

# Palmer G. Lewis Co., Inc.

1977  
Annual Report

...another year  
of substantial  
growth in  
building material  
distribution

ANNUAL REPORTS  
Palmer G. Lewis Co., Inc. 1977

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Lewis (Palmer G.) Co.

1977 Sales

76,200,000

1976 Sales

61,500,000

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## Product Lines

### Doors

Clopay Folding Doors  
Wood Bifold Doors  
Space-Saver Folding Doors

### Floorcovering

(Pacific Yard Service Division)  
Adhesives  
Flintkote Floor Tile  
High Pressure Laminates

### Hardware

(Pacific Yard Service Division)  
General Hardware  
Locks  
Tools - Hand and Power

### Insulation Board

Asphalt Impregnated Sheathing  
Ceiling Grid Systems  
Ceiling Tile and Board Products  
Fiberglass Ceilings

### Lumber

Common Dimension Lumber  
1" Boards  
Decking  
Studs

### Mortise

Adhesive and Accessories  
Board, Plank, Block  
Metal Mouldings

### Nails and Metal Products

Aluminum and Galvanized Sheets  
Canadian Nails  
Domestic Nails  
Fence Posts and Barbed Wire  
Import and Parkhead Nails  
Poultry Netting  
Rebar  
Simpson Strong-Tie Connectors  
Stronghold, Heliyx and other Specialty Nails  
Wire Mesh and Hardware Cloth

### Plasterboard

Board Items including Gypsum Sheathing  
Metal Trim and Metal Studs  
Plasterboard Accessories  
Sound Deadening Board

### Plywood

Fir Sanded Graded  
Marine Plywood  
Particle Board  
Plywood Sidings  
Shear Plywood

### Prefinished Wood Panels and Accessories

Prefinished Panels  
Prefinished Vinyl Mouldings  
Prefinished Wood Mouldings

### Rigid Insulation

Fiberglass Roof Insulation  
Insulfoam  
Mineral and Urethane Roof Insulation

### Roofing

Aluminum Sheets and Accessories  
Asphalt Shingle Products  
Building Papers  
Fiberglass  
Gutter Systems  
Roof Coatings

### Soft Insulation

Aerocor Household Insulation  
Certafoam  
Johns Manville  
Owens Corning

### Specialty Building Products

Adhesives  
Colotrim  
Cork  
Fiberglass Panels  
K-Lux  
Metalbestos Chimney Systems  
Olympic Stain  
Polyethylene Film  
Shelving  
Z-Brick

### Wallboards

Canfor Hardboard  
Cement Asbestos Board  
Domestic Hardboard

### Wood Mouldings, Jambs, Frames

Hemlock  
Mahogany  
Pine

### Wood Shakes, Shingles and Specialty Items

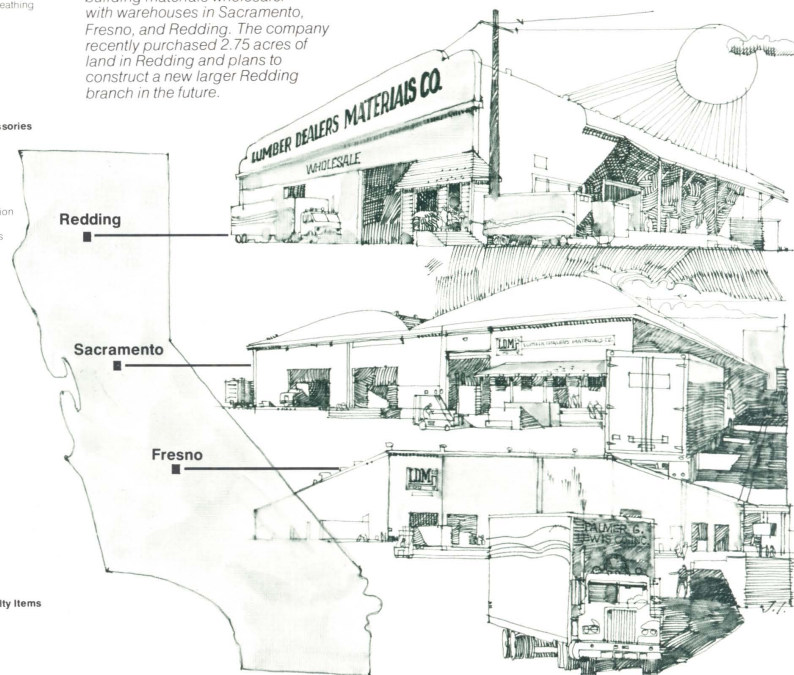
Cedar Closet Lining  
Cedar Paneling  
Hardwood Dowels  
Shim Shingles and Undercourse  
Wood Lath  
Wood Shakes and Shingles  
Wood Storage Buildings  
Wood Strip

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### Lumber Dealers Materials Co. - New Palmer G. Lewis Co., Inc. Acquisition in Northern California

In an exchange of stock in November of 1977, PGL acquired 'LDM' a California building materials wholesaler with warehouses in Sacramento, Fresno, and Redding. The company recently purchased 2.75 acres of land in Redding and plans to construct a new larger Redding branch in the future.



## Palmer G. Lewis Co., Inc. 1977 Annual Report

The Palmer G. Lewis Company is a distributor of a wide range of building materials—servicing primarily the retail building material dealers, the large retail general merchandise chains, roofing and drywall companies, and certain approved industrial and government accounts. The Company serves the area from Central California to Alaska through ten Palmer G. Lewis Branches in Washington and Alaska, three Pacific Yard Service Branches in Oregon, and three Lumber Dealers Materials Co. Branches in California. In addition, the Company owns 70% of Superior Building Supply, Inc., which services the Kenai Peninsula in Alaska with three retail outlets.

With the proper combination of warehousing, trucking and an outstanding marketing team, the Company offers its many customers a single wholesale source of building materials, while providing its many suppliers a major single outlet for their products.

## Financial Highlights\*

Years Ended	Jan. 27, 1978	Jan. 28, 1977	% Change
Net Sales .....	<b>\$76,159,358</b>	\$61,524,571	+24
Income Before Income Taxes .....	<b>\$ 2,545,841</b>	\$ 1,937,991	+31
Income Taxes .....	<b>\$ 1,138,000</b>	\$ 910,000	+25
Net Income .....	<b>\$ 1,407,841</b>	\$ 1,027,991	+37
Per Share .....	<b>\$ 1.60</b>	\$ 1.18	+36
Stock Dividends .....	<b>4%</b>	4%	—
Total Assets .....	<b>\$25,399,635</b>	\$19,128,075	+33
Average Shares Outstanding .....	<b>881,970</b>	869,042	+ 1
Stockholders' Investment .....	<b>\$ 7,230,642</b>	\$ 5,850,748	+24

\*Restated to reflect LDM acquisition accounted for as "pooling of interests," capitalization of leases, the 2-for-1 stock split in June 1976 and the 4% stock dividends paid in October 1977 and October 1976.

