

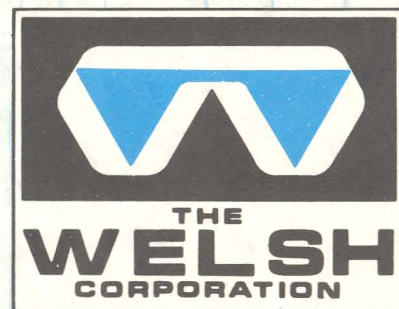
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ANNUAL REPORT

PACIFIC

JUL 6 1973



ANNUAL REPORT 1972

FINANCIAL HIGHLIGHTS

	<u>1972</u>	<u>1971</u>	<u>1970</u>
REVENUES	\$9,863,900	\$7,292,400	\$5,857,600
INCOME FROM CONTINUING OPERATIONS ...	181,800	90,300 ¹	10,700
NET INCOME (LOSS)	336,800	(186,700)	(78,200)
WORKING CAPITAL PROVIDED FROM OPERATIONS	501,200	174,600	128,700
WORKING CAPITAL	715,800	610,100	462,300
TOTAL ASSETS	5,242,000	3,671,000	3,080,000
STOCKHOLDERS' EQUITY	1,508,400	1,195,800	1,490,000
<hr/>			
AVERAGE SHARES	646,297	636,016	631,418
<hr/>			
EARNINGS PER COMMON SHARE:			
Income from continuing operations	\$.28	\$.14 ¹	\$.02
Extraordinary items and discontinued operations24	(.24)	(.14) ²
Net Income (loss)52	(.29)	(.12)

¹Before write-off of \$122,000 (\$.19 loss per share) of abandoned research and development costs.

²Includes \$.22 loss per share from discontinued operations.

TO OUR SHAREHOLDERS

Your new management is pleased to report record revenues and earnings were achieved for 1972. Revenues were \$9,864,000 and net earnings, free of income tax as a result of the loss carryforwards, were \$337,000, or \$.52 per share. This compared with revenues of \$7,292,420 and a net loss of \$186,710 reported for 1971.

The year 1972 saw actions planned in 1971, which were delayed by that year's 100-day dock strike, begin to bear fruit. Sales of wall panels and specialty products, including particleboard, increased rapidly as new accounts were opened and new products developed and introduced to the market. The Company's plant at Longview, Washington was operated at capacity during the year. A new plant was opened in Anaheim, California for the production of prefinished lauan and particleboard—specialty products, to better serve the West Coast furniture manufacturers. With the transfer of the specialty products from the Longview plant, increased efficiency in manufacturing has been achieved.

Continued increases in eastbound freight rates have led us to the conclusion that an eastern production facility should be planned in the near future. During 1972 a concentrated sales effort was made to increase our share of the western markets as well as to develop new outlets in the East to absorb the anticipated output of a proposed eastern facility.

The Buckley Laboratory Division, which contributed a modest profit in 1972, has received orders for equipment which will utilize its capacity through 1973. The Company also negotiated a raw wood purchasing agreement with an importer which should produce significant long-term benefits. In addition, the Company has increasingly relied on its own resources for acquiring raw wood. While there currently is instability in

raw wood markets, relationships established over the years appear to have assured the Company of an adequate supply of raw wood at prevailing market prices.

Most important during 1972 were contributions of the people who work at Welsh. Some came to the Company in 1972 and some undertook new challenges. In October, 1972, Mr. Ken Tourtellot, previously regional sales representative, mobile homes, Northwest, became Marketing Manager, with responsibility for all sales and marketing efforts for wall panels. Mr. Henry Preusser, Manager of Technical Services, and Mr. Michael Shaver, Manager of Specialty Products, engineered and supervised the development and construction of the Anaheim plant. The production staff in Longview, under Mr. Stough and Mr. Hensley, worked together to increase the capacity and efficiency of the Longview plant. Mr. Buckley successfully obtained substantial orders for equipment produced by that division. After a year-long study by our Treasurer and Controller, Mr. Tharl, a computer has been installed and is operating on various management and financial control programs. It is anticipated that this system will allow us to absorb additional growth with tight management and financial control. These people, however, merely typify the new attitude of all employees at Welsh.

The outlook for the year ahead is one of continued growth, increased profitability and the continued development of a strong vital management team. New challenges for 1973 will include planning for and financing an East Coast plant to increase productive capacity and enable the Company to service effectively the larger East Coast markets, expansion of the Anaheim plant and undertaking sales of related products. We are currently engaged in negotiations for the Longview plant labor contract. It is too early to determine what the results of these negotiations will be.

