

ANNUAL REPORTS
Palmer G. Lewis Co., Inc. 1986

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as their primary
source of supply
for products which
PGL distributes."

1986

Palmer G. Lewis

1986 Annual Report

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The Company

Palmer G. Lewis Co., Inc. is one of the largest independent wholesale distributors of a full line of building related materials in the western United States. The Company is composed of four operations including PGL Building Products, which distributes a broad line of basic building products and operates 17 service centers from Alaska to Arizona. Sea-Pac Sales Company, with five locations in the Northwest, distributes various floor products, carpeting, and appliances. Another subsidiary is Cochrane Northwest, Inc., which operates three wholesale locations in Washington state serving the high pressure laminate, ceramic tile, and floor covering accessory market. The Company also operates Truck Service, Inc., a truck repair facility and Marmon Truck dealer in Kent, Washington.



Palmer G. Lewis Co., Inc.

PGL Building Products
A Palmer G. Lewis Company

Sea-Pac Sales Company
A Palmer G. Lewis Company

Cochrane Northwest, Inc.
A Palmer G. Lewis Company

Truck Service, Inc.
A Palmer G. Lewis Company



● Service Centers

Financial Highlights

Years Ended	Jan. 30, 1987	Jan. 31, 1986	% Change
Net Sales	\$187,241,380	\$140,773,409	+33
Net Income before Tax	\$ 2,402,595	\$ 1,449,484	+66
Net Income after Tax	\$ 1,306,595	\$ 878,484	+49
Net Income per Share	\$.33	\$.23	+43
Cash Dividends	\$.28	\$.28	—
Stock Dividends	—	4%	N/A
Total Assets	\$ 63,456,757	\$ 50,448,924	+26
Stockholders' Equity	\$ 33,927,536	\$ 33,129,107	+ 2
Average Shares Outstanding	3,942,265	3,900,572	+ 1

Net income per share, cash dividends, and average shares outstanding have been adjusted for the stock dividend paid in October 1985.

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Message to PGL Stockholders

The obligation of any Chief Executive Officer of a publicly-owned company is to inform the company's owners (stockholders) in the annual report each year as to how things are going with their company. This year I will give you a broad overview in this message, and provide you with greater subsidiary Company operating details in the "Management's Discussion" section of this annual report.

1986 proved to be a favorably important year for our Company. Many of the goals we set last year were achieved. This resulted in a 49% increase in net income over the previous year, and while certainly way below a satisfactory return on investment, we clearly are in the process of achieving the turnaround needed. The fourth quarter was the sixth consecutive quarter in which we earned more than in the comparable previous year's quarter. The size of the improvements is increasing, and leading us into a better 1987.

The single most important event in 1986 was the acquisition of Western American Forest Products. This act brought a finely-tuned marketing organization into PGL, and gave us the diversification we needed for geographical, seasonal and cyclical reasons. The sales and earnings of this new addition more than offset the serious loss of business caused by the recession in Alaska.

Our stated goals last year were to challenge every operational activity, achieve greater market penetration and improve efficiencies. Evidence of our success can be seen in greatly improved results from the California and Oregon regions. The timing of the consolidation of the Tacoma-based Alaska division warehouse into our enlarged Auburn distribution center has enabled us to weather the Alaska problem much better.

Required personnel reductions to meet necessary operating efficiencies have not been pleasant, but it is exciting to see the growth in real management accountability at all levels of the Company. The teamwork displayed throughout the Company, at all locations and in all jobs, is making a smoother running entity, and this is showing up favorably in our customer relations.

The financial condition of PGL remains very secure. We have an admirable 2.7 to 1 current ratio, even after the acquisition of Western American. There has been much attention paid to making the best use of assets. This is the first report in many years in which interest rates and housing starts have not been major subjects. Management has taken the position that we simply have to operate profitably at *whatever* levels interest rates or housing starts are. These issues have, therefore, been minimized in our operating strategies.

In looking ahead to 1987 I am very enthusiastic about further improved results. We are a leaner, tougher Company with employees who are determined to increase market share and secure a reasonable return on the stockholders' investment. In our present distribution businesses our goal is to be the BEST distributor *as viewed by our CUSTOMERS*. In the financial investment community our goal is to have PGL stock recognized as an EXCELLENT medium-to-long-term investment, *as viewed by our STOCKHOLDERS*. I feel more confident than ever that we are well on our way toward reaching that goal.



John N. Anderson
*Chairman, President, and
Chief Executive Officer*

John N. Anderson
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*Chairman, President, and
Chief Executive Officer*

Operations

The Company is comprised of four operations: PGL Building Products, Sea-Pac Sales Company (Sea-Pac), Cochrane Northwest, Inc. (CNI), and Truck Service, Inc. (TSI). Total sales for these entities for 1986 were \$187.2 million, up 33% when compared to the \$140.8 million for 1985. The majority of the sales increase (\$41 million) resulted from the purchase of Western American Forest Products Incorporated (Western American), which was acquired July 1, 1986 for cash and convertible debentures. The acquisition was accounted for as a purchase and consolidated statements include Western American's results from July 1, 1986.

Cost of goods sold increased in 1986, not only in total because of the Western American acquisition, but also as a percentage of sales. Operating expenses increased because of the Western American addition but decreased as a percentage of sales. Depreciation expense also increased because of the amortization of the added Western American assets. Although interest expense was up almost 50% and included interest on the debentures issued for Western American plus the assumption of its bank borrowings, the weighted average interest rate on short-term borrowings declined from 8.7% to 7.0%. Other income increased in 1986 and included a gain on the sale of surplus property.

Pretax income increased 66% over the previous year. However, the Company's effective income tax rate increased due to changes in the availability of certain tax credits under the new tax law. As a result, net income increased 49% to \$1.3 million. Earnings per share were 33¢ in 1986 as compared to 23¢ in 1985. A discussion of each of the Company's operations follows.

PGL Building Products

PGL Building Products is a wholesale distributor of a broad line of basic building products. It operates 17 service centers covering the regions from Alaska to Arizona, serving retail lumber and building material dealers, home center chains and selected industrial accounts.