The Company's common stock is traded on the Northwest over-the-counter market. The high and low stock quotations, for each fiscal quarter of 1977 and 1976 adjusted for the 2-for-1 stock split in June 1976, the 4% stock dividends in October 1977 and October 1976 were as shown below:

	Bid		Ask		Cash Dividends Per Share
	High	Low	High	Low	
1976					
1st Quarter .....	\$ 7.60	\$ 5.41	\$ 8.06	\$ 5.88	\$ .025
2nd Quarter .....	7.60	7.37	8.06	7.83	.030
3rd Quarter .....	7.68	7.20	8.16	7.68	.030
4th Quarter .....	9.12	7.44	9.60	7.92	.030
1977					
1st Quarter .....	\$11.52	\$ 9.12	\$12.48	\$ 9.60	\$ .040
2nd Quarter .....	12.48	10.56	13.92	11.52	.040
3rd Quarter .....	12.25	10.32	13.25	11.28	.040
4th Quarter .....	12.50	11.50	13.50	12.50	.050

## Message to PGL Stockholders

We're proud to report that PGL Company continues to grow in a consistent and dependable manner. Each year tends to establish new higher levels in both sales and earnings, and 1977 certainly followed this growth pattern. It was our 7th consecutive record year with sales increasing by 24%, reaching a level of \$76.2 million. Earnings rose 36% to \$1,408,000, which was \$1.60 per share.

Through the years, we have managed your Company with four basic long term objectives. Here's a very brief summary of how we're doing on these four objectives:

**1. Keep growing. Strive for a long term annual growth rate of 15% in both sales and earnings. This will double our business every five years.** Over the past 30 years, our growth rate has been about 16-17%. During the last 10-year period, we've had an average growth rate of 18% in sales and 20% in earnings per share. During the most recent years (starting with '71), our growth has accelerated even more.

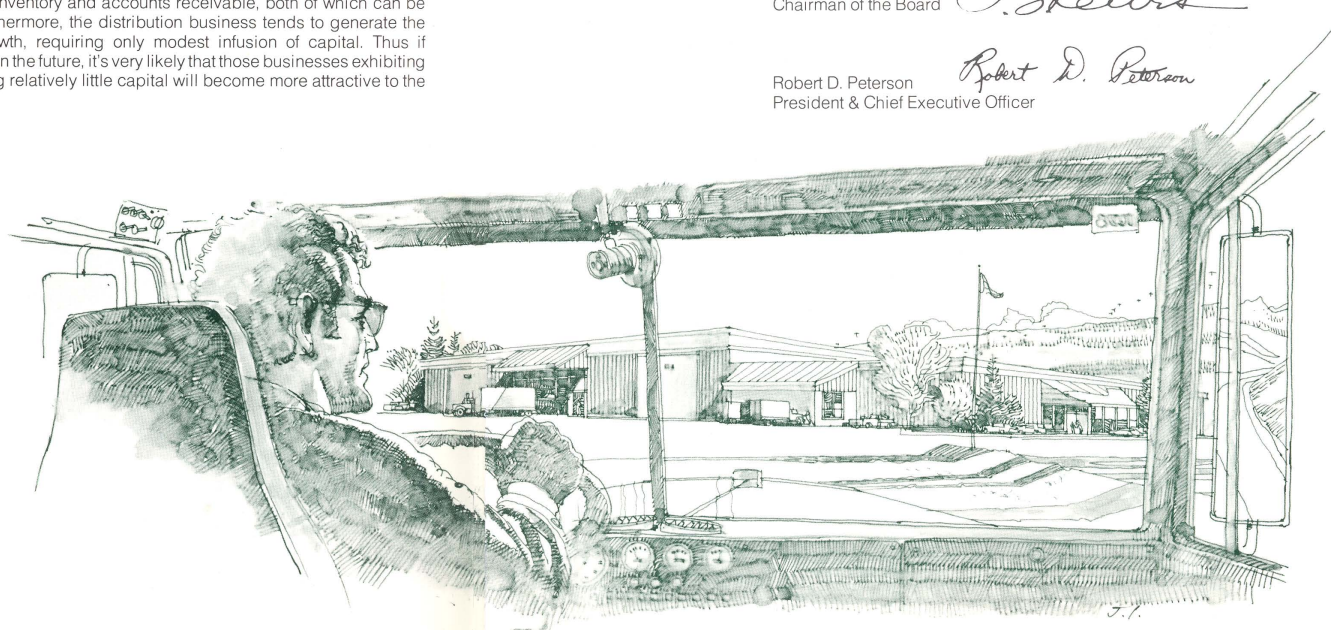
**2. Keep striving to achieve a 15% return, or better, on investment (ROI).** PGL's return on investment has been climbing in our most recent years. For example, it was 19.0% in '75, 21.1% in '76, and it reached 24.1% in '77. There isn't any doubt, however, that inflation has helped boost our earnings during the last few years.

**3. Keep the Company solvent, virile, and aggressive in order to provide dependable results, now and in the future, for both our employees and our stockholders.** You may be sure that Company management is well aware of their fiscal responsibility and also their motivational responsibility to our employees. We're tuned to the basic belief that "people make this company go"—and we don't intend to forget it.

**4. Do our best, by our record, to earn a reasonable PE (price earnings) ratio for our PGL stock.** We're really trying, and it's our hope that the investment community will better appreciate the value of our Company as time goes by. We think that this will happen.

You've often heard us say that "the distribution business is a good sound business." And it certainly is, as our own record indicates. One of its big advantages is that it has a proven profit potential—with relatively low capital requirements, as compared to a manufacturing enterprise. Basically, its capital is concentrated in inventory and accounts receivable, both of which can be converted into cash in 60-90 days. Furthermore, the distribution business tends to generate the money needed to sustain its own growth, requiring only modest infusion of capital. Thus if competition for capital becomes intense in the future, it's very likely that those businesses exhibiting a high return on investment and requiring relatively little capital will become more attractive to the investment community.

**New Superior Building Supply, Inc.  
Soldotna Alaska Warehouse**  
\$850,000 wood frame structure contains 7,200 sq. ft. retail sales area with 16,900 sq. ft. of covered warehouse on 5¼ acre site. PGL Co. owns 70% of SUPERIOR BUILDING SUPPLY, INC. The new store will open in Spring '78.



