

Palmer G. Lewis Co., Inc.

1987 Annual Report

ANNUAL REPORTS
Palmer G. Lewis Co., Inc. 1987

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We believe in building mutually beneficial relationships with our customers, our stockholders, our suppliers and our employees. Palmer G. Lewis Co., Inc. will strive to be known as the best service-oriented wholesale distributor of building-related materials in the United States.

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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 15 service centers from Alaska to Arizona. Sea-Pac Sales Company, with five locations in the North-

west, 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



Financial Highlights

Years Ended	Jan. 29, 1988	Jan. 30, 1987	% Change
Net Sales	\$216,588,921	\$187,241,380	+16
Net Income before Tax	\$ 2,784,611	\$ 2,402,595	+16
Net Income after Tax	\$ 1,570,611	\$ 1,306,595	+20
Net Income per Share	\$.40	\$.33	+21
Cash Dividends per Share	\$.28	\$.28	—
Total Assets	\$ 60,180,146	\$ 65,511,180	-8
Stockholders' Equity	\$ 31,940,190	\$ 33,927,536	-6
Average Shares Outstanding	3,938,796	3,942,265	—

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Message to PGL Stockholders

Year-end messages to stockholders are easier to write when things are going better for the subject Company. Such is the case for the fiscal year just ended.

Again in 1987 our Company has improved its recent performance as measured by total dollars earned and by earnings per share. The 21% increase in earnings per share continues a three-year trend toward increased profitability. This bottom line increase in profitability was achieved even after a \$239,000 provision for a LIFO reserve, and after the closure of two branches of PGL Building Products in Spokane and Boise.

At mid-year the directors voted to purchase up to 500,000 shares of PGL stock at what appeared to be attractive investment prices. At year-end we had purchased 437,850 shares, 11% of the total outstanding shares, at an average cost of \$6.98 per share, approximately \$1.75 below book value. We have since purchased additional shares at about the same price. In spite of over \$3 million used for stock purchases, and a reduction of over \$1 million in long-term debt, we have been able to retain a current ratio of 2.3 to 1, a healthy ratio by any standards. Book value was increased to \$8.76 per share, and cash flow remains strong.

PGL employees are playing a key role in our

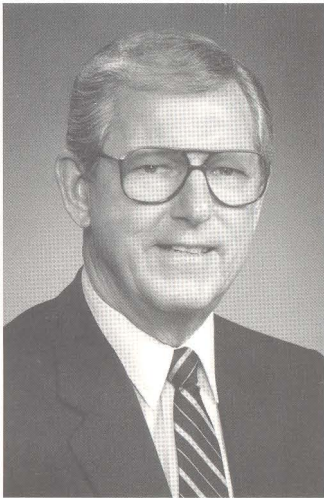
improved performance. During 1987 there was a concerted effort to train employees in most departments on the importance of return on investment, and the key elements which affect better bottom line performance. We have seen a marked improvement in inventory turns, greater selectivity in product choices to be distributed, and the more timely sale of unused assets.

Understandably, there seems to be a growing concern, both inside and outside our organization, as to where the Company is headed. There are some basic facts which can help answer this question. These questions have arisen because of the closing of some of our unprofitable branches and the resultant reduction of personnel at both the branches and at headquarters. The fact is that these branches had not been profitable for several years, and these actions, in retrospect, should have been taken some time ago. On several occasions we have stated that size alone is not a goal of this management. The elimination of losing operations, which result in improved corporate profits, should rightfully be viewed with enthusiasm by stockholders.

Our attitude is that we should achieve adequate profitability within our present organization before actively

seeking new acquisition opportunities. Those observers who interpret our corrective actions as part of a receding Company are seriously misreading our true business philosophy. We expect to be a growing Company, first in earnings per share in the present organization, and then in future earnings per share increases through addition of profitable sales generated both internally and by acquisition. The acquisition path is not always easy to predict. The two most recent important acquisitions happened in unexpected ways which could not have been foreseen greatly in advance. Because of our strong financial statement, we are able to evaluate any variety of opportunities and act in ways which will maximize additional value to our Company.

Both management and the Board of Directors recognize the need to improve stockholder value. Usually the way to do this in our kind of business is to increase bottom line profits. We clearly have a trend going in our favor. Now our efforts are directed to sharpening the upward earnings curve. Barring unforeseen difficulties, stockholders should expect to benefit through continued improved Company performance.