Sales and profits for 1986 were better than the prior year, and we expect improvements in 1987 will generate results much closer to a satisfactory return on invested dollars. Although the Alaskan market remains depressed, with no major improvement anticipated during 1987, we expect the remainder of PGL Building Products operations to perform well during the coming year. This improvement will result from the improved market conditions and the restructuring which has taken place during the last several months.

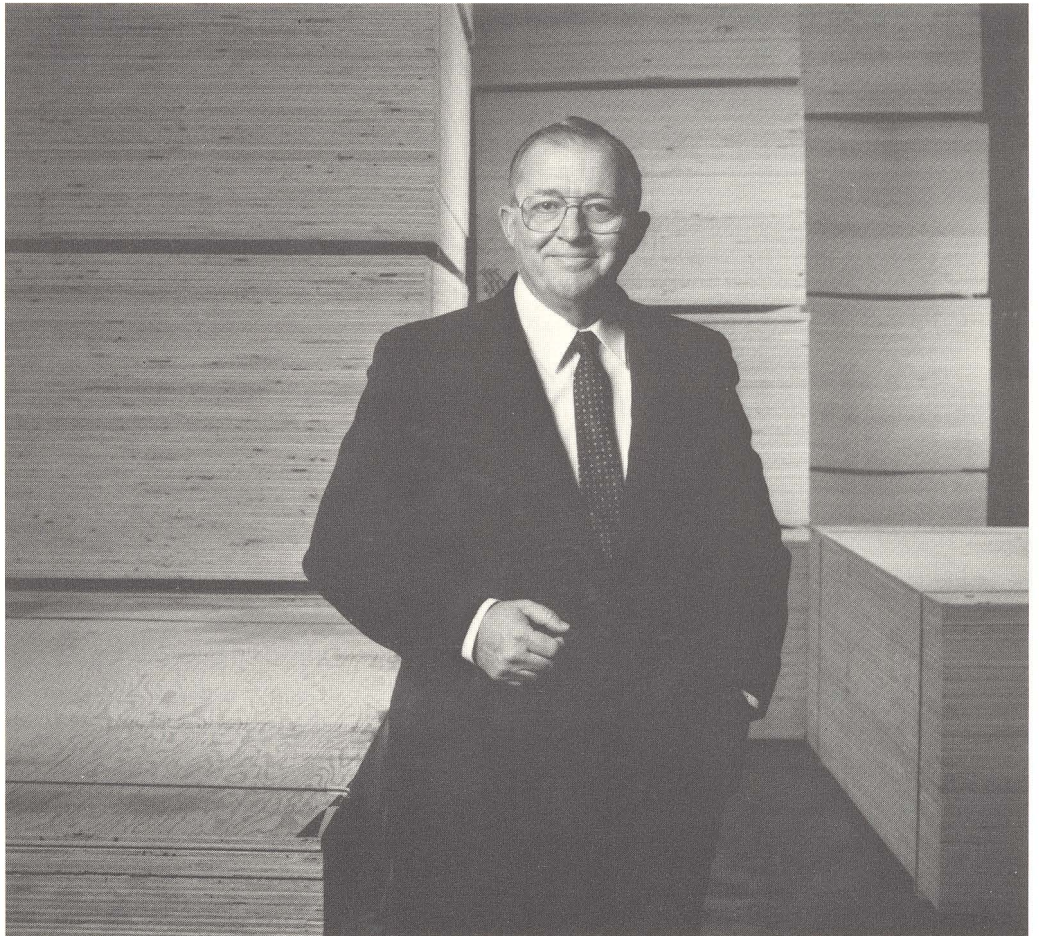
Important business changes occurred during 1986. By the end of July we had completed the acquisition of Western American. This California-based company distributes building materials, heavily oriented towards specialty wood products, from distribution operations in Rialto and City of Industry (in Southern California), Benicia (East San Francisco Bay Area), Fresno, California, and Phoenix, Arizona. The Western American acquisition gives us a much stronger presence in the very important California-Arizona market with a network of branches in geographical areas not previously served. We believe this expansion will reduce our vulnerability to seasonal and cyclical sales fluctuations. Growth offered through the enlarged PGL distribution pipeline should make the Company more attractive to major suppliers and multistate retailers.

"Pretax income increased 66% over the previous year."

Many operational changes have been instituted during 1986, and additional changes are being made in 1987. The size of our staff has been trimmed and all products are being evaluated in terms of customers' needs and profitability. While we will continue to evaluate operational changes on an ongoing basis, our primary concern for 1987 is to increase sales and market penetration. To this end, PGL Building Products will continue its efforts to become a "service-driven" organization. As we move toward this goal the strong emphasis will be directed toward customer support and service. We are initiating sales training programs and changing our compensation systems to enhance our ability to

"Our primary concern is to increase sales and market penetration."

Jim Ben Edens
President
PGL Building Products



provide enthusiastic expert sales specialists to serve both our customers and suppliers.

The PGL Building Products team is striving to become more important to both our customers and suppliers. This will provide an opportunity to generate even better returns for our stockholders during the coming years.

Sea-Pac Sales Company

Sea-Pac Sales is a wholesale distribution company specializing in flooring, floor coverings, carpeting, and appliances. The five Sea-Pac distribution centers are located in Seattle and

Spokane, Washington; Portland, Oregon; Salt Lake City, Utah; and Billings, Montana. Sea-Pac's sales effort is centered primarily in the states in which the warehouses are located, plus Idaho and Alaska.

The success and reputation which Sea-Pac has achieved is based on its customer service orientation and its specialization in a limited number of high quality brand named products. Sea-Pac products include ARMSTRONG resilient flooring, ARMSTRONG carpets, BRUCE hardwood floors, GIBSON appliances, and SHARP microwave ovens. Accessory products complementing the major product lines are included in the Company's

"The goal of achieving greater market penetration is paramount in all planning at Sea-Pac."

John N. Anderson
President
Sea-Pac Sales Company



sales effort. Being a wholesale distributor, Sea-Pac serves floor covering dealers, building material dealers, home centers and appliance departments in a variety of retail stores.

During 1986 the Company overcame previously reported operational change problems, and by the last half was experiencing sales improvements beyond previous quarters. In Spokane, Sea-Pac and its sister company, Cochrane Northwest, Inc., joined to build a new combined branch distribution center to better serve the customer base, and to perform that service on a more efficient basis.

