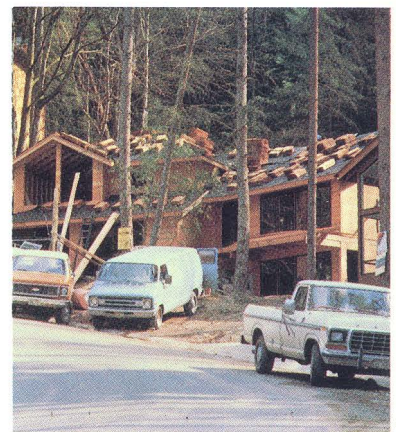
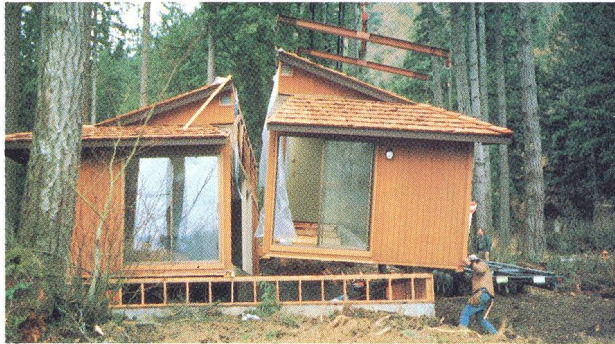
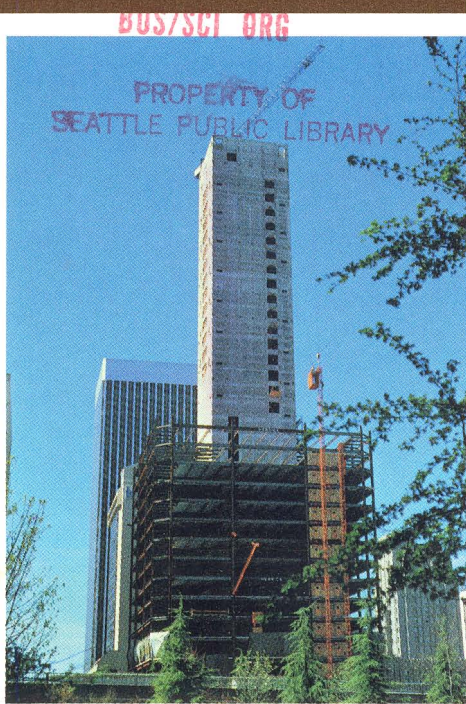


1979
PACIFIC
STACK



ANNUAL
REPORT 1979



TIMBERLAND INDUSTRIES, INC.

Timberland Industries, Inc.

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- 2** President's Message to Shareholders
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- Financial Review/Inside Financial Cover

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 as depicted on our cover.

ANNUAL MEETING

May 21, 1980 at 2:00 p.m.
Arcade Level Auditorium
Seattle-First National Bank Building
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

	1979	1978
Net sales	\$99,395,000	\$93,352,000
Earnings from continuing operations before income taxes	\$ 1,704,000	\$ 2,464,000
Earnings		
Continuing operations	\$ 1,300,000	\$ 1,412,000
Discontinuing operations	(56,000)	(192,000)
Net earnings	\$ 1,244,000	\$ 1,220,000
Per share		
Continuing operations	\$ 1.36	\$ 1.49
Discontinued operation	(.06)	(.20)
Net earnings	\$ 1.30	\$ 1.29
Total Assets	\$21,894,000	\$22,568,000
Shareholders equity	\$ 7,804,000	\$ 6,696,000
Return on shareholders equity	19.4%	25.6%
Book value per share	\$ 8.46	\$ 7.36
Cash flow from operations	\$ 1,854,000	\$ 1,984,000
Average shares outstanding & common stock equivalents	957,000	947,000
Cash dividends per share	\$.19	\$.15
Stock dividends per share	20%	5%

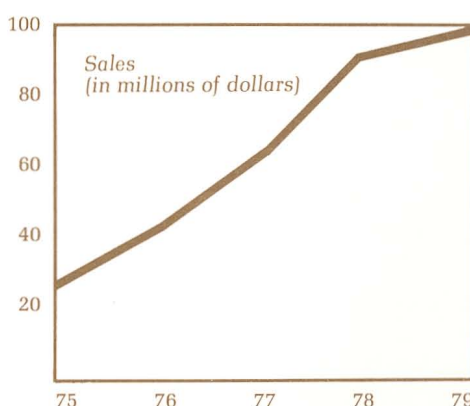
The Company's stock is traded over-the-counter under NASDAQ symbol TIMB.