We are confident that your Company will continue to grow in a steady, consistent pattern, and we are making the necessary capital investments to handle the growth. Here are some examples of recent expansion programs. You'll notice that they are graphically illustrated throughout this report.

1. Our acquisition of Lumber Dealers Materials Co. (LDM) in California marked a new milestone. We believe that the importance of getting a position in central and northern California will be quite evident in the future. The sales potential is very large.

2. Construction is now underway on a new 85,000 sq. ft. warehouse and office building in Tigard, Oregon, just a few miles south of Portland. PYS will consolidate the old Tigard and Portland branches into this beautiful new facility. It should be opening about September 1.

3. Our new Yakima warehouse opened last November, and sales are excellent. In addition, Bremerton and Auburn have completed construction of enlarged outside storage areas, together with a new truck marshalling area for the Distribution Center in Auburn. We also anticipate that construction will soon start on a new 51,000 sq. ft. addition to the Auburn Distribution Center to be completed by August.

4. In Alaska, Superior Building Supply has just opened their large new retail store on a 5.7 acre plot in Soldotna, which is one of the fastest-growing communities in Alaska. We expect Superior sales and profits to grow right with it.

All of these substantial investments, together with so many more made in recent years, have now positioned PGL to take full advantage of their opportunities. In addition, our requirements for capital expenditures should be more modest in the immediate years ahead.

In conclusion, we'd like to call your attention to some interesting observations in the Financial Review on the next page. The figures make pretty good reading. We also want you to know that your Company is off to a wonderful start in February and March. Our business is extremely strong and we're also happy to report that it is broad-based, extending all the way from central California to Alaska. At this point, it certainly appears that 1978 will be another good year for PGL.

Palmer G. Lewis  
Chairman of the Board

Robert D. Peterson  
President & Chief Executive Officer



## Financial Review

### Net Sales

1977 sales rose to \$76.2 million—a 24% increase over the previous year. Sales growth has been especially consistent during the past two decades. During the last ten years alone, sales increased by more than 500%.

### Net Income

1977 profits amounted to \$1,407,841—a 37% increase over the year ago figure. Earnings per share amounted to \$1.60, which was 36% more than the previous year.

Growth in PGL earnings has been even faster than our sales growth. For example, during the most recent ten year period, our annual compound growth rate in earnings per share has been 20%, compared to 18% in sales.

Net income, as a % of sales, has risen to 1.85%—an all-time high. Our long term goal is still 2.0%, and we still intend to get there.

Our return on stockholders' investment (ROI) has also set a new high—24.1%. Our long term goal is to average 15% or better.

### Cash Flow

Cash flow (net income + non-cash items, primarily depreciation) increased to \$2,153,328 in '77. Depreciation amounted to \$678,610 in 1977, reflecting amortization of continued investments in fixed assets which better position PGL to handle a constantly growing volume of business.

### Dividends

1977 was the 15th consecutive year in which PGL paid cash dividends. Prior to 1968, they were paid annually. Starting with the 3rd quarter of 1968, dividends have been paid quarterly for 38 consecutive quarters. The current annual rate is 20c (5c per quarter). In addition to cash dividends, the company has paid an annual 4% stock dividend since 1968.

During these past 15 years, PGL has never lowered a dividend nor have they missed a dividend payment.

### Net Worth (Stockholders' Investment)

Totaled \$7,230,642 at the end of our last fiscal year which represented an increase of more than 24% over last year. Dividing this net worth (book value) figure of \$7,230,642 by the number of PGL shares outstanding at year end gives a current book value figure of \$8.15 per share.

PGL owns all of their trucks, forklifts, warehouse and office equipment, computer, and a majority of their buildings and property. We estimate that the current market value of these fixed assets, in excess of book value, amounts to approximately \$3.50 per share.

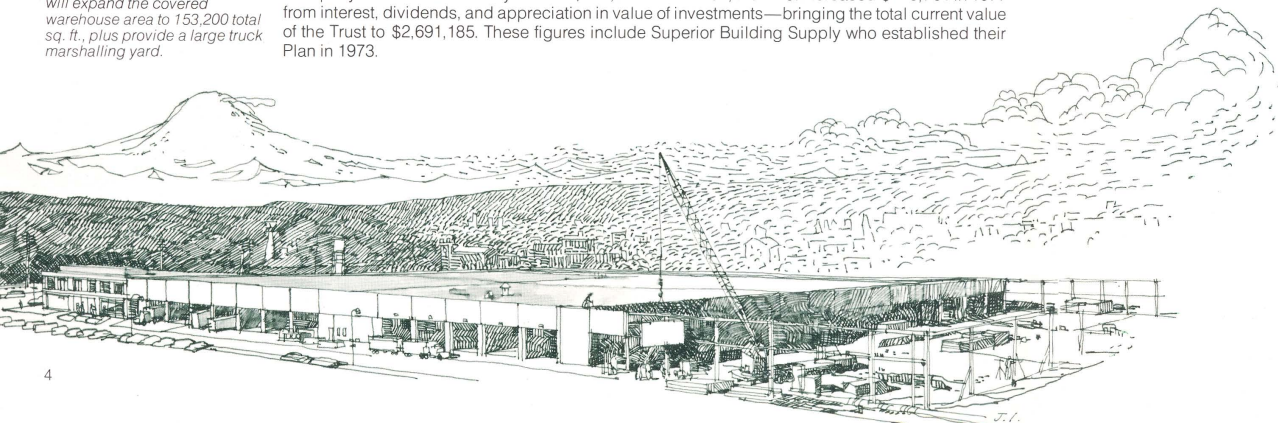
### Profit Sharing Trust

There is absolutely no question that our greatest asset is the spirit of our career employees. In the long run, it is this quality that really determines the future of any company. Our PGL Profit Sharing Plan is our strongest tool in attracting and holding the large number of ambitious employees that every solid company needs.

It's always a pleasure to report that our Profit Sharing Plan also had a great year. The total Company contribution for last year was \$477,605. In addition, the Trust increased \$118,761 in 1977 from interest, dividends, and appreciation in value of investments—bringing the total current value of the Trust to \$2,691,185. These figures include Superior Building Supply who established their Plan in 1973.

### New Addition to Palmer G. Lewis Co., Inc. Auburn, WA Distribution Center

Completion of the 51,200 sq. ft. addition is expected to take place in late Summer 1978 and will expand the covered warehouse area to 153,200 total sq. ft., plus provide a large truck marshalling yard.



We always like to point out that the total PGL net worth in 1958 (the year we started the Profit Sharing Plan) was only \$268,000. The growth of **both** PGL and the Profit Sharing Trust is excellent testimony to our free enterprise system and also proof that the concept of sharing profits really pays off for all concerned.

