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1977

TIMBERLAND INDUSTRIES, INC.

ANNUAL REPORT 1977

The Company: Timberland Industries is a manufacturer of specialty wood building products and a wholesale distributor of plywood, lighting and builder's hardware. We are also a producer of modular and component homes. Our operating units serve the residential and commercial construction, mobile home and home improvement industries.

The Cover: Pacific Northwest conifers such as hemlock and fir provide Timberland Industries with our primary raw materials. But those illustrated on the cover also serve to symbolize the organization's strength and accelerating growth —from sales of $23 million in 1972 to $45 million in 1976, and $67 million in 1977.

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Financial Highlights

	1977	1976
OPERATIONS		
Sales and other income	$66,707,575	$45,134,824
Costs and expenses	64,636,866	43,967,809
Income taxes	955,000	560,000
Net income	$ 1,115,709	$ 607,015
Net income per share		
Based on average shares outstanding	$1.60	$ .88
Dilution from common stock equivalents from assumed exercise of stock options	(.09)	
	$1.51	$ .88
FINANCIAL POSITION		
Total assets	$21,796,891	$14,957,625
Property, plant and equipment, net	3,225,502	1,908,910
Net working capital	3,682,141	3,033,066
Long-term debt	1,745,858	842,231
Stockholders' equity	5,515,008	4,456,281
ANALYTICAL DATA		
Return on stockholders' equity	22.4%	14.6%
Current ratio	1.26/1	1.32/1
Debt/equity ratio	.32/1	.19/1
Cash flow from operations	$ 1,640,573	$ 1,025,255
Book value per share	$7.93	$6.43
STOCK DATA		
Average shares outstanding and common stock equivalents:		
Average shares outstanding	694,226	693,575
Common stock equivalents	44,134	
	738,360	693,575
Number of shareholders, approximate	1,500	1,500
Bid price range by quarter:		
First	$4¾-3⅞	$3⅛-2
Second	5⅛-4⅜	3⅝-2⅞
Third	5⅞-4⅝	2⅞-2
Fourth	6 -5¼	3¼-2⅜
DIVIDENDS		
Per Share	$ .09	None

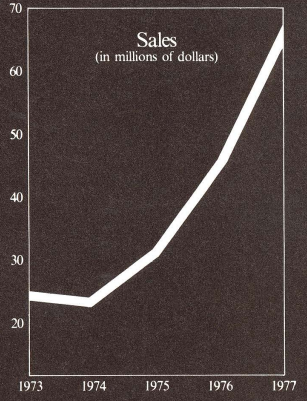
The Company's stock is traded Over-the-Counter under NASDAQ symbol TIMB.

President's Report to Stockholders

The results of 1977 can be simply stated — record sales and earnings. Revenues reached $66.7 million, 48% above the $45.1 million of 1976. Net income was $1,116,000 compared to $607,000, an 84% increase. Net income per share increased from $.88 in 1976 to $1.51 in 1977. The $1.51 results from previously reported earnings per share of $1.60 less $.09 for common stock equivalents. The 1977 sales and earnings performance represented a dramatic improvement over 1976 and prior years. In many ways it was the culmination of our continuing efforts to build a financially strong and efficiently operating organization. At the same time, 1977 established new benchmarks for setting future goals.

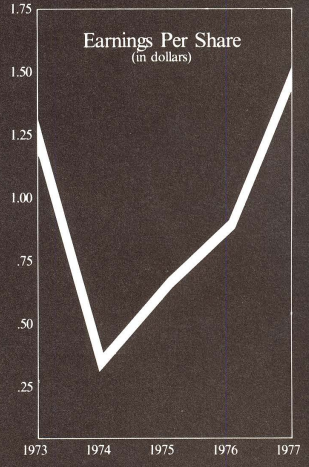
Our goals are often influenced by the economic health of the housing and construction industries. We have noted in previous reports that our objective is to outperform the market on a relative basis. In 1974 and 1975 we made significant progress in light of the depressed economic conditions. As our markets improved in 1976 we were able to respond quickly and profitably. In 1977 we had an opportunity to measure our effectiveness in a very favorable economic climate. We had the opportunity and our people performed.

Our manufacturing operations — Western Cabinet & Millwork, Cal-Wood Door and Timberland Panel (formerly Welsh Panel) — increased sales by 38%, to $26.5 million, and earnings by 175%, to $832,000. Western Cabinet & Millwork achieved both record sales and earnings for the fourth consecutive year. The expansion



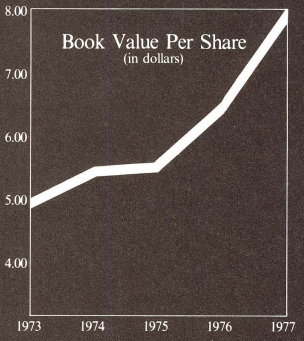
of facilities in Kirkland, Washington, and Boise, Idaho, coupled with a new operation in Richland, Washington, highlighted Western Cabinet's continuing effort to improve and expand its product and service capabilities for customers throughout the Northwest and Hawaii. Cal-Wood Door established new sales and earnings records on the strength of improved national and regional markets. The company's efforts to further broaden its product line for commercial, institutional and residential use was a principal ingredient in the 1977 results. Timberland Panel operated at a moderate loss in 1977, improving its performance substantially from 1976. New products introduced in 1977 helped increase sales to mobile home and recreational vehicle manufacturers and building material distributors. The company also undertook a program of prefinishing panels for door manufacturers. This activity served to increase efficiency at Timberland Panel and assisted Cal-Wood Door's production and sale of prefinished door products during 1977.

Our distribution operations — Timberland Forest Products and Brennan Supply Company — improved on excellent 1976 performances, with a combined 64% sales increase and earnings improvement of 37%. Timberland Forest Products continued its program of establishing a national plywood distribution organization with the addition of facilities in northern California and Illinois. The expanded product and service



functions added to the company's profitability in 1977 and will be a further benefit in future years. Brennan Supply turned in its best earnings performance as the company's sales of light fixtures, hardware and related building products expanded with the growth of housing and commercial construction in the Greater Seattle area.

Our only disappointment during 1977 was the performance of Timberland Homes (formerly Western Modular Corporation).



After improving its performance to record a modest profit in 1976, the company reversed the trend and recorded a $95,000 loss in 1977. Our major problems were lagging sales volume in early 1977 and the delay of a major project from last fall to this spring. We are expending every effort to correct the problems we experienced during 1977. On a more positive note, the company has developed a program of complete customer service that includes site preparation for, and the installation of, our modular homes. This service is particularly important in the company's rural and semi-rural markets.

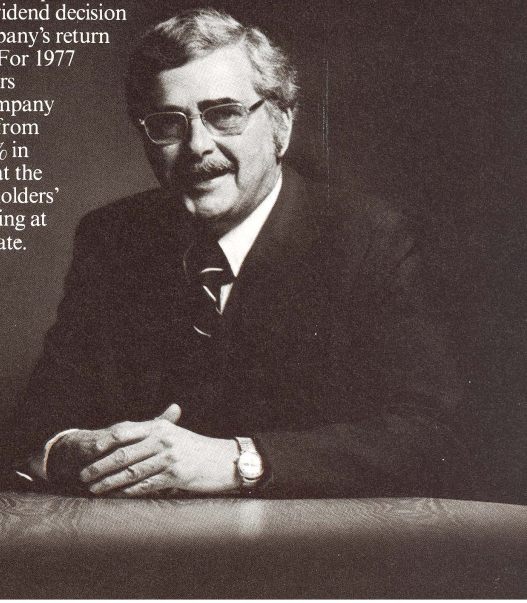
The combined performance of all our operations further strengthened the Company's financial capability, a factor that is key to the future growth of sales and earnings. During 1977 we increased working capital by 21% to $3.7 million, and expended $1.7 million to enhance our production and distribution capability. Long-term debt increased from $842,000 at the end of 1976 to $1,746,000 at the end of 1977, a modest 32% of stockholder's equity, which increased to $5.5 million. The increase in equity during 1977 raised the book value per share to $7.93.