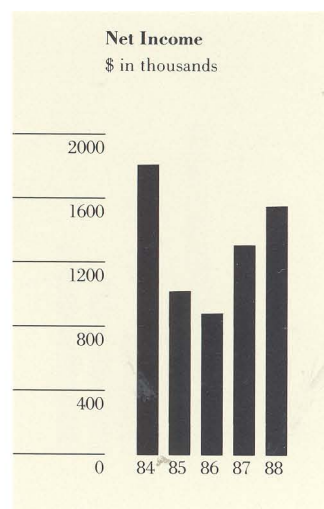
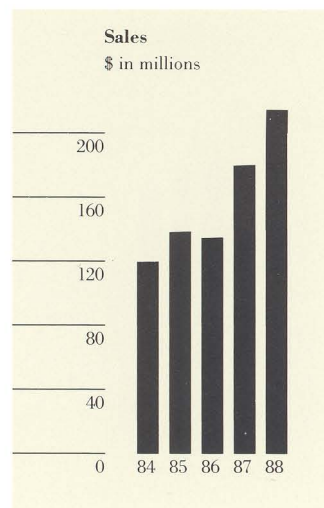
John N. Anderson
John N. Anderson
Chairman, President, and
Chief Executive Officer

SERVICE
PLUS

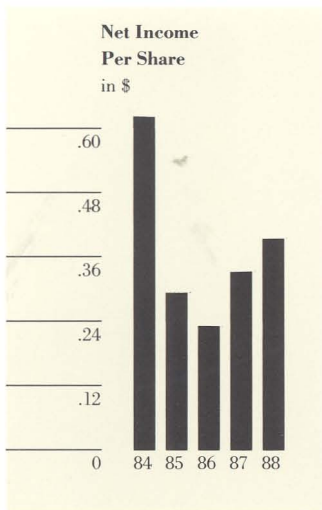
Management's Discussion

The Palmer G. Lewis Co., Inc. Companies have operated with a consistent guiding philosophy—quality products and quality service will never be compromised. That guiding philosophy has enabled the Company to develop strong ties as the vital link between our suppliers and customers. The distribution business has greatly changed over the last few years, and will

likely continue to do so for some time to come. The Palmer G. Lewis Company has similarly changed, and is changing its methods of operation, while maintaining its objectives of consistent, quality service. We view outstanding service as a value-added component of our products. That objective has been a guiding motto since the inception of the Palmer G. Lewis



We are using
SERVICE PLUS
to identify this
recommitment
and to instill
this philosophy
throughout all
levels of the
organization.



Company, and is currently taking on an even greater meaning and emphasis as the Company approaches its 50th anniversary year.

Hard work and a complete rededication to our fundamental principle, succinctly summarizes the approach each of the Palmer G. Lewis Companies is currently undertaking. This commitment represents the Companies' investment in the future. We are using the motto —SERVICE PLUS— to identify this recommitment and to instill this philosophy throughout all levels of the organization. Management of each of the Palmer G. Lewis Companies is instituting plans to take these concepts into action. At PGL Building Products, for example —new service-

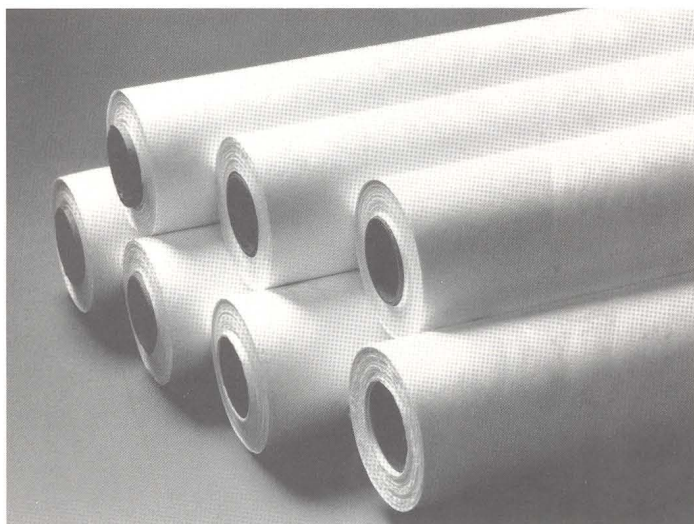
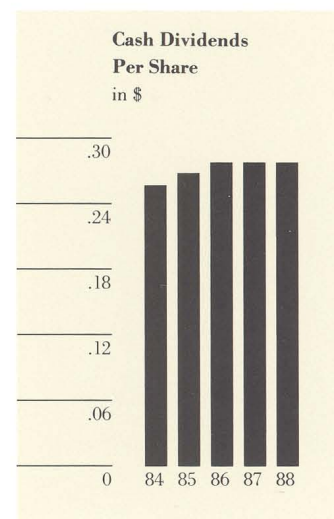
driven marketing programs are being emphasized and recognition of employees demonstrating levels of superior service is occurring regularly.

