

SKIPPER'S, INC.

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BSL 079

Annual Report 1984

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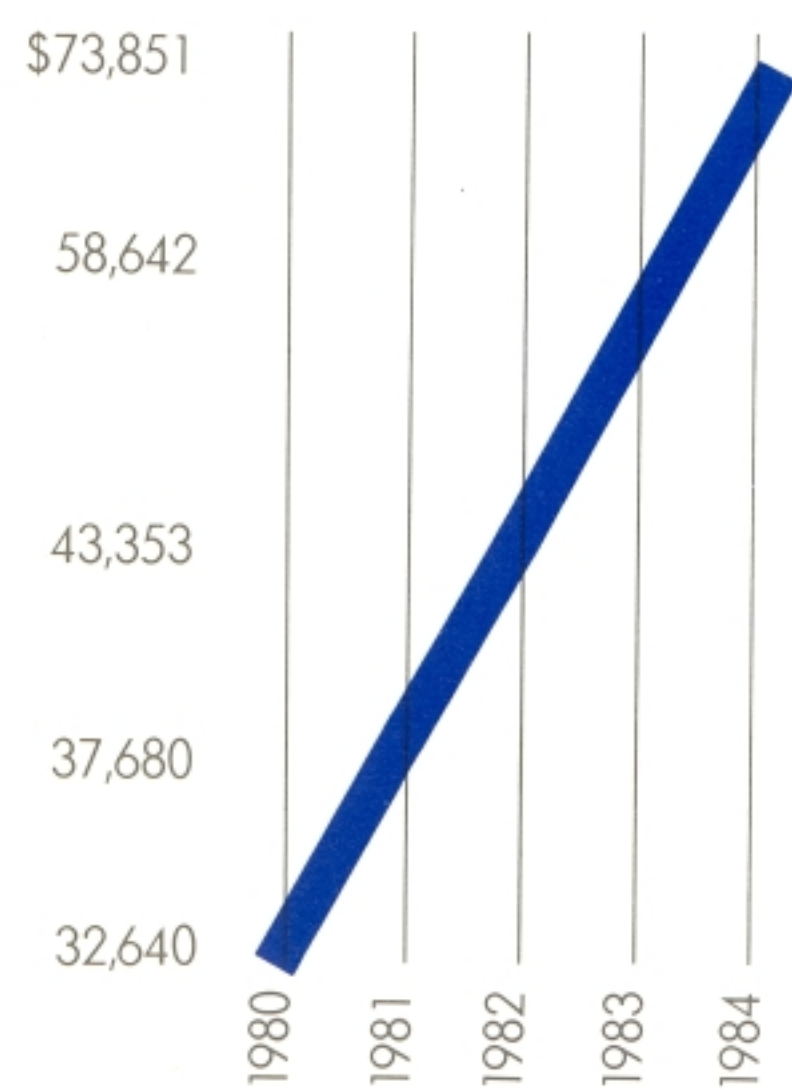
FINANCIAL HIGHLIGHTS

Skipper's,® Inc.

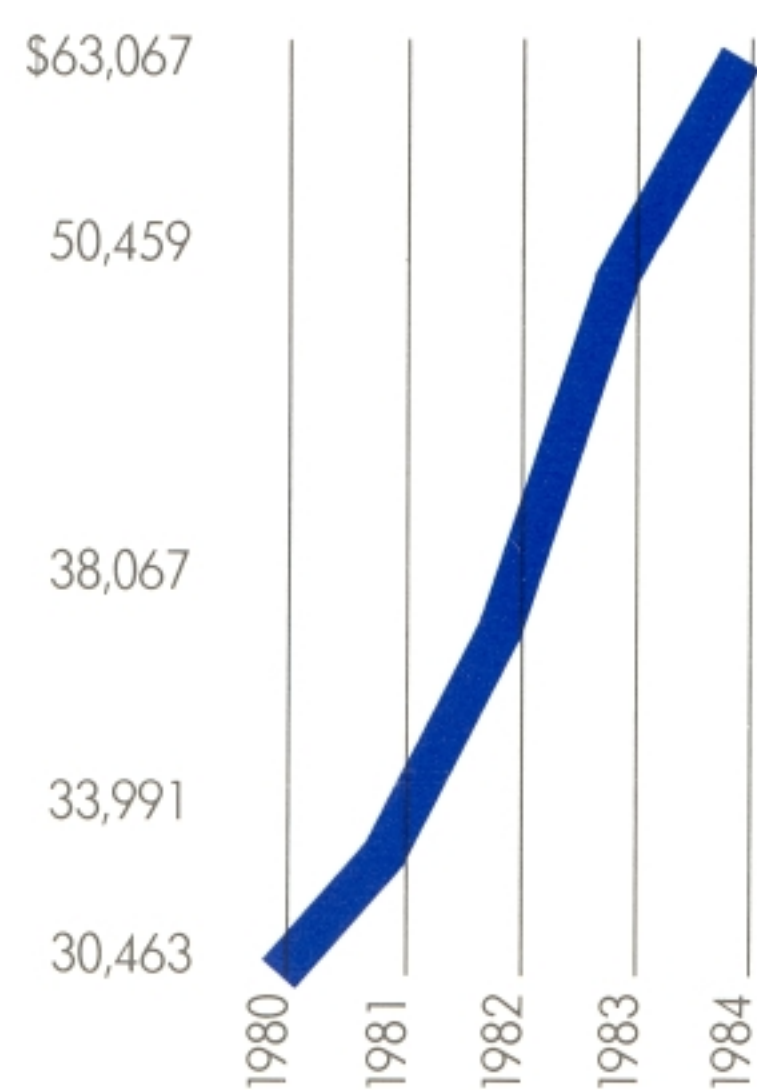
	For the 53 Weeks Ended December 30, 1984	For the 52 Weeks Ended December 25, 1983
Restaurant Sales:		
Company-operated	\$62,306,000	\$49,956,000
Franchised	11,545,000	8,686,000
Systemwide Total	73,851,000	58,642,000
Revenues	63,067,000	50,459,000
Income Before Provision for Income Taxes	3,731,000	2,956,000
Net Income	2,532,000	2,020,000
Earnings per Common Share	.93	.81
Restaurants Open:		
Company-operated	147	133
Franchised	26	18
Systemwide Total	173	151