### Comments on the Future

At the beginning of this decade, we commented in our Annual Report that we thought 1970 marked the low point in our industry—and we expressed confidence that the next 10 years would present even greater growth opportunities than the past. These were prophetic words—when you consider that '77 PGL sales were 4.1 times more than in '70 and '77 PGL profits were 6.2 times more than '70.

Can we keep it up? We think we can—for the same basic reasons so often expressed in our messages to stockholders.

1. The distribution business is a good sound business, and it's growing everywhere.
  2. We're doing business in the right area—from Central California to Alaska.
  3. The need for building materials is a basic need. Growth in the remodeling and do-it-yourself area is impressive, and PGL continues to place added emphasis in this area.
  4. PGL is strongly people-oriented. About 85% of our employees are part-owners of their company. When the chips are down, they try just a little harder.
- We're looking for another good year in 1978 and will do our best to make it happen.

## Five Year Review (1)

Years Ended	Jan. 27, 1978	Jan. 28, 1977	Jan. 30, 1976	Jan. 31, 1975	Jan. 25, 1974
Net Sales	76,159,358	61,524,571	51,801,100	45,124,441	33,755,892
Cost of Sales	60,627,055	48,893,901	41,411,908	35,563,399	26,926,894
Other Operating Expenses	11,327,785	9,326,904	7,786,792	7,036,566	5,207,974
Interest Expense	980,067	809,966	723,888	713,536	481,759
Depreciation	678,610	555,809	459,107	399,949	310,752
Income before Taxes	2,545,841	1,937,991	1,419,405	1,410,991	828,513
Income Taxes	1,138,000	910,000	632,700	687,000	353,661
Net Income	1,407,841	1,027,991	786,705	723,991	474,852
Net Income:					
Per Common Share	1.60	1.18	.91	.85	.56
As % of Sales	1.85%	1.67%	1.52%	1.60%	1.41%
As a % of Stockholders' Investment (2)	24.1%	21.1%	19.0%	20.9%	15.6%
Average Shares Outstanding					
Used to Compute Net Income					
Per Share (3)	881,970	869,042	860,158	853,291	842,622
Dividends per Common					
Share Cash (4)	.16	.11	.09	.08	.07
Stock	4%	4%	4%	4%	4%
Shares Outstanding at Year					
End Used to Compute					
Dividends Per Share (3)	894,469	876,649	867,158	858,714	850,045
Cash flow (net income + non-cash items)	2,152,328	1,717,837	1,250,348	1,147,630	796,018
Capital expenditures, net of retirements	2,938,888	1,954,757	1,323,502	783,246	560,211
Working Capital	4,721,872	4,762,329	2,918,808	3,129,339	2,504,253
Stockholders' Investment	7,230,642	5,850,748	4,872,361	4,138,925	3,460,513
Total Assets	25,399,635	19,128,075	16,257,027	14,502,813	12,309,317
Profit Sharing Trust Value (Includes current year's contribution)	2,691,185	2,166,835	1,516,385	1,125,257	950,822
Number of Employees	358	301	275	263	230

(1) Restated to reflect LDM acquisition accounted for as "pooling of interests" and capitalization of leases.

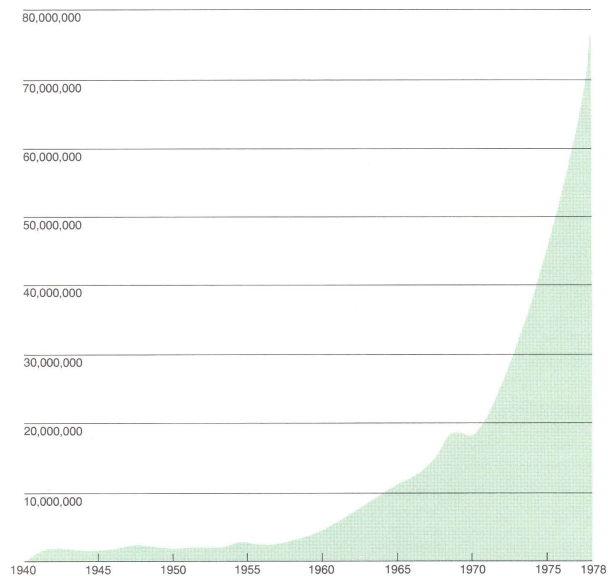
(2) Based on Stockholders' Investment at the beginning of the year.

(3) Adjustments have been made to reflect the 2-for-1 stock split in June 1976 and for stock dividends in October, 1977, October, 1976, October, 1975, September, 1974 and November, 1973.

(4) Excludes consideration of dividends paid by LDM.

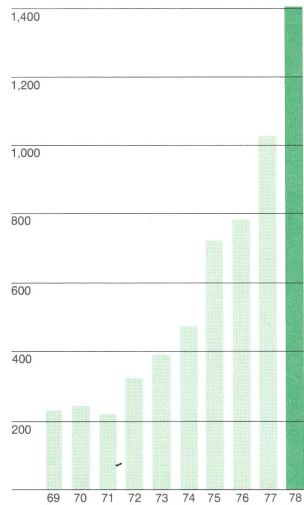


## PGL Sales Continue to Grow

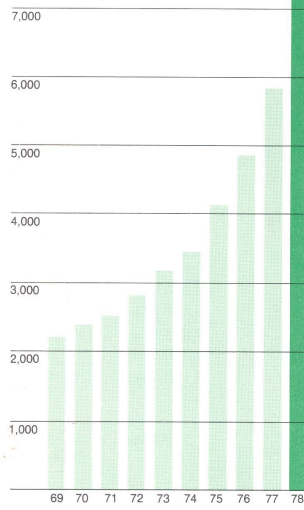


## PGL Ten Years of Growth

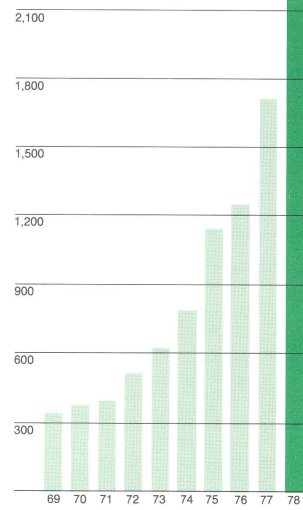
**Net Income**  
\$ in thousands



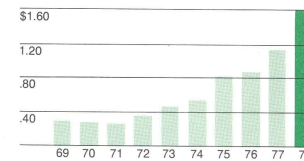
**Net Worth**  
\$ in thousands



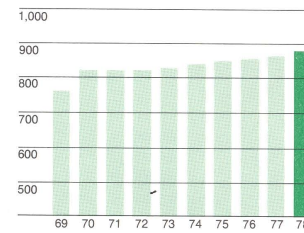
**Cash Flow**  
\$ in thousands



**Net Income Per Share**



**Average Number of Shares Outstanding**  
Per thousand shares



## New Pacific Yard Service Distribution Center Planned for Tigard, Ore. To Open in August of 1978

The new warehouse, situated on a 7.6 acre site on the outskirts of Portland contains 84,160 sq. ft., with two floors of office space. This large facility will combine the inventories and operations of the present Portland and Tigard warehouses.