Our outstanding service commitment is demonstrated through our professional and reliable sales force, consistently high levels of inventory fill rates, cooperative advertising programs, including administrative support, and efficient and consistent trucking deliveries. This continual commitment is evidenced by the long-term relationships we have maintained with many of our customers.

As another example of this reemphasis, Sea-Pac Sales Company has instituted a specific quality control program in one of its

product lines. For customers participating in this service program, Sea-Pac guarantees absolute customer satisfaction in terms of product quality and service as well as offering other dealer assistance incentives. Sea-Pac backs up this guarantee with a monetary commitment. This program has also been taken internally to recognize employees demonstrating outstanding customer service. Sea-Pac is working aggressively to have Sea-Pac and SERVICE PLUS become synonymous in our customers' minds. Through these and other programs, Sea-Pac is adding value to its products through customer service.

The Company is building stronger relationships with our customers and our suppliers through such programs. We view these ties as critical to the continuance of our quality product and service commitment. We view our suppliers as partners who share our goal of achieving the highest quality standards and most consistent levels of service.



Tyvek Housewrap, an energy saving air filtration barrier, is one of the fine products distributed by the Company.

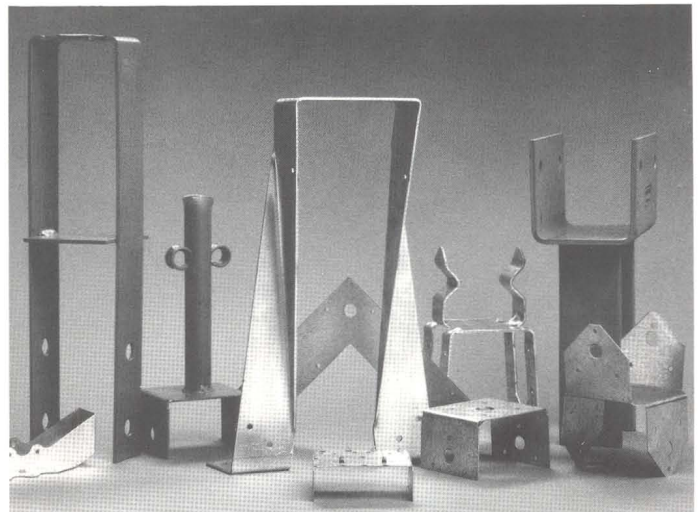
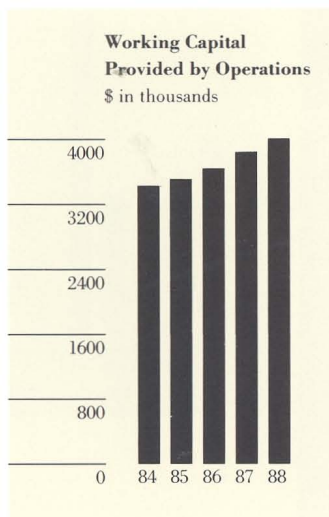
Responding to our customer needs on a timely basis with superior service requires immense coordination both within our Company and with the supplier. The Palmer G. Lewis Company has been and will continue to be a dependable, reliable source of products for our customers.

These interrelationships build value, not only in fulfilling the customers' needs, but also in building a more valuable Company for our stockholders. The management of the Palmer G. Lewis Company is dedicated to creating value by performing in a manner that will enhance our stockholders' returns on their investments. Increasing the Company's returns includes not only earning higher margins and decreasing operating costs to yield enhanced bottom-line profitability; but it also entails purchasing common stock to increase earnings per share, maintaining cash flow from income tax advantages of the LIFO method of inven-

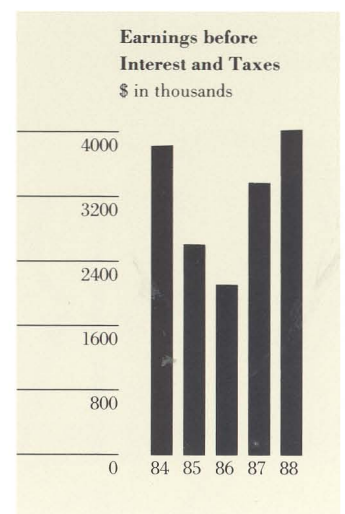
tory reporting, continuing improvements in inventory and receivables management, and increasing our employees' understanding of the fundamental reasons to increasing profitability through return on investment seminars.