FINANCIAL HIGHLIGHTS

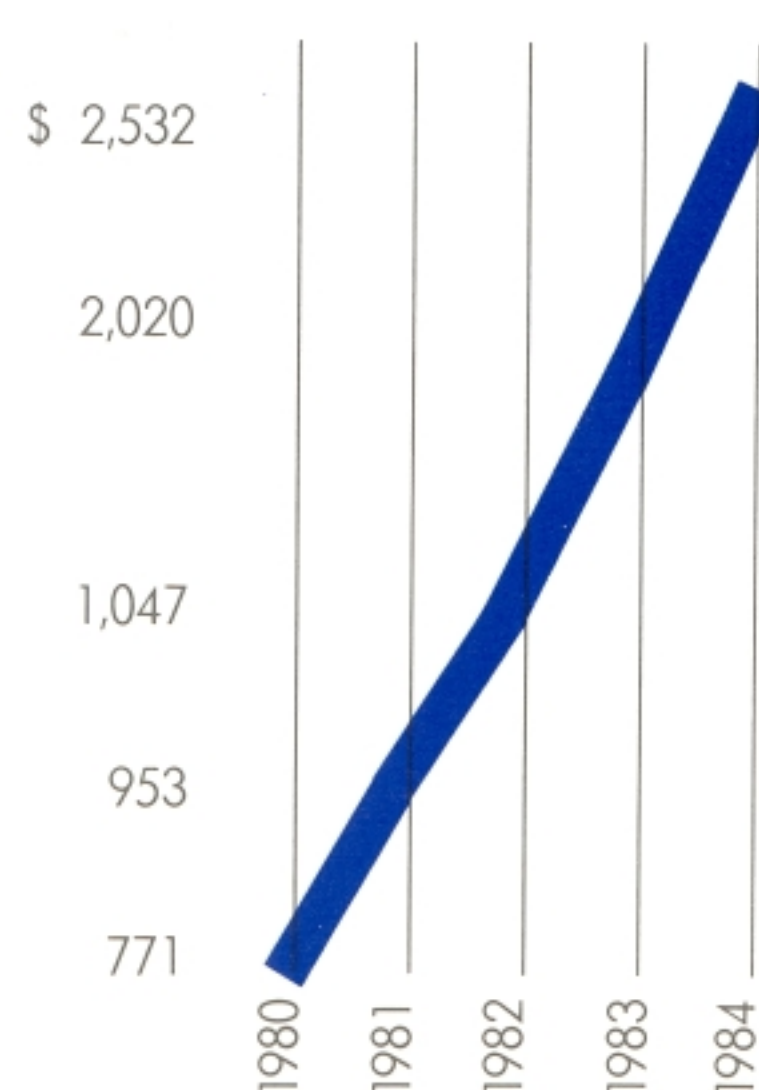
Systemwide Sales
(Dollar amounts in thousands)



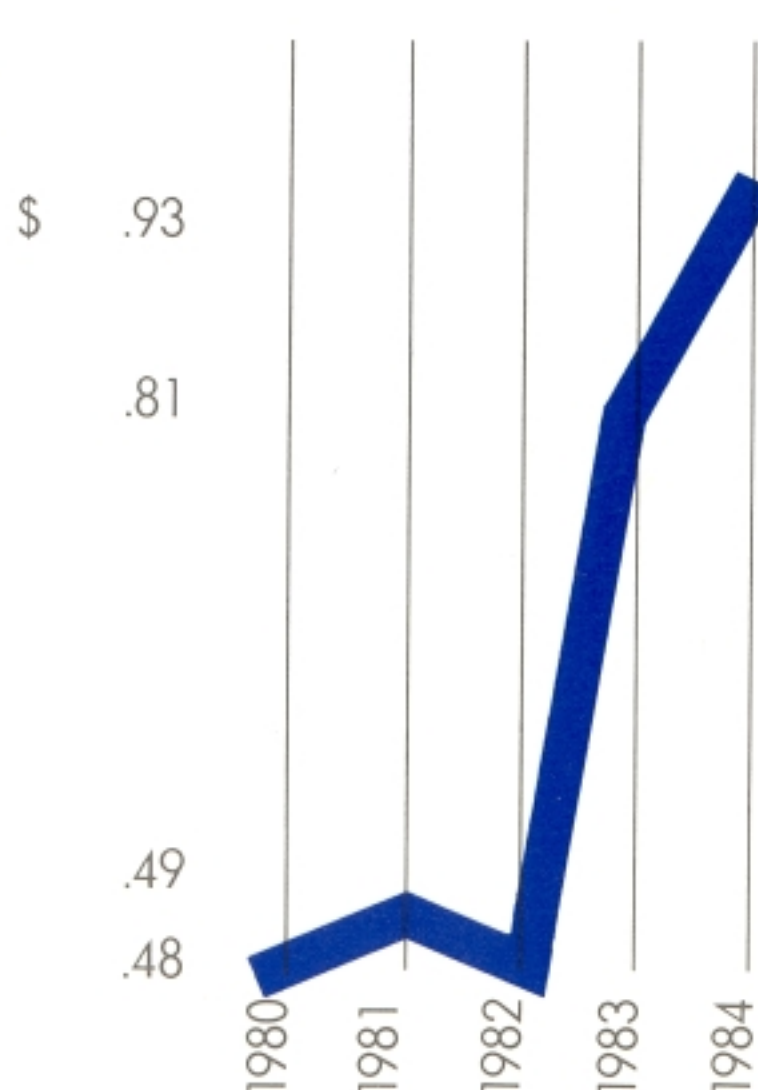
Revenues
(Dollar amounts in thousands)



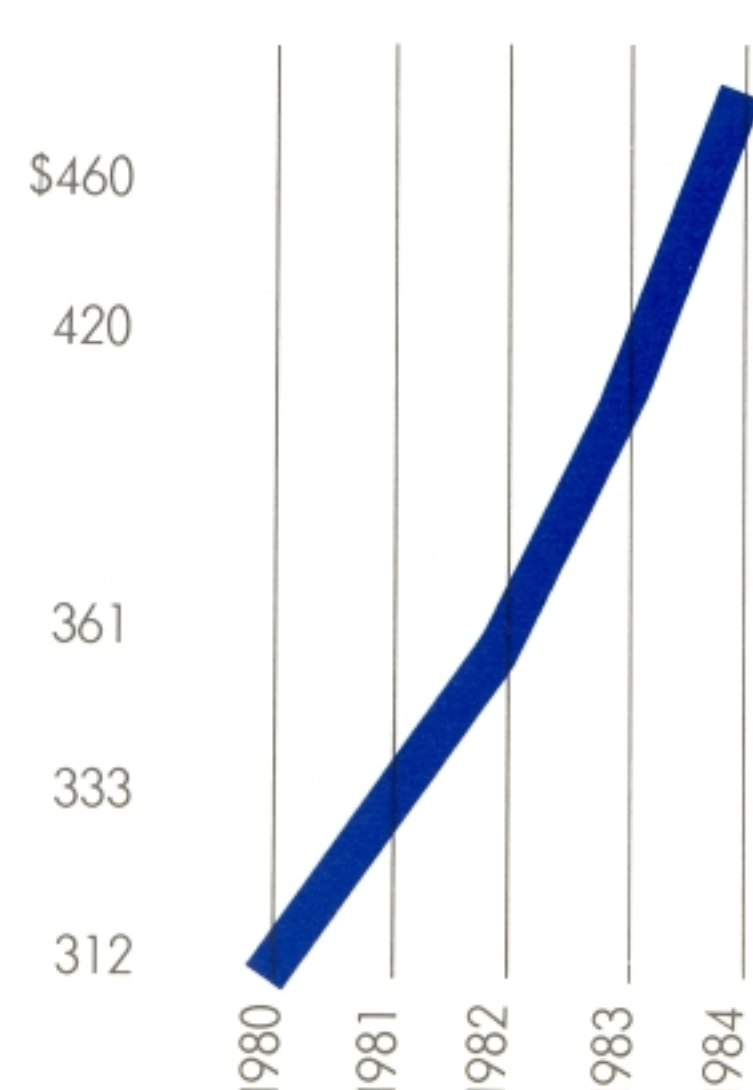
Net Income
(Dollar amounts in thousands)



Earnings per Common Share



**Systemwide Average Annual
per Restaurant Sales**
(Dollar amounts in thousands)



THE COMPANY

The company was incorporated in the State of Washington in 1969 and introduced its franchising program in 1978.

As of December 30, 1984 Skipper's, Inc. operated and franchised 173 Skipper's Seafood 'n Chowder House restaurants. The 147 company-

operated restaurants are located in Washington, Oregon, California, Utah, Idaho and Colorado; 26 franchised operations are located in Alaska, Arizona, British Columbia, Hawaii, Kansas, North Dakota, Montana, Idaho, Colorado, California and Oregon.