**Consolidated Balance Sheets**

January 27, 1978 and January 28, 1977

<b>ASSETS</b>	<b>1978</b>	<b>1977</b>
		(Note 1)
<b>CURRENT ASSETS:</b>		
Cash .....	\$ 306,042	\$ 257,815
Receivables, less allowance for doubtful accounts of \$403,000 in 1978 and \$286,000 in 1977 .....	6,972,580	5,410,140
Inventories (Note 1) .....	8,492,493	6,090,160
Prepaid expenses .....	93,050	158,947
Total current assets .....	<u>15,864,165</u>	<u>11,917,062</u>
<b>LAND, BUILDINGS AND EQUIPMENT, at cost</b> (Notes 1 and 2):		
Land and land improvements .....	1,355,117	834,614
Buildings .....	3,254,776	2,896,534
Leased property under capital leases .....	2,007,000	2,007,000
Equipment .....	3,497,393	2,816,360
Furniture and fixtures .....	572,651	507,206
	<u>10,686,937</u>	<u>9,061,714</u>
Less-accumulated depreciation and amortization .....	<u>2,830,858</u>	<u>2,197,260</u>
	7,856,079	6,864,454
Construction in progress .....	<u>1,320,630</u>	<u>50,977</u>
	<u>9,176,709</u>	<u>6,915,431</u>
<b>OTHER ASSETS:</b>		
Unamortized cost in excess of acquired tangible net assets (Note 1) .....	108,766	106,250
Notes receivable, net of current portion of \$22,000 in 1978 and \$38,000 in 1977 included in receivables above .....	72,752	80,257
Other .....	<u>177,243</u>	<u>109,075</u>
	<u>358,761</u>	<u>295,582</u>
	<u>\$25,399,635</u>	<u>\$19,128,075</u>

<b>LIABILITIES AND STOCKHOLDERS' INVESTMENT</b>	<b>1978</b>	<b>1977</b>
		(Note 1)
<b>CURRENT LIABILITIES:</b>		
8.5% notes payable to banks (Note 3) .....	\$ 3,982,500	\$ 1,862,000
Current portion of long-term debt .....	272,000	244,000
Accounts payable .....	4,854,774	3,477,667
Accrued liabilities .....	1,683,394	1,287,733
Income taxes payable .....	349,625	283,333
Total current liabilities .....	<u>11,142,293</u>	<u>7,154,733</u>
<b>LONG-TERM DEBT, net of current portion</b> shown above (Note 2) .....	<u>6,585,381</u>	<u>5,747,152</u>
<b>DEFERRED CREDITS:</b>		
Deferred income taxes payable (Note 1) .....	134,000	125,000
Deferred income on sale of real property .....	31,453	45,462
	<u>165,453</u>	<u>170,462</u>
<b>OPERATING LEASES (Note 4)</b>	<u>—</u>	<u>—</u>
<b>MINORITY INTEREST IN SUBSIDIARIES</b>	<u>275,866</u>	<u>204,980</u>
<b>STOCKHOLDERS' INVESTMENT (Notes 1 and 5):</b>		
Common stock, par value \$1.00, authorized 2,000,000 shares; outstanding 894,469 shares in 1978 and 846,467 shares in 1977 .....	894,469	846,467
Paid-in capital .....	2,318,059	1,862,686
Retained earnings .....	4,032,317	3,148,475
	<u>7,244,845</u>	<u>5,857,628</u>
Less - treasury stock, 1,149 shares in 1978 and 860 shares in 1977, at cost .....	(14,203)	(6,880)
	<u>7,230,642</u>	<u>5,850,748</u>
	<u>\$25,399,635</u>	<u>\$19,128,075</u>

The accompanying notes are an integral part of these balance sheets.



## Consolidated Statements of Income

For the years ended January 27, 1978 and January 28, 1977

	1978	1977
		(Note 1)
NET SALES .....	<b>\$76,159,358</b>	\$61,524,571
COSTS AND EXPENSES:		
Cost of goods sold .....	<b>60,627,055</b>	48,893,901
Selling and handling expenses .....	<b>5,732,953</b>	4,901,483
General and administrative expenses .....	<b>5,303,532</b>	4,117,705
Interest .....	<b>980,067</b>	809,966
Depreciation and amortization (Note 1) .....	<b>678,610</b>	555,809
Employees' profit sharing plans .....	<b>495,031</b>	405,087
Minority interest in net income of subsidiaries .....	<b>70,886</b>	46,811
	<b>73,888,134</b>	59,730,762
Income from operations .....	<b>2,271,224</b>	1,793,809
OTHER INCOME, principally from interest and sale of assets ..	<b>274,617</b>	144,182
Income before provision for income taxes .....	<b>2,545,841</b>	1,937,991
PROVISION FOR INCOME TAXES (Note 1) .....	<b>1,138,000</b>	910,000
INCOME BEFORE CUMULATIVE EFFECT OF A CHANGE IN ACCOUNTING PRINCIPLE .....	<b>1,407,841</b>	1,027,991
CUMULATIVE EFFECT ON PRIOR YEARS (TO JANUARY 30, 1976) OF CHANGE IN ACCOUNTING FOR CERTAIN LEASES (NOTE 2) .....	—	(59,614)
NET INCOME .....	<b>\$ 1,407,841</b>	\$ 968,377
NET INCOME PER SHARE (Note 1):		
Income before cumulative effect of a change in accounting principle .....	<b>\$1.60</b>	\$1.18
Cumulative effect on prior years of change .....	—	(.07)
Net income .....	<b>\$1.60</b>	\$1.11

The accompanying notes are an integral part of these statements.



