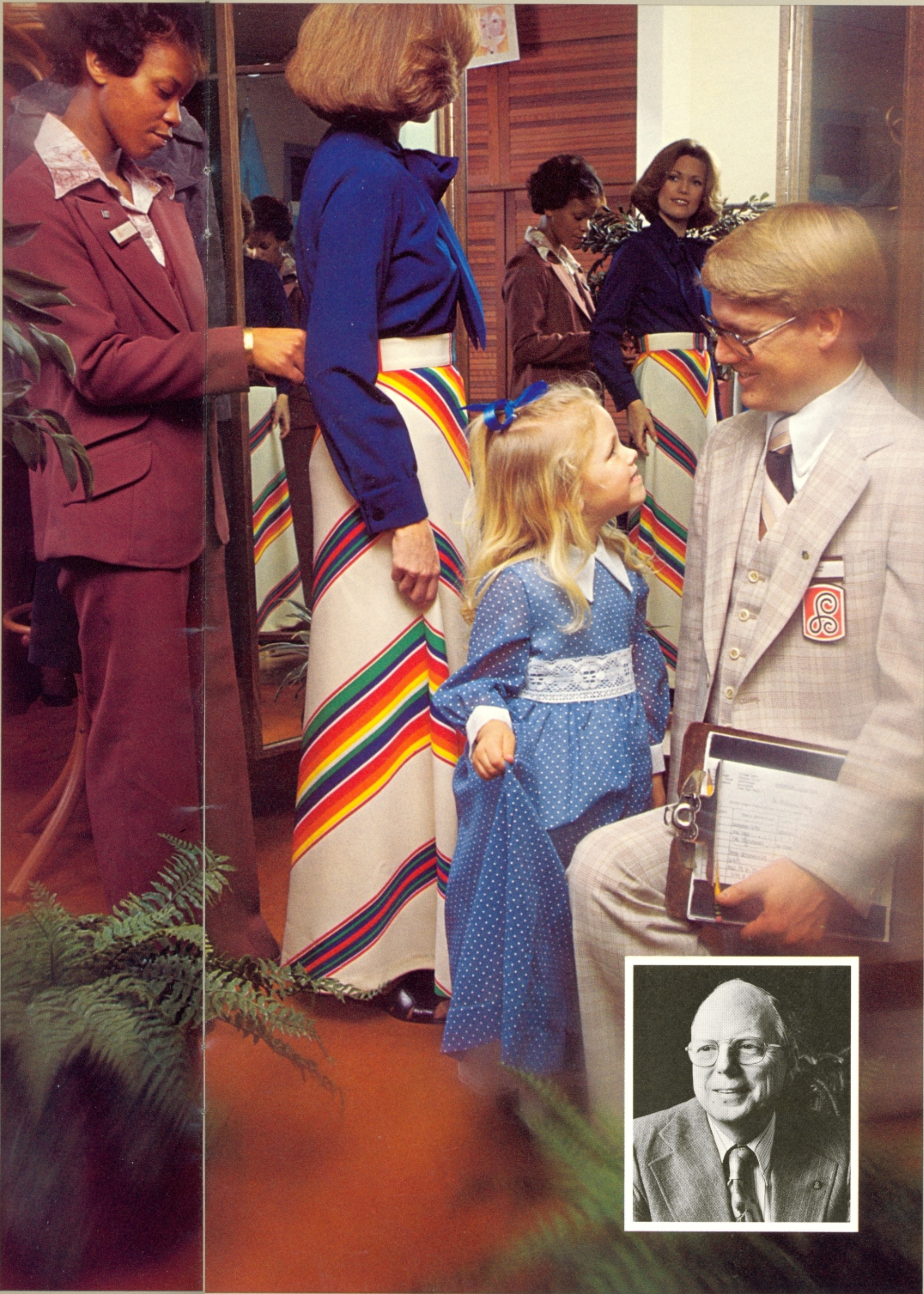
We've added two new positions to the division—an operations manager to improve administration and operations, and a fashion director to improve our apparel selections and serve as a consultant.

Our assets and merchandising formula are solid enough to merit the opening of three more stores in the year ahead, so it will be an exciting year for us. We'll open one in Fairbanks and two in Seattle. ■

Apparel Division

(Lamonts)

	Year ended January 31	
	1977	1976
Sales	\$35,647,738	\$28,404,945
% Corporate sales	8%	9%
Income before income taxes	\$4,461,660	\$3,783,109
% Corporate income	16%	17%
Stores in operation	12	10



The Corporation is expanding rapidly and profits are rising steadily. And we seek managers who will continue that trend. We've found another one in John Reek of Lamont's.

We set high performance standards for our managers. We back them up with the resources necessary for doing a quality job. But we give our managers the authority and independence to run their stores their own way. On the average, they have spent seven to eight years training, and they know their business.

John is one of 166 managers on line in Fiscal 1977. He, like the others, has a lot of responsibility operating his store. But you can often see him out on the floor with his customers. Because no matter how busy he is, he still finds time to ask that familiar question—"May I help you?" ■