Skipper's restaurants feature a limited, fast-food menu, consisting of deep-fried seafood and chicken, clam chowder, seafood salad, a salad bar and assorted beverages. In most

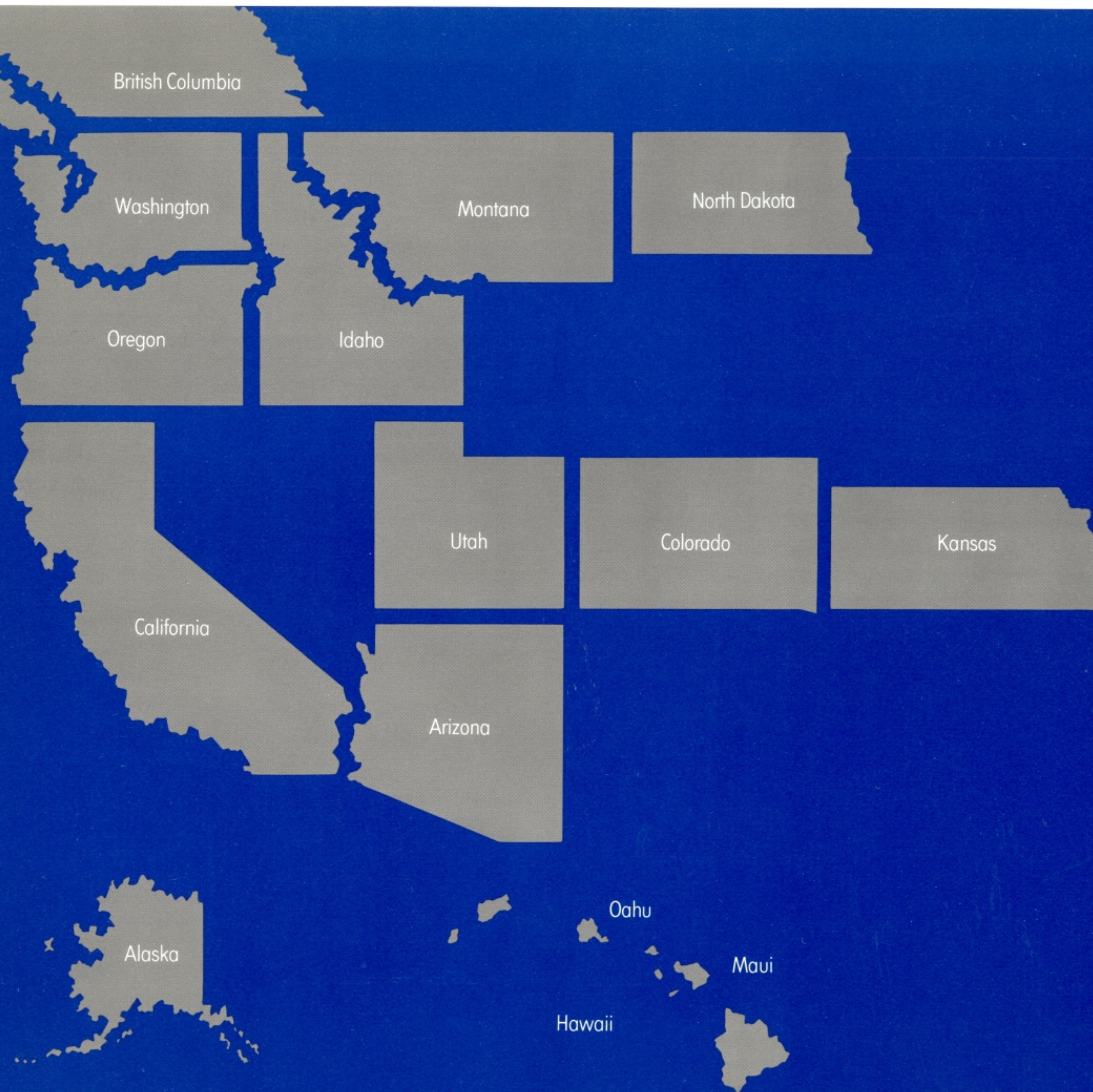
areas, beer and wine are served. All menu items, except beer and wine, are available for "eat-in" or "take-out" convenience.

The company's restaurants are located in free-standing one story buildings or in-line store fronts; square footage is approximately 2,000 square feet with a seating capacity of 100 to 120 seats.

The nautical decor of the restaurant is casual, suitable for family dining. With the company's limited-service format, all meal orders are taken centrally at the cash register, then prepared and delivered to the customer by Skipper's employees.

The company's common stock is traded over-the-counter on the NASDAQ system under the symbol "SKIP." There were approximately 2,500 shareholders of record as of December 30, 1984.





**Skipper's restaurants
at year-end 1984**

Washington	63
Oregon	30
California	25
Utah	14
Colorado	13
Idaho	11
Alaska	4
North Dakota	3
Hawaii	3
Montana	3
British Columbia	2
Kansas	1
Arizona	1
	<hr/>
	173

TO OUR SHAREHOLDERS

Through the fine performance of our 2,300 employees, Skipper's, Inc. ended 1984 with its sixth consecutive year of increased revenue and profit.

As we have maintained in years past, we believe that our ability to attract and keep high quality people is at the heart of our success. The substantial increases in our financial results reflect the growing competence and strong determination of our people to achieve the company's goals. Systemwide sales rose 26% to \$74 million; net income increased 25% to \$2.5 million; revenues were 25% higher at \$63.1 million; and earnings per share increased 15% to \$.93.

The results that we produced in 1984, however, were by no means easily achieved. As many of you know, business in general exhibited a degree of uncertainty during the third and fourth quarters. The restaurant industry, as one of the leading indicators of economic direction, experienced a sharp downward trend, in contrast to a robust 1983 and first half 1984.

For Skipper's, this situation intensified the many challenges that we faced in our efforts to outperform our record accomplishments of the prior year. To ensure continued growth in 1984 we encouraged more flexibility and aggressiveness in achieving our objectives. Our capable management team took the challenge, quickly executing sales and profit-building programs in imaginative ways while still focusing on the development and implementation of long-term corporate programs.

What we accomplished—and learned—during 1984 is provided in the following overview.

Operations

Skipper's restaurant operations group, as the "front line" team, is our most enduring example of entrepreneurial enthusiasm combined with the discipline of chainwide consistency. The effectiveness of this combination is best illustrated by this satisfying figure: systemwide average sales per restaurant in 1984 increased 10% to \$460,000. We are especially proud of this accomplishment because we have now surpassed the industry's largest fast seafood chain in average per unit sales volume.

To increase sales volume, our restaurant operations group executed a number of programs, concentrating their efforts on building customer frequency. They intensified their multi-pronged endeavors to ensure that the fundamentals of customer satisfaction—quick, friendly service, high quality product and restaurant cleanliness—were consistently applied. As a result, customer counts increased more than 6% in 1984.

As a means of building sales volume, a greater effort was directed towards improving the consistency of training and the application of operational procedures. This was accomplished by placing more emphasis on the company's training certification program throughout the year. Restaurant managers and district managers must undergo and pass rigorous testing and evaluation procedures before they are certified by the company's training staff to train other employees.

Increased levels of field marketing and local promotions also were solid contributors to building frequency of visits and restaurant sales volume. During 1984, we saw the development of a fully decentralized field marketing system, with the placement of field marketing managers in each region of the company. The

immediate benefits of field marketing to the development and execution of local promotion programs were improved consistency with company programs and the integration of long-term planning. As the program matures over the next few years, we expect to realize the full sales-building effectiveness of this decentralized system.

The industrywide sales slowdown in the second half of the year, together with delays in some restaurant openings, put pressure on existing restaurant operations to improve operating margins. This pressure was met with an effective combination of discipline and imagination. Operations management reviewed labor guidelines and determined that a slight reduction in labor costs would still provide the labor hours needed in each restaurant to maintain the level of service that our customers have come to expect. By year-end the efforts of the company's restaurant operations group had reduced labor costs by one-half percent under the first two quarters of the year.