1987 should see further improvement in Sea-Pac's performance. Additional specialization has been implemented in sales and management responsibilities. There is evidence of greater effectiveness in several branch and product areas. The goal of achieving greater market penetration is paramount in all planning at Sea-Pac. We know that improvement can only come to pass by providing the highest quality products combined with quality service to the dealer and the end-user. This requires a highly-trained sales force and a company-wide support team dedicated to making its customers *want* to do business with Sea-Pac.

"CNI is positioned for growth in both product lines and market penetration."

Mark F. Smith
President and General Manager
Cochrane Northwest, Inc.



Cochrane Northwest, Inc.

Cochrane distributes high pressure laminates, ceramic tile, and floor covering accessories. Operating three locations in Washington state, it services retail floor covering dealers, kitchen and bath dealers, and the fabricator and applicator trade.

CNI's sales were higher this year than the previous year. During 1986 growth was stressed and internal operational changes were made which were costly. Profits were lower but still provided an adequate return on investment.

**"1986 represented
a new record in
both sales and
profits for TSI."**

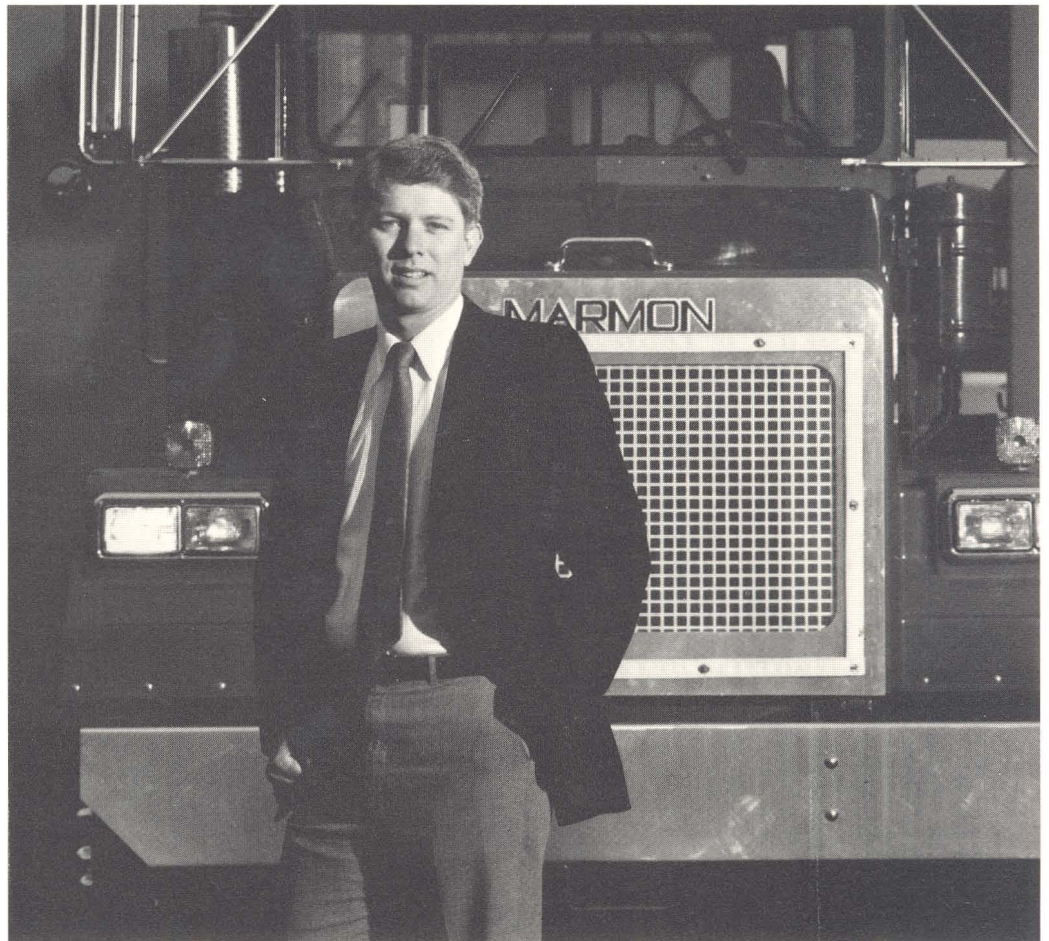
James V. Kelly
*Vice President and
General Manager*
Truck Service, Inc.

At the close of the year CNI acquired a manufacturing facility that produces a carpet tackstrip under the Timberline label. In addition, the Spokane branch was combined into a new facility with Sea-Pac.

In 1987 CNI should show significant sales and profit improvement since the operation is positioned for growth in both product lines and market penetration.

Truck Service, Inc.

TSI, located in Kent, Washington, is a complete service center for truck repairs and truck



parts. In addition, the company is a dealer for Marmon trucks manufactured in Dallas, Texas.

Originally acquired in 1977 to assure a quality source of repair for PGL's truck fleet, TSI has grown steadily over the years. The company now provides its services to many Northwest businesses which operate truck fleets in the Puget Sound area. Today only 10% of TSI's total business is generated from the PGL truck fleet.

1986 represented a new record in both sales and profits for TSI. The outlook for 1987 is continued growth in both sales and service.

Balance Sheet Data

The Company's balance sheet remains strong even after the Western American acquisition. Working capital increased \$3.3 million and the current ratio is a healthy 2.7:1. During the year, the Company negotiated a \$6 million long-term bank line of credit at favorable interest rates which amortizes over five years. This replaced Western American's borrowings which were at substantially higher interest rates. Total short-term bank borrowings peaked at approximately \$11.0 million in 1986, up from the \$5.9 million in 1985.

For further information on bank lines of credit and interest rates on short-term borrowings, see Note 3 to Consolidated Financial Statements.

Dividend

The Company continued to pay cash dividends of 28¢ per share (7¢ per quarter), the same rate it has paid over the past two years. In 1986, the Company discontinued its 4% stock dividend, which had been paid since 1968. The goal of increasing the liquidity of the Company's stock through the stock dividends had been achieved.

Other Data

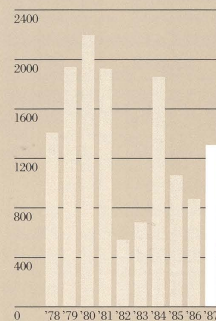
The Company continued to restrict expenditures for property, plant and equipment, except for the facilities acquired with Western American. Cash flow from operations, \$3.9 million in 1986, remains strong and adequate to fund the Company's needs.