# **Consolidated Statements of Stockholders' Investment**

For the years ended January 27, 1978 and January 28, 1977

	Common stock		Paid-in capital	Retained earnings	Treasury stock	
	Shares	Amount			Shares	Amount
BALANCE, JANUARY 30, 1976, AS PREVIOUSLY REPORTED . . . . .	720,504	\$720,504	\$1,444,192	\$2,275,689	—	\$ —
Lumber Dealers Materials Co. Inc. acquisition accounted for as "pooling of interests" (Note 1) . . . . .	88,000	88,000	176,210	228,001	—	—
BALANCE, JANUARY 30, 1976, AS RESTATED . . . . .	808,504	808,504	1,620,402	2,503,690	—	—
Sale of common stock (Note 5) . . . . .	9,491	9,491	35,862	—	(5,140)	(42,903)
Purchase of treasury stock . . . . .	—	—	—	—	6,000	49,783
Common stock dividend . . . . .	28,472	28,472	206,422	(234,894)	—	—
Cash dividends . . . . .	—	—	—	(88,698)	—	—
Net income . . . . .	—	—	—	968,377	—	—
BALANCE, JANUARY 28, 1977 . . . . .	846,467	846,467	1,862,686	3,148,475	860	6,880
Sale of common stock (Note 5) . . . . .	17,820	17,820	102,804	—	(3,011)	(33,127)
Purchase of treasury stock . . . . .	—	—	—	—	3,300	40,450
Common stock dividend . . . . .	30,182	30,182	352,569	(382,751)	—	—
Cash dividends . . . . .	—	—	—	(141,248)	—	—
Net income . . . . .	—	—	—	1,407,841	—	—
BALANCE, JANUARY 27, 1978 . . . . .	894,469	\$894,469	\$2,318,059	\$4,032,317	1,149	\$14,203

The accompanying notes are an integral part of these statements.



**Consolidated Statements of Changes in Financial Position**

For the years ended January 27, 1978 and January 28, 1977

	1978	1977 (Note 1)
SOURCES OF WORKING CAPITAL:		
Operations		
Net income before cumulative effect of a change in accounting principle . . . . .	\$1,407,841	\$1,027,991
Charges (credits) not affecting working capital:		
Depreciation and amortization . . . . .	678,610	555,809
Provision for deferred income taxes . . . . .	9,000	41,000
Minority interest in net income of subsidiaries . . . . .	70,886	46,811
Other . . . . .	(14,009)	(13,388)
	<u>2,152,328</u>	<u>1,658,223</u>
Cumulative effect of a change in accounting principle . .	—	59,614
	<u>2,152,328</u>	<u>1,717,837</u>
Proceeds from -		
Sale of stock . . . . .	153,751	88,256
Long-term debt . . . . .	1,044,723	3,629,763
	<u>3,350,802</u>	<u>5,435,856</u>
APPLICATIONS OF WORKING CAPITAL:		
Purchases of land, buildings and equipment . . . . .	2,939,888	1,954,757
Reduction of long-term debt . . . . .	206,494	1,487,744
Cash dividends . . . . .	141,248	88,698
Purchase of treasury stock . . . . .	40,450	49,783
Other assets . . . . .	63,179	11,353
	<u>3,391,259</u>	<u>3,592,335</u>
INCREASE (DECREASE) IN WORKING CAPITAL . . . . .	<u>\$ ( 40,457)</u>	<u>\$1,843,521</u>
WORKING CAPITAL INCREASED (DECREASED) AS FOLLOWS:		
Current assets -		
Cash . . . . .	\$ 48,227	\$ 117,555
Receivables . . . . .	1,562,440	772,179
Inventories . . . . .	2,402,329	623,626
Prepaid expenses . . . . .	(65,893)	(6,949)
	<u>3,947,103</u>	<u>1,506,411</u>
Current liabilities -		
Notes payable to banks . . . . .	(2,120,500)	1,123,000
Current portion of long-term debt . . . . .	(28,229)	286,375
Accounts payable . . . . .	(1,376,878)	(570,000)
Accrued liabilities . . . . .	(395,661)	(282,233)
Income taxes payable . . . . .	(66,292)	(220,032)
	<u>(3,987,560)</u>	<u>337,110</u>
INCREASE (DECREASE) IN WORKING CAPITAL . . . . .	<u>\$ (40,457)</u>	<u>\$1,843,521</u>

The accompanying notes are an integral part of these statements.



## Notes to Financial Statements

January 27, 1978

### 1. Summary of Significant Accounting Policies

#### Principles of Consolidation

The accompanying consolidated financial statements include the accounts of Palmer G. Lewis Co., Inc. (the Company) and its majority owned subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation.

#### Acquisition of Lumber Dealers Materials Co., Inc.

In November, 1977, the Company acquired all of the common stock of Lumber Dealers Materials Co., Inc. (LDM) and its subsidiary company which are in the building materials wholesale distribution industry, in exchange for 88,000 shares of common stock. This acquisition was accounted for as a "pooling of interests" and accordingly the financial statements have been restated to include the results of operations of LDM for all periods prior to the combination.

Following is a summary of the net sales and net income of the previously separate companies for the two fiscal years ended 1978:

	The Company	LDM	Combined
<i>January 27, 1978</i>			
Net Sales .....	\$69,769,000	\$6,390,000	\$76,159,000
Net Income .....	<u>1,334,500</u>	<u>73,400</u>	<u>1,407,900</u>
<i>January 28, 1977</i>			
Net Sales .....	\$56,436,000	\$5,088,000	\$61,524,000
Net Income .....	<u>900,000</u>	<u>68,000</u>	<u>968,000</u>

LDM's accounting year end was December 31 and the impact of changing it to January 27 was not material.

#### Inventories

Inventories consist of only finished goods and are stated primarily at the lower of cost (first-in, first-out) or market. LDM inventories are stated at cost using the last-in, first-out (LIFO) method. Inventories at January 27, 1978, and each of the two preceding year ends used in determining cost of sales are summarized below:

	1978	1977	1976
The Company except LDM .....	\$7,708,102	\$5,642,869	\$5,178,500
LDM .....	<u>784,391</u>	<u>447,291</u>	<u>288,034</u>
	<u>\$8,492,493</u>	<u>\$6,090,160</u>	<u>\$5,466,534</u>

#### Depreciation and amortization, repairs and maintenance

For financial statement purposes, buildings, equipment, furniture and fixtures are depreciated using the straight-line method over the estimated useful lives of the assets. For income tax purposes, depreciation is reported using the declining balance method. Estimated useful lives are summarized below:

#### Estimated Useful Lives

Land improvements and buildings .....	10 - 40 years
Equipment .....	3 - 10 years
Furniture and fixtures .....	5 - 10 years



Capital leases are amortized over 20 years, the terms of the related leases, using the straight-line method. The unamortized cost in excess of acquired tangible net assets is amortized over 40 years using the straight-line method.

Maintenance, repairs and minor replacements are expensed as incurred. Betterments and replacement of major units are capitalized. The cost and related accumulated depreciation of property sold or retired is removed from the accounts and the resultant gain or loss is reflected in operations.