Cod fillets are Skipper's most popular product: seven out of every ten customers select an entree featuring cod. We believe this popularity is due to the quality handling of the product that we demand from start to finish.

Our cod is fished in the cold, clear waters of the Gulf of Alaska. Within hours of being caught it is cleaned and frozen aboard large processing ships. Freezing ensures a naturally moist, firm texture down the line when the fillet is served to a Skipper's customer.





Excellent customer service is still recognized as a primary factor in the success of the Skipper's concept. As we head into 1985, we believe our guidelines for labor cost control maximize efficiency while preserving Skipper's emphasis on high quality customer service.

Other cost saving ideas evolved as the year progressed. A rather simple but clearly effective means to reduce food cost was the offer of Jell-O® as an alternative to coleslaw on all adult entrees. Based upon frequent customer requests and prompted by a suggestion from our Oregon operations, this policy was expanded companywide during the fourth quarter. Significant food cost savings should be achieved in 1985, in addition to increased customer satisfaction for those who prefer Jell-O® to coleslaw on their entree orders.

Additional measures to improve the food cost of our menu items were market tested in 1984. One measure tested in 1984 and implemented in 1985 was the elimination of cocktail sauce as a delivered condiment on seafood entrees because it is readily available to customers at our self-serve condiment bar. If other cost

saving actions prove positive in market tests, with no diminishment of value perception by our customers, they will be implemented.

During the year, two programs which are expected to provide ongoing reductions in operating expenses were initiated: an energy management program and a new point-of-sale cash register system.

The energy management program has two objectives: to identify, develop and implement systems which will reduce energy costs and repair and maintenance costs immediately and for the long-term; and to develop active corporate support of energy conservation, the results of which will benefit Skipper's and consumers alike in the future.

As the first step in our energy management program, we began installing a computerized energy control system in our restaurants late in 1984. It should provide substantial savings, and we anticipate that it will be fully operational on a chainwide basis by year-end 1985.

The sophisticated new point-of-sale cash register system was selected during the year and is expected to provide cost savings through the use of detailed product and consumer information. The centrally-based system has been installed in a small

base of test restaurants and over the next two years will become fully operational chainwide.

Expansion

Solid progress was made in the total number of new restaurant openings for the year. We opened 24 new Skipper's Seafood 'n Chowder House restaurants, nine of which were franchised operations.

Our greatest achievement was in the Denver, Colorado area where we significantly improved our market penetration with eight new restaurants for a total of 13 restaurants in that market by year-end.

During the year we also closed two company-operated restaurants: an unprofitable unit in California and a unit in Washington whose lease had expired.

For a variety of reasons, including stringent permit regulations and poor weather, some of our company-operated restaurants experienced delays in the scheduled opening dates, and our expected entry into the Minneapolis market did not occur until early 1985. As noted earlier, these delayed openings pressured existing operations to produce higher sales and profits. Improved familiarity with local regulations and

increased lead time in our newer markets will benefit our expansion efforts this year, especially in Minneapolis where we anticipate a number of new restaurant openings in 1985.

Most of our 1984 franchise restaurant opening goals were met, with the exception of units in Nevada and New Mexico, now scheduled to open in 1985. In 1984 we opened new franchise restaurants in Arizona, Kansas, California, Hawaii and Montana, the first two states being new Skipper's markets.

We are confident that our 1985 expansion goal of 25-30 new restaurants is realistic. At year-end 1984 we were in a very favorable position for expansion, with five restaurants under construction, six real estate packages completed for company restaurant openings, and nine new franchise area development agreements signed.

The new franchise area development agreements call for the opening of 27 new Skipper's restaurants over the next several years. When added to commitments on previous area development agreements, there are a total of 58 franchised units contracted for future development, in addition to the 26 franchise units already opened. Continued aggressive promotion of the franchise program will complement the company's expansion plans during 1985.



At the restaurants, Skipper's employees hand fillet each piece of fish, then prepare it using a specially formulated batter and breading. When a customer places an order the fillet is deep fried and served immediately, piping hot.



Purchasing

As a major achievement of the purchasing department, our primary raw product costs generally decreased in 1984. The one exception was the price of cod which increased when we switched to a higher quality product. We tested and approved a change from North Atlantic cod to Alaskan cod in an effort to improve the cod's quality for the 70% of our customers who order fish entrees. As an added benefit, the new cod provides less product waste, thus lowering food cost. And because its firmer, more consistent texture is easier to fillet, training and speed are improved, lowering production labor costs.

Marketing

Mixed results in our 1984 marketing program caused us to review and re-define some of our strategies and priorities.

The introduction of a new menu item, Seafood Salad, occurred during the third quarter. This menu item, priced at \$2.99, features a crabmeat and Pacific whitefish blend called surimi. Our objective was to quickly implement the addition of a non-fried seafood item to the menu, while other

non-fried seafood alternatives are still being investigated. The Seafood Salad, which achieved modest but expected trial by customers during the introductory period, has not sustained anticipated sales levels. The result has prompted us to rethink our future product development strategies. We have defined two levels of focus: long-term menu additions with improved research and market testing criteria prior to chainwide implementation; and short-term product development strategies which will focus on promotional items, such as seasonal specials, to increase customer frequency and give us a competitive edge.

Significant progress was achieved in our quality assurance program by approving alternate suppliers for many of our basic products. We began the year with only one primary product supplier for each of our baseline items: cod, shrimp, clams, chowder and french fries. By year-end we had developed at least one alternate supplier for each of these products. The benefits are far-reaching, providing us with improved resources to ensure continuity of supply and greater control over product quality. The procurement of alternate suppliers also provides our purchasing department with a solid negotiating tool for obtaining the company's yearly product contracts.

During the third quarter we introduced a new broadcast advertising campaign. Creatively, it was a marked departure from prior television campaigns and received extremely favorable customer response during the introductory period. And, although it appears to have far more immediate audience impact than previous campaigns, its long-term effectiveness is uncertain at this point. The new campaign, introduced just prior to the industry's downward sales trend, has undergone some major revisions which complement our short-term product promotion strategy.

In an effort to improve operating margins we increased our menu prices by 2.4%, as compared to the industry average of 2.05% (Source: *Restaurant Industry Trends*). Historically, we have kept our menu price increases to a minimum, under the industry average. The increase resulted in improvement of our profit margins but we believe that customer resistance to the new prices—especially that of our biggest selling menu item, the All-You-Can-Eat—somewhat limited our real sales gains for the year. We plan to make only conservative menu price increases, if any, during 1985.

In summary, we faced many challenges in 1984: to outperform our record 1983 results; to overcome a slowdown in sales during the second half of the year; and to fulfill sales goals even when several projected restaurant openings did not occur or were delayed.

We achieved good results—our sixth consecutive year of record performance. And, in so doing, we reaffirmed our belief that Skipper's strength is in the deeply-rooted entrepreneurial spirit of its people. It required a determination by all to identify and benefit from opportunities, to face problems head-on with innovative solutions, and to treat every situation as a valuable learning experience. The obstacles and opportunities we encounter in 1985 will be met with the same determination.



Gene Stone, President-
Chief Executive Officer



Herbert I. Rosen,
Chairman of the Board

February 22, 1985

Skipper's customers appreciate our quality handling, returning again and again for fish. In 1984, customer counts rose more than 6% and the company served more than 5 million pounds of fish.

Skipper's has benefitted from the growing trend towards health and fitness as more consumers add seafood to their diets. For years we've been providing an alternative to ordinary fast food. As we expand into new markets we believe our commitment to serving quality fish and seafood at a fair price will continue to be the cornerstone of our success.