J. Kenneth Green,
Vice President,
Lamonts Division Manager

Pay 'n Save Corporation and Subsidiary Companies
Five-Year Summary of Operations

For the year ended January 31	1977	1976	1975	1974	1973
SALES AND OTHER REVENUE					
Net sales	\$453,297,273	\$330,083,444	\$223,566,284	\$181,723,203	\$147,825,128
Interest and other income	2,387,663	1,769,207	995,053	1,165,947	820,590
	<u>455,684,936</u>	<u>331,852,651</u>	<u>224,561,337</u>	<u>182,889,150</u>	<u>148,645,718</u>
COSTS AND EXPENSES					
Cost of merchandise sold	319,800,145	230,590,027	154,265,616	126,649,422	103,802,281
Operating and administrative expenses ...	107,656,388	78,128,772	55,297,365	45,688,072	37,158,703
Interest	1,287,956	1,128,345	1,060,663	635,767	287,307
	<u>428,744,489</u>	<u>309,847,144</u>	<u>210,623,644</u>	<u>172,973,261</u>	<u>141,248,291</u>
Income before federal and state income taxes	26,940,447	22,005,507	13,937,693	9,915,889	7,397,427
Provision for federal and state income taxes	12,602,000	10,350,000	6,655,000	4,612,000	3,465,000
Net income for the year	<u>\$ 14,338,447</u>	<u>\$ 11,655,507</u>	<u>\$ 7,282,693</u>	<u>5,303,889</u>	<u>3,932,427</u>
Net income per common and common equivalent share	<u>\$2.63</u>	<u>\$2.53</u>	<u>\$1.70</u>	<u>\$1.24</u>	<u>\$.92</u>

Management's Discussion and Analysis of the Statement of Consolidated Income of Pay 'n Save Corporation

Comparison of the year ended January 31, 1977 to the year ended January 31, 1976 and the year ended January 31, 1976 to the year ended January 31, 1975

Net Sales—Sales volume increased approximately 37% in the current year in comparison to the year ended January 31, 1976, and increased approximately 48% in the prior year in comparison to the year ended January 31, 1975. The above sales increases are due to greater physical volume from existing stores and the addition of new stores. The increases also include inflation-related price increases, the amount of which cannot be determined. The new stores (net of closure) were 26 in 1977, 30 in 1976, and seven in 1975. The 1977 addition includes the July 1, 1976, acquisition of two Yard Birds stores and the 1976 addition includes the acquisition of 13 Bi-Mart drug stores on August 3, 1975. Of the 37% sales increase in 1977, 13% is attributed to the Bi-Mart drug stores, and 3% to the Yard Birds stores.

Interest and Other Income—Interest and other income consist principally of customer service charges and income from leased departments. Both have increased as charge sales and the number of stores have increased. The years 1977 and 1976 include interest income from short term investments of approximately \$309,000 and \$139,000, respectively.

Cost of Merchandise Sold—The cost of merchandise sold increased to 70.6% in the current year in comparison to 69.9% for the year ended January 31, 1976, and 69.0% for the year ended January 31, 1975. The increases in both years can primarily be attributed to lower gross margins generated by the Bi-Mart stores. Bi-Mart figures are included for the full year in 1977 and for six months in 1976.

Operating and Administrative Expense—Operating and administrative expenses reflect growth in personnel, personnel related costs, and occupancy costs consistent with the higher level of operations. As a percentage of net sales, operating and administrative expenses were 23.7% (1977), 23.7% (1976), and 24.7% (1975). These expenses have not increased quite as rapidly as growth in sales, primarily due to their semi-fixed nature.

Interest Expense—Interest expense increased in the current year as compared to the year ended January 31, 1976, and increased in the year ended January 31, 1976, as compared to the previous year. The increases resulted from added borrowings for seasonal inventory, start-up costs, and expansion. The average of long term debt outstanding during the last three years was approximately \$15,307,000 (1977), \$10,851,000 (1976) and \$10,600,000 (1975). Approximate average interest rates for the three years were 7.25%, 7.70%, and 10.42%, respectively.

Provision for Income Taxes—The tax rate declined to 46.8% in the current year as compared to 47.0% in the year ended January 31, 1976. The tax rate declined to 47.0% in the year ended January 31, 1976, from 47.7% for the year ended January 31, 1975. The decreases result from increased investment tax credit.

Net Income—Primarily as a result of the factors discussed above, net earnings as a percentage of net sales decreased to 3.2% (1977) from 3.5% (1976) and 3.3% (1975).

Pay 'n Save Corporation and Subsidiary Companies

Income By Lines of Business

Percentage of sales by divisions

For the years ended January 31

	1977	1976	1975	1974	1973
Drug Divisions	68.90	69.70	67.17	66.83	69.94
Home Center Division	23.24	21.69	24.59	24.86	22.08
Apparel Division	7.86	8.61	8.24	8.31	7.98

Percentage of income before income taxes

and extraordinary items by divisions,

For the years ended January 31

	1977	1976	1975	1974	1973
Drug Divisions	55.77	53.57	49.42	44.04	47.54
Home Center Division	27.67	29.24	36.82	33.50	35.61
Apparel Division	16.56	17.19	13.76	18.97	16.63

Description of Business

Pay 'n Save Corporation, a Washington corporation, operates retail drug, home centers, sporting goods, apparel, and general merchandising stores. Originating with a single Seattle drug store in 1947, the Company has enlarged its business through acquisition and internal expansion, both geographically and by type of retail stores operated. As of January 31, 1977, the Company operated 166 stores in Washington, Oregon, California, Idaho, Utah, Alaska, Hawaii, Alberta, and British Columbia.

The drug stores are operated under the names Pay 'n Save and Bi-Mart. The Pay 'n Save stores have wide aisles and a clean, uncluttered low-profile; offer prescription departments, with registered pharmacists; and feature a wide selection of proprietary drugs, cosmetics, and toiletries. As a customer convenience, the stores also provide small household appliances, sporting goods, cameras and photofinishing, automotive accessories, sound equipment, tobacco products, stationery and school supplies, candy, and some food items. The Bi-Mart stores operate on a low overhead and carry brand name merchandise at discount prices. Bi-Mart stores issue family lifetime memberships at a one-time payment of \$2.00.

The home center stores are bright and modern in decor and operate under the name Ernst-Malmo. The home center units offer the do-it-yourselfer thousands of products for home remodeling and repair. The stores stock plumbing and electrical supplies, hardware, paint, arts and crafts, housewares and recreational equipment. Most stores sell pre-cut lumber and have nursery departments which sell indoor and outdoor plants, shrubs, flowers, insecticides, fertilizers, and gardening supplies.

