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# TIMBERLAND

INDUSTRIES, INC.

**1978**  
**ANNUAL**  
**REPORT**



# **Timberland Industries, Inc.**

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## **THE COMPANY**

Timberland Industries, Inc. is a diversified 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.

## **ANNUAL MEETING**

May 15, 1979 at 2:00 p.m.  
Rainier National Bank Tower  
One Rainier Square  
Seattle, Washington

## **FORM 10-K**

The Timberland Industries, Inc. 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, Inc.  
P. O. Box 3546  
Bellevue, WA 98009

## **REGISTRAR AND TRANSFER AGENT**

Rainier National Bank  
Seattle, Washington

## **LEGAL COUNSEL**

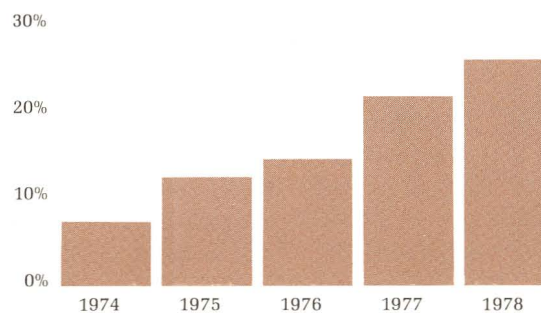
Foster, Pepper & Riviera  
Seattle, Washington

## FINANCIAL HIGHLIGHTS

	1978	1977	% Change
Net sales	<b>\$ 93,352,000</b>	\$64,494,000	43.6
Earnings from continuing operations before income taxes	<b>\$ 2,464,000</b>	\$ 2,152,000	14.4
Earnings			
Continuing operations	<b>\$ 1,412,000</b>	\$ 1,156,000	22.2
Discontinuing operations	<b>(192,000)</b>	(40,000)	
Net earnings	<b>\$ 1,220,000</b>	\$ 1,116,000	9.3
Per share			
Continuing operations	<b>\$ 1.81</b>	\$ 1.49	21.3
Discontinued operation	<b>(.25)</b>	(.05)	
Net earnings	<b>\$ 1.56</b>	\$ 1.44	8.3
Total Assets	<b>\$22,568,000</b>	\$21,797,000	3.5
Shareholders equity	<b>\$ 6,696,000</b>	\$ 5,515,000	21.4
Return on shareholders equity	<b>25.6%</b>	22.4%	14.3
Book value per share	<b>\$ 8.83</b>	\$ 7.93	13.6
Cash flow from operations	<b>\$ 1,984,000</b>	\$ 1,640,000	22.2
Average shares outstanding & common stock equivalents	<b>780,832</b>	773,047	1.0
Cash dividends per share	<b>\$.15</b>	\$.09	66.6
Stock dividends per share	<b>5%</b>		

The Company's stock is traded over-the-counter under NASDAQ symbol TIMB.

Return on Shareholders Equity

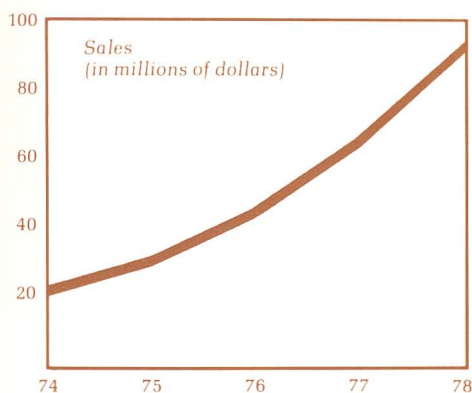


## President's Message To Shareholders

Timberland Industries continued to achieve gratifying rates of overall growth and profitability in 1978, further strengthening its financial position on record sales and earnings.

Performance improvement during the year was substantial enough to produce increased dividends for our shareholders as well as significantly higher book value per share.

Total sales by continuing operations in 1978 were \$93.3 million—up 44 percent from the prior record of \$64.5 million set in 1977. Earnings from continuing operations reached \$1,411,975 or \$1.81 per share last year—22 percent better than the \$1,155,791 or \$1.49 per share recorded in 1977.



In mid-year, the positive trend in operating results permitted us to increase the regular quarterly cash dividend from three cents to four cents per share. We also were able to issue a special five percent stock dividend on June 1, 1978.

Shareholder's equity rose to \$6.7 million at the end of 1978 for an increase of 21 percent over the 1977 year-end figure of \$5.5 million. As a result, book value per share was \$8.83 at the end of 1978, compared with \$7.93 a year before.

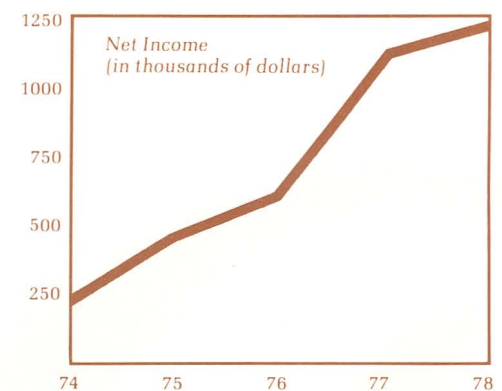
So, 1978 was a good year for Timberland Industries and its shareholders—with many of our primary objectives successfully met. And where problems were experienced during the year, appropriate actions were taken and new programs are underway to further bolster performance at all levels, and the Company's overall profitability should continue to climb in 1979.

Once again, our manufacturing operations combined to lead the distribution and homebuilding segments in terms of profits. Manufacturing earnings were \$1.02 million in 1978, up 23 percent, on sales of \$30.5 million, up 24 percent from the previous year.

Western Cabinet & Millwork, manufacturer and distributor of cabinets and complete interior wood systems for new single- and multi-family dwellings, recorded record sales and earnings for the fifth consecutive year. Economic health in Western Cabinet's primary market areas (Washington, Idaho and Hawaii) remains robust. To keep pace with continuing growth in these states, Western Cabinet is doubling its Western Washington production capacity with the construction of a new 140,000-square-foot complex scheduled for completion in late 1979.

Cal-Wood Door, manufacturer of commercial and residential interior and exterior doors, rebounded from a first-quarter profit slump caused by rapid increases in raw material prices to register normal margins during the final nine months. Cal-Wood's on-going research and development effort led to the successful introduction of several new fire-rated door products last year—an element of significant importance in the commercial door market.