Selected Consolidated Financial Information

Fiscal Years Ended January	1987	1986	1985	1984	1983
Income Statement Data:					
Net Sales	\$187,241,000	\$140,773,000	\$144,382,000	\$121,044,000	\$103,497,000
Interest Expense	1,043,000	704,000	1,346,000	982,000	1,725,000
Depreciation and Amortization	2,493,000	2,322,000	2,080,000	1,599,000	1,397,000
Income Taxes	1,096,000	571,000	249,000	1,059,000	335,000
Net Income	1,307,000	878,000	1,073,000	1,820,000	678,000
Net Income Per Share	.33	.23	.29	.64	.33
Average Shares Outstanding	3,942,000	3,901,000	3,640,000	2,828,000	2,060,000
Balance Sheet Data:					
Total Assets	63,457,000	50,449,000	53,805,000	42,490,000	38,966,000
Working Capital	25,781,000	22,524,000	21,240,000	17,664,000	8,115,000
Long-Term Debt					
(net of Current Portion)	10,160,000	2,311,000	2,526,000	2,236,000	2,360,000
Capitalized Leases					
(net of Current Portion)	2,341,000	2,288,000	2,413,000	2,525,000	2,620,000
Stockholders' Equity	33,928,000	33,129,000	33,179,000	27,029,000	16,490,000
Dividends Per Common Share:					
Cash	.28	.28	.27	.26	.25
Stock	—	4%	4%	4%	4%
Other Data:					
Net Capital Expenditures	1,422,000	672,000	3,648,000	1,846,000	1,579,000
Cash Flow (net income + non-cash items)	3,929,000	3,741,000	3,551,000	3,418,000	2,049,000
Number of Employees	589	462	492	403	369

Ten Year Review

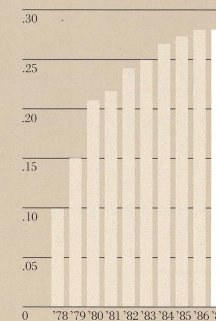
Net Income
\$ in thousands



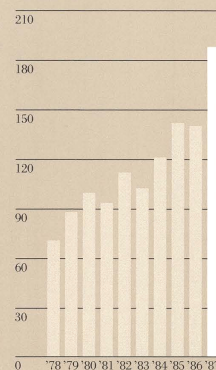
Net Income Per Share
in \$



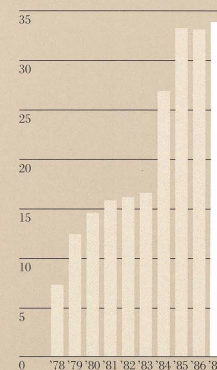
Cash Dividend Per Share
in \$



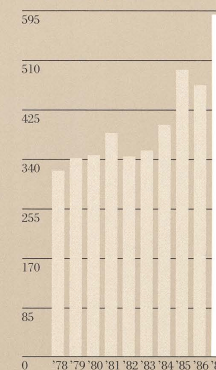
Sales
\$ in millions



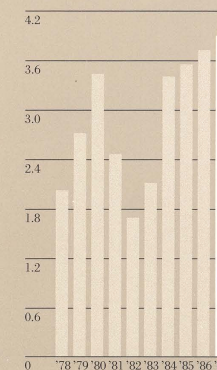
Net Worth
\$ in millions



Number of Employees



Cash Flow
\$ in millions



Consolidated Balance Sheets
Palmer G. Lewis Co., Inc. and Subsidiaries

Assets	January 30, 1987 and January 31, 1986	1987	1986
Current Assets:			
Cash and cash equivalents	\$	52,231	\$ 1,871,083
Receivables, less allowance for doubtful accounts of \$554,000 in 1987 and \$475,000 in 1986		18,207,317	14,127,039
Current portion of notes receivable		232,830	343,716
Inventories (Note 1)		22,116,604	17,114,837
Income tax receivable		219,251	—
Prepaid expenses and other		536,064	382,317
Total current assets		41,364,297	33,838,992
Land, Buildings and Equipment, at cost (Notes 1 and 4):			
Land and land improvements		5,214,882	2,010,194
Buildings		10,187,661	8,534,776
Equipment		9,788,046	9,250,522
Property held under capital leases		3,495,603	3,259,477
Furniture and fixtures		2,975,475	2,375,845
Construction in progress		52,213	297,644
		31,713,880	25,728,458
Less-accumulated depreciation and amortization		(12,754,594)	(10,946,622)
		18,959,286	14,781,836
Other Assets:			
Notes receivable, net of current portion shown above		479,143	1,155,073
Unamortized costs in excess of net assets of acquired businesses (Note 1)		1,424,323	88,251
Other		1,229,708	584,772
		3,133,174	1,828,096
		\$63,456,757	\$ 50,448,924

The accompanying notes are an integral part of these Balance Sheets.

Liabilities and Stockholders' Equity	1987	1986
Current Liabilities:		
Short-term notes payable (Note 3)	\$ 1,500,000	\$ —
Current portion of long-term debt and obligations under capital leases	988,152	368,154
Accounts payable	9,757,189	8,690,330
Accrued salaries and wages	1,418,272	978,429
Other accrued liabilities	1,720,582	1,073,926
Income taxes payable	199,109	204,518
Total current liabilities	15,583,304	11,315,357
Long-Term Debt (Note 4)	10,928,728	2,526,019
Obligations under Capital Leases (Note 4)	2,560,331	2,440,988
Less-current portion shown above	(988,152)	(368,154)
	12,500,907	4,598,853
Deferred Income Taxes and Other (Note 5)	1,445,010	1,405,607
Commitments (Note 6)		
Stockholders' Equity (Notes 1 and 7):		
Common stock par value \$1.00 —		
Authorized 8,000,000 shares;		
Issued and outstanding 3,998,107 shares in 1987 and 3,911,643 shares in 1986	3,998,107	3,911,643
Paid-in capital	26,709,640	26,198,036
Retained earnings	3,219,789	3,019,428
	33,927,536	33,129,107
	\$63,456,757	\$50,448,924