The home center division also includes two stores that operate under the name Yard Birds. The stores are very large general merchandising units and are located in Southwestern Washington.

Operating under the name Sportsland or Sportswest, the sporting goods outlets carry athletic equipment, sportswear and accessories, as well as major lines of fishing, hunting, golf, tennis, skiing, camping, and backpacking equipment.

The Lamonts apparel stores carry fashion for the entire family, with the accent on quality brand names. The stores feature an open, bright and attractive sales areas, emphasizing sportswear and casual wear, and offering national brand lines of men's, women's, children's, and infant's medium priced clothing. In addition, Lamonts has ladies accessories, giftware, cosmetics, linens, shoes, and speciality departments.

Pay 'n Save Corporation and Subsidiary Companies

Statement of Consolidated Income and Retained Earnings

For the year ended January 31	1977	1976
Sales and other revenue		
Net Sales	\$453,297,273	\$330,083,444
Interest and other income	2,387,663	1,769,207
	<u>455,684,936</u>	<u>331,852,651</u>
Costs and expenses		
Costs of merchandise sold	319,800,145	230,590,027
Operating and administrative expenses	107,656,388	78,128,772
Interest	1,287,956	1,128,345
	<u>428,744,489</u>	<u>309,847,144</u>
Income before federal and state income taxes	26,940,447	22,005,507
Provision for federal and state income taxes—		
Notes 1 & 3	12,602,000	10,350,000
Net income for the year	14,338,447	11,655,507
Retained earnings at beginning of year	37,568,177	27,195,106
Cash Dividends—\$.40 and \$.30 for years ended January 31, 1977 and 1976 respectively	(2,161,864)	(1,282,436)
Retained earnings at end of year	<u>\$ 49,744,760</u>	<u>\$ 37,568,177</u>
Net income per common and common equivalent share—Note 1	<u>\$2.63</u>	<u>\$2.53</u>

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

Report of Independent Accountants

TO THE STOCKHOLDERS
OF PAY 'N SAVE CORPORATION:

In our opinion, the accompanying consolidated balance sheets, the related statements of consolidated income and retained earnings, and of consolidated changes in financial position present fairly the financial position of Pay 'n Save Corporation and its subsidiaries at January 31, 1977 and 1976, the results of their operations and the changes in financial position for the years then ended, 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.

Seattle, Washington,
March 11, 1977

PRICE WATERHOUSE & CO.

Pay 'n Save Corporation and Subsidiary Companies

Consolidated Balance Sheet

ASSETS	January 31	1977	1976
CURRENT ASSETS			
Cash	\$	3,395,375	\$ 2,906,612
U.S. Government and other securities— at cost, which approximates market			16,028,235
Notes receivable		451,594	229,898
Accounts receivable, less allowance for doubtful accounts in 1977 of \$548,410 (for 1976 see Note 9)		15,010,297	1,273,561
Recoverable store location expenditures — Note 1		7,294,231	1,670,670
Inventories, at lower of cost or market— Note 1		86,840,064	64,146,890
Prepaid insurance and miscellaneous		486,683	918,691
Total current assets		113,478,244	87,174,557
INVESTMENTS, at cost			
Cash value of life insurance		209,684	192,726
Other investments		6,728	5,328
		216,412	198,054
PROPERTY, PLANT AND EQUIPMENT, at cost — Note 1			
Buildings		5,349,138	600,326
Furniture, fixtures and equipment		32,383,979	24,892,266
Leasehold improvements		9,310,399	8,296,110
		47,043,516	33,788,702
Less—Accumulated depreciation and amortization		16,564,945	12,612,145
		30,478,571	21,176,557
Land		2,041,461	1,127,648
		32,520,032	22,304,205
EXCESS OF COST OVER NET ASSETS OF ACQUIRED COMPANIES AND OTHER ASSETS—NOTE 1		3,831,536	3,709,217
		\$150,046,224	\$113,386,033

LIABILITIES	January 31	1977	1976
CURRENT LIABILITIES			
Notes payable—Note 4	\$13,000,000	\$ 761,310	
Accounts payable	21,975,440	19,172,595	
Withheld and accrued taxes	3,177,843	2,406,739	
Accrued salaries and bonuses	2,498,549	1,840,591	
Rent, pension, and other accrued expenses	2,735,982	2,288,400	
Current maturities on long-term indebtedness—Note 4	2,019,662	3,779,521	
Federal and state income taxes	543,314	3,415,773	
Deferred income taxes—Note 3	1,375,000		
Total current liabilities	47,325,790		33,664,929
 DEFERRED INCOME TAXES, non current	 140,000		
 LONG-TERM INDEBTEDNESS, less current maturities—Note 4	 17,718,766		7,651,506
 STOCKHOLDERS' EQUITY—Notes 4, 5 & 7			
Capital stock—authorized 10,000,000 shares without par value; outstanding 5,434,692 and 5,389,575 shares, respectively	35,116,908	34,501,421	
Retained earnings	49,744,760	37,568,177	
	84,861,668		72,069,598
 COMMITMENTS AND SUBSEQUENT EVENT— Notes 8 and 11			
	\$150,046,224		\$113,386,033