We believe that the integrity of our employees and our professional, reliable sales force have served the Company and our customers well over our first 49 years, and have built a strong and stable Company. This stability has been a source of strength for current Company operations and a good foundation to build on for the future. It is through processes such as our current recommitment to service through our SERVICE PLUS theme that

keeps this strength vital and alive. The Company has operated for decades with the knowledge that quality products and quality service are two of its most valuable assets. Our attention to high quality customer service and attention to detail will never diminish. We are rebuilding our Company for the positive years that lie ahead of us. We believe that we are currently changing the focus of our efforts to take the greatest advantage of the opportunities available to us. We are continuing to aim all our efforts towards the overriding concerns of consistent, uncompromising, quality products and quality service in order to achieve higher returns on investment for our stockholders.



The Simpson Strong-Tie Connectors line is another example of the high quality products that the Company distributes.



Our attention to high quality customer service and attention to detail will never diminish.

Financial Statement Data

The Company's balance sheet remains very strong, even after the purchase, during the latter part of the year, of 438,000 shares of its common stock for approximately \$3,058,000. These purchases were at prices averaging well below book value per share. Cash flow continues to be very healthy and has allowed the Company to purchase this stock as well as pay off the current maturities of its long-term obligations without significantly increasing its short-term borrowing requirements. During the year, the Company negotiated a \$10 million committed line of credit with a bank at favorable rates. The Company's short-term financing requirements were down significantly from the prior year, peaking at approximately \$5 million. Working capital is 2.3:1 at January 29, 1988, down slightly from

the prior year due to the common stock purchases. Additions to property, plant, and equipment continue to be tightly controlled as the Company continues to focus on generating higher returns on invested assets.

Net sales for the Company increased 16% over the prior year, due primarily to the inclusion of Western American for a full year. Earnings per share increased to \$.40 per share from \$.33 per share, an increase of 21%. The Company continues to pay cash dividends of \$.28 per share (\$.07 per quarter), the same rate that it has paid for the last three years.

SERVICE
PLUS

Selected Consolidated Financial Information

Fiscal Years Ended January	1988	1987	1986	1985	1984
Income Statement Data:					
Net Sales	\$216,589,000	\$187,241,000	\$140,773,000	\$144,382,000	\$121,044,000
Depreciation and Amortization	2,605,000	2,493,000	2,322,000	2,080,000	1,599,000
Earnings Before Interest and Taxes	4,049,000	3,446,000	2,153,000	2,668,000	3,861,000
Interest Expense	1,264,000	1,043,000	704,000	1,346,000	982,000
Income Taxes	1,214,000	1,096,000	571,000	249,000	1,059,000
Net Income	1,571,000	1,307,000	878,000	1,073,000	1,820,000
Net Income Per Share	.40	.33	.23	.29	.64
Average Shares Outstanding	3,939,000	3,942,000	3,901,000	3,640,000	2,828,000
Balance Sheet Data:					
Total Assets	60,180,000	65,511,000	50,829,000	55,059,000	43,534,000
Working Capital	22,468,000	25,625,000	22,359,000	21,004,000	17,634,000
Long-Term Debt					
(net of Current Portion)	8,513,000	10,160,000	2,311,000	2,526,000	2,236,000
Capitalized Leases					
(net of Current Portion)	1,369,000	2,341,000	2,288,000	2,413,000	2,525,000
Stockholders' Equity	31,940,000	33,928,000	33,129,000	33,179,000	27,029,000
Dividends Per Common Share:					
Cash	.28	.28	.28	.27	.26
Stock	—	—	4%	4%	4%
Other Data:					
Net Capital Expenditures	392,000	1,422,000	672,000	3,648,000	1,846,000
Working capital provided by operations (net income + non-cash items)	4,051,000	3,929,000	3,741,000	3,551,000	3,418,000