I wish to express my thanks to the many people who have worked so hard with me to make 1972 the successful year that it was.

Respectfully submitted,



Arthur L. Abel, President

PRODUCTS AND SALES

Manufactured Products

Welsh prefinishes and sells lauan wall panels. It also embosses and prints lauan plywood, hardboard and particleboard for sales to the furniture industry. Equipment is manufactured and sold by Welsh to the prefinish and paper industries.

Sales

Panels. Prefinished panels are sold nationally and in Canada by Welsh's own sales staff to independent building materials distributors, mobile home manufacturers and mass merchandisers. The principal lines are identifiable by names including "Ultima," "Elm," "Tomok," "Frontier," "Carriage House," and "Pique." These are shown in the sales brochure accompanying this report.

During 1972, increased sales efforts were made in areas west of the Rocky Mountains where Welsh has a freight advantage over prefinishers located in other parts of the United States. Sales in this area grew substantially in 1972 to 45% of total panel sales. Despite the emphasis upon western sales and substantially increased freight rates to eastern points, approximately 13% of Welsh's panel production in 1972 was sold on the East Coast. Welsh believes that because of the quality of its panels these sales were achieved despite freight advantages enjoyed by competition.

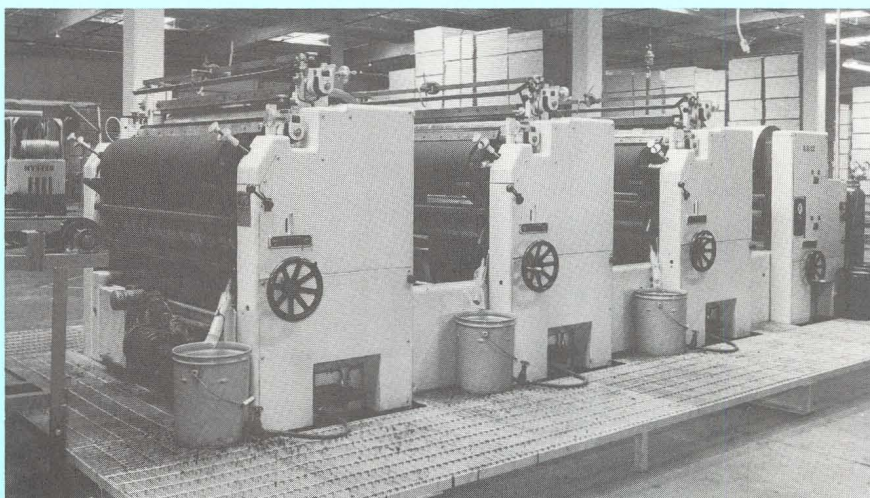
Specialty Products. Commencing in 1972, sales of specialty products, including embossed and printed particleboard, were substantially increased. A new plant in Anaheim, California was opened in late 1972.

Additional expansion of this plant and sales of products not presently produced by the Company are expected in this facility in 1973.

Equipment. Welsh believes that its technology is becoming increasingly recognized by other manufacturers. Sales of equipment have increased as Welsh's sales staff has placed Welsh in a competitive position which management believes will not be eroded by sales of equipment to major forest product companies. These companies distribute primarily through captive rather than independent distributors.



Buckley Laboratories—Bellevue, Washington.



Welsh three print embosser.

OPERATIONS

Embossed and/or printed wall panels are produced in the plant in Longview, Washington. Particleboard is embossed and/or printed in Anaheim, California, as well as Longview, Washington. Equipment is manufactured and research and development conducted at the Buckley Division in Bellevue, Washington.

Panels

A substantial portion of the equipment utilized in the production of panels has been developed and manufactured by Welsh at its research facility in Bellevue, Washington. This equipment, including embossing and printing machines, V-groovers and coaters, enables it to produce a high quality panel. One Welsh design has been licensed to a major wood products company for several years.

Specialty Products

During the past five years, Welsh has developed and refined machinery to convert particleboard and hardboard into a finished product with a grain and texturing closely

resembling in appearance that of natural wood. Welsh's specialty products facility was opened in Anaheim, California in October 1972. It is located in the main West Coast furniture manufacturing area and enjoys milling in transit privileges for east-bound shipment.

Future Expansion

Due primarily to the volume of panel sales west of the Rocky Mountains relative to the efficient production capacity of the Longview plant and transportation charges to the East Coast, management believes that an eastern plant will be needed in late 1973 or early 1974 to meet demand for Welsh wall panels. Timing of this facility and any increase in the productive capacity of the Anaheim facility is dependent upon obtaining financing and other factors.