President's Message To Shareholders

Timberland Industries overall held its position in housing and commercial construction markets and further strengthened its financial position in 1979. This was accomplished despite downward industry trends and unusual challenges faced during the year. Strong performance in several areas of operation sufficiently offset declines in others to maintain the strong earnings level of 1978. The Company provided an inflation bettering increase of 16 percent in the underlying value of our shareholders' investment.

Total sales in 1979 were \$99.5 million, a six percent increase over 1978. Net income at \$1,244,000 was substantially equal to 1978. Two elements that allowed maintenance of our earnings level were (1) the reduction in losses from our discontinued panel manufacturing operation and (2) a significant tax credit resulting principally from the construction of a new manufacturing facility for our cabinet and millwork division.

In an effort to continue sharing our growth with current benefits to our shareholders, at mid-year we increased our quarterly cash dividend from 4¢ to 5¢. Simultaneously, a 20 percent special stock dividend was declared. The combination of these dividends represented a yield increase of 50 percent.



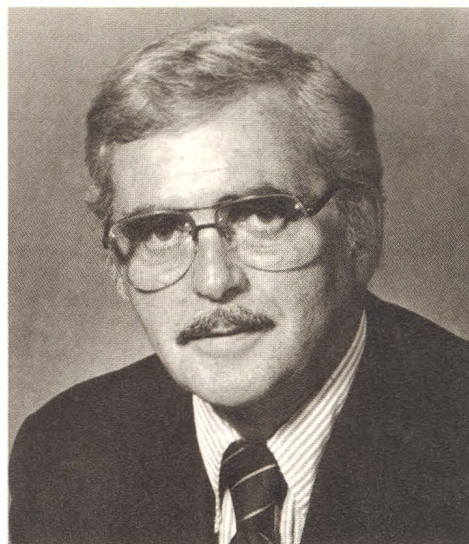
Shareholders' equity rose to \$7.8 million, an increase of 16 percent over 1978. As a result, book value per share was \$8.46 at year end. The Company's compounded growth rate of earnings over the past five years stands at 23.4 percent.

Following the pattern of the past several years, our manufacturing operations were our most profitable business segment. Manufacturing sales increased 8 percent to \$32.9 million, with an income increase of 37 percent.

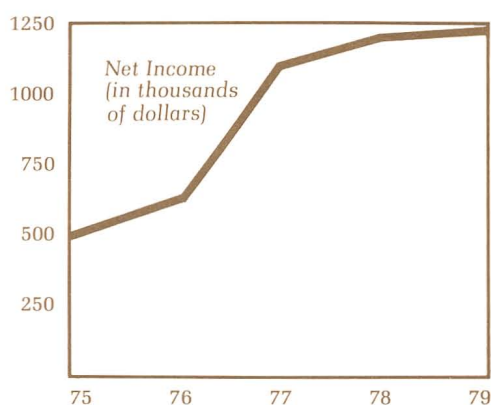
Western Cabinet & Millwork, our residential cabinet and wood systems manufacturer, provided record sales and earnings for the sixth consecutive year. The new 140,000 square foot Woodinville, Washington facility, completed by year end, will allow a 100 percent production capacity increase with substantial productivity improvement to meet the growing demand for our products and services in the years ahead. Western Cabinet & Millwork solidified its dominant position in the Pacific Northwest market during 1979 and continues to set the pace in its operating areas.