### Income Taxes

For the two fiscal years ended 1978, the provision for income taxes consisted of the following:

January 27, 1978	Federal	State	Total
Current taxes payable . . . . .	\$1,193,000	\$111,000	\$1,304,000
Less - Investment and job tax credits . . . . .	(175,000)	—	(175,000)
Deferred taxes payable . . . . .	9,000	—	9,000
Provision for income taxes . . . . .	<u>\$1,027,000</u>	<u>\$111,000</u>	<u>\$1,138,000</u>
January 28, 1977			
Current taxes payable . . . . .	\$ 850,000	\$ 70,000	\$ 920,000
Less - Investment tax credit . . . . .	(51,000)	—	(51,000)
Deferred taxes payable . . . . .	38,500	2,500	41,000
Provision for income taxes . . . . .	<u>\$ 837,500</u>	<u>\$ 72,500</u>	<u>\$ 910,000</u>

The difference between the Federal provision for income taxes computed using the "statutory rate" of 48% and the "effective rates" (40% in 1978 and 43% in 1977) is principally from the utilization of investment and job tax credits.

The provision for deferred income taxes for the two fiscal years ended 1978, consisted primarily of differences between income tax and financial statement reporting of depreciation and capital leases.

### Net Income Per Share

Net income per share is based on the weighted average number of shares of common stock outstanding during each year (881,970 shares in 1978 and 869,042 shares in 1977) after giving retroactive effect to the stock issued in connection with the acquisition of LDM accounted for as a pooling of interests, and the stock dividends or stock split during the years. Outstanding stock options had no material dilutive effect on net income per share.

## 2. Long-term debt

At January 27, 1978 and January 28, 1977 long-term debt consisted of the following:

	1978	1977
8.6% and 9% capital lease obligations . . . . .	\$1,838,596	\$1,888,040
8% to 10¼% notes payable to banks, secured by mortgages on certain land, buildings and equipment costing \$3,325,000, payable in monthly installments of \$32,857, including interest, to 1987 . . . . .	3,471,505	3,219,816
8½% and 9½% notes payable, secured by mortgages on certain land, buildings, and equipment costing \$1,094,000, payable in monthly installments of \$8,432, including interest, to 2003 . . . . .	863,082	162,947
7% and 8% unsecured notes and other . . . . .	684,198	720,349
Total . . . . .	<u>6,857,381</u>	<u>5,991,152</u>
Less - current portion due . . . . .	<u>272,000</u>	<u>244,000</u>
	<u>\$6,585,381</u>	<u>\$5,747,152</u>



Included in the notes payable of \$863,082 is a 9½% note of \$712,500 which represents a reclassification of a short-term obligation that will be financed over 25 years in fiscal year ending 1979.

### Capital leases

In November, 1976, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 13, "Accounting for Leases." This accounting standard requires that if certain criteria are met, lease transactions must be classified as "capital leases." Since the FASB recommended early adoption, the Company concluded to account for the two applicable lease transactions entered into prior to January 1, 1977, as "capital leases," whereas in prior years such leases were accounted for as "operating leases." The applicable leases are for branch and office facilities under long-term agreements with related parties. One of the leases is with a partnership in which a partner is the President and a major stockholder of the Company. The other lease is with the former majority shareholders of LDM, who became stockholders of the Company as a result of LDM's acquisition.

The effect of the accounting change was to reduce net income for the year ended January 28, 1977, by \$28,000. The cumulative effect of the change (to January 30, 1976) was \$59,614 as reflected in the accompanying statement of income for the year ended January 28, 1977. For income tax purposes, the capital leases have been reported as operating leases.

Following is a summary of long-term debt maturities for the five fiscal years ending 1983:

<i>Fiscal year ending</i>	Notes Payable	Capital Lease Obligations	Total
1979 .....	\$218,000	\$ 54,000	\$ 272,000
1980 .....	206,000	59,000	265,000
1981 .....	190,000	64,000	254,000
1982 .....	179,000	70,000	249,000
1983 .....	196,000	76,000	272,000
	<u>\$989,000</u>	<u>\$323,000</u>	<u>\$1,312,000</u>

### 3. Short-term notes payable to banks

At January 27, 1978, the Company had line of credit agreements with banks to borrow, primarily at ½% over prime, up to \$10,525,000 under unsecured arrangements. During the two fiscal years ended 1978, the weighted average interest rate, average borrowings and maximum amount of short-term borrowings at any month-end were as follows:

	1978	1977
Weighted average interest rate .....	7.9%	7.6%
Average borrowings .....	\$5,383,000	\$5,314,000
Maximum amount of short-term borrowings at any month-end .....	\$9,071,000	\$8,025,000

### 4. Operating leases

The Company leases certain other branch facilities, vehicles and equipment which are accounted for as "operating leases." Following is a summary of the future minimum lease payments:

<i>Fiscal year ending</i>	
1979 .....	\$ 279,000
1980 .....	214,000
1981 .....	162,000
1982 .....	151,000
1983 .....	125,000
Later years .....	265,000
	<u>\$1,196,000</u>

Substantially all of the above lease obligations are for branch facilities. The lease obligations for all office and branch facilities also extend to property taxes, insurance, and repairs and maintenance.

## 5. Stock Purchase and Option Plans:

### Stock Purchase

The Company has an employee stock purchase plan for officers and employees. Participation in the plan is voluntary. Under the plan, the stock purchase price is established as the lesser of 90% of the market value at the date of grant, or 100% of the market value at the date exercised, but not less than par value of \$1.00.

A summary of the stock purchase plan activity for the two fiscal years ended 1978 follows:

	1978			1977		
	Shares	Average Price Per Share	Total	Shares	Average Price Per Share	Total
Shares purchased . . . . .	11,106	\$9.67	\$107,442	10,533	\$6.42	\$67,588

At January 27, 1978, and January 28, 1977, common stock reserved for issuance under this plan was 30,635 and 40,185, respectively.

### Stock Options

The Company also has a qualified stock option plan for officers and other key employees. Options for common stock are exercisable over five years from the date of grant. The exercise price is the market value at the date of grant.

A summary of stock option activity for the two fiscal years ended 1978 follows:

	1978			1977		
	Shares	Average Price Per Share	Total	Shares	Average Price Per Share	Total
Options granted . . . . .	11,002	\$12.50	\$137,525	4,500	\$8.70	\$39,150
Options exercised . . . . .	9,445	4.45	42,064	4,098	5.05	20,625
Options outstanding and exercisable . . . . .	52,131	7.09	369,445	48,741	5.87	286,110

At January 27, 1978, no common stock was reserved for issuance of stock options and at January 28, 1977, there were 10,354 shares reserved for issuance.