In recognition of the Company's improved performance and financial posture, last year we established a policy of paying a regular quarterly cash dividend. Over the past four quarters we have paid dividends totaling $.12 per share. We look forward to increasing the dividends as our growth and the related financial requirements allow. One of the principal elements of our dividend decision relates to the Company's return on its equity base. For 1977 the return on dollars retained in the Company was over 22%, up from approximately 15% in 1976, indicating that the value of the stockholders' investment is growing at an above normal rate. In recognition of that growth and the underlying value, we have seen over the past year a solid increase in the market value of the Company's shares. To varying degrees, that increase is attributable to factors within our control — sales, earnings, dividends, etc. For the most part however, it is a result of increased awareness and confidence on the part of all our shareholders.

We have endeavored over the past few years to build an effective organization, one that could perform to the best of its ability today and at the same time be building for tomorrow. In many ways we have succeeded. We reached many of the goals that were established for 1977. We have newer and more ambitious ones for 1978 and future years.

J. Allan MacDonald,
President

March 30, 1978.



TIMBERLAND INDUSTRIES

WESTERN CABINET & MILLWORK

Pacific Northwest manufacturer and distributor of complete interior wood systems, including kitchen cabinets, vanities, interior and exterior doors, and lineal molding. Manufacturing and distribution facilities in Kirkland and Richland, Washington, and Boise, Idaho. Additional sales offices in Wenatchee and Tacoma, Washington, and Honolulu, Hawaii.

Milton D. Skutle, President

TIMBERLAND PRODUCTS

National wholesale distributor of plywood, operating five distribution centers throughout the United States. Principal facility in Seattle, Washington. Additional warehouse locations in Spokane, Washington, McCloud, California, Natchez, Mississippi, and Joliet, Illinois.

Donald S. Hansen, President

BRENNAN SUPPLY

Western Washington distributor of lighting fixtures, hardware and building product specialty items for contractors, builders and do-it-yourselfers. Store and warehouse locations in Seattle and Redmond, Washington.

Alfred W. Finch, President

CAL-WOOD DOOR

National manufacturer and distributor of interior and exterior flush wood doors, jambs and casings, serving the residential and commercial building markets. Manufacturing and distribution facility in Santa Rosa, California. Additional sales locations in Los Angeles, California, Portland, Oregon, Fort Worth, Texas, Denver, Colorado, and St. Louis, Missouri.

Ian MacDonald, President

TIMBERLAND PANEL

Manufacturer of prefinished interior wall panels for retail home improvement centers and the mobile home industry. Manufacturing facility in Longview, Washington.

Ian MacDonald, President

TIMBERLAND HOMES

Manufacturer of modular and component homes, supplying the Pacific Northwest and Alaska with both single family and multiple unit structures. Manufacturing facility in Kent, Washington.

Ronald D. Andre', President

A breadth of products, applications and markets.

The growing demand for Timberland Industries' products and services can be attributed to intensified product-development and marketing efforts, as well as the obvious strength of the nation's construction industry as a whole.

But of no less significance are some additional factors which may be best summed up by one key word — diversity, including a diversity of applications.

The types of products we supply are used in every kind of residential and commercial structure — in single-family and multi-family homes and apartments, in modular and mobile homes, in office buildings, hotels and hospitals. We also supply materials to the vast and consistently expanding home-improvement and "do-it-yourself" market.

Virtually all of these applications have been accelerated by the rising number of new U.S. households being created each year, particularly by those in the 25- to 34-year-old age group. Marriages now exceed 2 million annually, and single and divorced persons are also forming new households at an increasing rate.

Our basic goal is to continue to enlarge our share of this total "building" marketplace — one whose vitality was reflected by 2 million housing starts in 1977, and one expected to encompass another 1.8 million starts in 1978.

Diversity also describes our extensive product capabilities.

Whether you read this report in your home or office, you're almost certain to be surrounded by products such as those we manufacture or distribute. Your kitchen cabinets, for instance. The door through which you entered the room. All the plywood that helped create that room. The paneling on your walls, the lighting fixtures overhead — these are all examples.

In fact, the kinds of products we can provide add up to more than 20% of the total dollar value of materials used in home construction.

This range of products also serves to level the impact of those cyclical fluctuations generally associated with the housing and construction industries.

So, too, does the diversity of our markets.

Timberland Industries does business throughout the U.S. But, within this broad scope, each of our operations has established strong regional markets. And, of course, the sound economic growth of the region in which we're based, the Pacific Northwest, has made it one of the most productive of those markets.

Our Western Cabinet & Millwork subsidiary has been especially successful in concentrating its activities within this region, along with Alaska and Hawaii. Indeed, during 1977, Western-made wood cabinet systems were installed in more than 8,800 kitchens in these areas. At the same time, Western's vanities, prehung interior and exterior doors, lineal molding and related wood-trim items were installed in more than 14,000 homes.

As a result, while 1977 housing starts in Western's marketing areas rose 20% over those in 1976, the company's unit sales increased by more than 34%.

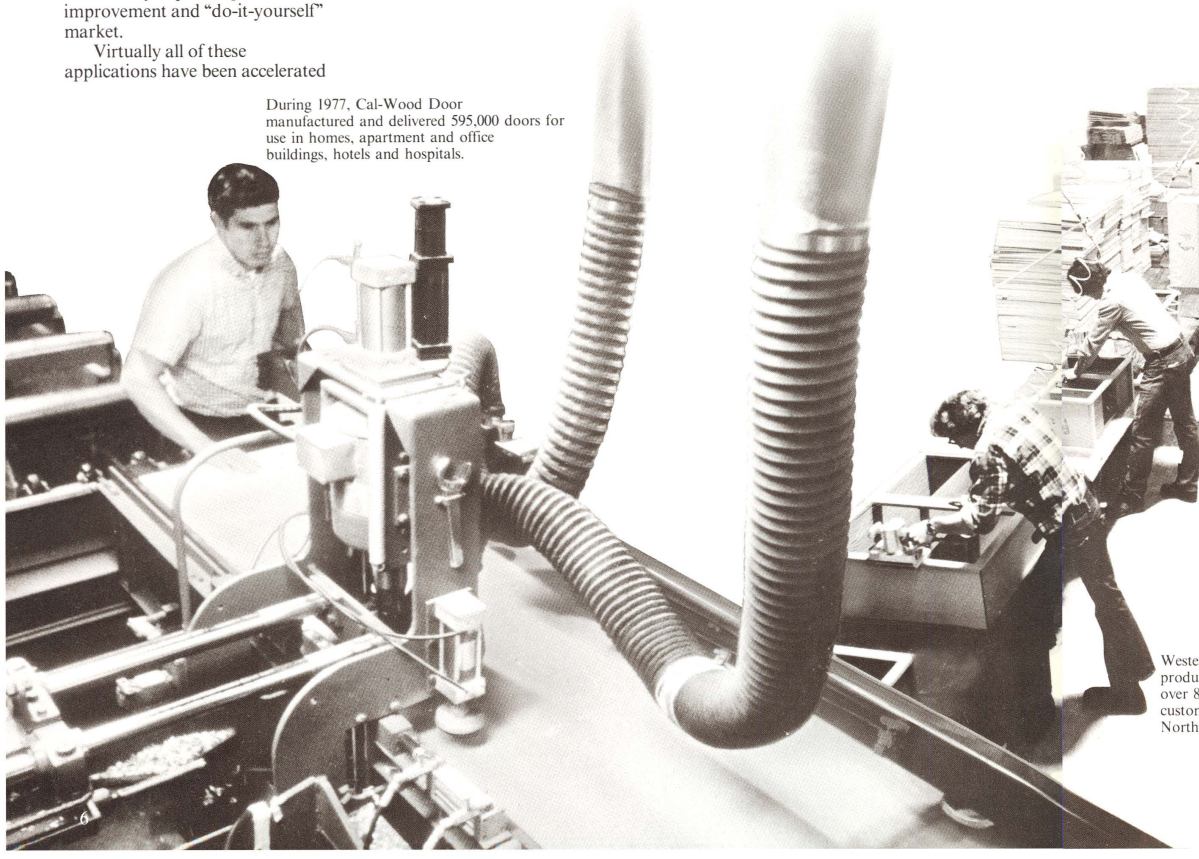
Western has also continued to maintain a leading role in product development, creating new cabinet systems and more durable cabinet finishes for use by large and small builders, developers and remodeling contractors.