Timberland Panel operations were discontinued in late 1978 after continuing to produce a drain on Company profits. It was determined that market potential did not warrant the additional capital investment needed to be competitive in light of rapid changes in panel prefinishing technology. This closure accounts for our reporting to you in terms of "continuing operations," and effects of the phase-out are fully stated in the 1978 results, with the exception of certain lease commitments which will be disposed of early in 1979.



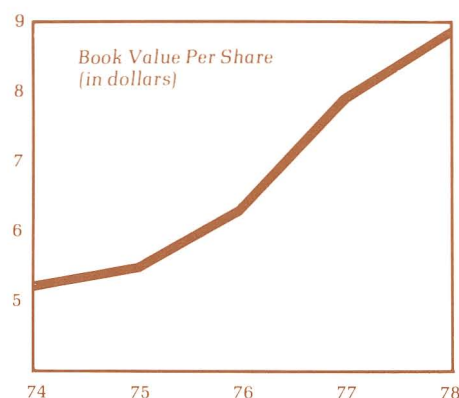


Performance in the Company's distribution segment was mixed last year. Sales jumped to \$54.5 million—51 percent better than the \$36 million of 1977. But 1978 earnings declined by 17 percent, from \$379 thousand in 1977 to \$319 thousand last year.

Timberland Forest Products, our national distributor of plywood, accounted for the drop in earnings when extremely difficult pricing conditions cropped up in the fourth quarter to spoil an otherwise good profit year. Nevertheless, the operation acquired new customers and met record demands for plywood during the year, and current indications of an essential return to more traditional pricing patterns raise the prospect of better earnings performance in 1979. An aggressive marketing program is underway to take further advantage of new market penetration successes experienced last year.

Brennan Supply, our Northwest distributor and retailer of lighting and hardware products, turned in its sixth consecutive year of record sales and earnings. Strong economic growth continues in its market area, and to meet the increasing demand for its products while improving its market penetration, Brennan Supply will soon open a third distribution facility and retail store south of Seattle.

Timberland Homes, the Company's manufactured home building operation, doubled its sales last year—\$8.3 million compared with \$4 million in 1977. Earnings were \$73,000 compared with the previous year's loss of \$95,000. Partially responsible for these increases was the addition last year of site preparation and home installation to the Division's marketing activity. While the 1978 performance reflects obvious improvement, earnings were not up to expectations, and new profit opportunities are being studied for 1979 and beyond.



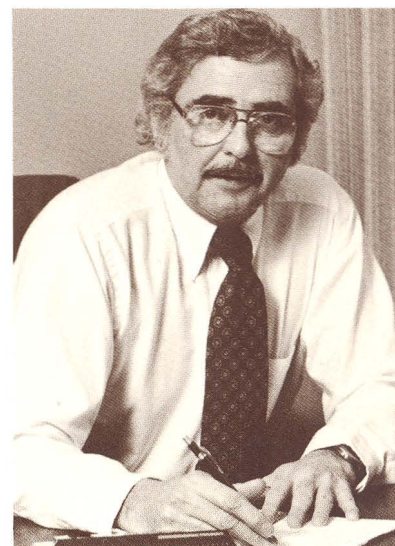
In summary, overall 1978 results contributed substantially to a lengthening history of sustained success for Timberland Industries. Over the past five years, our sales and earnings both have grown at a compounded rate of 32 percent. These results are attributable to the Company's logically diversified position in the building products industry. Meanwhile, additional penetration of existing markets and expansion into new regions are priority goals for the future, and we are increasingly optimistic about the prospects.

While facts, figures and charts are of great importance in the evaluation of a business, the basic criterion for our company's achievements involves the quality of its employees at all levels. Our record stems in great measure from the skill and efforts of our people.

We appreciate the confidence that you as well as much of the financial community have placed in Timberland Industries. As you can see, your investment has become more valuable during the past year, and our demonstrated commitment to orderly growth should continue to enhance your return in the years ahead.

J. Allan MacDonald  
President

March 30, 1979



## Profile of Timberland

OPERATIONS	DIVISIONS	PRODUCTS	MARKETS
<b>Manufacturing</b> Operations involved in the manufacture and distribution of interior wood systems and flush wood doors.	Western Cabinet & Millwork Kirkland, Washington  Cal-Wood Door Santa Rosa, California	Kitchen cabinets, vanities interior and exterior doors, and lineal molding.  Interior and exterior flush wood doors, jambs and casings.	Residential and commercial builders primarily in the Pacific Northwest and Hawaii.  Residential and commercial builders throughout the United States.
<b>Distribution</b> Operations involved in the wholesale distribution of plywood, and building hardware (wholesale and retail).	Timberland Products Seattle, Washington  Brennan Supply Seattle, Washington	Plywood  Lighting fixtures, hardware and building product specialty items.	Building supply distributors throughout the United States.  Contractors, builders and do-it-yourselfers in Western Washington.
<b>Homebuilding</b> Operations involved in the manufacture and installation of modular and component housing.	Timberland Homes Kent, Washington  Timberland Erectors Kent, Washington	Single-family and multiple-family structures.  Site preparation for and erection of Timberland Homes products.	Contractors, developers and dealers in the Pacific Northwest and Alaska.  Major contracts for housing projects in Alaska.



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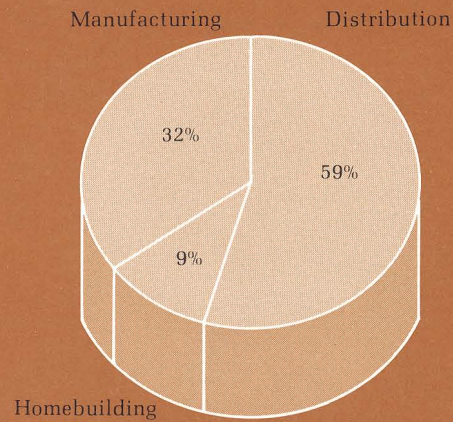
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by Line of Business

## 1978 OPERATING RESULTS BY SEGMENT

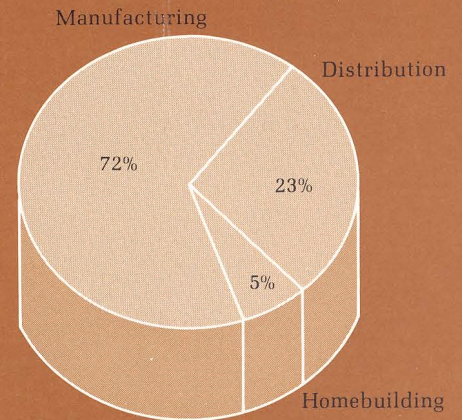
(in thousands)

