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# Annual Report 1971

## **DIRECTORS**

Eric R. Haessler, *Chairman*

Arthur L. Abel

Bill J. Joyner

J. David A. McGrath

Lou Nagy

Walter G. Tharl

Larry W. Wells

## **OFFICERS**

Arthur L. Abel, *President*

Walter G. Tharl, *Treasurer*

Mark G. Copeland, *Secretary*

## **TRANSFER AGENT**

Registrar & Transfer Company

15 Exchange Place

Jersey City, New Jersey

## **AUDITORS**

Arthur Young & Company

Seattle, Washington

## **GENERAL COUNSEL**

Keane, Haessler, Harper, Pearlman & Copeland

Portland, Oregon

## **COMPANY OFFICES**

Panel Way, P. O. Box 1218

Longview, Washington

## To The Shareholders:

During 1971 your Company had revenues of \$7,292,420 and earnings of \$107,766 from continuing operations prior to write-offs of \$121,784 relating to development costs and equipment no longer applicable because of improvements in the Company's fire retardant process, repurchase of stock options for \$17,500, and provision of \$155,912 for settlement of Xercon litigation, which produced a net loss of \$186,710. Earnings were adversely affected by the 100-day West Coast dock strike, but the strike has apparently been resolved and current operations are much improved. The first quarter report is in preparation at the present time and your Company expects to be able to report the highest first quarter earnings in its history.

Marketing programs developed during 1970 produced increased sales and profits. New product lines introduced during the year should contribute to additional earnings in the future. Plant efficiency increased due to the higher level of sales, improved maintenance, less downtime and better labor utilization. Several projects have been engineered for early 1972 which will further reduce costs.

It was determined early in 1972 that certain procedures and processes used in the original approach of the fire project could be duplicated by a simpler method, and costs involved in the now discarded procedures were written off against 1971 earnings. Recent tests again indicate our ability to reach Class I flame spread on panels using our process. Final economic evaluation of the process is underway at the present time.

The furniture program moved ahead rapidly in 1971. While contributing less than 5% in total sales volume, its contribution to earnings was far more significant. The outlook for 1972 is excellent with several new customers beginning with the Company in early 1972.

Buckley Laboratories has received several orders for equipment for delivery early in 1972. Further support will be given to this activity during the months ahead.

Mr. Richard A. Setter has resigned as Chairman and as a director of the Company, but has agreed to make his services available to the Company as a consultant. Mr. Henry Preusser has joined the Company as Manager of Technical Services and Mr. Phillip Gorne as Quality Control Supervisor. Their technical competence adds to the engineering capabilities available to us through our Buckley Laboratories Division.

We particularly wish to express our appreciation to the employees who have contributed so much to the current improvement in the Company's operations.

Respectfully submitted,

  
Arthur L. Abel, President

  
Eric R. Haessler, Chairman

THE WELSH CORPORATION

## Report of Certified Public Accountants

The Board of Directors  
The Welsh Corporation

We have examined the accompanying balance sheet of The Welsh Corporation at December 31, 1971 and the related statements of operations, stockholders' equity and changes in financial position for the year then ended. Our examination was 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. We have previously made a similar examination of the financial statements for the prior year.

In our opinion, the statements mentioned above present fairly the financial position of The Welsh Corporation at December 31, 1971 and 1970, the results of operations and the changes in financial position for the years then ended, in conformity with generally accepted accounting principles applied on a consistent basis during the period.