Pay 'n Save Corporation and Subsidiary Companies

Statement of Consolidated Changes in Financial Position

For the year ended January 31	1977	1976
Financial resources were provided by:		
Net income	\$14,338,447	\$11,655,507
Add income charges not affecting working capital in the year		
Depreciation	4,131,356	2,891,196
Amortization of excess of cost over net assets of acquired companies and other assets	124,883	77,612
Deferred income taxes	140,000	
Working capital provided by operations for the year	18,734,686	14,624,315
Increase in long-term debt:		
Proceeds from borrowings	5,100,000	
Obligations incurred in connection with acquisitions—Note 2	3,362,361	2,606,729
Obligations assumed in connection with acquisitions—Note 2	3,927,894	213,870
Proceeds from stock options	615,487	130,189
Proceeds from sale of stock		21,905,070
Miscellaneous, net	16,357	10,326
TOTAL	31,756,785	39,490,449
Financial resources were used for:		
Acquisition of property and equipment, including \$5,768,412 relating to the Yard Birds acquisition in 1977 and \$1,535,574 to the Bi-Mart acquisition in 1976	14,409,753	9,521,861
Excess of cost over the net assets of Bi-Mart		3,615,119
Long-term debt paid or coming due currently	2,322,995	4,816,757
Cash dividends	2,161,864	1,282,436
Increase in non-current notes receivable	219,347	
TOTAL	19,113,959	19,236,173
Increase in working capital including \$1,371,401 in 1977 of working capital of Yard Birds at acquisition and \$3,715,138 of Bi-Mart at acquisition in 1976	\$12,642,826	\$20,254,276
ANALYSIS OF CHANGES IN WORKING CAPITAL		
Increase (decrease) in current assets		
Cash	\$ 488,763	\$ 2,008,109
U.S. Government and other securities	(16,028,235)	16,028,235
Receivables	19,581,993	(8,491,326)
Inventories	22,693,174	23,563,286
Other	(432,008)	741,125
	26,303,687	33,849,429
Increase (decrease) in current liabilities:		
Notes payable	12,238,690	761,310
Accounts payable and accrued expenses	4,679,489	8,752,153
Current maturities on long-term debt	(1,759,859)	3,006,976
Federal and state income taxes	(1,497,459)	1,074,714
	13,660,861	13,595,153
Increase in working capital	\$12,642,826	\$20,254,276

Notes to Financial Statements

Years ended January 31, 1977 and 1976

NOTE 1—Accounting Policies

The significant accounting policies applied in the financial statements follow:

Basis of Consolidation—The financial statements include the accounts of Pay 'n Save Corporation and its subsidiaries, all of which are wholly-owned. All material intercompany transactions and profits are eliminated in consolidation.

Inventories—The company's inventories comprise merchandise held for sale and are valued at the lower of cost or market. Cost is determined on an identified item basis except for apparel store and Yard Birds inventories for which cost is determined by the retail inventory method, and The Bi-Mart Company inventories for which cost is determined predominantly at the retail price less computed departmental average gross profit percentages for the year.

Recoverable Store Location Expenditures—Recoverable store location expenditures result from construction and development costs incurred by the company for certain new stores; the stores are sold upon completion and opening, and the expenditures recovered, with no material gain or loss (sales price generally based upon signed contract prior to development). Eleven of the 166 existing store locations were developed through sale-leaseback transactions.

Property and Equipment—Provision is made for depreciation of buildings predominantly by the 150% declining balance method over estimated useful lives ranging from 15 to 30 years. Provision is made for depreciation of furniture, fixtures and equipment predominantly by the double declining method over estimated useful lives ranging from eight to ten years. The company's operations are conducted on leased premises and the cost of leasehold improvements is amortized by the straight line method over the period of the respective leases or the useful lives of the improvements, whichever is shorter. Maintenance and repairs are charged to income and renewals and betterments are capitalized. Cost and accumulated depreciation in respect to assets retired or otherwise disposed of are eliminated from the property accounts at the time of retirement or sale and the resulting gain or loss is applied to income.

Income Taxes—Deferred income taxes are provided on non-permanent differences between financial statement and taxable income, resulting principally from the use of the installment method of reporting sales for tax purposes. The investment tax credit is applied in reduction of the provision for income taxes in the year in which the credit arises.

Excess of Cost Over Net Assets of Acquired Companies—The excess of cost over value of tangible net assets acquired resulting from the acquisition of The Bi-Mart Company (\$3,615,119) (Note 2) is being amortized over a 40-year period.

Earnings Per Share—Earnings per common and common equivalent share have been based on the weighted average number of shares outstanding during each year and the assumption that all dilutive stock options had been exercised at the beginning of the year (or date of grant, if during the year) and the proceeds used to purchase shares of the company's common stock at the average market price during

the year. Fully diluted earnings per share are not materially different from primary earnings per share.

NOTE 2—Acquisitions

In August, 1975, the company acquired all of the outstanding capital stock of The Bi-Mart Company for \$9,000,000. Of this amount, \$6,393,271 had been paid as of January 31, 1976, and the remaining \$2,606,729 was paid on January 2, 1977 (Note 4). The Bi-Mart Company operated 13 drug stores, primarily in Oregon, selling brand name merchandise using a discount pricing concept.

This acquisition has been accounted for as a purchase and, accordingly, the statement of consolidated income and retained earnings for the year ended January 31, 1976, includes the results of The Bi-Mart Company operations only since acquisition (August 3, 1975). Had The Bi-Mart Company been acquired as of February 1, 1975, and had sufficient shares (452,000) been issued at the actual per share amount realized in the public offering (Note 7) to pay the acquisition cost, the results of operations on a pro forma basis for the year ended January 31, 1976, would have been approximately as follows:

Sales and other revenues	\$365,112,000
Net income	\$ 12,242,000
Earnings per share	\$2.48

On July 1, 1976, the company acquired the Yard Bird organization which operated two general merchandise stores in Washington. The purchase price was approximately \$4,127,000. Of this amount, \$765,000 was paid on closing and the balance is payable over several years (Note 4). The acquisition was accounted for as a purchase. Sales and net income of the two stores since acquisition, included in the statement of consolidated income for the year ended January 31, 1977, are \$10,775,000 and \$431,000 respectively.