MANAGEMENT'S DISCUSSION AND ANALYSIS

Results of Operations. The company ended 1984 with its sixth consecutive year of increased revenue and net income. Systemwide sales, which include franchised restaurant sales, increased 26% to \$73,851,000 in 1984 from \$58,642,000 in 1983, which was a 35% increase over systemwide sales of \$43,353,000 in 1982.

Sales for company-operated restaurants increased 25% in 1984, 33% in 1983, and 12% in 1982. This reflects a combination of continuing growth in real sales, the opening of new restaurants and slight menu price increases. Real sales (total sales minus menu price increases and new restaurant openings) accounted for 6.3% of the 1984 increase. Real sales increased by 12% in 1983 and 1% in 1982. Management believes an industry wide sales slowdown in the second half of 1984 combined with severe weather conditions in most of the company's market areas in the fourth quarter account for the slower volume growth rate.

During 1984, fifteen company-operated restaurants opened; eight in Colorado, three in California, two in Utah, one in Oregon and one in Washington. Two company-operated restaurant locations were closed in 1984; an unprofitable unit in California and a unit in Washington

where the lease had expired. Anticipated openings in the new market area of Minneapolis were delayed to early 1985. During 1983 and 1982, the company opened 15 and 12 company-operated restaurants respectively.

Skipper's instituted a 1.0% menu price increase in July 1984 and a 1.4% menu price increase in September 1984. During 1983 and 1982 the company had aggregate menu price increases of 2.7% and 8.6% respectively. The company anticipates conservative, if any, menu price increases in 1985.

Franchised restaurant sales were \$11,545,000 in 1984, \$8,686,000 in 1983 and \$5,649,000 in 1982. In 1984 Skipper's franchise revenues rose 51% as a result of the increased sales and the opening of nine restaurants in 1984.

Food costs decreased as a percentage of sales to 34.7% in 1984 from 35.2% in 1983, the second consecutive year of such a decrease. In 1982, food cost as a percent of sales was 35.4%. Improved product quality, more favorable distribution agreements and relatively stable raw product costs contributed to the decrease.

Restaurant labor costs as a percentage of sales were 23.9%, 23.7% and

24.3% in 1984, 1983 and 1982 respectively. The increase in 1984 resulted primarily from increased payroll tax rates.

General and administrative expenses, which consist of corporate general and administrative expenses and advertising, stayed constant at 17.0% of revenue in 1984 and 1983 as opposed to 17.9% in 1982. A management program to minimize costs in this area will continue in 1985.

Net income as a percentage of revenue stayed constant at 4.0% of revenue for 1984 and 1983 as compared with 2.8% in 1982. The increase in net income for both 1984 and 1983 as compared to 1982 resulted from the reduction of both restaurant and general and administrative expenses as a percentage of revenue.

Liquidity. Due to costs of expansion and because restaurant businesses generally do not require significant investment in accounts receivable or inventory but often receive trade credit in purchasing food and supplies, many companies in this industry operate with working capital deficits, where current liabilities exceed current assets. The May, 1983 sale of common stock provided sufficient working capital to finance

restaurant openings for that year and continued to finance growth through most of 1984. However, by December 30, 1984, the stock offering proceeds were fully utilized resulting in a return to a working capital deficit.

To fund working capital deficits, the company can utilize a revolving credit line of \$5,000,000 which at July 1, 1985 increases to \$10,000,000 with stipulated interest at prime. Borrowings under this bank agreement at December 30, 1984 were \$1,439,000.

Capital Resources. During the three years ended December 30, 1984, the company opened 42 restaurants requiring capital expenditures totaling \$19,600,000. Additionally, 37 restaurants were remodeled for a total expenditure of \$2,300,000. The major portion of these expenditures was internally financed through the use of working capital, the proceeds from public stock offerings in 1981 and 1983, and obligations under capital leases totaling \$1,300,000.

The company's second public stock offering in May, 1983, provided net proceeds of \$5,816,000. Of this amount, \$4,400,000 was utilized in 1983 for the construction and equipping of new restaurants and the remainder was invested in short term securities at various interest rates. The balance of the proceeds was fully

utilized to finance expansion in 1984. The company expects to continue the opening of new restaurants through and beyond 1985. Funding of new restaurants will come from a variety of sources including the revolving line of credit, sale and leaseback transactions, and internally generated funding from operations. Specifically, subsequent to December 30, 1984, the company entered into an agreement with a limited partnership for the sale and leaseback of five Skipper's restaurants in the amount of \$2,950,000.

Inflation. Because of the absence of receivables and inventory in the restaurant business, it is difficult to compute and evaluate the effects of inflation and changing prices upon the operations of the company. During 1984, 1983 and 1982, the company did experience modest increases in the cost of food, labor and other products. These rising costs were generally offset by menu price increases.

Management partially controls inflation in occupancy costs either by owning the properties or by entering long-term fixed rate leases. However, most leases require Skipper's to pay taxes, maintenance, insurance, repairs and utility costs, all of which are subject to inflationary pressures.

SELECTED FINANCIAL DATA(Dollar amounts in thousands,
except earnings and dividends per share)

	1984	1983	1982	1981	1980
Operating Results					
Company-operated restaurant sales	\$ 62,306	\$ 49,956	\$ 37,704	\$ 33,751	\$ 30,315
Franchised restaurant sales	11,545	8,686	5,649	3,929	2,325
Systemwide restaurant sales	73,851	58,642	43,353	37,680	32,640
Company-operated restaurant sales	62,306	49,956	37,704	33,751	30,315
Franchise revenues	761	503	363	240	148
Total revenues	63,067	50,459	38,067	33,991	30,463
Income before provision for income taxes	3,731	2,956	1,443	1,418	1,104
Provision for income taxes	1,199	936	396	465	333
Net income	2,532	2,020	1,047	953	771
Weighted average common shares outstanding ¹	2,722,695	2,508,043	2,174,312	1,956,344	1,616,774
Earnings per common share ¹	.93	.81	.48	.49	.48
Cash dividends declared per common share ¹	.06	.057	.053	.05	.04
Depreciation and amortization expense	2,872	2,231	1,788	1,541	1,283
Capital expenditures	11,956	7,760	5,428	2,795	2,132
Financial Position (End of Year)					
Total assets	34,349	27,565	18,800	16,913	13,191
Working capital	(1,934)	1,057	(1,884)	672	(1,971)
Long-term debt	7,469	4,956	4,899	4,977	5,357
Stockholders' equity	19,734	17,401	9,695	8,793	4,506
Ratio Analysis					
Net income as a percentage of revenues	4.01	4.00	2.75	2.80	2.53
Percent return on average equity during the year	13.64	14.91	11.33	14.33	18.62
Current ratio	.66	1.24	.50	1.23	.38
Total liabilities to equity ratio	.74	.58	.94	.92	1.93
Book value per outstanding common share ¹	7.26	6.40	4.47	4.05	2.96
Restaurants					
Number open (end of year)					
Company-operated	147	133	118	107	102
Franchised	26	18	15	10	7
Total restaurants	173	151	133	117	109
Average annual systemwide sales	460	420	361	333	312
Company Employment					
Number of employees (average)	2,216	1,864	1,487	1,341	1,283

¹Amounts have been restated to give effect to the May, 1983 and May, 1981 stock splits, as applicable.