	Sales	%	Income	%
Manufacturing	\$30,500	32	\$1,020	72
Distribution	54,500	59	319	23
Homebuilding	8,300	9	73	5
Total	93,300	100%	1,412	100%

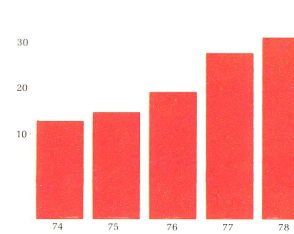
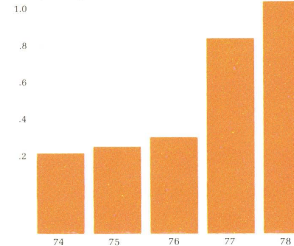
Sales by Segment



Income By Segment





Manufacturing Sales  
(millions)Manufacturing Income  
(millions)

Comprising Timberland Industries' manufacturing line of business are Western Cabinet & Millwork and Cal-Wood Door—both having major positions in the primary markets they serve. In 1978, this segment accounted for 72 percent of the Company's earnings and 32 percent of its sales, continuing a five-year record of consistent growth in both those respects.

Western Cabinet & Millwork is the Pacific Northwest's leading producer and distributor of prefinished interior wood systems primarily for newly constructed single- and multi-family dwellings. Products include kitchen cabinets, bathroom vanities, moldings, pre-hung interior and exterior doors, residential hardware, and related wood trim items.

Western Cabinet's marketing strategy is to offer "one-stop shopping" for such wood system needs to contractors, builders and developers of all sizes in Washington, Idaho, Oregon, Hawaii and Alaska. The major emphasis is on service to these customers during their planning and design phases. In addition, studies are underway to enter the home remodeling supply market, which has sales potential as vast as in new construction.

The Western Cabinet design team is continually developing new products. During 1978, the operation introduced two new Oak cabinet lines, which accounted for about ten percent of its sales. Its cabinets were installed in more than 10,000 kitchens last year, while more than 20,000 homes were fitted with its vanities, doors and moldings.

With the regional housing market expected to remain strong in 1979 and beyond, Western Cabinet is building a new 140,000-square-foot manufacturing and warehouse complex at Woodinville, near Seattle. Scheduled for completion in December of 1979, it will replace the Kirkland, Washington facilities and double Western Washington production capacity. Other manufacturing plants are located in Boise, Idaho, and Richland, Washington, with sales offices in Wenatchee and Tacoma, Washington, and Honolulu, Hawaii.

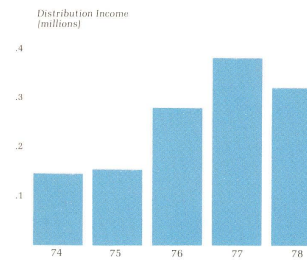
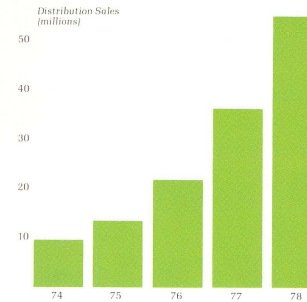
Cal-Wood Door, located in Santa Rosa, California, has a national reputation as a quality producer of residential and commercial flush wood doors and related moldings. It serves suppliers to the construction market—including Western Cabinet and Timberland Homes—as well as hospitals, schools, offices, hotels, and all types of residential construction.

One of the keys to Cal-Wood Door's marketing success has been its emphasis on research and development of fire-resistant doors—producing the widest selection of fire-rated doors available to the construction industry. The product line ranges from a simple residential interior door to a sophisticated 1½-hour fire-rated commercial door.

Principal residential markets are located in the West, Southwest and Southeast, while its commercial and institutional markets are national. Additionally, the Division continues to expand its export markets in Japan, other Pacific Rim countries, and the Middle East.

During 1978, Cal-Wood Door delivered more than 250,000 doors for use in commercial buildings and supplied more than 50,000 homes with interior doors. It also expanded its door pre-finishing capabilities during the year, which provides its customers with the economic and quality advantages of factory finishes versus on-the-job finishing.





Timberland Forest Products is the nation's leading independent sorting and transit plywood wholesaler. Brennan Supply is a leading wholesaler and retailer of lighting fixtures, hardware and related supplies in Western Washington. These two operations comprise the Company's distribution line of business, and contributed 23 percent of earnings and 59 percent of sales in 1978.

Timberland Forest Products performed very well during 1978 in light of the unusual market conditions which affected the entire plywood industry in the fourth quarter. Much of the credit for this success can be laid to the late-1977 addition of new distribution centers in the Southwest and Southeast, where last year's sales were triple those of 1977.

The role of Timberland Forest Products in the marketplace centers around the fact that individual plywood mills tend to manufacture limited grade and size ranges, depending on local log yield and economic conditions. Plywood customers, on the other hand, desire to maintain a balanced inventory with a broad variety of grades and sizes. As a sorting and transit operation, Timberland Forest Products purchases plywood in carload lots from the mills and packages mixed shipments to meet the specific needs of wholesale stocking distributors.

During 1978, Timberland Forest Products formulated plans for a sophisticated computer network which will link all distribution centers together. It becomes operational in June of 1979. The system will monitor activities including costs, inventory levels, sales, and profitability by product line.

New methods for faster inventory turnover at its distribution centers were begun during the year, along with modified transportation modes to improve customer service.

Timberland Forest Products provides a vital link in transferring both western and southern pine plywood from the mill to the marketplace. Last year, it moved more than 3,100 railcar and truck loads—handling about one percent of all the plywood sold in the country.

Headquarters are located in Seattle, with additional warehouse facilities in Spokane, Washington; McCloud, California and Natchez, Mississippi.