ARTHUR YOUNG & COMPANY

Seattle, Washington  
March 28, 1972



THE WELSH CORPORATION

# Statement of Operations

Years ended December 31, 1971 and 1970

| REVENUES:   | 1971                | 1970               |
|---|---------------------|--------------------|
| Net sales.....  | \$7,245,946         | \$5,789,908        |
| Royalties and other.....  | 46,474              | 67,706             |
|   | <u>7,292,420</u>    | <u>5,857,614</u>   |
| OPERATING COSTS AND EXPENSES:   |                     |                    |
| Cost of sales.....  | 6,280,305           | 5,063,237          |
| Administrative and selling.....   | 828,368             | 706,394            |
| Research and development costs written off (Note 2).....                | 121,784             | 13,059             |
| Interest on long-term debt.....   | 22,552              | 10,275             |
| Amortization of debt discount and expense.....                          | 5,557               | 6,036              |
| Other interest.....   | 65,372              | 47,876             |
|   | <u>7,323,938</u>    | <u>5,846,877</u>   |
| Income (loss) from continuing operations.....                           | (31,518)            | 10,737             |
| (Loss) from discontinued operations of<br>Xercon Division (Note 6)..... | —                   | (138,910)          |
| (Loss) before extraordinary items.....                                  | (31,518)            | (128,173)          |
| Extraordinary items (Note 6):   |                     |                    |
| Settlement of litigation on sale of<br>Xercon Division.....             | (155,192)           | —                  |
| Life insurance proceeds.....  | —                   | 50,000             |
| Net (loss) (Note 7).....  | <u>\$ (186,710)</u> | <u>\$ (78,173)</u> |
| Common shares (Note 8).....   | <u>636,016</u>      | <u>631,418</u>     |
| Per common share (Notes 7 and 8):                                       |                     |                    |
| Income (loss) from continuing operations.....                           | \$ (.05)            | \$ .02             |
| (Loss) from discontinued operations.....                                | —                   | (.22)              |
| Extraordinary items.....  | <u>(.24)</u>        | <u>.08</u>         |
| Net (loss).....   | <u>\$ (.29)</u>     | <u>\$ (.12)</u>    |

See accompanying notes.

**Balance Sheet**

December 31, 1971 and 1970

| <b>Assets</b>  | <u>1971</u>        | <u>1970</u>        |
|--|--------------------|--------------------|
| <b>CURRENT ASSETS:</b>   |                    |                    |
| Cash.....  | \$ 130,563         | \$ 93,010          |
| Receivables:   |                    |                    |
| Trade (Pledged), less allowance of \$20,000 in 1971<br>and \$17,000 in 1970 for doubtful accounts (Note 3) | 1,298,701          | 1,007,142          |
| Other.....   | 15,266             | 160,622            |
|  | <u>1,313,967</u>   | <u>1,167,764</u>   |
| Inventories (Pledged) (Notes 1 and 3).....   | 1,181,080          | 579,943            |
| Prepaid expenses.....  | 55,036             | 69,773             |
| Total current assets.....  | <u>2,680,646</u>   | <u>1,910,490</u>   |
| <b>EQUIPMENT AND IMPROVEMENTS, AT COST (PLEDGED<br/>IN 1971) (NOTE 3):</b>                                 |                    |                    |
| Machinery and equipment.....   | 1,227,726          | 1,126,745          |
| Office equipment.....  | 30,121             | 26,423             |
| Leasehold improvements.....  | 25,401             | 25,401             |
| Construction in progress.....  | 74,284             | 49,600             |
|  | <u>1,357,532</u>   | <u>1,228,169</u>   |
| Less accumulated depreciation and amortization<br>computed principally on the straight-line method....     | 533,694            | 377,929            |
| Net equipment and improvements.....  | <u>823,838</u>     | <u>850,240</u>     |
| <b>DEFERRED CHARGES, INTANGIBLE AND OTHER ASSETS:</b>  |                    |                    |
| Deferred research and development costs (Notes 2 and 6)  | 21,084             | 87,538             |
| 8% notes receivable.....   |                    | 80,000             |
| Deposits, at cost (\$62,020 pledged under leases).....   | 74,750             | 73,625             |
| Patents, at cost less amortization of \$22,708 in 1971<br>and \$21,653 in 1970.....                        | 32,134             | 30,157             |
| Unamortized debt discount and expense, amortization<br>on the bonds outstanding method.....                | 15,811             | 21,368             |
| Cash held by sinking fund trustee (Note 3).....  | 23,082             | 27,000             |
| Total deferred charges,<br>intangible and other assets.....  | <u>166,861</u>     | <u>319,688</u>     |
|  | <u>\$3,671,345</u> | <u>\$3,080,418</u> |