QUARTERLY FINANCIAL INFORMATION

(Unaudited)

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
(Dollar amounts in thousands, except earnings per share)				
For the Year Ended December 30, 1984				
Systemwide sales	\$ 15,402	\$ 16,838	\$ 17,296	\$ 24,315
Company sales and franchise revenue	13,369	14,415	14,560	20,723
Gross profit	3,047	3,317	3,283	4,815
Net income	545	584	501	902
Earnings per common share	.20	.22	.18	.33
Weighted average common shares outstanding	2,723,227	2,724,032	2,724,032	2,720,292

For the Year Ended December 25, 1983

Systemwide sales	\$ 12,217	\$ 13,532	\$ 14,032	\$ 18,861
Company sales and franchise revenue	10,529	11,690	11,934	16,306
Gross profit	2,403	2,752	2,662	3,695
Net income	439	551	414	616
Earnings per common share	.20 ¹	.24	.15	.22
Weighted average common shares outstanding	2,168,147 ¹	2,352,506	2,719,998	2,720,619

Annual Dividend Per Share-paid semi-annually

1984
\$.06

1983
\$.057

Quarterly Low & High Bid Prices For the Fiscal Year

First Quarter
Second Quarter
Third Quarter
Fourth Quarter

1984
\$ 9.00 - \$10.75
9.25 - 11.75
8.00 - 11.25
9.00 - 10.88

1983
\$ 4.83 - \$ 7.83¹
7.33 - 15.00¹
12.25 - 15.25
9.00 - 13.25

(OTC market; NASDAQ Symbol: SKIP)

Shareholders and Shares at Fiscal Year End

Approximate shareholders of record
Shares outstanding

1984
2,500
2,719,072

1983
2,400
2,720,619

12 ¹ Amounts have been restated to reflect the May, 1983 three-for-two stock split.

REPORT OF INDEPENDENT ACCOUNTANTS

To the Board of Directors and Shareholders of Skipper's, Inc.:

In our opinion, the accompanying consolidated balance sheet and the related consolidated

statements of income, of stockholders' equity and of changes in financial position present fairly the financial position of Skipper's, Inc. and its subsidiaries at December 30, 1984 and December 25, 1983, and the results of

their operations and the changes in their financial position for each of the three years in the period ended December 30, 1984, 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 1, 1985

CONSOLIDATED STATEMENT OF INCOME

	For the Year Ended		
	December 30, 1984	December 25, 1983	December 26, 1982
Sales	\$62,306,000	\$49,956,000	\$37,704,000
Franchise revenues	761,000	503,000	363,000
	<u>63,067,000</u>	<u>50,459,000</u>	<u>38,067,000</u>
Cost of sales	21,630,000	17,560,000	13,360,000
Salaries, wages and benefits	14,885,000	11,856,000	9,178,000
Other restaurant expenses	12,090,000	9,531,000	7,259,000
	<u>48,605,000</u>	<u>38,947,000</u>	<u>29,797,000</u>
General and administrative expenses	10,731,000	8,556,000	6,827,000
	<u>59,336,000</u>	<u>47,503,000</u>	<u>36,624,000</u>
Income before provision for income taxes	3,731,000	2,956,000	1,443,000
Provision for income taxes—Note 6:			
Currently payable	673,000	603,000	191,000
Deferred	526,000	333,000	205,000
	<u>1,199,000</u>	<u>936,000</u>	<u>396,000</u>
Net income	<u>\$ 2,532,000</u>	<u>\$ 2,020,000</u>	<u>\$ 1,047,000</u>
Earnings per common share—Note 7	<u>\$.93</u>	<u>\$.81</u>	<u>\$.48</u>

See accompanying notes to consolidated financial statements

CONSOLIDATED BALANCE SHEET

	December 30, 1984	December 25, 1983
ASSETS		
Current Assets:		
Cash and short-term cash investments of \$2,723,000 in 1983	\$ 963,000	\$ 2,933,000
Marketable securities	1,278,000	1,016,000
Inventories	637,000	621,000
Prepaid expenses	415,000	307,000
Other	498,000	496,000
Total current assets	3,791,000	5,373,000
Property and Equipment —Notes 2, 3 and 4	29,818,000	21,589,000
Intangibles and Other Assets —Note 5	740,000	603,000
	<u>\$34,349,000</u>	<u>\$27,565,000</u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities:		
Salaries, wages and payroll taxes payable	\$ 1,716,000	\$ 1,547,000
Trade accounts payable	2,059,000	1,296,000
Accrued contingent rents—Note 4	559,000	411,000
Accrued sales tax	420,000	331,000
Current portion of long-term debt and capital leases—Notes 3 and 4	297,000	244,000
Other	674,000	487,000
Total current liabilities	5,725,000	4,316,000
Noncurrent Obligations:		
Long-term debt—Note 3	1,988,000	77,000
Obligations under capital leases—Note 4	5,481,000	4,879,000
	<u>7,469,000</u>	<u>4,956,000</u>
Deferred Franchise Revenue	224,000	221,000
Deferred Federal Income Taxes —Note 6	<u>1,197,000</u>	<u>671,000</u>
Stockholders' Equity —Notes 7 and 8		
Preferred stock, 1,000,000 shares authorized; No shares issued		
Common stock, 10,000,000 shares authorized; 2,719,072 in 1984 and 2,720,619 in 1983 issued and outstanding	10,192,000	10,228,000
Retained earnings	9,542,000	7,173,000
	<u>19,734,000</u>	<u>17,401,000</u>
Commitments—Notes 3, 4 and 10	<u>\$34,349,000</u>	<u>\$27,565,000</u>

See accompanying notes to consolidated financial statements

CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITYFor the Three Years Ended
December 30, 1984

	Common stock		Retained earnings	Total
	Shares issued	Contributed capital		
Balance, December 27, 1981	1,449,240	\$ 4,431,000	\$4,362,000	\$ 8,793,000
Exercise of stock options	319	2,000		2,000
Redemption of common stock	(4,700)	(25,000)		(25,000)
Net income for the year ended December 26, 1982			1,047,000	1,047,000
Dividends (\$.053 per share)			(116,000)	(116,000)
Other		(6,000)		(6,000)
Balance, December 26, 1982	1,444,859	4,402,000	5,293,000	9,695,000
Three for two stock split—Note 7	722,388			
Exercise of stock options	3,372	10,000		10,000
Sale of common stock, net of related expenses	550,000	5,816,000		5,816,000
Net income for the year ended December 25, 1983			2,020,000	2,020,000
Dividends (\$.057 per share)			(140,000)	(140,000)
Balance, December 25, 1983	2,720,619	10,228,000	7,173,000	17,401,000
Exercise of stock options	3,453	11,000		11,000
Redemption of common stock	(5,000)	(47,000)		(47,000)
Net income for the year ended December 30, 1984			2,532,000	2,532,000
Dividends (\$.06 per share)			(163,000)	(163,000)
Balance, December 30, 1984	<u>2,719,072</u>	<u>\$10,192,000</u>	<u>\$9,542,000</u>	<u>\$19,734,000</u>

See accompanying notes to consolidated financial statements

CONSOLIDATED STATEMENT OF CHANGES IN FINANCIAL POSITION

	For the Year Ended		
	December 30, 1984	December 25, 1983	December 26, 1982
Financial resources were provided by:			
Net income	\$ 2,532,000	\$ 2,020,000	\$ 1,047,000
Add (deduct) income charges (credits) not affecting working capital in the period—			
Depreciation and amortization	2,872,000	2,231,000	1,788,000
Deferred income taxes	526,000	374,000	222,000
Loss on disposition of property and equipment	49,000	25,000	8,000
Revenue from initial franchise fees	(146,000)	(40,000)	(80,000)
Working capital provided by operations	5,833,000	4,610,000	2,985,000
Proceeds from long-term debt	1,963,000		
Long-term obligations arising from capitalization of leases	820,000	305,000	145,000
Proceeds from sales of property and equipment	1,092,000	379,000	112,000
Proceeds from public stock offering		5,816,000	
Proceeds from initial franchise fees	149,000	138,000	154,000
Other	23,000	217,000	202,000
Total financial resources provided	9,880,000	11,465,000	3,598,000
Financial resources were used for:			
Additions to property and equipment	11,071,000	7,461,000	5,281,000
Additions to capital leases	885,000	305,000	149,000
Additions to intangibles and other assets	429,000	343,000	189,000
Current maturities under long-term debt and capital lease obligations	233,000	242,000	224,000
Payment of dividends	163,000	139,000	116,000
Redemption of common stock	47,000		25,000
Other	42,000	34,000	170,000
Total financial resources used	12,870,000	8,524,000	6,154,000
Increase (decrease) in working capital	\$ (2,990,000)	\$ 2,941,000	\$ (2,556,000)