Consolidated Statements of Income

Palmer G. Lewis Co., Inc. and Subsidiaries

For the three fiscal years ended January 30, 1987	1987	1986	1985
Net Sales	\$187,241,380	\$140,773,409	\$144,382,029
Cost and Expenses:			
Cost of goods sold	156,164,915	116,144,779	120,134,905
Selling, general and administrative expenses	25,928,128	20,955,850	20,247,700
Depreciation and amortization	2,492,897	2,322,235	2,079,614
Interest expense	1,043,093	704,337	1,345,667
Employees' profit sharing plan	211,879	83,751	244,427
Interest income	(344,818)	(476,199)	(488,314)
Other income	(657,309)	(410,828)	(503,801)
	184,838,785	139,323,925	143,060,198
Income before Provision for Income Taxes	2,402,595	1,449,484	1,321,831
Provision for Income Taxes (Note 5)	1,096,000	571,000	249,000
Net Income	\$ 1,306,595	\$ 878,484	\$ 1,072,831
Per Share Data (Note 1)			
Net Income	\$.33	\$.23	\$.29
Dividends			
Cash	\$.28	\$.28	\$.27
Stock	—	4%	4%

The accompanying notes are an integral part of these statements.

Consolidated Statements of Stockholders' Equity

Palmer G. Lewis Co., Inc. and Subsidiaries

For the three fiscal years ended January 30, 1987

	Common Stock		Paid-In Capital	Retained Earnings	Treasury Stock	
	Shares	Amount			Shares	Amount
Balance, January 27, 1984	2,843,598	\$2,843,598	\$19,029,858	\$5,203,327	(5,258)	\$(48,076)
Common stock issued for acquisition of Sea-Pac Sales Company	747,732	747,732	5,234,124	—	—	—
Sale of common stock under stock purchase and stock option plans (Note 7)	7,141	7,141	19,653	—	33,258	260,201
Purchase of treasury stock	—	—	—	—	(28,000)	(212,125)
Common stock dividend	142,554	142,554	935,154	(1,077,708)	—	—
Cash dividends	—	—	—	(979,330)	—	—
Net income	—	—	—	1,072,831	—	—
Balance, January 25, 1985	3,741,025	3,741,025	25,218,789	4,219,120	—	—
Sale of common stock under stock purchase and stock option plans (Note 7)	21,143	21,143	119,905	—	14,888	109,104
Purchase of treasury stock	—	—	—	—	(15,000)	(110,000)
Retirement of common stock	(112)	(112)	(784)	—	112	896
Common stock dividend	149,587	149,587	860,126	(1,009,713)	—	—
Cash dividends	—	—	—	(1,068,463)	—	—
Net income	—	—	—	878,484	—	—
Balance, January 31, 1986	3,911,643	3,911,643	26,198,036	3,019,428	—	—
Sale of common stock under stock purchase and stock option plans (Note 7)	86,464	86,464	511,604	—	—	—
Cash dividends	—	—	—	(1,106,234)	—	—
Net income	—	—	—	1,306,595	—	—
Balance, January 30, 1987	3,998,107	\$3,998,107	\$26,709,640	\$3,219,789	—	—

The accompanying notes are an integral part of these statements.

Consolidated Statements of Changes in Financial Position

Palmer G. Lewis Co., Inc. and Subsidiaries

For the three fiscal years ended January 30, 1987	1987	1986	1985
Sources of Working Capital:			
Operations			
Net income	\$ 1,306,595	\$ 878,484	\$ 1,072,831
Charges (credits) not affecting working capital —			
Depreciation and amortization	2,492,897	2,322,235	2,079,614
Provision for deferred income taxes	130,000	46,000	571,000
Other	—	494,421	(172,545)
Working capital provided from operations	3,929,492	3,741,140	3,550,900
Proceeds from —			
Sale of common stock	598,068	250,152	6,268,851
Long-term debt and obligations under capital leases	3,211,389	20,782	607,455
Net liabilities of acquired business (Western American), land, buildings, equipment and other (\$6,584,111); less long-term debt (\$7,564,308). Excludes working capital acquired (\$4,678,297). (Note 2)	980,197	—	—
	8,719,146	4,012,074	10,427,206
Applications of Working Capital:			
Purchase of land, buildings and equipment, net	1,422,309	671,770	3,647,751
Reduction of long-term debt and obligations under capital leases	2,873,642	360,966	447,968
Cash dividends	1,106,234	1,068,463	979,330
Purchase of treasury stock	—	110,000	212,125
Increase in notes receivable and other, net	59,603	516,615	21,660
Net assets of acquired business (Sea-Pac)	—	—	1,542,753
	5,461,788	2,727,814	6,851,587
Increase in Working Capital	\$ 3,257,358	\$ 1,284,260	\$ 3,575,619
Working Capital Increased (Decreased) as follows:			
Current assets —			
Cash and cash equivalents	\$(1,818,852)	\$ 1,390,328	\$ 147,360
Receivables	4,080,278	(1,916,105)	4,132,941
Current portion of notes receivable	(110,886)	(64,869)	195,171
Inventories	5,001,767	(498,723)	2,601,794
Income tax receivable	219,251	(720,451)	720,451
Prepays	153,747	173,799	37,236
	7,525,305	(1,636,021)	7,834,953
Current liabilities —			
Short-term notes payable	(1,500,000)	4,200,000	(3,100,000)
Current portion of long-term debt	(619,998)	(7,911)	(115,304)
Accounts payable	(1,066,859)	(1,326,778)	(659,051)
Accrued salaries and wages	(439,843)	(77,435)	158,924
Other accrued liabilities	(646,656)	336,923	(586,990)
Income taxes payable	5,409	(204,518)	43,087
	(4,267,947)	2,920,281	(4,259,334)
Increase in Working Capital	\$ 3,257,358	\$ 1,284,260	\$ 3,575,619

The accompanying notes are an integral part of these statements.

January 30, 1987
Notes to Consolidated Financial Statements
Palmer G. Lewis Co., Inc. and Subsidiaries

1. Summary of
Significant
Accounting Policies

Principles of Consolidation

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

Inventories

Inventories consist of finished goods and are primarily stated at the lower of average cost (which approximates the first-in, first-out (FIFO) method), or market. Western American Forest Products Incorporated (Western American) states its inventory on the last-in, first-out (LIFO) method. Had the FIFO method been used, inventories would have been greater by \$2,695,000 at January 30, 1987 and \$2,612,000 at the date of acquisition.