Meanwhile, at Cal-Wood Door, 1977 saw this subsidiary manufacture its flush-type wood doors for some 40,000 homes. The company also produced more than 200,000 architecturally-designed doors for use in hotels, office complexes, hospitals and other types of commercial buildings.

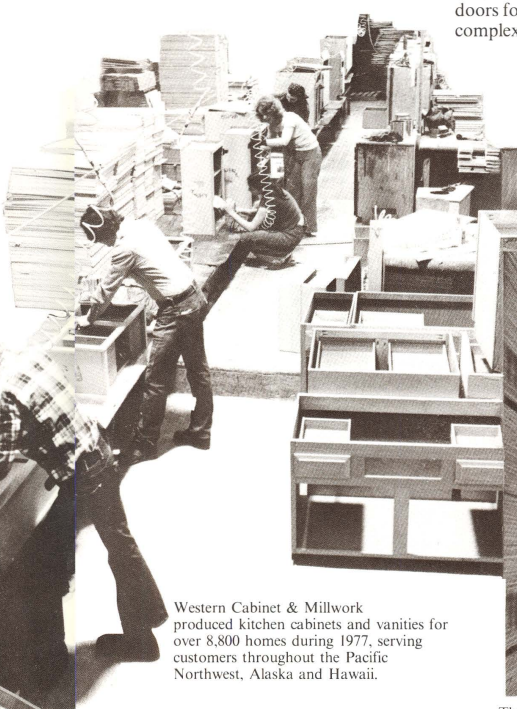
In addition to its role as a major door-maker, Cal-Wood deals in wood door frames, closet shelf packs, prehung door units and extensive research and development. Among the results of the latter activity is the broadest range of wood fire doors available to the construction industry. These specialty doors carry fire ratings of 20 minutes, 45 minutes, 1 hour and 1½ hours. Most feature SLM,™ a unique perimeter edge system which not only improves their fire resistance, but contributes to superior performance in heavy-usage applications.

Although Cal-Wood's residential marketing activities focus principally on the west, southwest and southeast, its commercial/architectural markets span much of the country and include foreign nations as well.

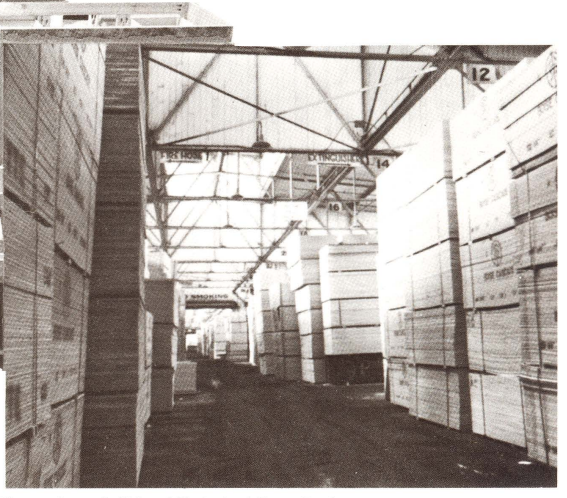
Yet, Timberland Forest Products, which became a truly nationally-oriented sorting-in-transit operation just two years ago, continues to enjoy the broadest marketing scope of all our subsidiaries.



During 1977, Cal-Wood Door manufactured and delivered 595,000 doors for use in homes, apartment and office buildings, hotels and hospitals.



Western Cabinet & Millwork produced kitchen cabinets and vanities for over 8,800 homes during 1977, serving customers throughout the Pacific Northwest, Alaska and Hawaii.



The warehouse facilities of Timberland Forest Products can and frequently do house up to 400 railroad carloads of various plywood products, which are distributed to customers across the United States.

The multiple rewards of diversification...

Serving major regional lumber distributors and dealers, Timberland Forest Products accounted for approximately 1% of all U.S.-produced plywood sold during 1977.

The company buys carload lots from specialized mills and then delivers mixed cars or truckloads to its customers, most of whom require relatively small, but balanced, inventories.

The firm supplies an exceptionally wide variety of plywood types, grades and sizes, along with plywood siding, hardwoods and particleboard. It also offers customers the lowest possible shipping costs, whether by rail or truck, from six sorting-in-transit facilities located in Washington, California, Montana, Mississippi and Illinois. Collectively, these locations can house up to 400 carloads of lumber products at any given time.

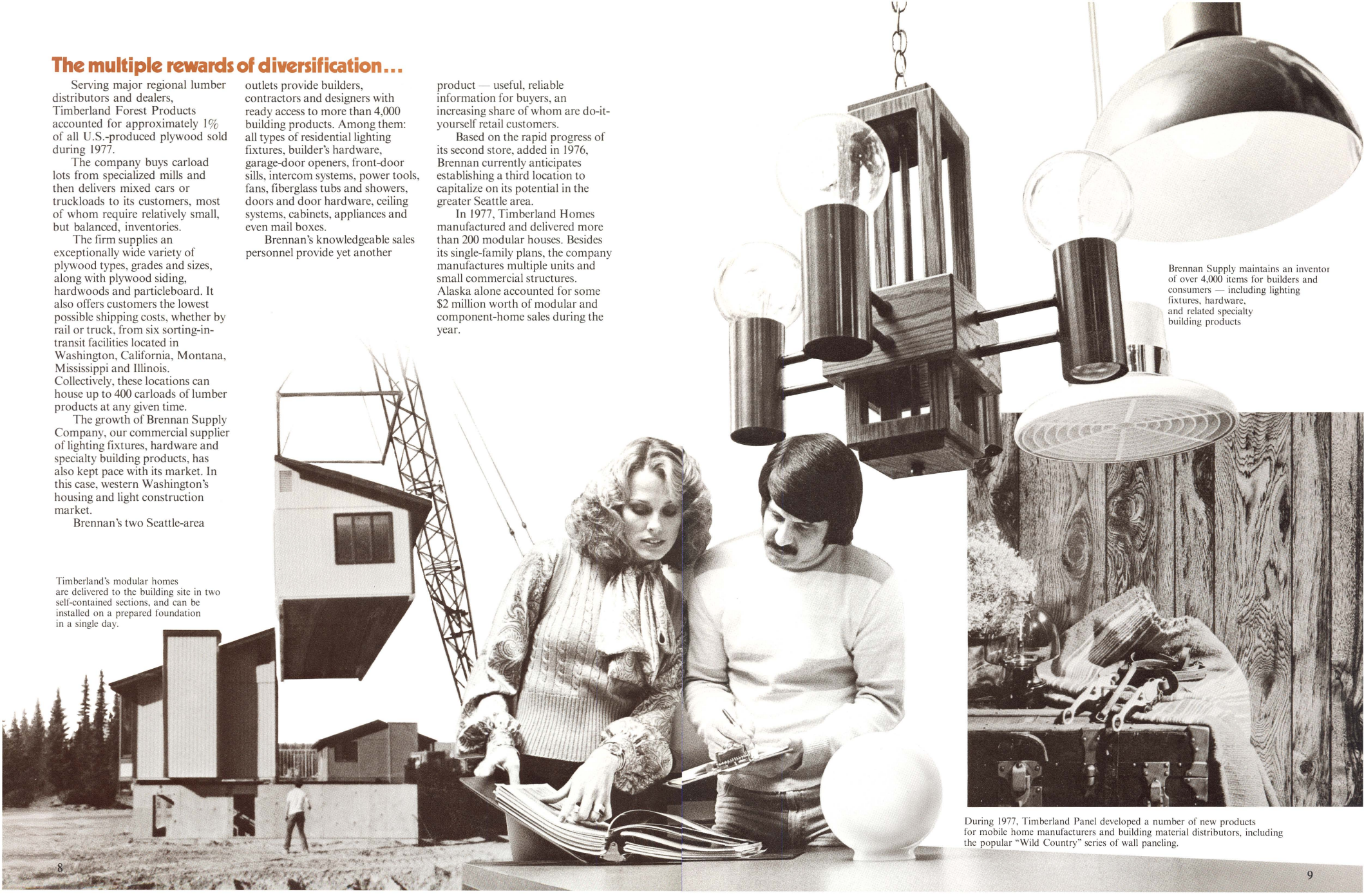
The growth of Brennan Supply Company, our commercial supplier of lighting fixtures, hardware and specialty building products, has also kept pace with its market. In this case, western Washington's housing and light construction market.