See accompanying notes.

| <b>Liabilities and Stockholders' Equity</b>  | <u>1971</u>        | <u>1970</u>        |
|--|--------------------|--------------------|
| <b>CURRENT LIABILITIES:</b>  |                    |                    |
| Notes payable to bank (Note 3).....  | \$1,138,652        | \$ 799,080         |
| Trade accounts payable (Note 3).....   | 751,056            | 522,857            |
| Accrued liabilities.....   | 100,084            | 100,138            |
| Long-term debt due within one year.....  | 80,706             | 26,145             |
| Total current liabilities.....   | <u>2,070,498</u>   | <u>1,448,220</u>   |
| <b>LONG-TERM DEBT (NOTE 3):</b>  |                    |                    |
| 7% note payable to bank, due \$84,660<br>annually including interest to 1976.....  | 290,000            |                    |
| 6% convertible subordinated debentures<br>due October 1976.....  | 115,000            | 136,500            |
| Equipment contracts, due September 1972.....   |                    | 5,706              |
| Total long-term debt.....  | <u>405,000</u>     | <u>142,206</u>     |
| <b>COMMITMENTS AND CONTINGENCIES (NOTE 4)</b>  |                    |                    |
| <b>STOCKHOLDERS' EQUITY (NOTES 3 AND 5):</b>   |                    |                    |
| Preferred stock, \$100 par value; 6% cumulative<br>dividends, 1,000 shares authorized and none issued  |                    |                    |
| Convertible preferred stock, \$10 par value; 500,000<br>shares authorized and none issued  |                    |                    |
| Common stock, \$.25 par value; 3,000,000 shares<br>authorized, 115,031 shares reserved (158,911 in 1970)<br>635,929 shares issued (634,137 in 1970)..... | 158,982            | 158,534            |
| Capital in excess of par value.....  | 1,712,003          | 1,819,886          |
| Deficit.....   | (675,138)          | (488,428)          |
| Total stockholders' equity.....  | <u>1,195,847</u>   | <u>1,489,992</u>   |
|  | <u>\$3,671,345</u> | <u>\$3,080,418</u> |

See accompanying notes.

## THE WELSH CORPORATION

## Statement of Changes in Financial Position

Years ended December 31, 1971 and 1970

| SOURCE OF FUNDS:  | 1971             | 1970               |
|---|------------------|--------------------|
| Operations:   |                  |                    |
| (Loss) before extraordinary items.....  | \$ (31,518)      | \$(128,173)        |
| Charges against operations not involving working capital:                     |                  |                    |
| Depreciation and amortization.....  | 156,986          | 120,868            |
| Amortization of research and development costs (Note 2).....                  | —                | 15,259             |
| Amortization of debt discount and expense....                                 | 5,557            | 6,036              |
| Unamortized research and development costs written off (Note 2).....          | 121,784          | 53,204             |
| Equipment retirements and patents written off                                 | —                | 11,468             |
| Other.....  | (3,033)          | —                  |
|   | 249,776          | 78,662             |
| Extraordinary items (Note 6).....   | (155,192)        | 50,000             |
| 8% notes receivable cancelled.....  | 80,000           | —                  |
| Total provided by operations.....   | 174,584          | 128,662            |
| Addition to long-term debt.....   | 350,000          | —                  |
| Reduction of cash held by sinking fund trustee.....                           | 20,000           | —                  |
| Issuance of common stock and warrants (Note 5).....                           | 5,500            | 11,799             |
|   | 550,084          | 140,461            |
| APPLICATION OF FUNDS:   |                  |                    |
| Additions to equipment and improvements.....                                  | 130,580          | 310,875            |
| Additions to deferred research and development costs (Note 2).....            | 55,329           | 32,469             |
| Transfers of amounts included in above additions (Note 2).....                | (1,051)          | (121,203)          |
| Addition to 8% notes receivable.....  | —                | 80,000             |
| Addition to deposits.....   | 1,125            | 22,000             |
| Addition to patents.....  | 3,033            | 4,356              |
| Payment to sinking fund trustee (Note 3).....                                 | 13,500           | 10,140             |
| Reduction of long-term debt.....  | 87,206           | 15,645             |
| Purchase of outstanding warrants (Note 5).....                                | 24,393           | —                  |
| Expenses applicable to the registration of common stock (Note 5).....         | 88,091           | —                  |
| Other.....  | —                | 975                |
|   | 402,206          | 355,257            |
| Increase (decrease) in working capital.....                                   | <u>\$147,878</u> | <u>\$(214,796)</u> |
| The net increase (decrease) in the elements of working capital is as follows: |                  |                    |
| Cash.....   | \$ 37,553        | \$ (4,738)         |
| Receivables.....  | 146,203          | 118,789            |
| Inventories.....  | 601,137          | (269,231)          |
| Prepaid expenses.....   | (14,737)         | 32,379             |
| Notes payable to bank.....  | (339,572)        | (120,426)          |
| Trade accounts payable.....   | (228,199)        | 13,071             |
| Accrued liabilities.....  | 54               | (11,540)           |
| Long-term debt due within one year.....                                       | (54,561)         | (3,000)            |
| Customer deposit.....   | —                | 29,900             |
| Increase (decrease) in working capital.....                                   | <u>\$147,878</u> | <u>\$(214,796)</u> |