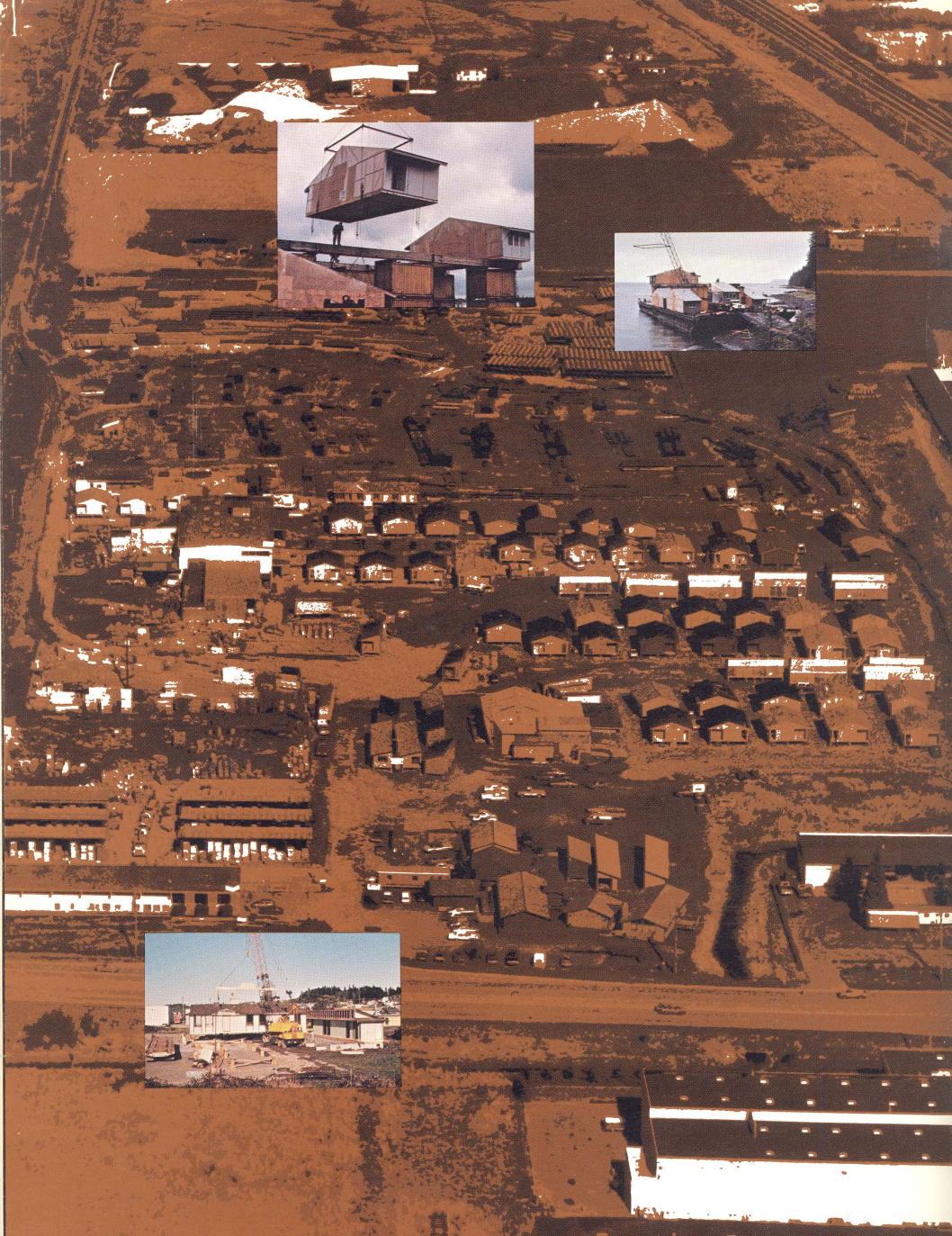
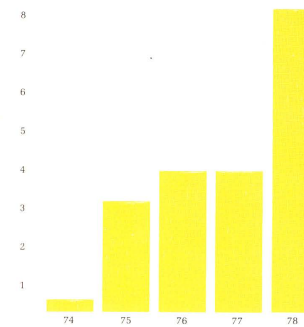
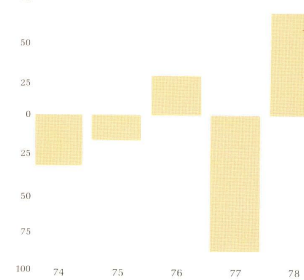
Brennan Supply's two retail and wholesale outlets are located in the heart of the fastest-growing area of Washington State. They carry more

than 4,000 products for the home—including lighting fixtures, builder's hardware, range hoods, and related building accessories. Emphasis is not only on availability of a wide range of products, but also on customer service to both the contractor and do-it-yourself remodeling, repair and maintenance markets.

During 1978, about 85 percent of Brennan Supply's sales were to professional builders, with the remainder to homeowners.

Having posted its sixth consecutive year of record sales and earnings, Brennan Supply expects even greater market penetration with the opening of a new 9,000-square-foot outlet in the spring of 1979. Located in a major shopping center at Federal Way, south of Seattle, this third site is in an area with unusually high potential for new housing development.



Homebuilding Sales  
(millions)Homebuilding Income  
(Thousands)

This business line prepares the building site, lays the foundation and manufactures modular and component built homes for both the Washington and Alaska markets. In 1978, it accounted for five percent of the Company's earnings and nine percent of sales.

Established in 1974, Timberland Homes is a relatively young organization and has had the usual concerns of a developing business. In 1977, the Division operated at a loss of \$95,000 on sales of \$4 million. In 1978, it had earnings of \$73,000 on sales of \$8.3 million.

This improvement in performance is due, in part, to last year's addition of a total turn-key approach in delivering homes to customers. It includes not only the manufacturing processes, but also direct participation in building lot preparation and on-site installation of the housing units.

During 1978, Timberland Homes delivered 218 units—both single- and multi-family dwellings. Highlights of the year included the near-completion of a \$4 million contract for 117 units in several villages in Southeast Alaska. It also received another \$4 million contract for the manufacture and installation of 80 single-family homes in the western part of Alaska for 1979. Both contracts were for HUD-financed housing for Alaskan natives. These projects are locally sponsored to meet the need for adequate housing for this segment of the state's population.

Homes for the Alaska market are built at the Division's manufacturing facility in Kent, Washington. At the same time the homes are being manufactured, Timberland Erectors—its construction division—is clearing the property and laying the foundation. The home components are transported by barges, which can carry as many as 60 units at a time.

Depending on their final destination, the units are either unloaded at dockside or set directly on the beach by crane. From there they are delivered to the building site and installed on the foundations. The entire trip covers about 1,500 miles and usually takes seven days from loading on the barges in Seattle to delivery at the site.