Brennan's two Seattle-area outlets provide builders, contractors and designers with ready access to more than 4,000 building products. Among them: all types of residential lighting fixtures, builder's hardware, garage-door openers, front-door sills, intercom systems, power tools, fans, fiberglass tubs and showers, doors and door hardware, ceiling systems, cabinets, appliances and even mail boxes.

Brennan's knowledgeable sales personnel provide yet another product — useful, reliable information for buyers, an increasing share of whom are do-it-yourself retail customers.

Based on the rapid progress of its second store, added in 1976, Brennan currently anticipates establishing a third location to capitalize on its potential in the greater Seattle area.

In 1977, Timberland Homes manufactured and delivered more than 200 modular houses. Besides its single-family plans, the company manufactures multiple units and small commercial structures. Alaska alone accounted for some $2 million worth of modular and component-home sales during the year.



Timberland's modular homes are delivered to the building site in two self-contained sections, and can be installed on a prepared foundation in a single day.

Brennan Supply maintains an inventor of over 4,000 items for builders and consumers — including lighting fixtures, hardware, and related specialty building products

During 1977, Timberland Panel developed a number of new products for mobile home manufacturers and building material distributors, including the popular "Wild Country" series of wall paneling.

and a growing, dynamic industry.

Thanks to the addition of site-preparation and installation services for its modular-home customers, Timberland Homes recently completed negotiations to manufacture and erect 10 multiple-unit Alaskan buildings valued at $3.8 million. Designed for occupancy by elderly Alaskan natives, these HUD-financed structures will be located in 7 different villages when completed later this year.

The favorable attention and added credibility generated by such multiple sales is also expected to complement and influence the sales of additional single-family homes throughout the Pacific Northwest.

Further evidence of our product diversity was supplied by Timberland Panel's Longview, Washington, facility, which embossed, printed and prefinished more than 24 million square feet of interior paneling during 1977.

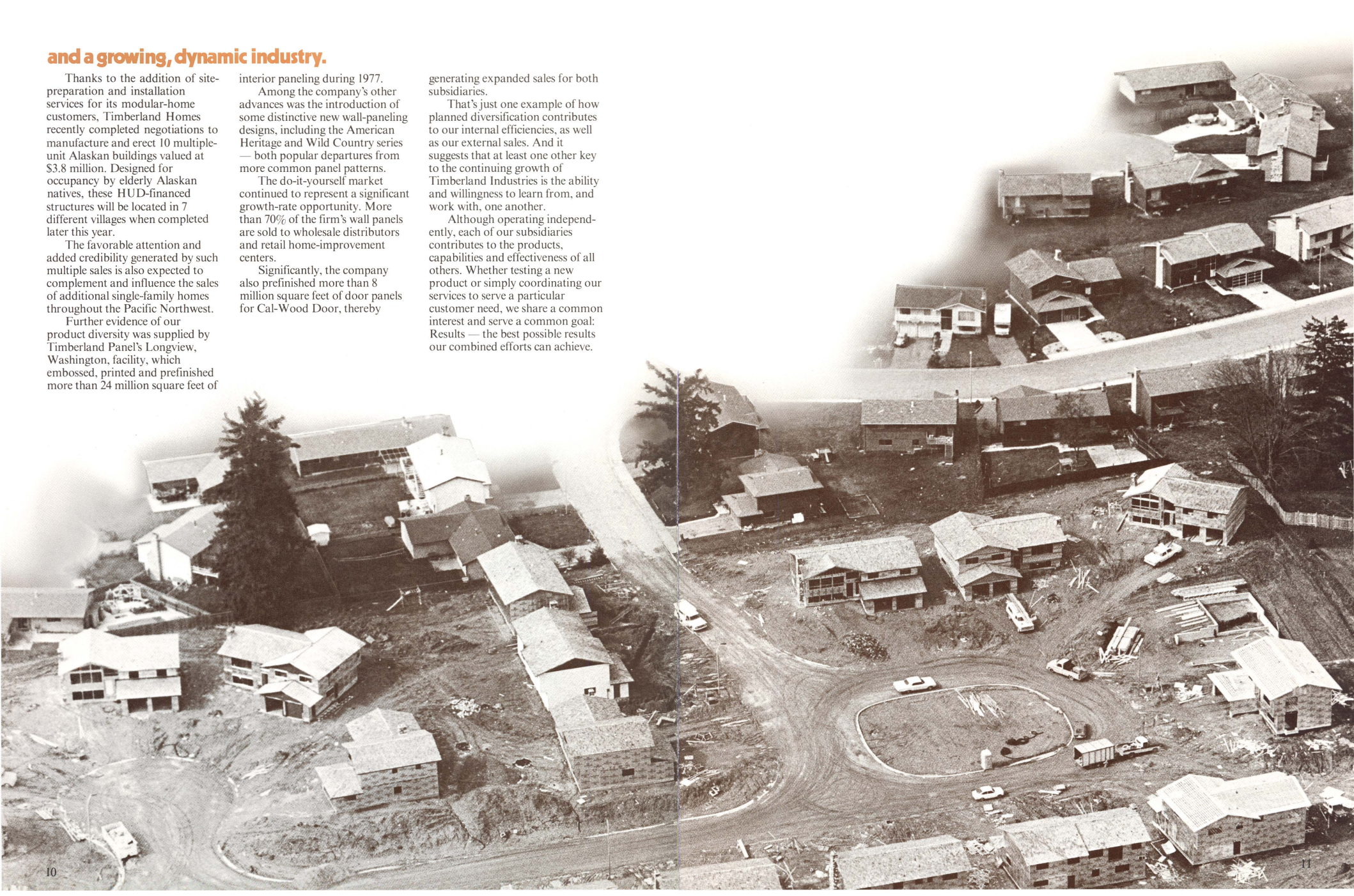
Among the company's other advances was the introduction of some distinctive new wall-paneling designs, including the American Heritage and Wild Country series — both popular departures from more common panel patterns.

The do-it-yourself market continued to represent a significant growth-rate opportunity. More than 70% of the firm's wall panels are sold to wholesale distributors and retail home-improvement centers.

Significantly, the company also prefinished more than 8 million square feet of door panels for Cal-Wood Door, thereby generating expanded sales for both subsidiaries.

That's just one example of how planned diversification contributes to our internal efficiencies, as well as our external sales. And it suggests that at least one other key to the continuing growth of Timberland Industries is the ability and willingness to learn from, and work with, one another.