See accompanying notes.



## Statement of Stockholders' Equity

Two years ended December 31, 1971

|  | Common<br>stock   | Capital in<br>excess of<br>par value | Deficit             | Total              |
|--|-------------------|--------------------------------------|---------------------|--------------------|
| Balance, December 31, 1969.....  | \$ 157,175        | \$1,809,446                          | \$ (410,255)        | \$1,556,366        |
| Net loss, year ended<br>December 31, 1970.....   | —                 | —                                    | (78,173)            | (78,173)           |
| Issuance of 5,438 shares of<br>common stock under the<br>1968 Employee Stock<br>Bonus Plan (Note 5).....   | 1,359             | 10,440                               | —                   | 11,799             |
| Balance, December 31, 1970.....  | 158,534           | 1,819,886                            | (488,428)           | 1,489,992          |
| Net loss, year ended<br>December 31, 1971.....   |                   |                                      | (186,710)           | (186,710)          |
| Purchase of 35,750 outstand-<br>ing warrants (Note 5).....   | —                 | (24,393)                             | —                   | (24,393)           |
| Exercise of warrants to<br>purchase 2,000 shares<br>of common stock at \$2.75<br>per share (Note 5).....   | 500               | 5,000                                | —                   | 5,500              |
| Cancellation of 208 shares<br>of common stock granted<br>under the 1968 Employee<br>Stock Bonus Plan, due to<br>termination of employ-<br>ment (Note 5)..... | (52)              | (399)                                | —                   | (451)              |
| Expenses applicable to the<br>registration of 273,258<br>shares of common stock<br>(Note 5).....   | —                 | (88,091)                             | —                   | (88,091)           |
| Balance, December 31, 1971.....  | <u>\$ 158,982</u> | <u>\$1,712,003</u>                   | <u>\$ (675,138)</u> | <u>\$1,195,847</u> |

*See accompanying notes.*



THE WELSH CORPORATION

# Notes to Financial Statements

December 31, 1971

## 1. INVENTORIES

Inventories are stated at the lower of cost (first-in, first-out) or market. Market for prefinished plywood is determined on the basis of current selling prices, less cost of disposal. Market for other inventories is determined on the basis of current replacement cost.