NOTE 3—Income Taxes

The income tax provisions comprise:

Year ended	(000 omitted)		
January 31, 1977	Federal	State	Total
Current	\$10,957	\$855	\$11,812
Deferred	1,415	100	1,515
Investment tax credit	(725)		(725)
	<u>\$11,647</u>	<u>\$955</u>	<u>\$12,602</u>
Year ended			
January 31, 1976			
Current	\$10,181	\$690	\$10,871
Investment tax credit	(521)		(521)
	<u>\$ 9,660</u>	<u>\$690</u>	<u>\$10,350</u>

There are cumulative undistributed earnings of Canadian subsidiaries amounting to approximately \$714,000 at January 31, 1977 on which deferred income taxes have not been provided in as much as these earnings have been reinvested for an indefinite period of time. Deferred income taxes result from the installment method of reporting sales for tax purposes (\$1,625,000) less miscellaneous other differences between financial statement and taxable income (net \$110,000).

NOTE 4—Indebtedness

Long-term indebtedness comprised the following notes and contracts payable:

	Year ended January 31	
	1977	1976
Payee		
Banks	\$ 7,400,000	\$ 8,500,000
Former stockholders of the Bi-Mart Company (note 2)		2,606,729
Former stockholders of Yardbirds (Note 2)		
Liability incurred through acquisition	3,362,361	
Liability assumed through acquisition	3,600,000	
Insurance companies	5,100,000	
Others	276,067	324,298
	<u>\$19,738,428</u>	<u>\$11,431,027</u>
Less current maturities	<u>2,019,662</u>	<u>3,779,521</u>
	<u>\$17,718,766</u>	<u>\$ 7,651,506</u>

The notes payable to banks are unsecured. The interest charges on the notes were at $\frac{1}{4}$ of 1% over prime up to October 1, 1975, and at $\frac{1}{2}$ of 1% over prime thereafter (January 31, 1977, interest rate was 6.75%). The principal payments are due in quarterly installments commencing October 1, 1975, with the balance due in full October 1, 1978. The various financing agreements place restrictions on creation of additional debt and require that net worth not be reduced below \$27,000,000 plus 50% of earnings after January 31, 1973, or \$46,290,268 at January 31, 1977. Additionally, the agreements require net working capital of not less than \$30,000,000 and a current ratio of not less than 1.6 to 1. Further, demand deposit accounts must be maintained with banks at traditional levels.

The two notes payable to the former stockholders of Yardbirds bear interest at 7% and are secured by letters of credit issued by a bank. One note requires annual principal and interest payments of \$400,000 through 1991, and the other requires annual principal and interest payments totaling approximately \$691,000 due in 1977 and \$446,000 from 1978 through 1986. The purchase agreement requires maintenance of net worth not less than \$60,000,000 and working capital not less than \$40,000,000.

The notes payable to the insurance companies bear interest at 8.825% and are payable through 1997 in annual installments totaling \$506,000 including interest. The notes are secured by the real property of a retail store located in Chehalis, Washington.

Notes and contracts payable to others bear interest at rates ranging from 6% to 7.5%.

A summary of maturities for the five years ending January 31, 1982 follows:

Year ending January 31	Amount
1978	\$2,020,000
1979	\$6,610,000
1980	528,000
1981	566,000
1982	605,000

The Company's maximum short-term borrowings at any month ended during the years ended January 31, 1977 and 1976, respectively, were \$16,000,000 and \$17,314,000, and the averages amount outstanding during each year were approximately \$2,320,000 and \$5,302,000. The interest rate on short-term borrowing at January 31, 1977 averaged 6.5%. The approximate weighted average interest rate on short-term borrowings was 6.9% in the current year and 7.7% in the preceding year, computed on the basis of the number of days each interest rate was in effect.

NOTE 5—Employee Stock Options

The company adopted a Qualified Stock Option Plan on March 2, 1973, whereby 150,000 shares of the company's capital stock have been reserved. Options have been granted in prior years for all shares reserved under a 1967 plan. Option prices under the new plan may not be less than the market value of the shares at the time of grant. Options may not be granted for more than 7,499 shares to one person, may not be exercised for two years and expire after five years. Options for 34,150 shares were granted during the year under the 1973 plan, 1,700 were cancelled due to terminations and 1,000 were exercised during the year at an average price of \$14.28 or a total of \$14,281. Options for 44,117 shares under the 1967 plan were exercised during the year at an average price of \$13.63 or a total of \$601,206; options for 6,983 shares expired. Options outstanding at January 31, 1977, of which 45,650 were exercisable at that date, were as follows:

Granted during year ended January 31,	Number of shares	Option Price	
		Per share	Total
1973 Plan			
1974	22,150	14.50	321,175
1975	23,500	13.625	320,188
1976	26,850	13.75	369,187
1977	33,150	27.125	899,194

The company also has granted options for 6,000 shares (2,000 shares during 1974 at an option price of \$13.625, 2,000 shares during 1975 at an option price of \$13.75, and 2,000 shares during 1976 at an option price of \$27.125) to the President who does not participate in the Qualified Stock Option Plan.

NOTE 6—Pension Plan

During the year the company combined its three separate pension plans into one pension plan which included certain amendments to provisions of the prior plans in order to conform with the Pension Reform Act of 1974. The effect of these amendments increased the combined unfunded liability approximately \$1,600,000. This combined plan covers all employees who are not eligible for other pension benefits such as pension under union contracts and is funded entirely by company contributions.

The company's contribution to the plans amounted to \$1,193,000 for the year ended January 31, 1977, and \$655,000 for the year ended January 31, 1976. These contributions represent normal cost and amortization of prior service costs over periods ranging from 15 to 30 years. It is the company's policy to fund pension costs accrued. The combined un-

funded liability under these plans amounted to approximately \$5,585,000 and \$3,149,000 at January 31, 1977 and 1976, respectively.