Although operating independently, each of our subsidiaries contributes to the products, capabilities and effectiveness of all others. Whether testing a new product or simply coordinating our services to serve a particular customer need, we share a common interest and serve a common goal: Results — the best possible results our combined efforts can achieve.



Five-year Summary of Operations

Timberland Industries, Inc. and Subsidiaries

	1977	1976	1975	1974	1973
Net sales	**$66,635,491**	$45,084,098	$30,880,897	$23,711,868	$24,092,913
Other income	**72,084**	50,726	117,159	32,083	114,814
	66,707,575	45,134,824	30,998,056	23,743,951	24,207,727
Costs and expenses					
Cost of sales	**58,222,234**	39,277,022	26,635,406	20,322,075	19,752,296
Selling and administrative expenses	**5,316,434**	3,900,737	3,079,947	2,188,491	2,370,823
Interest expense	**664,286**	450,809	356,918	394,116	185,045
Depreciation and amortization	**433,912**	339,241	255,679	228,482	187,575
	64,636,866	43,967,809	30,327,950	23,133,164	22,495,739
Income from continuing operations before income taxes	**2,070,709**	1,167,015	670,106	610,787	1,711,988
Provision for income taxes	**955,000**	560,000	278,000	279,000	827,000
Income from continuing operations	**1,115,709**	607,015	392,106	331,787	884,988
Income (loss) from a former subsidiary			42,804	(87,388)	(10,365)
Net income	**$ 1,115,709**	$ 607,015	$ 434,910	$ 244,399	$ 874,623
Average shares outstanding and common stock equivalents:					
Average shares outstanding	**694,226**	693,575	694,891	697,240	714,124
Common stock equivalents from assumed exercise of stock options	**44,134**				
	738,360	693,575	694,891	697,240	714,124
Net income per share:					
Based on average shares outstanding,					
From continuing operations	**$1.60**	$ .88	$ .57	$ .48	$1.23
From a former subsidiary			.06	(.13)	(.01)
Dilution from the assumed exercise of stock options	**(.09)**				
	$1.51	$ .88	$ .63	$ .35	$1.22
Dividends					
Cash dividends per common share	**$ .09**				
Stock			10%		

Management's Discussion and Analysis

1977 During 1977, sales increased 48%, once again reflecting the strong demand for wood and building products in expanded national and regional housing and construction markets. Manufacturing and distribution operations provided the increase, while modular and component home sales remained at the 1976 level. The largest single sales increase was in the plywood distribution business, where sales increased by $13.3 million, accounting for 62% of the consolidated sales increase.

The Company's gross profit margin remained at 13%. All other costs increased 20% on the 48% higher sales volume, reflecting continuing increased marketing activities, higher levels of receivables, inventories and depreciation charges on asset additions.

Net income was up 84% from 1976 to 1977. The manufacturing operations accounted for the largest part of the income increase, with the prefinished paneling operation substantially reducing its 1976 loss. The modular/component home subsidiary recorded a loss in 1977 as compared to a modest profit in 1976.

1976 During 1976, sales increased 46%, reflecting the continued improvement in demand for wood and building products. Each of the Company's manufacturing, distribution and homebuilding operations contributed to the increase. The largest single increase was in the plywood distribution business where sales were up $8 million, accounting for 56% of the higher consolidated sales.

The Company's gross profit margin was 13% in 1976 compared to 14% in 1975. The decrease is attributable principally to the higher percentage of plywood distribution sales and the low margins realized in the manufacturing of prefinished panels. All other costs increased 27% on the 46% sales increase, reflecting expanded marketing activities, higher levels of receivables and inventories, and depreciation charges on asset additions.

Net income from continuing operations was up 55% from 1975 to 1976. All operations contributed to the increase except for the Company's prefinished-paneling manufacturer, where a significant loss was recorded in its first full year of operations. The Company's homebuilding subsidiary recorded a profit in its second full year of operations.

Analysis of Sales and Net Income by Line of Business

Timberland Industries, Inc. and Subsidiaries

(in thousands)	1977	1976	1975	1974	1973
Manufacturing					
Sales	**$26,700**	$19,200	$14,200	$13,400	$13,800
Net income	**832**	303	262	227	208
Distribution					
Sales	**36,000**	21,900	13,500	9,800	10,300
Net income	**379**	276	147	141	677
Homebuilding					
Sales	**4,000**	4,000	3,200	500	
Net income	**(95)**	28	(17)	(36)	
Total					
Sales	**$66,700**	$45,100	$30,900	$23,700	$24,100
Net income	**1,116**	607	392	332	885

Consolidated Balance Sheet

Timberland Industries, Inc. and Subsidiaries

Assets	December 31 1977	1976
Current Assets		
Cash	$ 269,399	$ 393,377
Receivables, principally trade accounts, less allowances for doubtful accounts of $271,779 in 1977 and $232,535 in 1976 (Note 2)	6,275,079	3,889,433
Inventories (Notes 1 and 2)	11,004,297	7,751,206
Account balances with brokers (Note 8)	188,164	192,287
Prepaid expenses	80,618	148,580
Total current assets	17,817,557	12,374,883
Property, plant and equipment—at cost (Notes 1, 2 and 3):		
Land	448,932	76,338
Buildings	1,500,882	841,261
Machinery	1,662,476	1,387,654
Automobiles and trucks	665,376	460,629
Furniture and fixtures	374,931	270,300
Leasehold improvements	181,198	169,832
	4,833,795	3,206,014
Less, accumulated depreciation and amortization	(1,608,293)	(1,297,104)
	3,225,502	1,908,910
Excess of cost of investment in subsidiary over the net asset value at date of acquisition (Note 1)	498,027	518,778
Notes receivable (Note 2)	252,888	150,887
Other assets	2,917	4,167
	$21,796,891	$14,957,625

Liabilities & Stockholders Equity	December 31 1977	1976
Current liabilities		
Notes payable:		
Banks (Note 2)	$ 6,900,000	$ 4,334,588
Other	118,700	115,000
Accounts payable	5,168,463	3,651,633
Customer deposits and other deferred income	115,415	20,611
Accrued liabilities:		
Salaries and wages	631,243	300,079
Interest	62,050	18,132
Taxes, other than on income	310,525	241,096
Other	228,568	175,477
Current portion of long-term debt (Note 3)	230,593	282,709
Accrued Federal and State income taxes	369,859	202,492
Total current liabilities	14,135,416	9,341,817
Long-term debt, less current portion shown above (Note 3)	1,745,858	842,231
Deferred income taxes (Notes 1 and 6)	356,778	265,825
Deferred income	43,831	51,471
Commitments and contingencies (Notes 4 and 8)		
Stockholders' equity (Notes 2, 5 and 9):		
Common stock, authorized 2,500,000 shares of $.16 par value, issued and outstanding. 695,575 shares in 1977 and 693,575 in 1976	111,292	110,972
Additional paid-in capital	1,603,295	1,598,115
Retained earnings	3,800,421	2,747,194
	5,515,008	4,456,281
	$21,796,891	$14,957,625

The accompanying notes are an integral part of these financial statements.