Cal-Wood Door, our door manufacturing division in Santa Rosa, California, had an excellent year. Prior years' efforts in product research and development continue to have a major impact on Cal-Wood's financial success. Its national and international reputation for high quality and broad product lines should continue to dictate profit performance. Operating income from this division increased substantially over the prior year.

Earnings results of our distribution operations were mixed. Sales rose modestly but earnings declined.



Brennan Supply, our multi-outlet distributor of lighting fixtures and builders hardware products encountered a very modest earnings decline after 5 successive year-to-year increases. We do not consider this a trend reversal but rather a result of costs incurred from a new store opening in June 1979. This new facility, Brennan's third, is located in Federal Way, Washington, and provides us access to a very active South Puget Sound residential construction market.

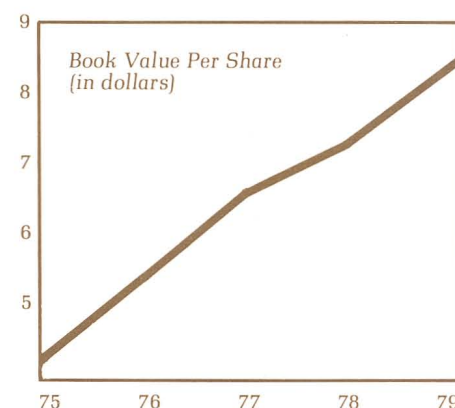


Timberland Forest Products, our national plywood distribution operation, which represented 56 percent of our overall sales volume, operated at a loss. The year 1979 was a very unstable year in the plywood industry, particularly in the national distribution element of the business. The continuing shift of

production to the Southern pine region, major changes in railroad freight structure along with industry overcapacity at prevailing housing start levels all contributed to the earnings difficulties. Needless to say, we have been taking the necessary action to minimize the impact of these unfavorable conditions on our future earnings.

Timberland Homes, our modular home manufacturer made some solid progress during the year despite a modest operating loss. Substantial unreimbursed costs were incurred in 1979 for contract changes relating to a federally funded Alaska housing project. Negotiations are underway which we anticipate will result in a significant recovery.

The current tightening of mortgage funds and resultant curtailment in housing starts provides much uncertainty for 1980. Also, high interest costs in 1979 and into 1980 represent a serious concern. We recognize and have experienced the cyclical nature of our business. Although the down-cycles represent frustration and concern, we emerge into each up-cycle in a more favorable position. We have the products, technology, facilities and market position to meet many of the demands of the future and we are confident of our capability to deal with the challenges ahead.



Timberland Industries will continue to concentrate on areas of proven performance with growth potential, including increased penetration in existing markets and expansion into new market areas.

Our past success has been dependent on the excellent performance of our many employees. We appreciate their fine effort as we do the confidence and support of our shareholders.