NOTE 7—Capital Stock

During the year ended January 31, 1976, the company had a public offering of 1,100,000 shares of capital stock. Transactions in capital stock for the two years ended January 31, 1977, are summarized below:

	Capital Stock Shares	Amount
Balance, January 31, 1975	4,274,075	\$12,466,212
Sale of capital stock .	1,100,000	21,905,070
Exercise of employee stock options	15,500	130,139
Balance January 31, 1976	5,389,575	34,501,421
Exercise of employee stock options	45,117	615,487
Balance, January 31, 1977	5,434,692	\$35,116,908

NOTE 8—Lease Commitments

The company's operations are conducted on leased premises and, in addition, the company leases certain store fixtures and equipment. The store leases generally provide for minimum rental plus additional amounts based on a percentage of sales and cover a period from ten to thirty years with renewal options. Leases for fixtures and equipment are generally for ten years. Property taxes paid on some leases are included with rental expenses. Rental expenses amounted to \$12,500,000 and \$9,593,000 for the years ended January 31, 1977 and 1976, respectively, including excess rentals based on a percentage of sales of \$2,080,000 and \$2,028,000, respectively.

Certain of the company's leases meet the criteria of a "financing lease" as defined by the Securities and Exchange Commission to be a lease which, during the non-cancellable period, either (1) covers 75% or more of the economic life of the property or (2) has terms which assure the lessor of a full recovery of the fair market value of the property at the inception of the lease plus a reasonable return. For this purpose the company has made the assumption that leases of twenty years or more would meet the first criteria. The rental expense relating to these leases were \$7,352,000 and \$5,286,000 for the years ended January 31, 1977 and 1976, respectively, including excess rentals based on a percentage of sales of \$903,000 and \$790,000, respectively. The present values of the aggregate minimum rental commitments relating to such financing leases were approximately \$66,241,000 and \$43,480,000 for the years ended January 31, 1977 and 1976, respectively.

Interest rates implicit in the terms of the SEC defined financing leases ranged from 3.5% to 10.4% with a weighted average interest rate of 9.1%. On the assumption that SEC defined financing leases had been capitalized (after deductions for insurance, taxes and maintenance included in rentals paid) and the related property rights amortized on a straight line basis and interest expense computed on the basis of present value of the declining outstanding

balance of the lease commitments, net income would have been decreased approximately \$790,000 and \$543,000 for the years ended January 31, 1977 and 1976, respectively. Under such assumptions, amortization of the property rights would have amounted to \$2,510,000 and \$1,728,000 and interest expense would have amounted to \$4,635,000 and \$2,779,000 for the years ended January 31, 1977 and 1976, respectively.

Minimum rental commitments (net of immaterial sublease income) under leases in effect at January 31, 1977, are as follows:

Year ending January 31,	Fixtures and equipment leases	Store premises leases	
		All leases	Non- capitalized financing leases
1978	16,000	10,239,000	7,508,000
1979	16,000	10,226,000	7,565,000
1980	16,000	10,103,000	7,604,000
1981		9,933,000	7,610,000
1982		9,784,000	7,615,000
1983-1987		43,391,000	37,991,000
1988-1992		36,681,000	35,882,000
1993-1997		27,737,000	27,533,000
Remainder to 2007		23,632,000	23,632,000

The Financial Accounting Standards Board recently established new standards of financial accounting and reporting for leases, effective for leasing transactions entered into after January 1, 1977. Additionally, the new standard will require retroactive application for leases entered into prior to 1977, but such retroactive application is not required until 1981. The company is currently initiating efforts to determine the balance sheet and income statement effect of retroactive application.

NOTE 9—Sale of Accounts Receivable

The company has changed from the accrual method to the installment method of reporting sales for tax purposes in the current year. As part of the plan to accomplish this change, the company sold substantially all of its trade accounts receivables as of the last day of the prior fiscal year.

NOTE 10—Quarterly Financial Information

Unaudited financial information for the company by quarter for 1976 is summarized below:

	(000 omitted except earnings per share)			
	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter
Sales and other revenue . . .	\$ 90,691	\$107,982	\$109,828	\$147,183
Net income . .	\$ 2,080	\$ 3,523	\$ 3,007	\$ 5,728
Net income per share . . .	\$.38	\$.65	\$.55	\$1.05