Specialty products plant—Anaheim, California.

STATEMENT OF OPERATIONS

Years ended December 31, 1972 and 1971

	<u>1972</u>	<u>1971</u>
REVENUES:		
Net sales	\$9,819,819	\$7,245,946
Royalties and other	<u>44,079</u>	<u>46,474</u>
	9,863,898	7,292,420
OPERATING COSTS AND EXPENSES:		
Cost of sales	8,448,843	6,280,305
Administrative and selling	924,866	828,368
Interest on long-term debt	26,716	22,552
Amortization of debt discount and expense	4,935	5,557
Other interest	121,740	65,372
Research and development costs written off (Notes 3 and 7)	<u>—</u>	<u>121,784</u>
	9,527,100	7,323,938
Income (loss) before federal income tax and extraordinary items	336,798	(31,518)
Provision for federal income tax (Note 7)	<u>155,000</u>	<u>—</u>
Income (loss) before extraordinary items	181,798	(31,518)
Extraordinary items:		
Tax benefits resulting from operating loss carry forward (Note 7)	155,000	—
Settlement of litigation on sale of Xercon Division	<u>—</u>	<u>(155,192)</u>
Net income (loss)	<u>\$ 336,798</u>	<u>\$ (186,710)</u>
Common shares (Note 1)	<u>646,297</u>	<u>636,016</u>
Earnings per share (Notes 1 and 7):		
Income (loss) before extraordinary items	\$.28	\$ (.05)
Extraordinary items24	(.24)
Net income (loss)	<u>\$.52</u>	<u>\$ (.29)</u>

See accompanying notes.

STATEMENT OF CHANGES IN FINANCIAL POSITION

Years ended December 31, 1972 and 1971

	1972	1971
SOURCE:		
Income (loss) before extraordinary items.....	\$ 181,798	\$ (31,518)
Items not affecting working capital in the current period:		
Depreciation and amortization (Note 1).....	159,500	156,986
Amortization of debt discount and expense (Note 1).....	4,935	5,557
Research and development costs written off (Notes 3 and 7).....	—	121,784
Provision for tax based on income (to extent of extraordinary credit—operating loss carry forward benefit).....	155,000	—
Other	—	(3,033)
Working capital provided from operations exclusive of extraordinary item.....	501,233	249,776
Extraordinary item	—	(155,192)
8% note receivable cancelled.....	—	80,000
	<u>501,233</u>	<u>174,584</u>
Addition to long-term debt.....	210,000	350,000
Reduction of deposits.....	5,750	—
Issuance of common stock and warrants.....	—	5,500
	<u>716,983</u>	<u>530,084</u>
APPLICATION:		
Additions to equipment and improvements	434,499	130,580
Additions to deferred research and developments costs (Notes 1 and 3).....	13,333	55,329
Pre-operating costs (Note 1)	32,500	—
Reduction of long-term debt	104,185	80,706
Purchase of outstanding warrants	—	24,393
Expenses applicable to the registration of common stock (Note 6).....	24,267	88,091
Other	2,539	3,107
	<u>611,323</u>	<u>382,206</u>
Increase in working capital	<u>\$ 105,660</u>	<u>\$ 147,878</u>
Changes in components of working capital:		
Increase (decrease) in current assets:		
Cash	\$ (545)	\$ 37,553
Receivables	1,016,915	146,203
Inventories	232,499	601,137
Prepaid expenses	31,954	(14,737)
	<u>1,280,823</u>	<u>770,156</u>
Increase (decrease) in current liabilities:		
Notes payable to bank	952,786	339,572
Trade accounts payable.....	133,141	228,199
Accrued liabilities	67,675	(54)
Long-term debt due within one year.....	21,561	54,561
	<u>1,175,163</u>	<u>622,278</u>
Increase in working capital.....	<u>\$ 105,660</u>	<u>\$ 147,878</u>

See accompanying notes.