Consolidated Balance Sheets

Palmer G. Lewis Co., Inc. and Subsidiaries

Assets	(January 29, 1988 and January 30, 1987)	1988	1987
Current Assets:			
Cash		\$ 749,752	\$ 2,106,654
Receivables, less allowance for doubtful accounts of \$537,000 in 1988 and \$554,000 in 1987		18,162,084	18,207,317
Inventories (Note 1)		20,292,610	22,116,604
Prepaid expenses and other		568,207	612,705
Income tax receivable		—	219,251
Total current assets		39,772,653	43,262,531
Land, Buildings and Equipment, at cost (Notes 1 and 4):			
Land and land improvements		5,077,705	5,214,882
Buildings		9,808,140	10,187,661
Equipment		9,325,527	9,788,046
Property held under capital leases		2,950,630	3,495,603
Furniture and fixtures		3,152,075	2,975,475
Construction in progress		452,887	52,213
		30,766,964	31,713,880
Less accumulated depreciation and amortization		(13,935,906)	(12,754,594)
		16,831,058	18,959,286
Other Assets:			
Notes receivable, net of current portion		1,203,223	635,332
Unamortized costs in excess of net assets of acquired businesses (Note 1)		1,339,680	1,424,323
Other		1,033,532	1,229,708
		3,576,435	3,289,363
		\$60,180,146	\$65,511,180

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

Liabilities and Stockholders' Equity	1988	1987
Current Liabilities:		
Short-term notes payable (Note 3)	\$ 2,000,000	\$ 1,500,000
Current portion of long-term debt and obligations under capital leases	1,571,496	988,152
Checks outstanding	1,640,880	2,054,423
Accounts payable	8,643,910	9,757,189
Accrued salaries and wages	1,656,725	1,418,272
Other accrued liabilities	1,745,336	1,720,582
Income taxes payable	46,407	199,109
Total current liabilities	17,304,754	17,637,727
Long-Term Debt (Note 4)	9,851,391	10,928,728
Obligations under Capital Leases (Note 4)	1,602,442	2,560,331
Less-current portion shown above	(1,571,496)	(988,152)
	9,882,337	12,500,907
Deferred Income Taxes and Other (Note 5)	1,052,865	1,445,010
Commitments (Note 6)		
Stockholders' Equity (Notes 1 and 7):		
Common stock par value \$1.00 —		
Authorized 8,000,000 shares; Issued and outstanding 3,644,123 shares in 1988 and 3,998,107 shares in 1987	3,644,123	3,998,107
Paid-in capital	24,614,475	26,709,640
Retained earnings	3,681,592	3,219,789
	31,940,190	33,927,536
	\$60,180,146	\$65,511,180

Consolidated Statements of Income

Palmer G. Lewis Co., Inc. and Subsidiaries

For the three fiscal years ended January 29, 1988

	1988	1987	1986
Net Sales	\$216,588,921	\$187,241,380	\$140,773,409
Cost and Expenses:			
Cost of goods sold	179,997,483	156,164,915	116,144,779
Selling, general and administrative expenses	30,588,028	25,928,128	20,955,850
Depreciation and amortization	2,605,312	2,492,897	2,322,235
Employees' retirement plans	333,915	211,879	83,751
Interest expense	1,264,178	1,043,093	704,337
Interest income	(243,215)	(344,818)	(476,199)
Other income	(741,391)	(657,309)	(410,828)
	213,804,310	184,838,785	139,323,925
Income before Provision for Income Taxes	2,784,611	2,402,595	1,449,484
Provision for Income Taxes (Note 5)	1,214,000	1,096,000	571,000
Net Income	\$ 1,570,611	\$ 1,306,595	\$ 878,484
Per Share Data (Note 1)			
Net Income	\$.40	\$.33	\$.23
Dividends			
Cash	\$.28	\$.28	\$.28
Stock	—	—	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 29, 1988

	Common Stock		Paid-In Capital	Retained Earnings
	Shares	Amount		
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)	36,031	36,031	214,121	—
Purchase of common stock	(15,000)	(15,000)	(95,000)	—
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
Sale of common stock under stock purchase and stock option plans (Note 7)	83,866	83,866	524,980	—
Purchase of common stock	(437,850)	(437,850)	(2,620,145)	—
Cash dividends	—	—	—	(1,108,808)
Net income	—	—	—	1,570,611
Balance, January 29, 1988	3,644,123	\$3,644,123	\$24,614,475	\$3,681,592