Depreciation and Amortization, Repairs and Maintenance

Buildings, equipment and property held under capital leases are depreciated using the straight-line method over the estimated useful lives of the assets or the lease term, if shorter. Estimated useful lives are summarized below:

Land improvements and buildings	10-40 years
Equipment	3-10 years
Property held under capital leases	20-25 years
Furniture and fixtures	5-10 years

The costs in excess of the net assets of acquired businesses is being amortized over a 20-year period. Maintenance, repairs and minor replacements are expensed as incurred. Betterments and replacements of major assets 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

Deferred income taxes are provided for the reporting of items differently between financial statement and income tax purposes. Investment tax credits are recognized currently as a reduction of income tax expense.

Net Income Per Share

Net income per share is based on the weighted average number of shares of common stock outstanding during each year (3,942,265 shares in fiscal 1987; 3,900,572 shares in fiscal 1986; and 3,640,181 shares in fiscal 1985) after giving effect to the stock dividends during the fiscal years 1986 and 1985.

Profit Sharing Plan

Contributions to the Company's profit sharing plan are made at the discretion of the Board of Directors.

Reclassifications

Certain reclassifications have been made to prior year financial statements in order to conform them to the current year's format.

2. Acquisition

Effective July 1, 1986, the Company acquired all of the outstanding stock of Western American Forest Products Incorporated for cash and convertible debentures totaling \$5,352,000. The transaction was accounted for as a purchase and, accordingly, the acquisition cost was allocated based on the fair value of Western American's net assets at that date. The operating results of Western American are included in the consolidated statements subsequent to July 1, 1986. Had Western American's results of operations been included for the entire years ended January 30,

1987 and January 31, 1986, unaudited pro forma activity would have been as follows: net sales \$220,500,000 and \$220,400,000; net income \$970,000 and \$1,200,000; and net income per share \$.25 and \$.31, respectively.

3. Short-Term Notes Payable

At January 30, 1987, PGL had unsecured lines of credit with banks to borrow up to \$22,000,000, primarily at prime or lower. Information regarding short-term borrowings during the three fiscal years ended 1987 follows:

<i>(Dollar amounts in thousands)</i>	1987	1986	1985
Weighted average interest rate	7.0%	8.7%	11.4%
Average borrowings	\$ 3,070	\$1,754	\$ 7,086
Maximum amount of short-term borrowings at any month-end	10,200	5,900	13,350
Year-end short-term notes payable to banks	1,500	—	4,200
Year-end weighted average interest rate	7.0%	—	9.1%

4. Long-Term Debt and Obligations under Capital Leases

As of January 30, 1987 and January 31, 1986, long-term debt and obligations under capital leases consisted of the following:

<i>(Dollar amounts in thousands)</i>	1987	1986
Note payable to bank, prime interest rate or lower, unsecured, payable in semi-annual installments of \$600, plus interest to 1991.	\$ 5,400	\$ —
6% convertible debentures, payable in annual installments of \$535 commencing in 1991, due August, 1996, convertible after August, 1988 at \$10 per share.	3,211	—
9½% note payable to bank, secured by a mortgage on certain land and buildings, payable in monthly installments of \$3, including interest to January, 1988.	275	279
9¾% note payable, secured by a mortgage on certain land, buildings and equipment, payable in monthly installments of \$15, including interest to 1994.	1,591	1,619
10% note payable, secured by a mortgage on certain land and buildings, payable in annual installments of \$100 plus interest to July, 1989.	300	400
Other	152	228
Total long-term debt	10,929	2,526
Capital lease obligations, \$38 payable monthly, including interest imputed at rates from 9% to 14½%, to 1996.	2,560	2,441
Less-current portion	(988)	(368)
	\$12,501	\$4,599

The capital leases are for certain branch and office facilities. One of the leases is with a partnership in which a partner is a member of the Board of Directors and a stockholder of PGL. As of January 30, 1987 and January 31, 1986, this capital lease obligation was \$1,211,000 and \$1,340,000, respectively, and the annual payments to the partnership during each of the three fiscal years ended 1987 were \$255,000. PGL may lease the facility for a term of seven more years, expiring in 1993, at the current rate or exercise an option to purchase the property at any time at fair market value. There is a renewal option at the end of the lease for an additional ten years at the then fair market value.

The following summarizes long-term debt maturities for the five fiscal years ending 1992 and subsequent years:

<i>Fiscal Year Ending (Amounts in thousands)</i>	Long-Term Debt	Capital Lease Obligations	Total
1988	\$ 769	\$ 219	\$ 988
1989	1,340	239	1,579
1990	1,344	264	1,608
1991	1,244	293	1,537
1992	1,781	269	2,050
Subsequent years	4,451	1,276	5,727
	\$10,929	\$2,560	\$13,489

5. Income Taxes

For the three fiscal years ended 1987, the provision for income taxes consisted of the following:

<i>(Amounts in thousands)</i>	Federal	State	Total
January 30, 1987			
Current taxes payable	\$910	\$110	\$1,020
Less-tax credits	(54)	—	(54)
Deferred taxes payable	130	—	130
Provision for income taxes	\$986	\$110	\$1,096
January 31, 1986			
Current taxes payable	\$779	\$ 50	\$ 829
Less-tax credits	(121)	—	(121)
Deferred taxes payable	(137)	—	(137)
Provision for income taxes	\$521	\$ 50	\$ 571
January 25, 1985			
Current taxes payable	\$364	\$ 42	\$ 406
Less-tax credits	(326)	—	(326)
Deferred taxes payable	169	—	169
Provision for income taxes	\$207	\$ 42	\$ 249

The tax effect of timing differences resulting in deferred income taxes for each fiscal year is as follows:

<i>(Amounts in thousands)</i>	1987	1986	1985
Depreciation	\$ 40	\$ 184	\$135
Installment sales	(11)	33	(8)
Retirement benefit plans	62	24	(54)
Pension plan conversion	—	(196)	—
Adjustment to inventory	(99)	(99)	56
Other — net	138	(83)	40
	\$130	\$(137)	\$169