In August, 1977, the Board of Directors granted to the President a nonqualified stock option to purchase 15,600 shares of the Company's common stock at an exercise price of \$5.64 per share. The option price was determined by the Board of Directors based on the weighted average price of options outstanding in the qualified plan. The President is not eligible to participate in the qualified stock option plan. The shares are exercisable in varying quantities to August 31, 1980; thereafter, all or a portion of the shares may be exercised at any time prior to August 31, 1987. At January 27, 1978, 5,000 shares were exercisable. The market value of the stock at the date of grant and at January 27, 1978, was \$168,750 or \$10.82 per share, and \$195,000 or \$12.50 per share, respectively. The market value at the date of grant was based upon the average of the bid and asked price on that date. For financial statement purposes, the compensation cost of the nonqualified stock option is accrued as an expense over three years. For income tax purposes such costs are measured and deductible in the year the stock options are exercised.

The number of shares and price are adjusted for stock splits and stock dividends under all of the above plans. In addition, treasury stock or common stock reserved for issuance may be issued for stock purchases or options exercised.



## 6. Unaudited Quarterly Financial Results of Operations

Prior to fiscal year ended 1978, the Company was exempt under certain Securities and Exchange Commission regulations from reporting the quarterly financial results in its annual report. The following quarterly financial results of operations have been restated to include the results of operations of LDM in periods prior to acquisition.

<i>Quarter Ended</i>	April 25, 1977	July 25, 1977	October 25, 1977	January 27, 1978
Net sales:				
As previously reported . . . . .	\$13,906,037	\$18,212,931	\$21,384,354	\$ —
As restated . . . . .	15,250,077	19,822,049	23,461,420	17,625,812
Provision for income taxes:				
As previously reported . . . . .	120,500	341,500	457,500	—
As restated . . . . .	141,861	369,253	473,049	153,837*
Net income:				
As previously reported . . . . .	133,043	385,102	495,534	—
As restated . . . . .	152,728	414,839	509,447	330,827
Earnings per share:				
As previously reported . . . . .	\$.17	\$.49	\$.62	\$ —
As restated . . . . .	.17	.47	.57	.37

\*The provision for income taxes during the year is based on the expected annual effective rate. The lower rate in the fourth quarter ended January 27, 1978 includes the tax benefit resulting from a job tax credit of \$100,000.

## Auditors' Report

To the Stockholders of  
Palmer G. Lewis Co., Inc.:

We have examined the consolidated balance sheets of Palmer G. Lewis Co., Inc. (a Washington corporation) and subsidiaries as of January 27, 1978 and January 28, 1977, and the related statements of income, stockholders' investment and changes in financial position for the years then ended. Our examinations 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.

In our opinion, the consolidated financial statements referred to above present fairly the financial position of Palmer G. Lewis Co., Inc. and subsidiaries as of January 27, 1978, and January 28, 1977, and the results of their operations and the changes in their financial position for the years then ended, in conformity with generally accepted accounting principles consistently applied during the periods subsequent to the change made as of January 29, 1977 (with which we concur) in the method of accounting for leases as required by Statement of Financial Accounting Standards No. 13 and explained in Note 2 to the financial statements.

ARTHUR ANDERSEN & CO.

Seattle, Washington,  
March 23, 1978.

## Board of Directors

**Palmer G. Lewis**, Chairman of the Board, Palmer G. Lewis Co., Inc., Auburn, Wash.

**William H. Gee**, Director, Investments, Seattle, Wash.

**J. Cutler Lewis**, Senior Vice-President, Palmer G. Lewis Co., Inc., Auburn, Wash.

**Richard E. Lundgren**, Executive Vice-President and Chief Operating Officer, Palmer G. Lewis Co., Inc., Auburn, Wash.

**James F. Parmley**, Senior Vice-President of Administration, Palmer G. Lewis Co., Inc., Auburn, Wash.

**Robert D. Peterson**, President and Chief Executive Officer, Palmer G. Lewis Co., Inc., Auburn, Wash.

**L. W. Wells**, Senior Vice President, Winmar Company, Inc., Seattle, Wash. (Financial Services)

**Alfred W. White**, Chairman of the Board, Frank B. Hall and Co. of Washington, Seattle, Wash. (Insurance Brokers)

## Auburn Distribution Center Managers and Supervisors

**Warren Leslie**—Manager, Alaska Sales

**John A. Fetch**—Invoicing & Data Processing

**Stephen P. Parmley**—Supervisor of Trucking

**Clifford Schattenkerk**—Supervisor of Warehousing

## PGL Branch Managers

**Robert Anderson, Jr.**—Lacey, Wash.

**J. J. Apostolou**—Anchorage, Alaska

**Ted DeMarcé**—Wenatchee, Wash.

**Pearson Hillius**—Bremerton, Wash.

**Gregory Lingle**—Seattle, Wash.

**Robert E. Johnson**—Everett, Wash.

**Walter Maes**—Spokane, Wash.

**Robert A. Ruud**—Yakima, Wash.

**J. R. Schiller**—Kenmore, Wash.

## Pacific Yard Service Division

**Zack T. Brandon**—Vice President of Oregon Operations

**Ronald Pulliam**—General Manager

**Gaelen Norton**—Sales Manager

**Ted Igl**—Eugene Branch Manager

**Earl W. Van Buskirk**—Tigard Branch Manager

## Lumber Dealers Materials Co.

**John E. Glover**—Vice President of California Operations

**Patricia Olmstead**—Office Manager

**Robert A. Babicky**—Sales Manager & Branch Manager, Sacramento

**Richard R. Clare**—Redding Branch Manager

**Martin W. Wells**—Fresno Branch Manager

## Superior Building Supply, Inc.

**Ted Grainge**—General Manager

## Annual Meeting:

The annual meeting of shareholders of Palmer G. Lewis Co., Inc. will be held on Thursday, May 25, 1978, at 2:00 P.M., at the Seattle-First National Bank Building, 1000 - Fourth Avenue, Seattle, Washington, Third Avenue Level Auditorium.

## Attorneys

Cartano, Botzer and Chapman, Seattle, Washington

## Independent Public Accountants

Arthur Andersen & Co., Seattle, Washington

## Registrar and Transfer Agent

Seattle-First National Bank, Seattle, Washington.

## Additional Information:

A copy of the Company's Form 10-K report for the year ended January 28, 1978 including financial statements and schedules, which will be filed with the Securities and Exchange Commission by April 28, 1978 is available to shareholders, without charge, upon written request to:

Gilbert R. Halley, Secretary  
Palmer G. Lewis Co., Inc.  
525 C Street N.W.  
Auburn, Washington 98002

## New Palmer G. Lewis Co., Inc. Distribution Center in Yakima

This structure situated on 2.7  
acre tract with combined  
warehouse and office space  
totalling 28,000 sq. ft. opened in  
November of 1977.