BALANCE SHEET

December 31, 1972 and 1971

ASSETS

	1972	1971
CURRENT ASSETS:		
Cash	\$ 130,018	\$ 130,563
Receivables:		
Trade (Pledged), less allowance of \$17,500 in 1972 and \$20,000 in 1971 for doubtful accounts (Note 4)	2,315,735	1,298,701
Other	15,147	15,266
	2,330,882	1,313,967
Inventories (Pledged) (Notes 1, 2 and 4)	1,413,579	1,181,080
Prepaid expenses	86,990	55,036
Total current assets	3,961,469	2,680,646
EQUIPMENT AND IMPROVEMENTS, AT COST (PLEDGED) (Notes 1 and 4):		
Machinery and equipment	1,659,762	1,227,726
Office equipment	31,752	30,121
Leasehold improvements	22,902	25,401
Construction in progress	75,116	74,284
	1,789,532	1,357,532
Less accumulated depreciation and amortization	688,791	533,694
Net equipment and improvements	1,100,741	823,838
DEFERRED CHARGES, INTANGIBLE AND OTHER ASSETS:		
Deferred research and development costs (Notes 1, 3 and 7)	34,416	21,084
Pre-operating costs (Note 1)	32,500	—
Deposits, at cost (\$62,020 pledged under leases)	69,248	74,750
Patents, at cost less amortization of \$24,611 in 1972 and \$22,708 in 1971 (Note 1)	32,522	32,134
Unamortized debt discount and expense (Note 1)	10,876	15,811
Cash held by sinking fund trustee (Note 4)	—	23,082
Total deferred charges, intangible and other assets	179,562	166,861
	<u>\$5,241,772</u>	<u>\$3,671,345</u>

See accompanying notes.

LIABILITIES AND STOCKHOLDERS' EQUITY

	<u>1972</u>	<u>1971</u>
CURRENT LIABILITIES:		
Notes payable to bank (Note 4)	\$2,091,438	\$1,138,652
Trade accounts payable	884,197	751,056
Accrued liabilities	167,759	100,084
Long-term debt due within one year	<u>102,267</u>	<u>80,706</u>
Total current liabilities	3,245,661	2,070,498
 LONG-TERM DEBT (Note 4):		
Notes payable to banks, at 2¼ % above prime rate, due \$122,378 annually including interest to 1977	415,733	290,000
6¾ % convertible subordinated debentures due October 1976	<u>72,000</u>	<u>115,000</u>
Total long-term debt	487,733	405,000
 COMMITMENTS (Note 5)		
STOCKHOLDERS' EQUITY (Notes 4 and 6):		
Preferred stock, \$100 par value; 6% cumulative dividends, 1,000 shares authorized and none issued		
Convertible preferred stock, \$10 par value; 500,000 shares authorized and none issued		
Common stock, \$.25 par value; 3,000,000 shares authorized, 109,483 shares reserved, 635,929 shares issued	158,982	158,982
Capital in excess of par value	1,687,736	1,712,003
Deficit	<u>(338,340)</u>	<u>(675,138)</u>
Total stockholders' equity	<u>1,508,378</u>	<u>1,195,847</u>
	<u>\$5,241,772</u>	<u>\$3,671,345</u>

See accompanying notes.

STATEMENT OF STOCKHOLDERS' EQUITY

Two years ended December 31, 1972

	<u>Common stock</u>	<u>Capital in excess of par value</u>	<u>Deficit</u>	<u>Total</u>
Balance, December 31, 1970	\$ 158,534	\$1,819,886	\$ (488,428)	\$1,489,992
Net loss, year ended December 31, 1971	—	—	(186,710)	(186,710)
Purchase of 35,750 outstanding warrants	—	(24,393)	—	(24,393)
Exercise of warrants to purchase 2,000 shares of common stock at \$2.75 per share	500	5,000	—	5,500
Cancellation of 208 shares of common stock granted under the 1968 Employee Stock Bonus Plan, due to termination of employment	(52)	(399)	—	(451)
Expenses applicable to the registration of 278,258 shares of common stock (Note 6)	—	(88,091)	—	(88,091)
Balance, December 31, 1971	158,982	1,712,003	(675,138)	1,195,847
Net income, year ended December 31, 1972 . . .	—	—	336,798	336,798
Expenses applicable to the registration of 278,258 shares of common stock (Note 6)	—	(24,267)	—	(24,267)
Balance, December 31, 1972 (Notes 4 and 6) . . .	<u>\$ 158,982</u>	<u>\$1,687,736</u>	<u>\$ (338,340)</u>	<u>\$1,508,378</u>

See accompanying notes.

NOTES TO FINANCIAL STATEMENTS

December 31, 1972 and 1971

1. ACCOUNTING POLICIES

Inventory pricing—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.

Research and development—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.

Pre-operating costs—Costs incurred in connection with the opening of a manufacturing facility in Anaheim, California are being amortized on the straight-line method over a three-year period to November 1975.