An analysis of the differences between the effective tax rates and the Federal statutory rate is set forth below:

	1987		1986		1985	
<i>(Amounts in thousands)</i>	Amount	Percent	Amount	Percent	Amount	Percent
Federal tax at statutory rate	\$1,105	46.0	\$667	46.0	\$ 608	46.0
State taxes, net of Federal tax benefit	59	2.4	27	1.9	23	1.7
Investment tax credit — net	1	.1	(70)	(4.8)	(279)	(21.1)
PAYSOP credit	(56)	(2.3)	(51)	(3.5)	(48)	(3.6)
Capital gains rate differential	(42)	(1.8)	(59)	(4.1)	(7)	(0.5)
Other — net	29	1.2	57	3.9	(48)	(3.7)
	\$1,096	45.6	\$571	39.4	\$ 249	18.8

6. Commitments

PGL leases certain branch facilities under "operating leases." Future minimum lease payments total \$6,360,000 and are payable as follows: 1988 \$869,000; 1989 \$769,000; 1990 \$565,000; 1991 \$499,000; 1992 \$492,000, and thereafter \$3,166,000. The lease obligations also extend to property taxes, insurance, and repairs and maintenance. Total lease expense charged to operations in the three fiscal years ended 1987 was \$687,000, \$636,000 and \$647,000, respectively.

7. Stock Purchase Plan and Stock Options

Stock Purchase Plan

PGL has an employee stock purchase plan for all employees with more than one year of service. 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. As of January 30, 1987, 508 employees were eligible to participate in the Plan and 239 were enrolled.

A summary of the stock purchase plan activity for the three fiscal years ended 1987 follows:

<i>Fiscal Year Ended</i>	Shares Purchased	Average Price Per Share	Total
1987	28,739	\$7.14	\$205,200
1986	34,949	6.92	241,900
1985	38,172	7.07	269,900

At January 30, 1987, common stock reserved for issuance under this plan was 41,376 shares.

Stock Options

A total of 421,301 shares of common stock has been approved for issuance under the Incentive Stock Option Plan. The option price for common stock is the market value at the date of grant. The options are non-transferable and are exercisable over five years from the date of grant. As of January 30, 1987, options were granted and are outstanding to a total of 31 employees. Options for 196,959 shares of common stock were available for grant at January 30, 1987. A summary of the activity, for the three fiscal years ended 1987 follows:

	Number of Shares	Option Price		Market Price	
		Avg. Price Per Share	Total	Per Share	Total
Fiscal Year ended 1987:					
Granted	—	—	—		
Exercised	57,725	\$6.81	\$392,849	\$8.25	\$475,948
Outstanding and Exercisable	172,656	7.62	1,315,247		
Fiscal Year ended 1986:					
Granted	61,000	7.38	449,875		
Exercised	1,082	7.63	8,253	8.63	9,332
Outstanding and Exercisable*	262,356	7.45	1,953,800		
Fiscal Year ended 1985:					
Granted	81,500	8.00	652,250		
Exercised	2,122	7.54	16,003	9.13	19,375
Outstanding and Exercisable*	208,972	7.48	1,562,600		

*Adjusted for the 4% stock dividends distributed in October 1985.

8. Unaudited Quarterly Financial Results

<i>Amounts in thousands, except per share data</i>	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Net Sales:				
1987	\$33,767	\$46,597	\$60,018	\$46,859
1986	32,975	37,510	39,941	30,347
Cost of Goods Sold:				
1987	\$27,847	\$38,804	\$50,273	\$39,241
1986	27,037	31,210	32,991	24,907
Net Income:				
1987	\$59	\$477	\$664	\$106
1986	11	213	625	29
Net Income Per Share:*				
1987	\$.02	\$.12	\$.17	\$.03
1986	—	.06	.16	.01
Quoted Market Price:*				
1987 High	\$10	\$9⁵/₈	\$9³/₈	\$8¹/₂
Low	7³/₈	7³/₈	8	7¹/₄
1986 High	9 ¹ / ₂	8 ⁵ / ₈	7 ⁷ / ₈	8 ¹ / ₄
Low	7 ³ / ₄	7 ⁵ / ₈	6 ³ / ₈	7
Dividends Per Share:*				
1987	\$.07	\$.07	\$.07	\$.07
1986	.07	.07	.07	.07

*Adjusted for Stock Dividends

Due to changes in the average number of shares outstanding during the year, the net income per share for the year does not necessarily equal the sum of the net income per share for each quarter.

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 30, 1987, and January 31, 1986 and the related consolidated statements of income, stockholders' equity and changes in financial position for each of the three years in the period ended January 30, 1987. 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 financial statements referred to above present fairly the financial position of Palmer G. Lewis Co., Inc. and subsidiaries as of January 30, 1987, and January 31, 1986, and the results of their operations and the changes in their financial position for each of the three years in the period ended January 30, 1987, in conformity with generally accepted accounting principles applied on a consistent basis.

Arthur Andersen & Co.

Seattle, Washington,
March 17, 1987.

Board of Directors

John N. Anderson†

*Chairman, President, and
Chief Executive Officer*
Palmer G. Lewis Co., Inc.
Auburn, Washington

Jim Ben Edens

Vice President
Palmer G. Lewis Co., Inc.
and President
PGL Building Products
Auburn, Washington

Douglas S. Gamble*

Retired President, CEO
Pacific Gamble Robinson
Bellevue, Washington

Elliot K. Knutson*

*President and
Chief Executive Officer*
Washington Federal Savings
and Loan Association
of Seattle
Seattle, Washington
(Financial Services)

Robert D. Peterson†

Retired Chairman of the Board
Palmer G. Lewis Co., Inc.
Auburn, Washington

L.W. Wells*†

Executive Vice President
SAFECO Properties, Inc.
Seattle, Washington
(Financial Services)

*Member of Audit Committee

†Member of Executive Committee

Annual Meeting

The annual meeting of shareholders of Palmer G. Lewis Co., Inc. will be held on Friday, May 15, 1987, at 2:00 p.m. in the Auditorium of the Washington Athletic Club, 1325 6th Avenue, Seattle, Washington.