In the other half of Timberland Homes' marketplace—Western Washington—sales are predominantly single-family homes in the \$29,000 to \$59,000 range, with styles ranging from colonial to contemporary. The homes are delivered completely finished, including carpeting and appliances. Construction methods used not only result in greater utilization of expensive skilled labor and reduced building time, but also provide for strict cost controls and better value for the customer's home-buying dollars.



## Analysis of Sales and Net Income by Line of Business

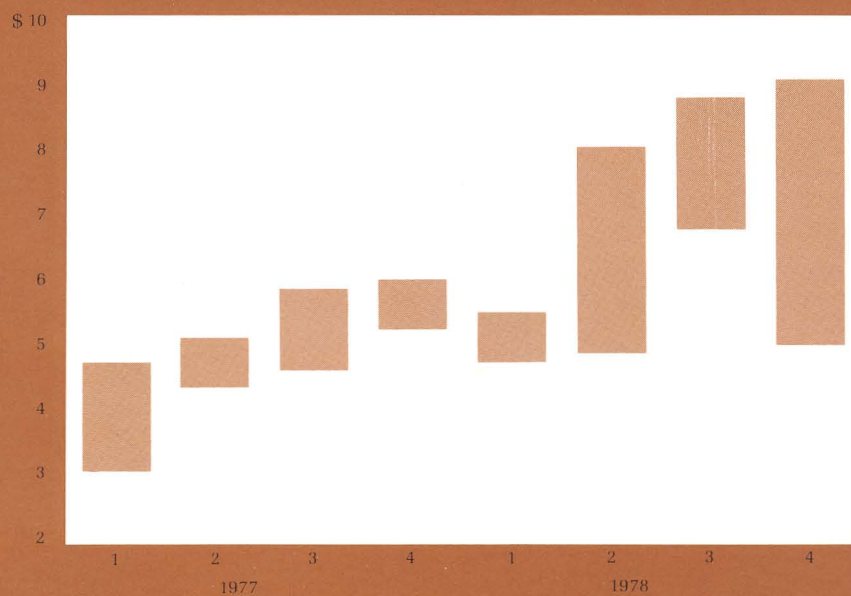
Timberland Industries, Inc. and Subsidiaries

	1978 (in thousands)	1977	1976	1975	1974
<b>Manufacturing</b>					
Sales	<b>\$30,500</b>	\$24,500	\$19,200	\$14,200	\$13,400
Income from continuing operations	<b>1,020</b>	872	303	262	227
<b>Distribution</b>					
Sales	<b>54,500</b>	36,000	21,900	13,500	9,800
Income from continuing operations	<b>319</b>	379	276	147	141
<b>Homebuilding</b>					
Sales	<b>8,300</b>	4,000	4,000	3,200	500
Income from continuing operations	<b>73</b>	(95)	28	(17)	(36)
<b>TOTAL</b>					
Sales	<b>\$93,300</b>	\$64,500	\$45,100	\$30,900	\$23,700
Income from continuing operations	<b>1,412</b>	1,156	607	392	332

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## COMMON STOCK QUARTERLY PRICE RANGE





## Management's Discussion and Analysis

### 1978

During 1978, sales increased 44 percent reflecting the growth of the Company's geographic market area and the continued strength in the housing construction markets. This demand for wood and building products remained high despite high interest rates in the home mortgage markets. All segments contributed to the increase in sales. The largest dollar increase was in the plywood distribution business where sales increased by \$18.5 million, accounting for 66 percent of the consolidated sales increase. This increase was due primarily to successful penetration of new market areas.

The Company's gross profit margin was 11 percent in 1978 as compared to 13 percent in 1977. This gross profit margin decline is primarily attributable to the large sales increase in the traditionally low-margin plywood distribution business. All other costs increased 31 percent on the 44 percent sales increase, reflecting continuing increased marketing activities, higher borrowing costs, and depreciation charges on asset additions. Net income from operations was up 22 percent. All continuing operations contributed to the increase with the cabinet manufacturing operation accounting for the largest increase.

### 1977

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

The Company's gross profit margin was 13 percent in 1977 as compared to 13 percent in 1976. All other costs increased 20 percent on the 48 percent sales increase, reflecting continuing increased marketing activities, higher levels of receivables and inventories and depreciation charges on asset additions.

Net income was up 84 percent from 1976 to 1977. All operations contributed to the increase except for the modular/component home manufacturer where a significant loss was recorded.

# Five-year Summary of Operations

Timberland Industries, Inc. and Subsidiaries

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	1978	1977	1976	1975	1974
Net sales	<b>\$93,351,878</b>	\$64,493,881	\$43,762,880	\$30,534,132	\$23,711,868
Other income	<b>274,876</b>	35,394	48,323	117,159	32,083
	<b>93,626,754</b>	64,529,275	43,811,203	30,651,291	23,743,951
Costs and expenses					
Cost of sales	<b>83,597,658</b>	56,281,826	37,902,293	26,242,457	20,322,075
Selling and administrative	<b>6,244,181</b>	5,112,063	3,640,247	2,961,628	2,188,491
Interest	<b>833,517</b>	590,288	403,235	344,753	394,116
Depreciation and amortization	<b>487,601</b>	392,893	304,327	240,298	228,482
	<b>91,162,957</b>	62,377,070	42,250,102	29,789,136	23,133,164
Income from continuing operations before income taxes	<b>2,463,797</b>	2,152,205	1,561,101	862,155	610,787
Provision for income taxes	<b>1,051,822</b>	996,414	751,056	379,978	279,000
Income from continuing operations	<b>1,411,975</b>	1,155,791	810,045	482,177	331,787
Discontinued operations (Net loss) from operations of discontinued Divisions	<b>(192,044)</b>	(40,082)	(203,030)	(47,267)	(87,388)
Net Income	<b>\$1,219,931</b>	\$1,115,709	\$ 607,015	\$ 434,910	\$ 244,399
Weighted average shares outstanding and common stock equivalents:	<b>780,832</b>	773,047	693,575	694,891	697,240
Net income per share:					
Based on weighted average shares outstanding and common stock equivalents					
From continuing operations	<b>\$1.81</b>	\$1.49	\$1.17	\$.70	\$.48
From discontinued operations	<b>(.25)</b>	(.05)	(.29)	(.07)	(.13)
	<b>\$1.56</b>	\$1.44	\$.88	\$.63	\$.35
Dividends					
Cash dividends per share	<b>\$ .15</b>	\$ .09			
Stock	<b>5%</b>			10%	