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 29, 1988	1988	1987	1986
Operating Activities:			
Net income	\$ 1,570,611	\$ 1,306,595	\$ 878,484
Non-cash items included in net income:			
Depreciation and amortization	2,605,312	2,492,897	2,322,235
Deferred income taxes	(125,000)	130,000	46,000
Net change in receivables, inventories, payables and accruals	1,130,203	(813,722)	3,928,494
Other	(70,969)	(275,722)	517,756
Net cash flow from operating activities	5,110,157	2,840,048	7,692,969
Investing Activities:			
Aquisition of land, buildings and equipment	(1,386,028)	(1,611,126)	(1,321,595)
Disposition of land, buildings and equipment	993,587	188,817	649,826
Long-term notes receivable issued, net	(567,891)	221,741	(162,377)
Purchase of Western American Forest Products Incorporated	—	(5,407,911)	—
Net cash used by investing activities	(960,332)	(6,608,479)	(834,146)
Financing Activities:			
Proceeds from short-term notes payable, net	500,000	1,500,000	(4,200,000)
Proceeds from employee stock purchases and option exercises	608,846	598,068	250,152
Payments of dividends	(1,108,808)	(1,106,234)	(1,068,463)
Payments to purchase common stock	(3,057,995)	—	(110,000)
Reduction in long-term debt and obligations under capital leases	(2,035,227)	(2,253,644)	(360,966)
Proceeds from long-term debt	—	3,211,389	20,782
Net cash provided from (used by) financing activities	(5,093,184)	1,949,579	(5,468,495)
Net increase (decrease) in cash, net of checks outstanding	\$ (943,359)	\$ (1,818,852)	\$ 1,390,328

The accompanying notes are an integral part of these statements.

January 29, 1988

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 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. The difference between the LIFO carrying value of Western American inventories for tax purposes and the fair market value reflected in the consolidated financial statements under purchase accounting was \$2,612,000 at the date of acquisition. The amount reflected in the financial statements is recorded net of the estimated taxes that would be paid were the LIFO election terminated for tax purposes. Thus \$1,698,000 has been included in inventories in the accompanying financial statements for this item. Additionally, had the FIFO method been used, inventories would have been greater by \$322,000 and \$83,000 at January 29, 1988 and January 30, 1987, respectively.

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 are being amortized over a 20-year period. Maintenance, repairs and minor replacements are expensed as incurred. 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.

Net Income Per Share

Net income per share is based on the weighted average number of shares of common stock outstanding during each year (3,938,796 shares in fiscal 1988; 3,942,265 shares in fiscal 1987, and 3,900,572 shares in fiscal 1986) after giving effect to the stock dividend during fiscal 1986.

Employees' Retirement Plans

The Company maintains a Profit Sharing Plan and Compensation Investment (401-K) Plan. Contributions to these plans 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 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.

3. Short-Term Notes Payable

At January 29, 1988, PGL had unsecured lines of credit with banks to borrow up to \$21,000,000, primarily at prime or lower. Information regarding short-term borrowings during the three fiscal years ended 1988 follows:

<i>(Dollar amounts in thousands)</i>	1988	1987	1986
Weighted average interest rate	7.5%	7.0%	8.7%
Average borrowings	\$2,386	\$ 3,070	\$1,754
Maximum amount of short-term borrowings at any month-end	5,000	10,200	5,900
Year-end short-term notes payable to banks	2,000	1,500	—
Year-end weighted average interest rate	7.5%	7.0%	—

4. Long-Term Debt and Obligations under Capital Leases

As of January 29, 1988 and January 30, 1987, long-term debt and obligations under capital leases consisted of the following:

<i>(Dollar amounts in thousands)</i>	1988	1987
Note payable to bank, prime interest rate or lower, unsecured, payable in semi-annual installments of \$600, plus interest, to 1991.	\$ 4,800	\$ 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	3,211
9.75% note payable, secured by a mortgage on certain land, buildings and equipment, payable in monthly installments of \$15, including interest, to 1994.	1,564	1,591
10% note payable, secured by a mortgage on certain land and buildings, payable in annual installments of \$100 plus interest to July, 1989.	200	300
9.62% note payable, secured by a mortgage on certain land and buildings, payable in monthly installments of \$3, including interest, to January, 1988.	—	275
Other	76	152
Total long-term debt	9,851	10,929
Capital lease obligations, \$33 payable monthly, including interest imputed at rates from 9% to 12.6%, to 1996.	1,602	2,560
Less-current portion	(1,571)	(988)
	\$ 9,882	\$12,501

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 29, 1988 and January 30, 1987, the capital lease obligation was \$1,068,000 and \$1,211,000, respectively, and the annual payments to the partnership during each of the three fiscal years ended 1988 were \$255,000. PGL has an option to purchase the property at any time prior to the expiration of the lease in 1993 at fair market value. There is also 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 1993 and subsequent years:

<i>Fiscal Year Ending (Amounts in thousands)</i>	Long-Term Debt	Capital Lease Obligations	Total
1989	\$ 1,338	\$ 233	\$ 1,571
1990	1,342	273	1,615
1991	1,246	287	1,533
1992	1,780	252	2,032
1993	585	273	858
Subsequent years	3,560	284	3,844
	\$ 9,851	\$1,602	\$11,453