*Inventories consist of the following:*

|                                  | 1971               | 1970             |
|----------------------------------|--------------------|------------------|
| Prefinished plywood (pledged) \$ | 516,251            | \$406,542        |
| Unfinished plywood (pledged)     | 534,884            | 69,116           |
| Supplies (pledged in 1971) ..... | 129,945            | 104,285          |
|                                  | <u>\$1,181,080</u> | <u>\$579,943</u> |

## 2. DEFERRED RESEARCH AND DEVELOPMENT COSTS

The Company follows the policy of deferring costs associated with research and development of new manufacturing processes and products. The costs of completed projects are amortized over a three-year period or the life of the process or product, whichever is shorter, and costs relative to abandoned projects are charged to expense in the year of abandonment (\$13,059 in 1970). Unamortized research and development costs of \$121,784 attributable to the Company's original process of impregnation of fire retardant chemicals into panels were written-off as of December 31, 1971 due to a decision in February 1972 to concentrate on a different process of impregnation.

Unamortized costs of \$40,145 (\$15,259 amortized) relating to solid-state light sensitive limit switches were written-off in connection with the disposition of the Xercon Division in 1970.

Costs aggregating \$121,203 relating to the furniture project were transferred in 1970 to machinery and equipment representing the cost of four machines being used in operations; the portion thereof representing research and development costs is not determinable.

The recovery of research and development costs as of December 31, 1971, in the amount of \$21,084 relative to a fire retardant process is dependent upon future developments.

## 3. LONG-TERM DEBT

At December 31, 1971, all trade receivables, inventories, equipment and improvements are pledged as collateral under security agreements covering all bank indebtedness and a trade account payable.

The 6 $\frac{3}{4}$ % convertible subordinated debentures are convertible into common stock until October 31, 1976 at \$7.21 per share, subject to anti-dilution adjustments. At December 31, 1971 18,031 shares of common stock were reserved for this conversion. Sinking fund payments are required each October 31, with \$15,000 due in 1972 and increasing to \$27,000 in 1976. Under terms of the indenture, when sinking fund cash exceeds \$25,000, the trustee is required to call (on October 31) for redemption at par, plus accrued interest, a sufficient number of debentures to use the amount in the fund. The indenture also contains, among other restrictions, provisions limiting payments for cash dividends on and redemption or other acquisition of the Company's common stock, except for stockholder approved bonus plans, if, after giving effect to such transactions, retained earnings would be less than \$250,000.

## 4. COMMITMENTS AND CONTINGENCIES

The Company's panel manufacturing operations are conducted on premises leased from the Port of Longview. The rent commitment per year under these non-cancellable leases, exclusive of payments for maintenance and insurance, is \$48,000 through 1972; \$56,000 in 1973; \$62,000 for 1974 through 1982; and \$35,000 in 1983. The Company has an option to renew these leases for five-year periods to a maximum of thirty years at rentals to be determined.

The laboratory premises are rented under an assignable lease calling for payments, exclusive of maintenance and insurance, of \$19,200 per year until December 1978, with an option to renew the lease at approximately the same rental for two five-year periods. The Company has equipment lease commitments of \$9,000 annually through 1972 and \$6,500 for 1973 and 1974.

Several patents and processes are being used under a licensing agreement requiring minimum royalty payments of \$12,000 per year to 1973. Royalty payments were \$12,000 each in 1970 and 1971.

## 5. STOCKHOLDERS' EQUITY

*Stock purchase warrants:*

At December 31, 1971 warrants were outstanding and exercisable for the purchase of common stock as follows:

| NUMBER OF<br>SHARES | PRICE PER<br>SHARE | EXPIRATION<br>DATE |
|---------------------|--------------------|--------------------|
| 1,000               | \$ 9.63            | October 22, 1973   |
| 1,000               | \$10.75            | November 15, 1973  |



In July, 1971, warrants outstanding at December 31, 1970 covering 35,750 shares were purchased at prices ranging from \$ .40 to \$ .85 per warrant aggregating \$24,393.

Warrants to purchase 2,000 shares of common stock at \$2.75 per share (aggregating \$5,500) were exercised in December 1971. The market value at the date exercised was approximately \$3.25 per share (aggregating \$6,500). An additional 3,500 warrants expired during the year ended December 31, 1971. No other warrants were exercised during the two years ended December 31, 1971.