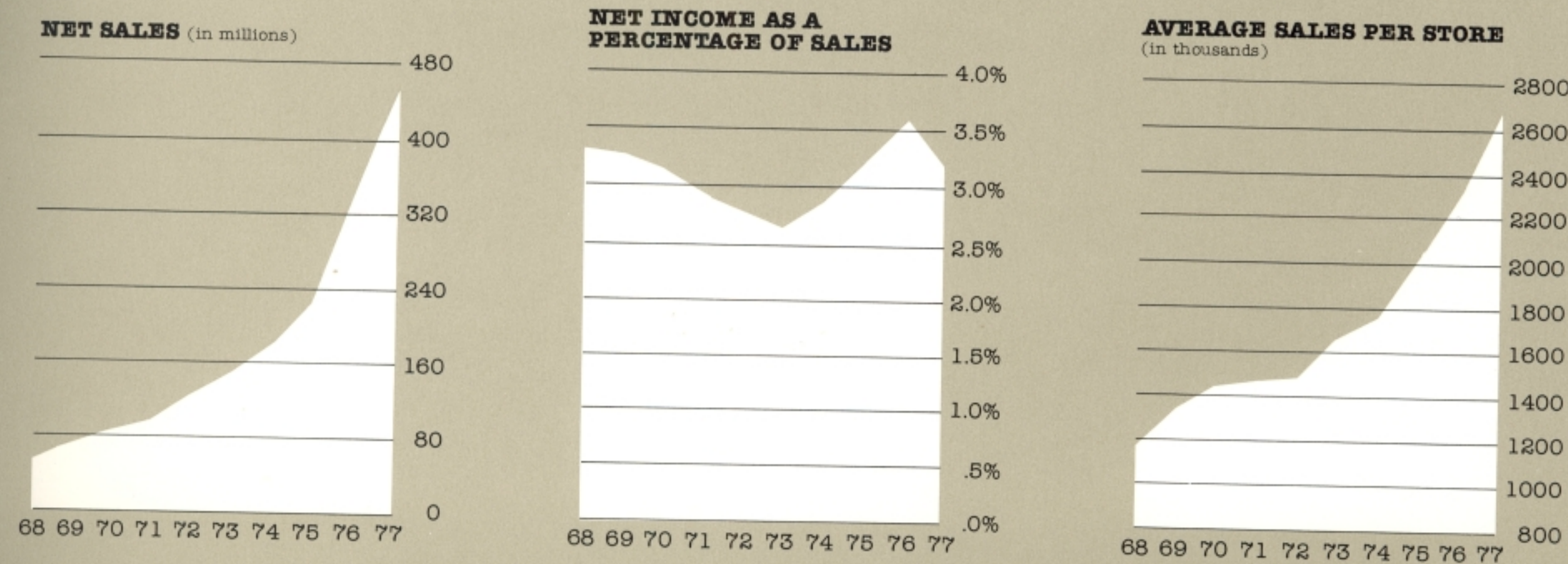
NOTE 11—Subsequent Event

Effective February 1, 1977, the company purchased the inventory, accounts receivable, store fixtures, and certain other assets of a retail hardware and home center store located in Las Vegas, Nevada, for approximately \$2,500,000. Additionally, the company has agreed to pay \$2,200,000 for a non-competition agreement, payable over an eight year period.

Pay 'n Save Corporation and Subsidiary Companies
Ten-Year Summary of Operations

For the year ended January 31	1977	1976	1975	1974	1973	1972	1971	1970	1969	1968
OPERATING RESULTS										
Net sales*	\$453,297	\$330,083	\$223,566	\$181,723	\$147,825	\$120,598	\$97,277	\$84,335	\$70,042	\$57,574
Net income*†	14,338	11,656	7,283	5,304	3,932	3,369	2,806	2,664	2,360	1,949
Net income as a percentage of sales	3.16%	3.53%	3.26%	2.92%	2.66%	2.79%	2.88%	3.16%	3.37%	3.39%
Earnings on equity at beginning of year	19.90%	29.39%	21.97%	18.92%	16.02%	15.38%	14.33%	15.37%	25.65%	31.39%
COMMON STOCK										
Per common and common equivalent share—See Note 1 to financial statements‡	\$ 2.63	\$ 2.53	\$ 1.70	\$ 1.24	\$.92	\$.80	\$.68	\$.64	\$.61	\$.58
Book value per share	15.61	13.37	9.28	7.81	6.67	5.91	5.27	4.76	4.25	2.69
Approximate price range of common stock	31-21	31-12	14-9	18-12	22-17	18-8	11-5	14-9	14-9	10-4
Shares outstanding (end of year)+	5,435	5,390	4,274	4,242	4,202	4,156	4,156	4,118	4,080	3,424
Stock dividends										5%
Cash dividends	\$.40	\$.30	\$.25	\$.20	\$.18	\$.175	\$.15	\$.125	\$.10	
FINANCIAL POSITION (End of Year)										
Working capital*	\$ 66,152	\$ 53,510	\$ 33,255	\$ 29,236	\$ 21,107	\$ 19,855	\$18,351	\$17,532	\$16,546	\$ 9,275
Current ratio	2.40	2.59	2.66	2.82	2.42	2.77	3.85	3.68	4.92	2.38
Long-term debt*	17,719	7,652	9,648	8,387	1,633	1,907	2,174	2,393	2,454	2,652
Stockholders' equity*	84,862	72,070	39,661	33,146	28,037	24,548	21,906	19,586	17,335	9,201
CAPITALIZATION PERCENTAGE										
Long-term debt	17.27	9.60	19.57	20.19	5.5	7.2	9.0	10.9	12.4	22.4
Stockholders' equity	82.73	90.40	80.43	79.81	94.5	92.8	91.0	89.1	87.6	77.6
STORES IN OPERATION										
Pay 'n Save Drug	89	81	71	66	61	55	40	36	31	29
Bi-Mart Stores	15	13								
Ernst-Malmo Home Centers	39	28	25	26	23	21	21	19	17	17
Sportswest & Sportsland	9	8	7	5						
Yard Birds	2									
Lamonts	12	10	7	6	5	5	5	4	4	4
Total number of stores	166	140	110	103	89	81	66	59	52	50
AVERAGE SALES PER STORE										
(based upon number of stores at end of the year*)	\$ 2,731	\$ 2,357	\$ 2,032	\$ 1,764	\$ 1,661	\$ 1,489	\$ 1,474	\$ 1,429	\$ 1,347	\$ 1,204

*Amounts in thousands of dollars.
+Thousands of shares outstanding, adjusted to give effect to stock splits in 1969 and 1973.
‡Includes extraordinary income or unusual items of \$243,000 or \$.06 per share in 1969, \$152,000 or \$.04 per share in 1970, \$150,000 or \$.04 per share in 1971 and \$259,624 or \$.06 per share in 1974.



Customers in eight western states have the convenience of shopping at a Pay 'n Save Corporation store.

In Washington, after 30 years of expansion, we are spread throughout the state, with a strong concentration of Pay 'n Save, Ernst-Malmo, Sportswest, and Lamonts stores in the Puget Sound area.