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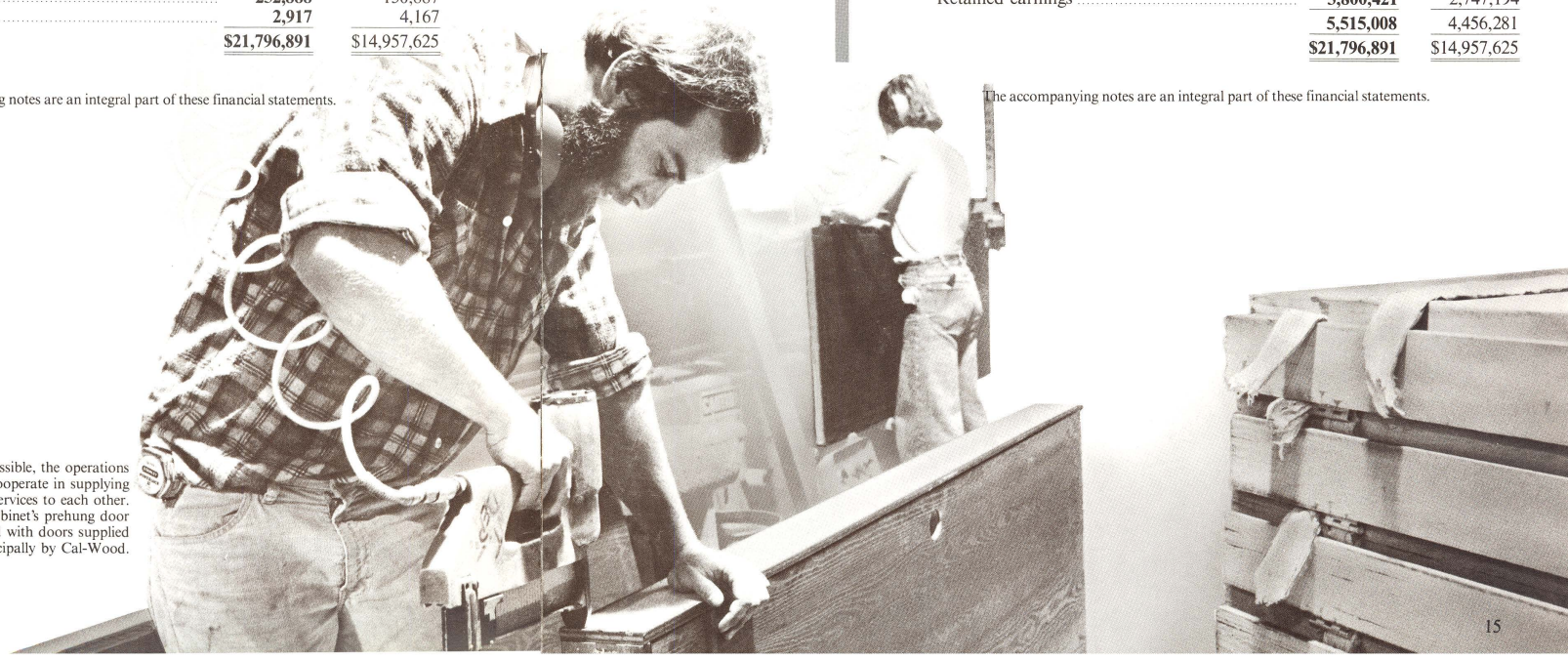


Where possible, the operations of Timberland Industries cooperate in supplying products and services to each other. For example, Western Cabinet's prehung door units are assembled with doors supplied principally by Cal-Wood.

Consolidated Statement of Income

Timberland Industries, Inc. and Subsidiaries

	Years Ended December 31 1977	1976
Net sales	**$66,635,491**	$45,084,098
Other income	**72,084**	50,726
	66,707,575	45,134,824
Costs and expenses		
Cost of sales	**58,222,234**	39,277,022
Selling and administrative expense	**5,316,434**	3,900,737
Interest expense	**664,286**	450,809
Depreciation and amortization	**433,912**	339,241
	64,636,866	43,967,809
Income before income taxes	**2,070,709**	1,167,015
Provision for income taxes (Notes 1 and 6)	**955,000**	560,000
Net income	**$ 1,115,709**	$ 607,015
Net income per share (Note 7):		
Based on average shares outstanding	**$1.60**	$ .88
Dilution from common stock equivalents from assumed exercise of stock options	**(.09)**	
Net income per share	**$1.51**	$ .88

The accompanying notes are an integral part of these financial statements.

Consolidated Statement of Stockholders' Equity

Timberland Industries, Inc. and Subsidiaries

Years Ended December 31, 1977 and 1976

	Number of Shares Outstanding	Par Value of Common Stock	Additional Paid-In Capital	Retained Earnings
Balance at December 31, 1975	693,575	$110,972	$1,598,115	$2,140,179
Net income				607,015
Balance at December 31, 1976	693,575	$110,972	$1,598,115	$2,747,194
Exercise of stock options	2,000	320	5,180	
Cash dividends ($.03 per share paid in June, September and December, 1977)				$ (62,482)
Net income				1,115,709
Balance at December 31, 1977	695,575	$111,292	$1,603,295	$3,800,421

The accompanying notes are an integral part of these financial statements.

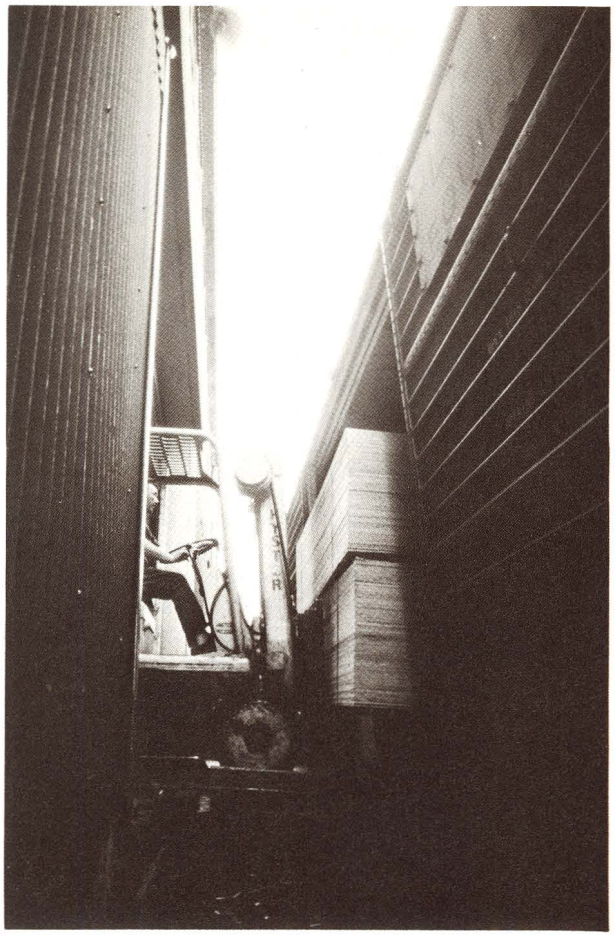
Western Cabinet, Brennan Supply, Timberland Forest Products and Cal-Wood Door all manufacture or distribute products used in building Timberland's modular homes.

Consolidated Statement of Changes in Financial Position

Timberland Industries, Inc. and Subsidiaries

	Years Ended December 31	
	1977	**1976**
Financial resources provided by:		
Income for the year	**$1,115,708**	$ 607,015
Add income charges not requiring use of working capital:		
Depreciation and amortization of plant and equipment	**413,161**	318,490
Amortization of excess cost of investment in subsidiary (Note 1)	**20,751**	20,751
Deferred income taxes (Note 6)	**90,953**	78,999
Total from operations	**1,640,573**	1,025,255
Additional long-term borrowings and refinancing of notes payable	**903,627**	43,537
Deferred income from the sale of a subsidiary in 1975	**(7,640)**	558
Stock options	**5,500**	
	2,542,060	1,069,350
Financial resources applied to:		
Payments of long-term debt (including reclassification of such debt due within one year)		120,732
Long-term notes receivable increase	**102,001**	(21,948)
Expended for property, plant and equipment, net	**1,729,753**	395,431
Cash dividends paid	**62,482**	
Other changes, net	**(1,251)**	533
	1,892,985	494,748
Increase in working capital	**$ 649,075**	$ 574,602
Changes in components of working capital		
Increases (decreases) in current assets:		
Cash	**$ (123,978)**	$ 249,897
Accounts and notes receivable	**2,385,646**	836,395
Inventories	**3,253,091**	3,292,620
Account balances with brokers	**(4,123)**	18,555
Prepaid expenses	**(67,962)**	49,821
	5,442,674	4,447,288
Less, increases (decreases) in current liabilities:		
Notes payable	**2,569,112**	1,379,529
Accounts payable and deposits	**1,611,634**	2,233,938
Accrued liabilities	**497,602**	348,854
Current portion of long-term debt	**(52,116)**	(209,944)
Accrued Federal and State income taxes	**167,367**	120,309
	4,793,599	3,872,686
Increase in working capital	**$ 649,075**	$ 574,602

The accompanying notes are an integral part of these financial statements.