5. Income Taxes

For the three fiscal years ended 1988, the provision for income taxes consisted of the following:

<i>(Amounts in thousands)</i>	1988	1987	1986
Federal			
Current	\$1,194	\$ 856	\$ 658
Deferred	(125)	130	(137)
	\$1,069	\$ 986	\$ 521
State			
Current	145	110	50
Total provision	\$1,214	\$1,096	\$ 571

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

<i>(Amounts in thousands)</i>	1988	1987	1986
Depreciation	\$(124)	\$ 40	\$ 184
Installment sales	52	(11)	33
Retirement benefit plans	43	62	24
Pension plan conversion	—	-	(196)
Adjustment to inventory	(147)	(99)	(99)
Other — net	51	138	(83)
	\$(125)	\$130	\$(137)

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

	1988		1987		1986	
<i>(Amounts in thousands)</i>	Amount	Percent	Amount	Percent	Amount	Percent
Federal tax at statutory rate	\$1,086	39.0	\$1,105	46.0	\$667	46.0
State taxes, net of Federal tax benefit	89	3.2	59	2.4	27	1.9
Non-deductible expenses	65	2.3	46	1.9	25	1.7
PAYSOP credit	—	—	(56)	(2.3)	(51)	(3.5)
Capital gains rate differential	(10)	(0.3)	(42)	(1.8)	(59)	(4.1)
Other — net	(16)	(0.6)	(16)	(0.6)	(38)	(2.6)
	\$1,214	43.6%	\$1,096	45.6%	\$571	39.4%

The Financial Accounting Standards Board has issued a pronouncement that would require the Company to change its method of accounting for income taxes no later than its fiscal year 1990. Adoption of the new standard will result in a catch-up adjustment that may be reported in the year the standard is implemented, or in an earlier year if the Company elects retroactive application. The Company has not yet decided when to implement this new pronouncement, nor has it decided whether to restate prior financial statements. Based on preliminary review, this pronouncement is expected to have a favorable impact on the Company's financial position.

6. Commitments

PGL leases certain branch facilities under "operating leases." Future minimum lease payments total \$5,296,000 and are payable as follows: 1989 \$781,000, 1990 \$575,000, 1991 \$540,000, 1992 \$507,000, 1993 \$384,000, and thereafter \$2,509,000. 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 1988 was \$791,000, \$687,000, \$636,000, 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 29, 1988, 500 employees were eligible to participate in the Plan and 200 were enrolled.

A summary of the stock purchase plan activity for the three fiscal years ended 1988 follows:

<i>Fiscal Year Ended</i>	Shares Purchased	Average Price Per Share	Total
1988	35,466	\$6.73	\$238,700
1987	28,739	7.14	205,200
1986	34,949	6.92	241,900

At January 29, 1988, common stock reserved for issuance under this plan was 105,910 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 29, 1988, options were granted and are outstanding to a total of 38 employees. Options for 137,762 shares of common stock are available for grant at January 29, 1988. A summary of the activity, for the three fiscal years ended 1988 is as follows:

	1988	1987	1986	1988 Option Price Range
Outstanding at beginning of year	172,656	262,356	208,972	\$5.56-8.89
Granted	94,000	—	61,000	7.50
Exercised	48,400	57,725	1,082	5.56-8.89
Cancelled	34,803	31,975	6,534	7.33-8.89
Outstanding at end of year	183,453	172,656	262,356	7.37-8.89
Exercisable at end of year	95,453	172,656	262,356	7.37-8.89

8. Unaudited Quarterly Financial Results

<i>Amounts in thousands, except per share data</i>	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Net Sales:				
1988	\$53,248	\$58,559	\$59,451	\$45,331
1987	33,767	46,597	60,018	46,859
Cost of Goods Sold:				
1988	\$44,089	\$48,932	\$49,187	\$37,789
1987	27,847	38,804	50,273	39,241
Net Income:				
1988	\$343	\$384	\$703	\$141
1987	59	477	664	106
Net Income Per Share:				
1988	\$.09	\$.10	\$.18	\$.04
1987	.02	.12	.17	.03
Quoted Market Price:				
1988 High	\$9⁷/₈	\$9¹/₂	\$9	\$7¹/₂
Low	7³/₈	8¹/₈	5⁷/₈	5¹/₂
1987 High	10	9 ⁵ / ₈	9 ³ / ₈	8 ¹ / ₂
Low	7 ³ / ₈	7 ³ / ₈	8	7 ¹ / ₄
Dividends Per Share:				
1988	\$.07	\$.07	\$.07	\$.07
1987	.07	.07	.07	.07

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.