Attorneys

Cartano, Botzer, Larson
and Birkholz
Seattle, Washington

Independent Public Accountants

Arthur Andersen & Co.
Seattle, Washington

Registrar and Transfer Agent

First Interstate Bank of California
Los Angeles, California

Additional Information

A copy of the Company's Form 10-K report for the year ended January 30, 1987 including financial statements and schedules, which will be filed with the Securities and Exchange Commission by May 1, 1987, is available to stockholders, without charge, upon written request to:

Lee R. Singer

Secretary
Palmer G. Lewis Co., Inc.
P.O. Box 1049
Auburn, Washington 98071-1049



Corporate Headquarters

525 C Street N.W.
Auburn, WA 98001-3944

John N. Anderson

*Chairman, President, and
Chief Executive Officer*

Palmer G. Lewis

*Emeritus Chairman
of the Board*

Jim Ben Edens

Vice President

Lee R. Singer

Secretary

Manager, Operations Analysis

Joseph M. Cahir

Treasurer

Corporate Controller

PGL Building Products Headquarters

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Auburn, WA 98001-3944

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President

Carl A. Liliequist

Director of Sales & Marketing

James L. Lang

Industrial Sales Manager

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Anchorage, AK 99502

Craig M. Herrity

Manager

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Benicia, CA 94510

Richard LeClair

Manager

Boise Branch

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Boise, ID 83705

Raymond E. Ogden

Manager

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Bremerton, WA 98801

John C. Ruud

Manager

City of Industry Branch

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William E. Conroy

Manager

Fresno Branch

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Fresno, CA 93703

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Manager

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Bothell, WA 98011

Jeffrey Z. Aiken

Manager

Marysville Branch

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Marysville, WA 98270

Robert Dunn

Manager

Medford Branch

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Medford, OR 97501

Harry Gerhard

Manager

Phoenix Branch

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Phoenix, AZ 85017

A. Wayne Helm

Manager

Reno Branch

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Reno, NV 89504

Kenneth T. Ammon

Manager

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Rialto, CA 92376

Wendell H. Lawson

Manager

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Sacramento, CA 95828

Earl W. Van Buskirk

Manager

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Robert E. Johnson

Manager

Tigard Branch

8100 Southwest Hunziker Road
Tigard, OR 97723

Thomas V. Horstmann

Manager

Yakima Branch

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Yakima, WA 98902

L.L. (Pete) Briles

Manager

Sea-Pac Sales Company Headquarters

3800 First Avenue South
Seattle, WA 98134

John N. Anderson

President

Dennis R. Moore

Vice President

Floor Products Division

David H. Blakley

Vice President

Appliance Division

Lyman H. Black

Vice President

Operations

Melvin D. Knorr

Vice President

Sales Administration

Billings Branch

505 North 26th Street
Billings, MT 59101

Bernice J. Beach

Operations Manager

Portland Branch

6060 North Cutter Circle
Portland, OR 97217-3935

Dale J. Griffiths

Manager

Salt Lake City Branch

1011 West 2610 South
Salt Lake City, UT 84119

Bruce D. Johnson

Manager

Spokane Branch

East 410 Trent Avenue
Spokane, WA 99202

Larry Rust

Regional Sales Manager

Bernice J. Beach

Operations Manager

Cochrane Northwest, Inc. Headquarters

3800 First Avenue South
Seattle, WA 98134

Mark F. Smith

President and General Manager

Peter Shirley

Sales Manager

Seattle Branch

3800 First Avenue South
Seattle, WA 98134

Thomas Strom

Manager

Spokane Branch

North 110 Greene Street
Spokane, WA 98202

Boyd C. Edelin

Manager

Tacoma Branch

1916 Marc Street
Tacoma, WA 98401

Rick Mercurio

Manager

Truck Service, Inc. Headquarters

911 West James Street
Kent, WA 98031

James V. Kelly

*Vice President and
General Manager*

Palmer G. Lewis Co., Inc.

P.O. Box 1049, Auburn, WA 98071-1049

PGL Product Lines

Adhesives
Caulking and Sealants
Caulking Guns
Eagle Grip Adhesives
Geocel Caulking

Insulation — Rigid
Fiberboard Roof Insulation
Fiberglass Roof Insulation
Fiberboard Sheathing
Foamboard
Foamular

— Soft
Insulation
Accessories

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Barkertile Panels and Tub Kits

Prefinished Wood Panels

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Steel and Wire Products

All Thread Rod
Barbed Wire
Farm Gates
Fence Posts
Field Fence
Galvanized Merchant Wire
Galvanized Utility Fabric
Hardware Cloth
Home and Garden Fence
Horse and Paddock Fence
Livestock Water Tanks
Material Handling Equipment
Nail Bins
Nails
Panel Nails
Poultry Netting
Rebar
Reinforcing Mesh
Stronghold, Helyx and Other
Specialty Nails
Tie Wire and Foundation Bolts

Wood — Lumber

1" Boards
Cedar Lumber
Decking
Dimension Lumber
Glu-Lam Beams
Pine Lumber
Redwood Lumber
Studs
Timbers
Treated Lumber and Plywood

Wood — Plywood

Marine Plywood
Particleboard
Plywood Sidings
Sanded and Sheathing
Waferwood

Wood — Specialty and Landscape Items

Bender Board
Cedar Lattice Panels
Exterior Doors
Fence Posts
Hardwood Lumber
Hardwood Plywood
Masonite Sidings
Moulding and Millwork
Peeler Cores
Railroad Ties
Surveyor Stakes
Shim and Undercourse Shingles
Wood Dowels
Wood Lath
Wood Shakes and Shingles
Particleboard Shelving

Sea-Pac Product Lines

Armstrong Carpeting
Armstrong Resilient Flooring
Bruce Wood Flooring
Carpet Pad
Gibson Home Appliances
Kentucky Wood Flooring
Modern Maid Appliances
Sharp Microwave Ovens

Cochrane Northwest Product Lines

Adhesives and Sealants
Aluminum/Plastic Mouldings
and Trims
Carpet Cushion
Carpet Tackstrip
Carpet Tapes
Floor Tools and Accessories
Grouts and Mortar
Marlite Products
Pionite Laminates
Ricchetti Ceramic Tile
Roppe Rubber Base Trim,
Treads and Raised Tile
Staples and Specialty Nails
Wilsonart Laminates