See accompanying notes to consolidated financial statements

CONSOLIDATED STATEMENT OF CHANGES IN FINANCIAL POSITION Continued

Analysis of Changes in Components of Working Capital	December 30, 1984	December 25, 1983	December 26, 1982
Increase (decrease) in current assets:			
Cash and short term cash investments	\$(1,970,000)	\$2,348,000	\$(2,387,000)
Marketable securities	262,000	1,016,000	
Inventories	16,000	133,000	54,000
Prepaid expenses	109,000	24,000	64,000
Other	2,000	(50,000)	480,000
	<u>(1,581,000)</u>	<u>3,471,000</u>	<u>(1,789,000)</u>
Increase (decrease) in current liabilities:			
Salaries, wages and payroll taxes payable	169,000	508,000	201,000
Trade accounts payable	763,000	(260,000)	507,000
Accrued contingent rents	148,000	133,000	24,000
Accrued sales tax	89,000	106,000	50,000
Current portion of long-term debt and capital leases	53,000	19,000	17,000
Other	187,000	24,000	(32,000)
	<u>1,409,000</u>	<u>530,000</u>	<u>767,000</u>
	<u>\$(2,990,000)</u>	<u>\$2,941,000</u>	<u>\$(2,556,000)</u>

See accompanying notes to consolidated financial statements

Note 1—Accounting Policies:
PRINCIPLES OF CONSOLIDATION

The consolidated financial statements include the accounts of the company and its wholly owned subsidiaries, and its majority owned limited partnership. Significant intercompany transactions have been eliminated from the consolidated financial statements.

The company operates on a 52 or 53 week fiscal year ending on the Sunday closest to December 31.

SHORT TERM CASH INVESTMENTS AND MARKETABLE SECURITIES

Short-term cash investments and marketable securities are stated at the lower of cost or market. Investment income earned on such instruments was \$410,000, \$345,000 and \$292,000 in 1984, 1983 and 1982, respectively.

INVENTORIES

Inventories consist primarily of food and beverages and are valued at the lower of cost or market. Cost is determined using the first in, first out method.

PROPERTY AND EQUIPMENT

Property and equipment are stated at cost and are depreciated on a straight-line basis over the estimated useful lives of properties and equipment owned by the company or over the terms of leases capitalized (Note 4). Estimated lives are generally 20 to 35 years for buildings and 7 to 10 years for equipment.

Interest costs associated with the acquisition phase of company owned property and equipment are capitalized as a cost of such assets. In 1984 interest costs capitalized amounted to \$99,000. Previously, interest costs eligible for capitalization were not significant and were charged to operations as incurred.

RESTAURANT PREOPENING COSTS

The company amortizes costs incurred in preparation of opening new restaurants on a straight-line basis over a three-year period (Note 5).

FRANCHISE OPERATIONS

The company grants franchise rights for a term of 20 years to private operators in exchange for an initial franchise fee which is deferred from income until preopening obligations are satisfied and restaurants are opened. Royalties based on a percentage of gross sales as well as expenses associated with franchise operations are recognized on the accrual basis.

INCOME TAXES

Deferred income taxes arise primarily from the use of accelerated depreciation methods for income tax purposes and the capitalization of facilities leases and deferral of restaurant preopening costs for financial reporting purposes. Investment tax credits are recognized when the assets are placed in service under the flow-through method of accounting.

EARNINGS PER COMMON SHARE

Primary earnings per common share are calculated using the weighted average number of common shares outstanding during each year. Average shares were 2,722,695, 2,508,043, and 2,174,312 in 1984, 1983 and 1982, respectively. Fully diluted earnings per common share are not materially different from primary earnings per common share (Note 7).

CONTRIBUTED CAPITAL

During 1984 certain changes were made to the Washington Business Corporation Act which included the elimination of the concept of treasury stock and the elimination of the legal effects of "par value" with respect to dividends, redemption of stock and payments for stock. All information presented in these financial statements has been restated to reflect such changes in Washington State law.

Note 2—Property and Equipment:

The company had property and equipment as follows:

	December 30, 1984	December 25, 1983
Buildings and leasehold improvements	\$13,024,000	\$ 9,223,000
Equipment	16,464,000	12,969,000
	29,488,000	22,192,000
Less-Accumulated depreciation and amortization	(8,887,000)	(7,356,000)
	20,601,000	14,836,000
Land	4,556,000	2,607,000
	25,157,000	17,443,000
Leased property under capital leases:		
Buildings and leasehold improvements	7,178,000	6,293,000
Equipment	155,000	213,000
	7,333,000	6,506,000
Less-Accumulated amortization	(2,813,000)	(2,501,000)
	4,520,000	4,005,000
Real estate held for sale	141,000	141,000
	\$29,818,000	\$21,589,000

Note 3—Long-Term Debt:

Long-term debt consists of the following:

	<u>December 30, 1984</u>	<u>December 25, 1983</u>
Payable to bank under revolving credit and term loan agreement	\$1,439,000	\$ 0
Contracts associated with purchase of equipment payable in monthly installments at interest rates ranging from 11 to 13% through August, 1994, collateralized by equipment with a net book value of \$57,000	503,000	0
Mortgages payable to bank in monthly installments at interest rates of 9 and 10% through 1995.	77,000	94,000
	2,019,000	94,000
Current maturities	(31,000)	(17,000)
	<u>\$1,988,000</u>	<u>\$ 77,000</u>

In 1984 the company entered into a bank loan agreement. The loan is unsecured and bears interest at the prime lending rate which at December 30, 1984 was 10.75%. Under the terms of that agreement, the company can borrow on a revolving line of credit basis up to \$5,000,000 until July 1, 1985 at which time the facility increases to \$10,000,000. The line shall terminate between June 30, 1987 and 1989, depending on certain conditions. On the termination date the company can convert the then outstanding principal balance of the line to a term loan payable over a five year period. The agreement contains restrictive covenants relating to net worth, debt-to-worth ratio, debt-service ratio and the level of dividends. For purposes of the following schedule of annual principal payments, it has been assumed that the balance currently outstanding will be converted to a term loan at the earliest of the termination dates.

Annual principal payments required on long-term debt are as follows:

<u>Fiscal Year</u>	
1985	\$ 31,000
1986	145,000
1987	219,000
1988	330,000
1989	273,000
Thereafter	1,021,000
	<u>\$2,019,000</u>

In addition the company has issued standby letters of credit in the amount of \$505,000 in connection with worker's compensation insurance policies.

Note 4—Leases:

The company leases a majority of its restaurant facilities and its administrative offices. Certain leases require the company to pay property taxes and insurance and others require additional rental payments contingent upon sales exceeding specified amounts. The leases are generally for 20-year periods and frequently provide options to renew for 5-to-10 year periods.