Fourth quarter adjustments and revisions to quarterly estimates (in thousands):

1988 — LIFO provision of \$239.

— Revisions to quarterly net sales for comparability to prior year presentation.

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 29, 1988, and January 30, 1987 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 29, 1988. 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 29, 1988, and January 30, 1987, and the results of their operations and the changes in their financial position for each of the three years in the period ended January 29, 1988, in conformity with generally accepted accounting principles applied on a consistent basis.

Arthur Andersen & Co.

Seattle, Washington,
March 18, 1988.

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
Seattle, Washington
(Financial Services)

Robert D. Peterson†

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

L.W. Wells*†

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

*Member of Audit Committee

†Member of Executive Committee

Annual Meeting

The annual meeting of stockholders of Palmer G. Lewis Co., Inc. will be held on Thursday, May 19, 1988, at 2:00 p.m. in the Auditorium of the Washington Athletic Club, 1325 6th Avenue, Seattle, Washington.

Attorneys

Riddell, Williams, Bullitt,
and Walkinshaw
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 29, 1988 including financial statements and schedules, which will be filed with the Securities and Exchange Commission by May 1, 1988, 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



Management and Service Center Locations

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

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

Jim Ben Edens
President

Carl A. Liliequist
*Vice President
Sales and Marketing*

Anchorage Branch
5900 Arctic Blvd.
Anchorage, AK 99502
Craig M. Herrity
Manager

Auburn Branch
525 C Street N.W.
Auburn, WA 98001-3944
Kenneth L. Thompson
Manager

Benicia Branch
3150 Bayshore Road
Benicia, CA 94510
Richard LeClair
Manager

Bremerton Branch
Old Belfair Road
Bremerton, WA 98801
John C. Ruud
Manager

City of Industry Branch
200 North Willow Avenue
City of Industry, CA 91746
William E. Conroy
Manager

Fresno Branch
1266 North Maple Avenue
Fresno, CA 93703
Jim R. Gaither
Manager

Kenmore Branch
6820 N.E. 175th Street
Bothell, WA 98011
Jeffrey Z. Aiken
Manager

Marysville Branch
15102 35th Avenue N.E.
Marysville, WA 98270
Robert Dunn
Manager

Medford Branch
2194 Sage Road
Medford, OR 97501
Harry Gerhard
Manager

Phoenix Branch
3601 North 34th Avenue
Phoenix, AZ 85017
A. Wayne Helm
Manager

Reno Branch
353 North Park Street
Reno, NV 89504
Kenneth T. Ammon
Manager

Rialto Branch
436 West Rialto Avenue
Rialto, CA 92376
Wendell H. Lawson
Manager

Sacramento Branch
8435 24th Avenue
Sacramento, CA 95828
Gerald L. Grider
Manager

Tigard Branch
8100 Southwest Hunziker Road
Tigard, OR 97723
Thomas V. Horstmann
Manager

Yakima Branch
2703 Fruitvale Blvd.
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
Dale J. Griffiths
Manager

Salt Lake City Branch
1011 West 2610 South
Salt Lake City, UT 84119
Bruce D. Johnson
Manager

Spokane Branch
E. 4002 Ferry 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
E. 4002 Ferry Avenue
Spokane, WA 99202
Boyd C. Edelin
Manager

Tacoma Branch
1916 Marc Street
Tacoma, WA 98401
Rick Mercurio
Manager

Timberline
10503 Lakeview S.W.
Tacoma, WA 98499
Raymond Choate
Manager

Truck Service, Inc. Headquarters

911 West James Street
Kent, WA 98031
William E. LaCoste
*Vice President and
General Manager*

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

PGL

Adhesive
Caulking
Caulking
Eagle Grip
Geocel Ca

Building

Asphalt Im
Bagged Co
Building B
Cement Bo
Constructi
Durock Bo
Fireplaces
Foundation
Hardboard
Pier Blocks
Polyethylene
Sound Dea
Tyvar Cons
Tyvek Hou
Wilsonart L

Ceilings

Acoustical
Armstrong Ceiling Products
Ceiling Grid Systems
Ceiling In
Fiberglass
Luminous

Home Im Products

Barkertile
Cork
Durex Ber
Fiberglass
Landscape
Shutters
Skylights
Vinyl Tack

Lib. Label-8

Plasterboard

Lib. Label-8

Steel and Wire Products

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
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 Pad
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