The Company utilizes
a broad range of shipping modes to
deliver its products to customers
throughout the United States
and, often, to foreign destinations.

Notes to Consolidated Financial Statements

Summary of Accounting Policies

(a) Principles of Consolidation. The consolidated financial statements include the accounts of the Company and its subsidiaries, all of which are wholly owned. All significant intercompany balances and transactions have been eliminated.

(b) Inventories. Inventories are valued at the lower of cost (principally average cost and first-in, first-out basis) or market. Inventories as of December 31, 1977 and 1976 are as follows:

	1977	1976
Finished goods	$ 2,793,402	$2,099,834
Work in process	256,812	48,187
Raw materials	7,954,082	5,603,185
	$11,004,297	$7,751,206

(c) Depreciation Policy, etc. The cost of property, plant and equipment is depreciated using the straight-line method over the estimated useful lives of the assets. Leasehold improvements are being amortized over the lesser of the life of the lease or the life of the improvement. The estimated useful lives for computing depreciation generally are as follows:

	Years
Buildings	20-25
Machinery	5- 8
Automobiles and trucks	3- 5
Furniture and fixtures	5- 8

Maintenance and repair expenditures are charged to operations; renewal and betterment expenditures are charged to property accounts. When assets are sold or retired, the cost and related accumulated depreciation are removed from the property accounts, and any resulting gain or loss is reflected in income.

(d) Amortization of Intangible. The excess of cost of investment in subsidiary over net assets acquired arose in connection with the acquisition of the operations and net assets of Brennan Supply Co., Inc., in 1969. Effective January 1, 1972, the Company adopted a plan of amortization whereby the remaining excess of cost of $622,533 be amortized over 30 years. Accordingly, $20,751 has been charged to operations in 1977 and 1976.

(e) Income Taxes. Income tax expense is computed on the basis of transactions entering into the operating results before tax, and is reduced by investment tax credits ($62,700 in 1977 and $27,500 in 1976) accounted for by the flow-through method. In 1977 there was also a tax reduction of $52,000 resulting from full utilization of the New Jobs Tax Credit by the Company. Deferred Federal income taxes have been provided in recognition of timing differences between reporting depreciation expense and certain other income and expense items for income tax purposes and financial reporting.

(f) Incentive Bonus Plan. The Company's Board of Directors adopted an executive bonus plan in 1977 which provides incentive compensation for selected corporate and division management personnel. Payments under the plan are accrued only if the Company has met pre-established performance goals involving capital return and profitability. In 1977, sixteen corporate officers and division managers participated in the plan. In 1976, eleven officers and division managers participated in a predecessor plan. Incentive bonuses charged to operations in 1977 and 1976 totaled $333,475 and $183,538, respectively.

(g) Pension Plan Costs. Pension plan costs are determined actuarially. The amounts charged against earnings include current costs and amortization, generally over 20 years, of prior service costs. Generally, pension costs are funded annually in the same amount as the charge against earnings (see Note 4).

(h) Reclassifications. Certain 1976 amounts have been reclassified to conform with the 1977 presentation.

Notes Payable to Banks

As of December 31, 1977, the Company had a revolving line of credit of $6,000,000 and a short-term note for $1,000,000, both with Rainier National Bank. Of the aggregate amount, $6,900,000 was outstanding at December 31, 1977. Interest on the revolving line of credit and short-term note is charged at a rate of 1¼% over the bank's prime lending rate. The interest rate at December 31, 1977, was 9%, and the weighted average for the year was 8.3%. The maximum outstanding at any month end was at December 31, 1977. The average aggregate short-term borrowings outstanding during the year was $5,862,500. Such borrowings are collateralized by accounts and notes receivable, inventories and equipment, and are subject to provisions of a loan agreement which require:

(a) Maintenance of 10 percent compensating balances; and

(b) Bank approval for certain transactions including acquisition of other business or engagement in any other business activity, and acquisition of fixed assets and payment of dividends in excess of certain limits; and,

(c) Maintenance of certain specified current and debt-to-equity ratios.

Long-Term Debt

Long-term debt consists of the following at December 31:

	1977	1976
Mortgage notes and other contracts collateralized by certain land, buildings and equipment bearing interest rates from 7% to 9.75%, payable in monthly installments, including interest, with final payments due variously from 1981 to 1992	**$1,311,389**	$ 759,126
Notes payable to certain individuals, bearing interest rates from 6% to 8%, requiring quarterly and semi-annual payments, due in 1978	**15,062**	34,972
Term notes payable to bank, bearing interest at 1.75% over the prime rate, requiring quarterly payments of $25,000, and monthly interest payments, with final payment due in 1984	**650,000**	330,842
	$1,976,451	$1,124,940
Less current portion	**230,593**	282,709
	$1,745,858	$ 842,231

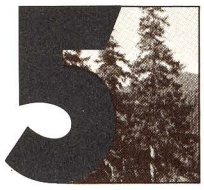
The term notes payable to bank are subject to the provisions of the loan agreement mentioned in Note 2.

Annual payments on long-term debt outstanding at December 31, 1977, to be made during the following five years, are approximately as follows: 1978—$231,000; 1979—$235,000; 1980—$220,000; 1981—$217,000; 1982—$218,000.

Employee Retirement Plans

Substantially all employees of the Company and its subsidiaries are covered by retirement plans. The Company contributes to various trusteed multi-employer and union retirement plans at fixed payments per hour, subject to negotiations in collective bargaining.

The Company has two company-administered plans. These two plans cover substantially all salaried employees and those hourly employees located at one of its subsidiaries. Unfunded past service costs for accrued benefits estimated at $465,000 on December 31, 1977, are amortized and funded generally over a period of 20 years. Pension costs of the two company-administered plans, charged to operations in 1977 and 1976 were $98,148 and $47,940, respectively.



Stock Options

In 1969, the Company adopted a qualified stock option plan under which common shares were reserved for the granting of options to key employees of the Company and its subsidiaries to purchase common shares at not less than 100% of the market value at the date of grant. Options may be granted covering up to 33,000 shares of the Company's authorized but unissued common stock and are exercisable at the date of grant.

Option activity (in shares) under the plan was:

	1977	1976
Outstanding, January 1	**24,150**	1,650
Granted		22,500
Exercised	**2,000**	
Outstanding and exercisable at December 31	**22,150**	24,150

At December 31, 1977, and 1976, 8,850 shares remained available for future options. Options outstanding at December 31, 1977, expire at various dates to August 30, 1981.

During 1974, the Company granted nonqualified options to purchase an aggregate of 55,000 shares at $2.727 per share, 27,500 shares each to two individuals, in connection with the formation of a subsidiary. These shares are exercisable in annual increments of 11,000 shares on January 31, 1975, through January 31, 1979. As of December 31, 1977, 33,000 shares were exercisable. Such options are exercisable for five years following the date on which they first become exercisable. In the event of termination of employment, options then exercisable shall be exercisable only for twelve months following such termination of employment.

During 1975, the Company granted nonqualified stock options to purchase 12,650 shares to the eight members of its Board of Directors at $2.386 per share which are exercisable to March 17, 1980. During 1976, options to purchase an additional 2,000 shares at $2.75 per share, were issued, such options exercisable to August 20, 1981. During 1977, options to purchase an additional 4,450 shares, at $5.375 per share, were issued, such options exercisable to May 18, 1982.