#### *Stock plans:*

At December 31, 1971, outstanding options granted in 1968 under an Executive Stock Option Plan to purchase 23,333 and 10,000 shares of common stock at \$7.00 and \$8.25 per share, respectively, (market value on the date of grant) aggregating \$245,831 were exercisable and expire in 1973. The market values on the dates first exercisable in 1969 were approximately \$17.25 and \$16.50 per share, respectively (aggregating \$567,494). In July 1971, the Company purchased 11,667 options, that had been outstanding at December 31, 1970, for \$17,500, which amount has been charged to operations as compensation. These options are available for grant under this plan.

In July 1970, the Board of Directors adopted a Qualified Stock Option Plan covering 50,000 shares of common stock. The Board of Directors may establish the terms of each option provided the exercise price is not less than the market value of the common stock at date of grant; the option term may not exceed five years from date of grant and the option may not be exercised prior to the expiration of the first six months of its term. At December 31, 1971, options to purchase 22,000 shares of common stock granted at \$2.07 per share (market value at grant date in July 1970) were outstanding (aggregating \$45,540). These granted options are exercisable 25% per year on a cumulative basis beginning with the date of grant. The market value of 4,400 shares (20%) at the dates first exercisable in 1971 was approximately \$5.50 per share, aggregating \$24,200; the option price of these shares was \$2.07 per share, aggregating \$9,100.

In July 1970, the administrative committee issued 5,438 shares, including 760 shares subject to cancellation in the event of termination of employment, expiring in January 1973, of common stock under the 1968 Employee Stock Bonus Plan which was terminated in October 1970. The shares were valued at the then current market of \$2.17 per share and \$4,781, the undistributed portion of the 1968 provision, was credited to income.

#### *Capital in excess of par value:*

In connection with a private placement of common stock in 1968, the Company was obligated to register those shares; costs of \$88,091 incurred through December 31, 1971, applicable to a registration statement which was declared effective in 1971, have been charged to capital in excess of par value.

#### 6. LOSS FROM DISCONTINUED OPERATIONS AND EXTRAORDINARY ITEMS

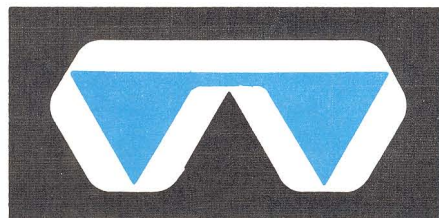
Included in the loss on discontinued operations are the 1970 net sales applicable to the Xercon Division (operations began in 1970) of \$131,000 which resulted in a loss on operations of \$147,352 less an \$8,442 gain (\$150,000 selling price) from the sale of the division's assets and the write-off of \$40,145 unamortized research and development costs, in connection with disposition of the division. These assets were sold following the death of the division's scientist, whose life was insured by the Company for \$50,000. In mid 1971, controversy arose over the sale which culminated in a suit being filed in January 1972. Rather than engage in lengthy litigation the Company settled out of court for \$155,192 in March 1972. The settlement of this litigation has been included as an extraordinary charge in 1971, as it resulted from a non-recurring transaction, i.e. sale of the Xercon Division.

#### 7. FEDERAL INCOME TAX

At December 31, 1971, net operating loss deductions were available to reduce future taxable income in the aggregate amount of approximately \$316,000, of which \$154,000 expires in 1972, \$26,000 in 1974 and \$136,000 in 1975 and an investment tax credit of approximately \$26,000 may be carried over for tax purposes through 1977. The settlement of litigation (\$155,192) and the write-off of unamortized research and development costs (\$121,784) will be deducted for federal income tax purposes in future periods. Consequently, the Company will have taxable income in 1971 of approximately \$100,000. The Company accounts for the investment tax credit on the flow-through method of accounting.

#### 8. PER COMMON SHARE

Per share computations are based on the weighted average number of shares of common stock outstanding. Contingently issuable shares were anti-dilutive in 1970 and 1971. Shares issuable upon conversion of the 6% convertible subordinated debentures were not common stock equivalents at date of issue.



THE WELSH CORPORATION / LONGVIEW, WASHINGTON