J. Allan MacDonald
President

March 31, 1980

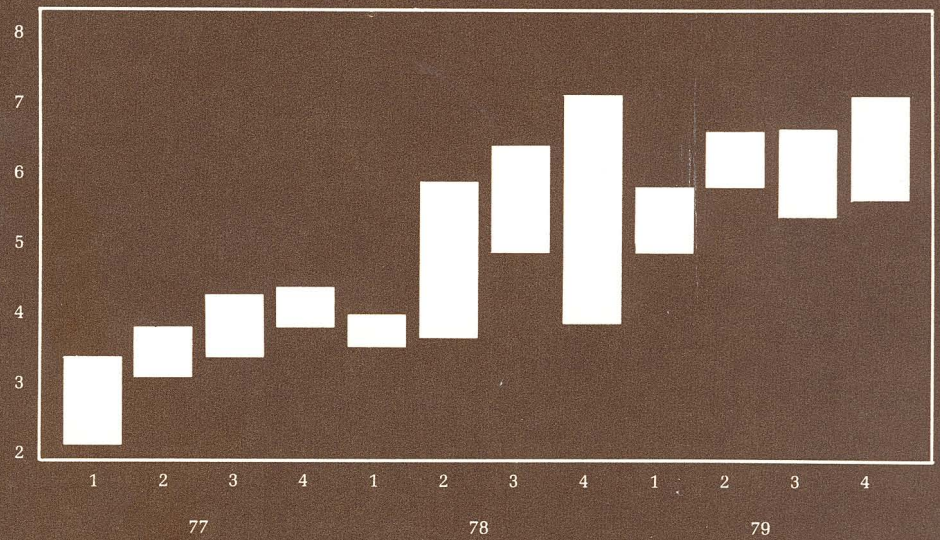
Profile of Timberland

OPERATIONS	DIVISIONS	PRODUCTS	MARKETS
Manufacturing 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.
Distribution 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.
Homebuilding 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.

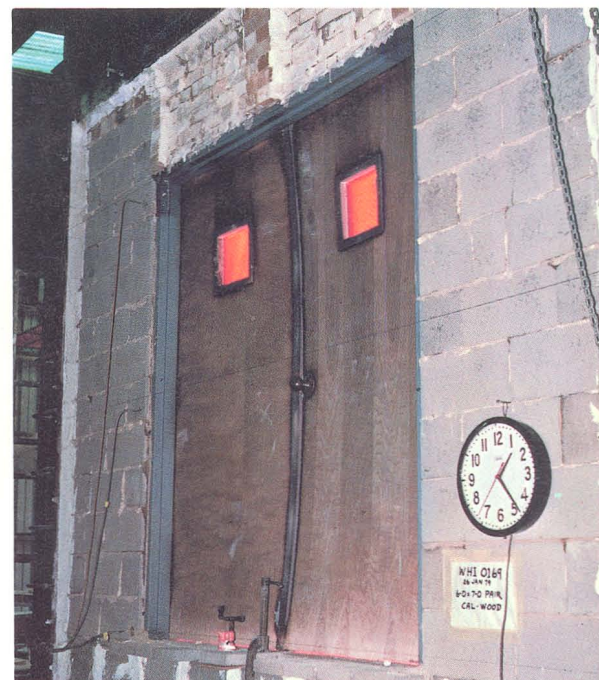
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- 7** Manufacturing
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COMMON STOCK QUARTERLY PRICE RANGE



Prices reflect 20% stock dividend as of June 1, 1979.

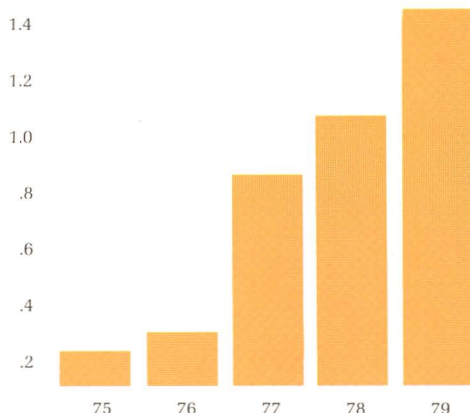
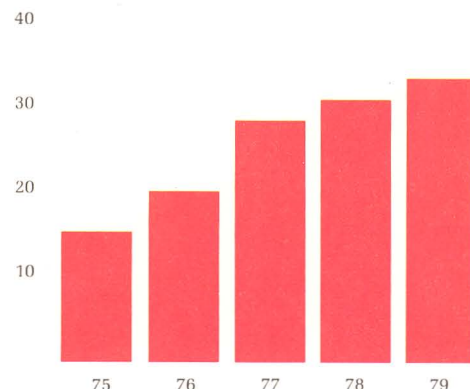


(Top L) Western Cabinets new kitchen cabinet production line with a capacity of 1000 boxes per shift.

(L) An example of installed kitchen cabinets, from Western Cabinet.

(Top R) Independent laboratory testing, subjects Cal-Wood Fire Doors to temperatures ranging from 1700° F. on the inside to 250° F. on the outside.

(R) After fire testing, the doors resist the impact of a water stream of 30 lbs pressure.

Manufacturing Income
(millions)Manufacturing Sales
(millions)

Western Cabinet & Millwork is a leading Pacific Northwest manufacturer and distributor of residential prefinished interior wood systems, including kitchen cabinets, bathroom vanities, moldings, pre-hung interior and exterior doors, and residential hardware.