## Consolidated Balance Sheet

Timberland Industries, Inc. and Subsidiaries

### Assets

	December 31,	
	1978	1977
Current Assets		
Cash	\$ 538,000	\$ 269,000
Receivables, principally trade accounts, less allowances for doubtful accounts of \$281,000 in 1978 and \$272,000 in 1977 (Note 2)	7,408,000	6,275,000
Costs and estimated earnings in excess of billings of \$3,674,000 on long-term construction contracts (Note 1)	873,000	
Inventories (Notes 1 and 2)	8,661,000	11,005,000
Account balances with brokers (Note 8)	72,000	188,000
Prepaid expenses	202,000	81,000
Total current assets	17,754,000	17,818,000
Property, plant and equipment — at cost (Notes 1, 2, and 3)		
Land	552,000	449,000
Buildings	1,721,000	1,501,000
Machinery	2,112,000	1,663,000
Automotive	710,000	665,000
Furniture and fixtures	404,000	375,000
Leasehold improvements	275,000	181,000
	5,774,000	4,834,000
Less accumulated depreciation and amortization	(1,907,000)	(1,608,000)
	3,867,000	3,226,000
Excess of cost of investment in subsidiary over the net asset value at date of acquisition (Note 1)	477,000	498,000
Notes receivable (Note 2)	470,000	255,000
	\$22,568,000	\$21,797,000

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

### Liabilities and Shareholders' Equity

	December 31,	
	1978	1977
Current liabilities		
Notes payable:		
Banks (Note 2)	\$ 7,000,000	\$ 6,900,000
Other	131,000	119,000
Current portion of long-term debt (Note 3)	246,000	231,000
Accounts payable		
Trade	4,240,000	5,168,000
Drafts	463,000	
Accrued liabilities, principally compensation	1,491,000	1,232,000
Customer Deposits	57,000	115,000
Federal and State Income Taxes Payable (Notes 1 and 6)	105,000	370,000
Total current liabilities	13,733,000	14,135,000
Long-term debt, less current portion shown above (Note 3)	1,662,000	1,746,000
Deferred income taxes (Notes 1 and 6)	441,000	357,000
Deferred income	36,000	44,000
Commitments and contingencies (Notes 4 and 8)		
Shareholders' equity (Note 5)		
Common stock, authorized 2,500,000 shares of \$.16 per value; issued and outstanding 758,000 shares in 1978, 696,000 shares in 1977	121,000	111,000
Additional paid-in capital	1,940,000	1,603,000
Retained earnings	4,635,000	3,801,000
Total shareholders' equity	6,696,000	5,515,000
	\$22,568,000	\$21,797,000

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

# Consolidated Statement of Income

Timberland Industries, Inc. and Subsidiaries

	Years Ended December 31,	
	1978	1977
Net sales	<b>\$93,352,000</b>	\$64,494,000
Other income	<b>275,000</b>	35,000
Total revenues	<b>93,627,000</b>	64,529,000
Cost and expenses		
Cost of sales (Note 1)	<b>83,598,000</b>	56,281,000
Selling and administrative expense	<b>6,244,000</b>	5,113,000
Interest	<b>833,000</b>	590,000
Depreciation and amortization	<b>488,000</b>	393,000
Total costs and expenses	<b>91,163,000</b>	62,377,000
Income from continuing operations before provision for income taxes	<b>2,464,000</b>	2,152,000
Provision for income taxes (Notes 1 and 6)	<b>1,052,000</b>	996,000
Income from continuing operations	<b>1,412,000</b>	1,156,000
Loss incurred from discontinued operation, net of tax benefits of \$135,000 in 1978 and \$41,000 in 1977 (Note 7)	<b>(146,000)</b>	(40,000)
Loss on disposition of discontinued operations, net of tax benefits of \$43,000 in 1978	<b>(46,000)</b>	
Net Income	<b>\$ 1,220,000</b>	\$ 1,116,000
Net income per common share (Note 1)		
Continuing operations	<b>\$1.81</b>	\$1.49
Discontinued operations	<b>(.25)</b>	(.05)
Net income	<b>\$1.56</b>	\$1.44

The accompanying notes are an integral part of the financial statement.



# Consolidated Statement of Shareholder's Equity

Timberland Industries, Inc. and Subsidiaries

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	Number of Shares Outstanding	Par Value of Common Stock	Additional Paid-In Capital	Retained Earnings
Balance at December 31, 1976	694,000	\$111,000	\$1,598,000	\$2,748,000
Exercise of stock options	2,000		5,000	
Cash dividends (\$.09 per share)				(62,000)
Net income				1,116,000
Balance at December 31, 1977	696,000	111,000	1,603,000	3,801,000
Exercise of stock options	28,000	4,000	70,000	
Stock dividend paid (5%) at fair market value	34,000	6,000	267,000	(273,000)
Cash dividends paid (\$.15 per share)				(113,000)
Net income				1,220,000
Balance at December 31, 1978	758,000	\$121,000	\$1,940,000	\$4,635,000

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



# Consolidated Statement of Changes in Financial Position

Timberland Industries, Inc. and Subsidiaries

	Years Ended December 31,	
	1978	1977
Financial resources provided by		
Income from continuing operations	\$1,412,000	\$1,156,000
Add items not requiring the use of working capital		
Depreciation and amortization	488,000	393,000
Deferral of Federal income taxes	84,000	91,000
Working capital provided by continuing operations	1,984,000	1,640,000
Loss from discontinued operation	(192,000)	(40,000)
Items not requiring working capital		
Depreciation	27,000	41,000
Working capital used by discontinued operation	(165,000)	1,000
Total working capital provided by operations	1,819,000	1,641,000
Proceeds from disposition of equipment	184,000	
Exercise of stock options	74,000	5,000
Long-term debt incurred	88,000	904,000
	2,165,000	2,550,000
Financial resources applied to		
Acquisition of plant and equipment	1,319,000	1,730,000
Reduction of term debt	172,000	
Cash dividends paid	113,000	62,000
Long-term receivables	215,000	101,000
Reduction in deferred income	8,000	8,000
	1,827,000	1,901,000
Increase in working capital	\$ 338,000	\$ 649,000
Changes in components of working capital		
Increases (decreases) in current assets		
Cash	\$ 269,000	\$ (124,000)
Accounts and notes receivable	1,133,000	2,386,000
Inventories	(2,344,000)	3,253,000
Account balances with brokers	(116,000)	(4,000)
Prepaid expenses	121,000	(68,000)
Costs and estimated earnings in excess of billings on long-term construction contracts	873,000	
	(64,000)	5,443,000
Less, increases (decreases) in current liabilities		
Notes payable	112,000	2,569,000
Accounts payable and deposits	(523,000)	1,612,000
Accrued liabilities	259,000	498,000
Current portion of long-term debt	15,000	(52,000)
Federal and State income taxes payable	(265,000)	167,000
	(402,000)	4,794,000
Increase in working capital	\$ 338,000	\$ 649,000