Total minimum commitments under noncancelable leases in force at December 30, 1984 are as follows:

<u>Fiscal Year</u>	<u>Capital Leases</u>	<u>Operating Leases</u>	<u>Total</u>
1985	\$ 840,000	\$ 1,496,000	\$ 2,336,000
1986	840,000	1,501,000	2,341,000
1987	841,000	1,513,000	2,354,000
1988	843,000	1,519,000	2,362,000
1989	843,000	1,527,000	2,370,000
Thereafter	6,398,000	18,044,000	24,442,000
Total minimum lease commitments	10,605,000	<u>\$25,600,000</u>	<u>\$36,205,000</u>
Less—Amounts representing implicit interest	(4,858,000)		
Present value of net minimum lease commitments	5,747,000		
Less—Current portion	<u>(266,000)</u>		
	<u>\$ 5,481,000</u>		

Total rent expense under operating leases was \$2,062,000, \$1,582,000, and \$1,219,000 during 1984, 1983 and 1982, respectively, which included contingent rent expense of \$571,000, \$421,000 and \$283,000, respectively.

Total interest costs incurred, which primarily relate to capital leases, were \$624,000, \$546,000, and \$509,000 during 1984, 1983 and 1982, respectively.

Note 5—Intangibles and Other Assets:

Intangibles and other assets are as follows:

	<u>December 30, 1984</u>	<u>December 25, 1983</u>
Restaurant preopening costs	\$962,000	\$533,000
Trademark and goodwill	209,000	209,000
Other	83,000	171,000
	1,254,000	913,000
Less—Accumulated amortization	(514,000)	(310,000)
	<u>\$740,000</u>	<u>\$603,000</u>

Note 6—Income Taxes:

The company files consolidated federal and state income tax returns. The difference between the total "expected" income tax rate of 46% and the actual tax rates is as follows:

	1984	1983	1982
Federal income tax rate	46.0%	46.0%	46.0%
Investment and other tax credits	(15.1)	(13.6)	(18.8)
State income taxes, net of federal tax benefit	1.3	1.3	1.3
Other, net	(.1)	(2.0)	(1.0)
Provision for income taxes	<u>32.1%</u>	<u>31.7%</u>	<u>27.5%</u>

Investment tax credits were \$520,000, \$372,000 and \$247,000 in 1984, 1983 and 1982, respectively.

Deferred tax expense was attributable to the following:

	1984	1983	1982
Excess tax depreciation	\$508,000	\$348,000	\$157,000
Capitalized leases	(60,000)	(60,000)	(61,000)
Restaurant preopening costs	94,000	113,000	88,000
Other	(16,000)	(68,000)	21,000
	<u>\$526,000</u>	<u>\$333,000</u>	<u>\$205,000</u>

Note 7—Capital Stock Transactions:

On March 29, 1983, the company declared a three-for-two stock split in the form of a 50% stock dividend paid on May 5, 1983. All references in the financial statements and other notes to the average number of shares of common stock, number of options and warrants outstanding and related prices, dividends and earnings per share amounts have been restated to give effect to this stock split.

Note 8—Stock Options and Warrants:

Under a nonqualified stock option plan adopted in 1977, options to purchase a total of 20,000 shares of the company's common stock may be granted to employees at prices not less than the fair market value (as determined by the Board of Directors) of the stock at date of grant. The plan terminates on June 30, 1987 but may be terminated sooner by the Board of Directors without affecting options then outstanding. Options become exercisable in five equal annual installments commencing one year from the date of grant and expire ten years from the option date. At December 30, 1984, 940 options were available for future grants. No options were granted during 1984. At December 30, 1984, there were outstanding options under the nonqualified plan to purchase 6,406 shares at prices ranging from \$3.00 to \$3.50. During 1984, 1983 and 1982, 3,453, 3,372, and 479 options, respectively, were exercised.

During 1984, the Board of Directors approved an employee incentive stock option plan under which 135,000 shares of common stock were made available for grant to employees. The option price is the closing bid price of the company's stock on the day preceding the grant. On March 16, 1984, 69,080 shares were granted under this plan at an option price of \$9.75 per share. On December 7, 1984, 30,550 shares were granted at an option price of \$10.00 per share. Options become exercisable in three annual installments commencing one year from the date of grant and expire ten years from date of grant. Grants of 200 or less options may be exercised in total one year from date of grant. At December 30, 1984, 36,970 options were available for future grants.

In addition, during 1984 the Board of Directors approved an employee stock purchase plan under which 80,000 shares of common stock were made available for periodic purchase by employees. Funding for purchases under this plan are effected by payroll withholding or through lump-sum payments. The employee must specify the amount of their purchases prior to the commencement of the relevant investment period (which periods are July 1 to January 1 and January 2 to June 30). Such amounts are then held by the company until the end of the investment period. The company issues shares under this plan at a price of 95% of the lower of the closing bid price at the first or last day in the investment period. At December 30, 1984 approximately \$21,000 had been collected from employees and on January 2, 1985 2,235 shares of stock were issued.

In connection with the company's initial public stock offering in 1981, warrants to purchase 66,450 shares of common stock were issued to the underwriter of such offering at an exercise price of \$8.88 per share. No warrants have been exercised and they expire May 27, 1986.

Note 9—Related Party Transactions:

The company leases its administrative offices in a building in which a stockholder has an ownership interest. Additionally, the company leases five of its restaurants from stockholders and two are with a company with which Skipper's has common stockholders. The remaining terms of these eight leases range from 7 to 14 years and will continue to require minimum annual payments of approximately \$383,000.

A director of the company also serves on the Board of Directors of a computer services company which provides services, hardware and software to the company in the amount of approximately \$367,000, \$77,000 and \$112,000 in 1984, 1983 and 1982, respectively.

Note 10—Financing Transactions Subsequent to December 30, 1984:

Subsequent to December 30, 1984 the company entered into an agreement with a limited partnership formed for the purpose of entering into sale and leaseback transactions involving currently owned and operating company restaurants. The agreement contemplates the sale of five restaurants at an aggregate price of approximately \$2,950,00. The restaurants will be leased back over 20 years with the company having three-five year rental option periods.

OFFICERS

Douglas C. Bamford

Vice President Marketing

Rodger A. Duncan

Vice President Operations

Chris R. LeSourd

Executive Vice President

Carol L. Nolan

Vice President Controller

Herbert I. Rosen

Chairman/Board of Directors

M. Eugene Stone

President/Chief Executive Officer

Jay W. Switzer

Vice President Finance

Secretary/Treasurer

DIRECTORS

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Executive Vice President

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Richard W. Hubbard

Vice President/Treasurer

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President/Chief Operating Officer

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President

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Vice President

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Seattle, Washington 98154

William M. Weisfield

President/CEO

Northwest Building Corporation

1400 Norton Building

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Larry Wells

Senior Vice President

Winmar, Inc.

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Seattle, Washington 98111

Herbert I. Rosen

Chairman of the Board

Skipper's, Inc.

M. Eugene Stone

President/Chief Executive Officer

Skipper's, Inc.

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Independent Accountants

Price Waterhouse

The Financial Center

Seattle, Washington 98161

Transfer Agent

Seattle-First National Bank

1001 4th Avenue

Seattle, Washington 98154

Annual Meeting

The 1985 annual meeting of stockholders will be held on Friday,

May 10, 1985 at 2:00 p.m. at the

First Interstate Bank Center,

999 Third Avenue, 6th Floor,

Seattle, Washington 98104.

For a copy of the Skipper's, Inc.

Annual Report on Form 10-K write:

Jay W. Switzer

Vice President Finance

Secretary/Treasurer

Skipper's, Inc.

14450 N.E. 29th Place

Suite 200

Bellevue, Washington 98007

A copy will be provided at no charge.

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