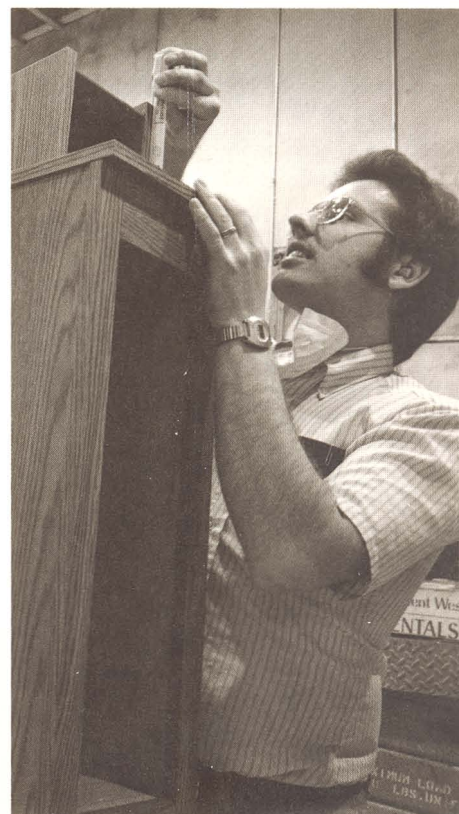
The operation celebrated its 25th anniversary at year end 1979 by expanding into a new 140,000 square foot manufacturing and warehouse facility in Woodinville, near Seattle. Located on 15 acres, the complex doubles production capabilities and allows for future growth. Additional manufacturing and distribution plants are located in Boise, Idaho and Richland, Washington.

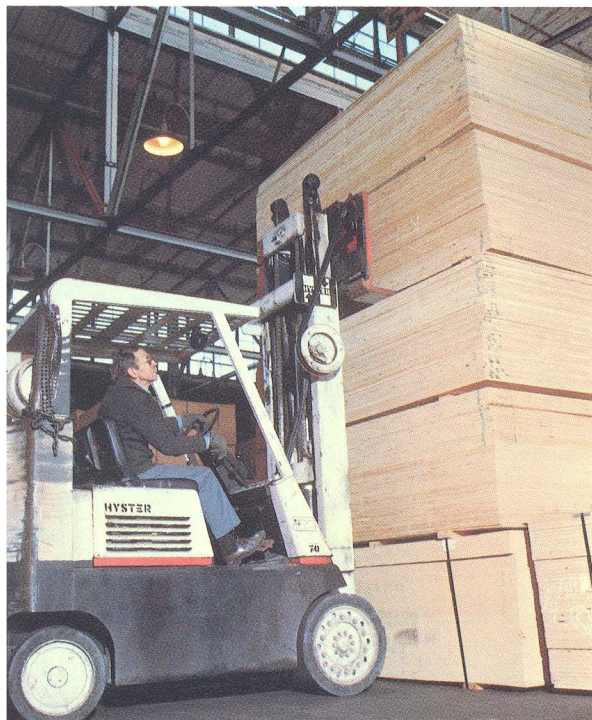
In the past, limited production capacity has limited sales principally to single-family housing. In recent years, manufacturing capability has been expanded to allow servicing the multi-family builder as well as the very viable high rise residential condominium market. Geographic sales diversification has also taken place into Idaho, Alaska, Hawaii and Northern California. The resulting volume increase dictated the construction of the new facility. This additional production capability with its higher productivity level has allowed entry into the mushrooming home remodeling market. To support this new business program Western Cabinet is currently developing a dealer network with encouraging success.

Cal-Wood Door, located in Santa Rosa, California, manufactures commercial and residential flush wood doors and related moldings, including a wide selection of fire-rated doors. This division serves two broad construction markets. Specialized products are manufactured for the commercial construction market, this includes products utilized in such diverse structures as hotels, schools, hospitals and office buildings. Residential products are manufactured for both single-family and multi-family buildings.