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



# Notes to Consolidated Financial Statements December 31, 1978 and 1977

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## NOTE 1 — SUMMARY OF SIGNIFICANT 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. The inventories used in the computation of cost of sales for the three years ended December 31, 1978, were as follows:

	<u>1978</u>	<u>1977</u>	<u>1976</u>
Finished goods	\$5,527,000	\$ 8,617,000	\$6,156,000
Work in process	759,000	257,000	48,000
Raw materials	2,375,000	2,131,000	1,547,000
	<u>\$8,661,000</u>	<u>\$11,005,000</u>	<u>\$7,751,000</u>

- (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:

	<u>Years</u>
Buildings	20-25
Machinery	5-8
Automotive	3-5
Furniture and fixtures	5-8

- (d) Amortization of Intangible — The excess of cost of investment in a subsidiary over net assets acquired is being amortized over 30 years. Accordingly, \$21,000 has been charged to operations in 1978 and 1977.

- (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 (\$69,000 in 1978 and \$63,000 in 1977) accounted for by the flow-through method. In 1978 and 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 certain items of income and expense for income tax purposes and financial reporting.

- (f) Contract Accounting — Earnings on long-term construction contracts are recognized on the percentage-of-completion method in the ratio that costs incurred bear to total estimated costs. Earnings and costs on contracts are subject to revision throughout the terms of the contracts, and any required adjustments are made in the periods in which revisions become known.

Costs and estimated earnings in excess of billings on uncompleted contracts comprise principally revenues recognized on contracts for which billings have not been

presented to the contract owners at the balance sheet date. Such revenues are expected to be billed and collected generally within one year.

In accordance with the industry practice, the Company includes in current assets and liabilities amounts realizable and payable under long-term construction contracts.

- (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. Pension costs are generally funded annually in the same amount as the charge against earnings (see Note 4).

- (h) Earnings Per Share — Earnings per share are computed by dividing net income by the weighted average number of common and common equivalent shares outstanding each year.

## NOTE 2 — NOTES PAYABLE TO BANK

	<u>1978</u>	<u>1977</u>
Revolving credit line	\$7,000,000	\$6,000,000
Interest rate	1¼% over prime lending rate	
Interest rate at December 31	13.0%	9.0%
Maximum outstanding during the year and at Dec. 31	\$7,000,000	\$6,000,000
Approximate avg. monthend borrowings	5,800,000	5,863,000
Weighted avg. interest rate	10.3%	8.3%
Short-term note, \$1,000,000 available at 2% over prime, outstanding at December 31		900,000

Loan provisions include:

Secured by notes and accounts receivable, inventories, equipment. Maintenance of compensating balances equal to 10% of borrowings. Maintenance of certain financial statement ratios. Approval of certain capital transactions. Dividend payments are restricted to 20% of annual net income.



### NOTE 3 — LONG TERM DEBT

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

	<u>1978</u>	<u>1977</u>
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.	<b>\$1,358,000</b>	\$1,311,000
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.	<b>550,000</b>	650,000
	<b>1,908,000</b>	1,961,000
Other		16,000
Less current portion	<b>246,000</b>	231,000
	<b><u>\$1,662,000</u></b>	<b><u>\$1,746,000</u></b>

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, 1978, to be made during the following five years, are approximately as follows: 1979 — \$176,000; 1980 — \$180,000; 1981 — \$183,000; 1982 — \$156,000; 1983 — \$155,000.

### NOTE 4 — EMPLOYEE BENEFIT PLANS

Substantially all employees of the Company and its subsidiaries are covered by retirement plans. The Company contributes to various trustee 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 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 \$458,000 on December 31, 1978, are amortized and funded generally over a period of 20 years. Pension costs of the two company-administered plans, charged to operations in 1978 and 1977 were \$133,000 and \$98,000, respectively. The actuarially computed value of vested benefits for non-retired lives and for retired lives whose benefits are not fully purchased at the time of retirement is \$298,000.

The Company adopted an executive bonus plan in 1977 which provides incentive compensation for certain corporate and division management personnel. Amounts under the plan are accrued only if the Company has met pre-established performance goals involving capital return and profitability. Incentive bonuses charged to operations in 1978 and 1977 totaled \$257,000 and \$333,000, respectively.

### NOTE 5 — 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:

	<u>1978</u>	<u>1977</u>
Outstanding, January 1	<b>22,150</b>	24,150
Granted		
Exercised	<b>3,650</b>	2,000
Outstanding and exercisable at December 31	<b><u>18,500</u></b>	<u>22,150</u>

At December 31, 1978 and 1977, 8,850 shares remained available for future options. Options outstanding at December 31, 1978, expire at various dates to August 30, 1981.

At December 31, 1978, nonqualified stock options were outstanding to eight members of the Board of Directors and the President of a subsidiary to purchase an aggregate of 47,850 shares, of which options to purchase 20,350 were held by the Board members. The Board members' options were granted at various dates from 1975, are exercisable at prices ranging from \$2.386 per share to \$7.875 per share and expire at various dates to May 12, 1983. The President of the subsidiary was granted an option for 27,500 shares in 1974 at \$2.727 per share, of which 22,000 are exercisable at December 31, 1978, and the remainder becomes exercisable in 1979. A second individual was also granted an option for 27,500 shares in 1974 at \$2.727 per share and exercised 22,000 of those options in 1978. The remaining 5,500 options were cancelled during the year when the individual left the company.