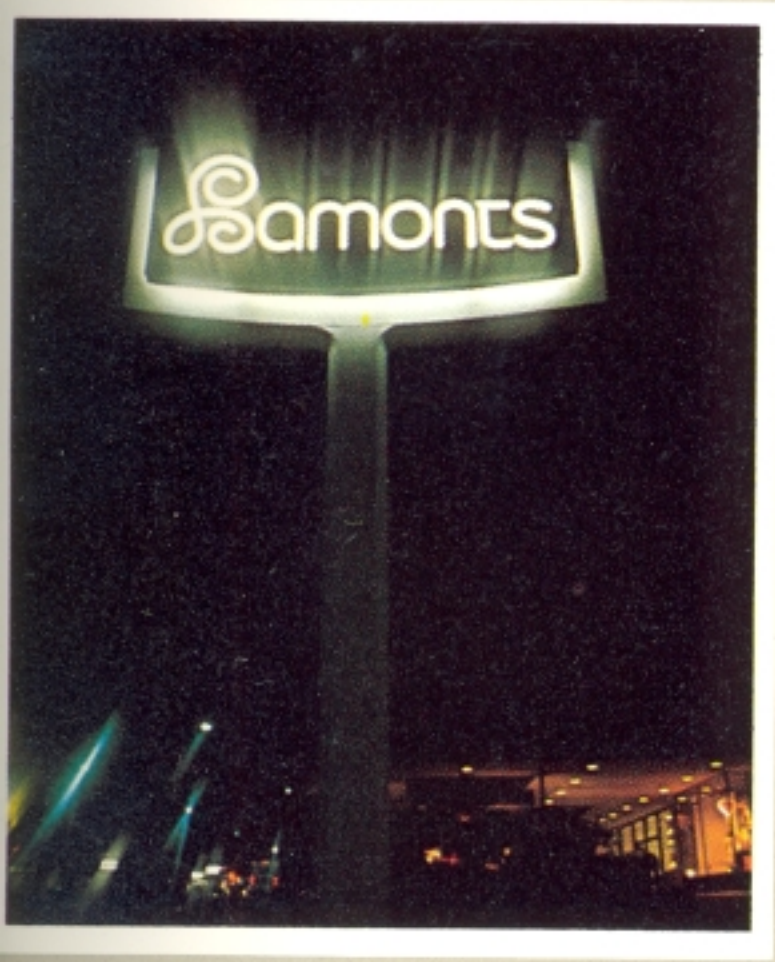
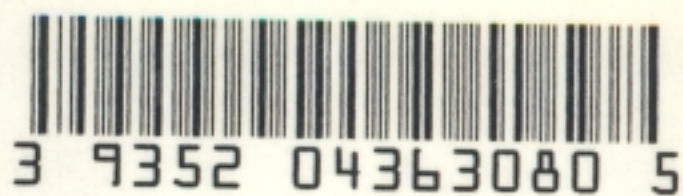
In Oregon, Bi-Mart stores are located across the state with Pay 'n Saves in Portland and an Ernst in Eugene.

In California and Hawaii, we operate drug stores and combination drug and home centers under the Pay 'n Save name. Our California stores are located in the northern half of the state, while our Hawaiian stores are mostly on Oahu, with the exception of one that overlooks the Kona Coast on the big island.

Idaho has Pay 'n Saves to the north and Ernst and Lamonts stores to the south. Our Alaska outlets, in Anchorage and Fairbanks are Pay 'n Saves and Lamonts. In Canada Pay 'n Saves are in Vancouver, B.C., and Calgary, Alberta.

Our entry into Utah has been fairly recent and our Ernst stores are centered around Salt Lake City. Nevada was entered the day after the fiscal year ended, when Von Tobel's in Las Vegas was purchased. ■





Stores	Wash	Calif	Alaska	Oregon	Hawaii	Idaho	Utah	Canada	Total
Pay 'n Save Drug Stores	45	23	6	3	5	2		5	89
Bi-Mart Drug Stores ..	1			14					15
Ernst-Malmo Home Centers	28			1		4	6		39
Lamonts Apparel Stores	9		1			2			12
Sportswest/Sportsland	9								9
Yard Birds Stores	2								2
	94	23	7	18	5	8	6	5	166

Officers

- Monte L. Bean**
Chairman of the Board
- M. Lamont Bean***
President
- E. R. Erickson***
Executive Vice President,
Operations
- Calvin Hendricks***
Executive Vice President,
Administration
- Joseph J. Petrino**
Vice President
- Thomas R. Lawrenson**
Vice President
- J. Kenneth Green**
Vice President
- Jack Phelan**
Vice President

- Paul R. Ross**
Vice President
- Walter R. Guidinger**
Vice President
- Raymond C. Swanson**
Secretary
- Joseph Christy**
Treasurer and Controller
- Jennie K. Hauge**
Assistant Treasurer
- Vernon S. Heggen**
Assistant Secretary

*Executive Committee

Directors

- Monte L. Bean**
- M. Lamont Bean**
- Joshua Green, Jr.,**
Chairman of the Board of Peoples
National Bank of Washington and
a Director and President of the
Joshua Green Corporation whose
principal business is stock and
real property investments.
- James H. Clawson**
Retired. Previously President and
Chairman of the Board of Puget
Sound Power and Light Company
- E. R. Erickson**
- Calvin Hendricks**
- Raymond C. Swanson**
Partner in law firm of Ryan,
Swanson, Hendel & Cleveland

~~JAN 28 1980~~

~~JAN 30 1980 - 9 00 AM~~

**Transfer Agents and
Registrars**

Peoples National Bank of
Washington, Seattle, Washington
Banker's Trust Company
New York, N.Y.

Auditors

Price Waterhouse & Co.

Counsel

Ryan, Swanson, Hendel &
Cleveland

General Offices

1511 Sixth Avenue
Seattle, Washington

Additional Information

A copy of the company's Form
10-K report for the year ended
January 31, 1977 filed with the
Securities and Exchange
Commission is available to
shareholders on request. Copies of
pertinent 10-K exhibits are also
available at a nominal cost. These
publications can be obtained by
writing to Pay 'n Save Corporation,
1511 6th Avenue, Seattle,
Washington 98101.