Activity in nonqualified stock options (in shares) was:

	1977	1976
Outstanding, January 1	**69,650**	67,650
Granted	**4,450**	2,000
Outstanding, December 31	**74,100**	69,650

Proceeds from the exercise of the stock options will be credited to the common stock account to the extent of the par value thereof and the excess credited to additional paid-in capital.

Income Taxes

The provision for taxes on income consists of the following:

	1977	1976
Amounts currently payable	**$978,727**	$508,501
Current additions to deferred income taxes	**90,973**	78,999
Reduction in federal income taxes as a result of the investment tax credit and new jobs tax credit	**(114,700)**	(27,500)
	$955,000	$560,000

The increase in deferred income taxes results from timing differences in the recognition of depreciation expense for tax and financial statement purposes, which includes a 1975 transaction in which a subsidiary of the Company in a partial liquidation transferred certain of its assets and liabilities to Timberland Industries, Inc., resulting in an increased tax basis in those assets.

Following is a reconciliation of the difference between the statutory United States income tax rate of 48.0% and the effective tax rates for 1977 and 1976:

	YE 12-31, 1977	YE 12-31, 1976
Statutory rate	**48.0%**	48.0%
State income taxes net of Federal tax benefit	**1.4%**	.9%
Investment tax credit	**(3.0%)**	(2.4%)
New jobs tax credit	**(2.5%)**	
Other items	**2.2%**	1.5%
Effective rate	**46.1%**	48.0%

Net Income Per Share

Net income per share is based upon the average shares outstanding during the periods, 694,226 and 693,575 shares during 1977 and 1976, plus equivalent common shares from the assumed exercise of stock options utilizing the treasury stock method. The treasury stock method results in an additional 44,134 common share equivalents to be added to the average shares outstanding during 1977. There was no material dilution from the assumed exercise of stock options in 1976.

Commitments and Contingencies

A subsidiary of the Company trades in the plywood and lumber futures market for its own account in both hedging and speculative transactions through The Chicago Board of Trade. Account balances with brokers in the amount of $188,164 and $192,287 represent principally margin deposits at December 31, 1977, and 1976, respectively.

Timberland Homes, Inc., a subsidiary of the Company, has been named as defendant, through counterclaims, in a civil action in the State of Alaska. The counterclaims, asserting damages for late delivery, slander of title and punitive damages aggregating in excess of $1,000,000, have arisen out of a lien foreclosure action that the Company has taken in pursuit of amounts due for the delivery of modular homes. The Company is vigorously contesting the alleged liability and in the opinion of counsel has asserted meritorious denials and defenses, and in the opinion of management and counsel, the matter should be resolved with no material adverse effect on the consolidated financial condition of Timberland Industries, Inc.

Corporate Changes

At the Company's Annual Meeting of Shareholders on May 18, 1977, the shareholders approved various amendments to the Articles of Incorporation, including changing the Company's name to Timberland Industries, Inc. from Pacific Western Industries, Inc., and increasing the authorized common shares to 2,500,000 shares from 1,250,000 shares.

Information by Line of Business

The Company operates in three principal lines of business: manufacturing, distribution and homebuilding. Operations in manufacturing involve production and sale of cabinets and millwork, doors and prefinished paneling. Operations in distribution include the wholesale distribution of plywood, and lighting, fixtures and hardware. Operations in homebuilding involve the production and sale of modular and component homes.

Total revenue includes both sales to unaffiliated customers, as reported in the Company's consolidated income statement, and affiliated sales, which are accounted for at prices which approximate arms length market prices. Operating profit consists of total revenues less operating expenses. In computing operating profit, general corporate charges, interest and income taxes were not deducted. Identifiable assets are those assets that are use in each line of business. Corporate assets are principally cash, notes receivable and purchased goodwill.

	Manufacturing	Distribution	Homebuilding	Adjustments and Eliminations	Consolidated
Sales to unaffiliated customers	$26,585,676	$36,037,465	$4,084,434		$66,707,575
Intersegment sales	389,945	199,495		$(589,440)	
Total revenue	$26,975,621	$36,236,960	$4,084,434	$(589,440)	$66,707,575
Operating profit	$ 2,077,965	$ 1,016,356	$ (156,935)		2,937,386
Interest expense					(664,286)
General corporate expenses					(202,391)
Income before income taxes					$ 2,070,709
Identifiable assets	$10,522,083	$ 8,781,426	$1,388,951	$(377,428)	$20,315,032
Corporate assets					1,481,859
Total assets					$21,796,891
Depreciation expense	$ 337,700	$ 29,300	$ 40,000		
Capital expenditures	$ 1,619,000	$ 69,000	$ 30,000		

Auditor's Report

To the Board of Directors
and Stockholders
Timberland Industries, Inc.

We have examined the consolidated balance sheet of Timberland Industries, Inc. (formerly Pacific Western Industries, Inc.) and subsidiaries as of December 31, 1977 and 1976, and the related consolidated statements of income, stockholders' equity and changes in financial position for the years 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.

In our opinion, the aforementioned statements present fairly the consolidated financial position of Timberland Industries, Inc. and subsidiaries at December 31, 1977 and 1976, and the results of their operations and changes in their financial position for the years then ended, in conformity with generally accepted accounting principles applied on a consistent basis.

Moss, Adams & Co.

Seattle, Washington
March 6, 1978

Board of Directors

J. Allan MacDonald,
President
Timberland Industries, Inc.

Donald S. Hansen,
President
Timberland Forest Products, Inc.

Ian MacDonald,
President
Cal-Wood Door

Delos W. McNutt,
President - Chief Executive
TAPCO, Inc. (Audio Electronics)

Robert J. DeArmond,
Vice Chairman
Idaho Forest Industries
(Lumber Products)

Jack H. Canvin,
Investor Relations Officer
Bank of America (Banking)

Curtis P. Lindley,
Senior Vice-President
Univar Corporation
(Industrial and Agricultural
Chemicals and Products)

Milton D. Skutle,
President
Western Cabinet & Millwork

James F. Aylward,
President
Sherwood & Roberts, Inc.
(Mortgage Banking)

Officers

J. Allan MacDonald,
President

Donald S. Hansen,
Vice-President

Ian MacDonald,
Vice-President

James A. MacDonald, Jr.,
Treasurer

Michael E. Stansbury,
Secretary
(Partner; Foster, Pepper &
Riviera, Attorneys)

Legal Counsel

Foster, Pepper & Riviera
Seattle, Washington

Registrar and Transfer Agent

Rainier National Bank
Seattle, Washington

Annual Meeting

May 11, 1978 at 2:00 p.m.
Rainier National Bank Tower
One Rainier Square
Seattle, Washington

Form 10-K

The Timberland Industries form 10-K Report filed with the Securities and Exchange Commission is available to shareholders at no cost upon written request to:
Stephen A. Barrie,
Manager of Administration
Timberland Industries
P.O. Box 3546
Bellevue, WA 98009

Operations

Corporate Offices:
Timberland Industries, Inc.
Yarrow Bay Office Park
P.O. Box 3546
Bellevue, Washington 98009

Timberland Forest Products, Inc.
1600 West Galer, Pier 88
Seattle, Washington 98119

Cal-Wood Door
101 Transport Avenue
Rohnert Park, California 94928

Western Cabinet & Millwork
11803 N.E. 116th
Kirkland, Washington 98033

Brennan Supply Co., Inc.
14032 Aurora Avenue North
Seattle, Washington 98133

Timberland Homes, Inc.
7418 S. 212th
Kent, Washington 98031

Timberland Panel Co.
50 Panel Way
Longview, Washington 98632

$60,000,000
$55,000,000
$50,000,000
$45,000,000
$40,000,000
$35,000,000
$30,000,000
$25,000,000
$20,000,000