Activity in non qualified stock options (in shares) was:

	<u>1978</u>	<u>1977</u>
Outstanding, January 1	<b>74,100</b>	69,650
Exercised	<b>(23,900)</b>	
Granted	<b>3,150</b>	4,450
Cancelled and adjusted	<b>(5,500)</b>	
Outstanding, December 31	<b><u>47,850</u></b>	<u>74,100</u>



**NOTE 6 — INCOME TAXES**

The provisions for taxes on income consists of the following:

	<u>1978</u>	<u>1977</u>
Amounts currently payable	<b>\$683,000</b>	\$979,000
Additions to deferred income taxes, current and deferred	<b>312,000</b>	91,000
Reduction in Federal income taxes as a result of the investment tax credit and new jobs tax credit	<u><b>(121,000)</b></u>	<u>(115,000)</u>
	<u><b>\$874,000</b></u>	<u><b>\$955,000</b></u>

The increase in deferred income taxes results from timing differences in the recognition of depreciation expense, gain on sale of land and revenues on construction contracts for tax and financial statement purposes.

Following is a reconciliation of the difference between the statutory United States income tax rate of 48.0 percent and the effective tax rates for the years ended December 31:

	<u>1978</u>	<u>1977</u>
Statutory rate	<b>48.0%</b>	48.0%
Investment tax credit	<b>(3.3)</b>	(3.0)
New jobs tax credit	<b>(2.5)</b>	(2.5)
Other items, including state income taxes	<u><b>(.5)</b></u>	<u>3.6</u>
Effective rate	<u><b>41.7%</b></u>	<u><b>46.1%</b></u>

**NOTE 7 — DISCONTINUED PANEL MANUFACTURING OPERATION**

In November 1978, the Company announced its intention to discontinue its panel manufacturing operation. In January 1979, the operating assets were sold at auction. The remaining assets have been valued at their net realizable value.

The 1978 operating results of the panel business have been segregated in the consolidated Statements of Income in order to show results of continuing operations separately. Similarly, 1977 and prior consolidated Statement of Income have been restated to show the same segregation. The results of operations of the panel business include:

	<b>Year Ended December,</b>	
	<u>1978</u>	<u>1977</u>
Net sales	<b>\$1,634,000</b>	\$1,878,000
Costs and expenses	<b>2,012,000</b>	2,261,000
Income tax benefit	<b>177,000</b>	41,000
Loss	<u><b>(192,000)</b></u>	<u>(40,000)</u>

**NOTE 8 — COMMITMENTS AND CONTINGENCIES**

A subsidiary of the Company trades in the plywood futures market for its own account in hedging transactions in order to minimize its risk due to plywood market fluctuations.

Timberland Homes, 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 delivery of modular homes. The Company is vigorously contesting the alleged liability; and in the opinion of management and counsel, the matter should be resolved with no material adverse affect on the consolidated financial condition of Timberland Industries, Inc.

The Company leases certain properties used in its operations. Total rental expense for 1978 was less than 1 percent of revenues.

**NOTE 9 — QUARTERLY RESULTS (Unaudited)**

	<b>1978</b>			
(Dollars in thousands except per share figures)	<b>First</b>	<b>Second</b>	<b>Third</b>	<b>Fourth</b>
Net sales	\$20,953	\$25,515	\$26,210	\$20,674
Gross margin	1,892	2,621	2,758	2,483
Income from continuing operations	204	410	415	383
Income (loss) from discontinued operations	(18)	(26)	(46)	(102)
Net income	186	384	369	281
Net income per common share				
Continuing operations	.26	.53	.53	.49
Discontinued operations	(.02)	(.04)	(.06)	(.13)
Net income per common share	.24	.49	.47	.36



## NOTE 10 — INFORMATION BY LINE OF BUSINESS

The Company operates in three principal lines of business: manufacturing, distribution, and housing. Operations in manufacturing involve production and sale of cabinets, mill-work and doors. Operations in distribution include the wholesale distribution of plywood, lighting, fixtures and hardware. Operations in housing involve the production and sale of modular and component homes.

### BUSINESS SEGMENTS

	Manu- facturing	Distri- bution	Housing	Elimi- nations	Consoli- dated
(Thousands of Dollars)					
Sales to Unaffiliated Customers					
1978	\$30,748	\$54,534	\$8,345		\$93,627
1977	24,407	36,038	4,084		64,529
Intersegment Sales					
1978	\$ 352	\$ 425		\$ (777)	
1977	390	199		(589)	
Total Revenue					
1978	\$31,100	\$54,959	\$8,345	\$ (777)	\$93,627
1977	24,797	36,237	4,084	(589)	64,529
Operating Profit					
1978	\$ 2,570	\$ 797	\$ 327		\$ 3,694
1977	2,086	1,016	(157)		2,945
General Corporate and Interest Expense					
1978					\$ 1,230
1977					793
Income from Continuing Operations Before Provision for Income Taxes					
1978					\$ 2,464
1977					2,152
Identifiable Assets					
1978	\$11,489	\$ 6,767	\$3,817	\$ (30)	\$22,043
1977	10,522	8,781	1,389	(377)	20,315
Corporate Assets					
1978					\$ 525
1977					1,482
Total Assets					
1978					\$22,568
1977					21,797
Depreciation and Amortization					
1978	\$ 389	\$ 36	\$ 63		\$ 488
1977	324	29	40		393
Capital Expenditures					
1978	\$ 996	\$ 50	\$ 273		\$ 1,319
1977	1,631	69	30		1,730

## Accountant's Report

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

We have examined the consolidated balance sheet of Timberland Industries, Inc. and subsidiaries as of December 31, 1978 and 1977, 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, 1978 and 1977, 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.

*Mess, Adams & Co.*

Seattle, Washington  
March 21, 1979





Members of Timberland Industries, Inc. Board of Directors at a recent meeting reviewing the plant layout of Western Cabinet & Millwork's new 140,000 square foot manufacturing and warehouse facility to be constructed this spring in Woodinville, Washington.

Members of the Board are (left to right): Jack Canvin, Robert J. DeArmond, Donald Hansen, J. Allan MacDonald, Delos W. McNutt, James F. Aylward, Curtis P. Lindley, Ian MacDonald and Milton Skutle.

## Officers

J. Allan MacDonald,  
President

Donald S. Hansen,  
Vice President

Ian MacDonald,  
Vice President

Milton D. Skutle,  
Vice President

Stanley A. Gillman,  
Secretary & Treasurer

Stephen A. Barrie,  
Assistant Secretary

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

## Board of Directors

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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,  
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)

\*Member of the Audit Committee and Compensation Committee



**TIMBERLAND**  
**INDUSTRIES**

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