Amortization of patents—Patents are being amortized on the straight-line basis over the life of the applicable patent.

Amortization of debt discount and expense—Debt discount and expense is being amortized on the bonds outstanding method.

Depreciation and amortization of equipment and improvements—Depreciation and amortization of equipment and improvements has been computed principally on the straight-line method. Estimated useful lives

employed are ten years for machinery and office equipment, and ten years, or life of lease, whichever is shorter, for leasehold improvements. Expenditures for maintenance and repairs are charged to income as incurred. Major expenditures for renewals or betterments are capitalized. When items are sold, retired, or otherwise disposed of, the cost of such assets and the related accumulated depreciation are removed from the accounts. Gains or losses on such sales or retirements are included in income.

Investment tax credit—The investment tax credits will be accounted for as a reduction of income taxes on the flow-through method.

Earnings per share—Per share computations are based on the weighted average number of shares of common stock outstanding and, in 1972, contingently issuable shares which were dilutive. Shares issuable upon conversion of the 6¾% convertible subordinated debentures were not common stock equivalents at date of issue.

2. INVENTORIES

Inventories (pledged) consist of the following:

	1972	1971
Prefinished plywood \$	626,707	\$ 516,251
Unfinished plywood .	615,987	534,884
Supplies	170,885	129,945
	<u>\$1,413,579</u>	<u>\$1,181,080</u>

NOTES TO FINANCIAL STATEMENTS

(continued from preceding page)

3. DEFERRED RESEARCH AND DEVELOPMENT COSTS

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.

The recovery of research and development costs as of December 31, 1972, in the amount of \$34,416 relative to a fire-retardant process is dependent upon future developments.

4. LONG-TERM DEBT

At December 31, 1972, all trade receivables, inventories, equipment and improvements are pledged as collateral under security agreements covering all bank indebtedness.

The 6¾% 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, 1972, 12,483 shares of common stock were reserved for this conversion. Sinking fund payments are required each October 31, with \$18,000 due in 1973 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.

5. COMMITMENTS

Manufacturing facilities require annual rentals, exclusive of maintenance and insurance, of \$118,000 in 1973, \$104,000 in 1974 through 1977, \$76,000 in 1978, \$48,000 in 1979 through 1982 and \$20,000 in 1983. The Company has options to renew leases for periods ranging from five to 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.

6. STOCKHOLDERS' EQUITY

Stock purchase warrants:

At December 31, 1972 warrants were outstanding and exercisable, expiring in November 1973, to purchase 1,000 shares of common stock, each at \$9.63 and \$10.75 per share, respectively, aggregating \$20,380.

(continued on next page)

Stock plans:

At December 31, 1972, outstanding options granted in 1968 under an Executive Stock Option Plan to purchase 11,667 and 10,000 shares of common stock at \$7.00 and \$8.25 per share, respectively, (market value on the date of grant) aggregating \$164,169 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 \$366,256). In July 1972, 11,666 options previously granted were cancelled and 23,333 options are now 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, 1972, options to purchase 39,000 shares of common stock granted at \$2.07 and \$3.50 per share (market value at dates of grant) were outstanding (aggregating \$105,040). Beginning with the date of grant, these options are exercisable

on a cumulative basis of 20% per year as to 22,000 shares and 50% per year as to 17,000 shares. Market value of 17,300 shares at the dates first exercisable in 1971 and 1972 was \$5.50 per share (4400 shares) and \$3.50 per share (12,900 shares) aggregating \$69,350; the option price of these shares was \$2.07 per share (8800 shares) and \$3.50 per share (8500 shares) aggregating \$47,966.

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 \$112,358 (1971—\$88,091; 1972—\$24,267) were incurred applicable to a registration statement and have been charged to capital in excess of par value.

7. FEDERAL INCOME TAX

At December 31, 1972, net operating loss deductions were available to reduce future taxable income in the aggregate amount of approximately \$140,000, of which \$4,000 expires in 1974 and \$136,000 in 1975 and an investment tax credit of approximately \$56,000 may be carried over for tax purposes through 1977. The 1971 write-off of unamortized research and development costs (\$121,784) will be deducted for federal income tax purposes in future periods.

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, 1972 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, 1972 and 1971 and the results of operations and 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
January 27, 1973

DIRECTORS

Arthur L. Abel
Mark G. Copeland
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

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Seattle, Washington

GENERAL COUNSEL

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THE WELSH CORPORATION/LONGVIEW, WASHINGTON