Cal-Wood Door's continual emphasis on developing high-quality, sophisticated products for their commercial markets has resulted in the development of a number of proprietary items. Acceptance of these products has enabled Cal-Wood to expand its international business. Ten percent of sales are now generated by export to such diverse locations as Japan, Saudi Arabia, Egypt and Guam. This offshore business offers potential for future expansion and profitability.

Continuing to automate its production facilities, Cal-Wood Door installed a number of new machines, some of which are allowing more precise control over the detailing process. Advances such as these have helped establish and maintain the facility as one of the most modern and innovative on the West Coast. To help meet the growing demand for its broad product line, the company in 1980 will be installing a new door sizer, capable of increasing the current production capacity.

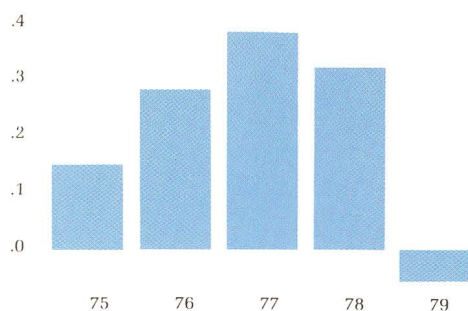
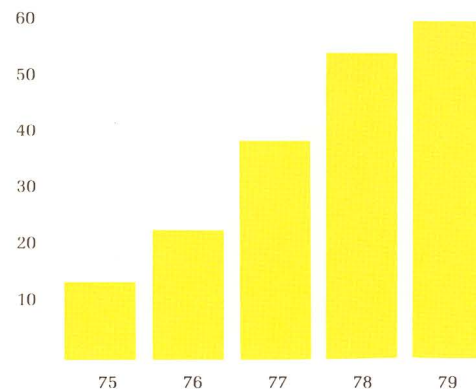




(Top L) Units of plywood in our Timberland Forest Products Warehouse, which can house 150 carloads of forest products.

(L) Wall sheathing is one of the many uses of plywood.

(R) Recently opened Brennan Supply Store in Federal Way, Washington.

Distribution Income
(millions)Distribution Sales
(millions)

Timberland Forest Products is our national distributor of softwood plywood. They purchase plywood in carload lots from the mills and package mixed carload shipments to meet the specific needs of wholesale stocking distributors. Approximately 1% of the national plywood production is handled by the company.

Distribution warehouses are located in close proximity to the regional plywood mills: Seattle, Spokane, Northern California and Mississippi. Shipments are principally by railcar.

Timberland Forest Products provides a vital link in transferring both western and southern pine plywood from the mill to the marketplace. Because of the pricing risk in this high volume, low margin business, as a hedging device, the company also deals in plywood futures contracts on the Chicago Board of Trade.

1979 was a difficult year in the plywood distribution business for a number of reasons, resulting in a significant operating loss. High short term interest costs and changes in the rail rate structure had a material impact on profitability. When these factors were combined with declining housing starts, the continuing shift to southern pine plywood and the industry overcapacity supported by high priced wood chips, a plywood by-product, declining prices offset the low margins in this operation.

In light of the difficulties during 1979 and the recent trend toward consolidation of production and distribution into the hands of the major forest products companies, the roll of the independent national plywood distributor is being carefully evaluated by the company.

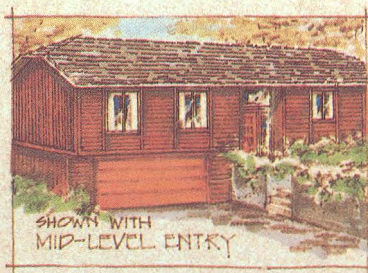
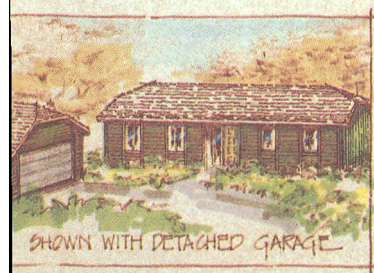
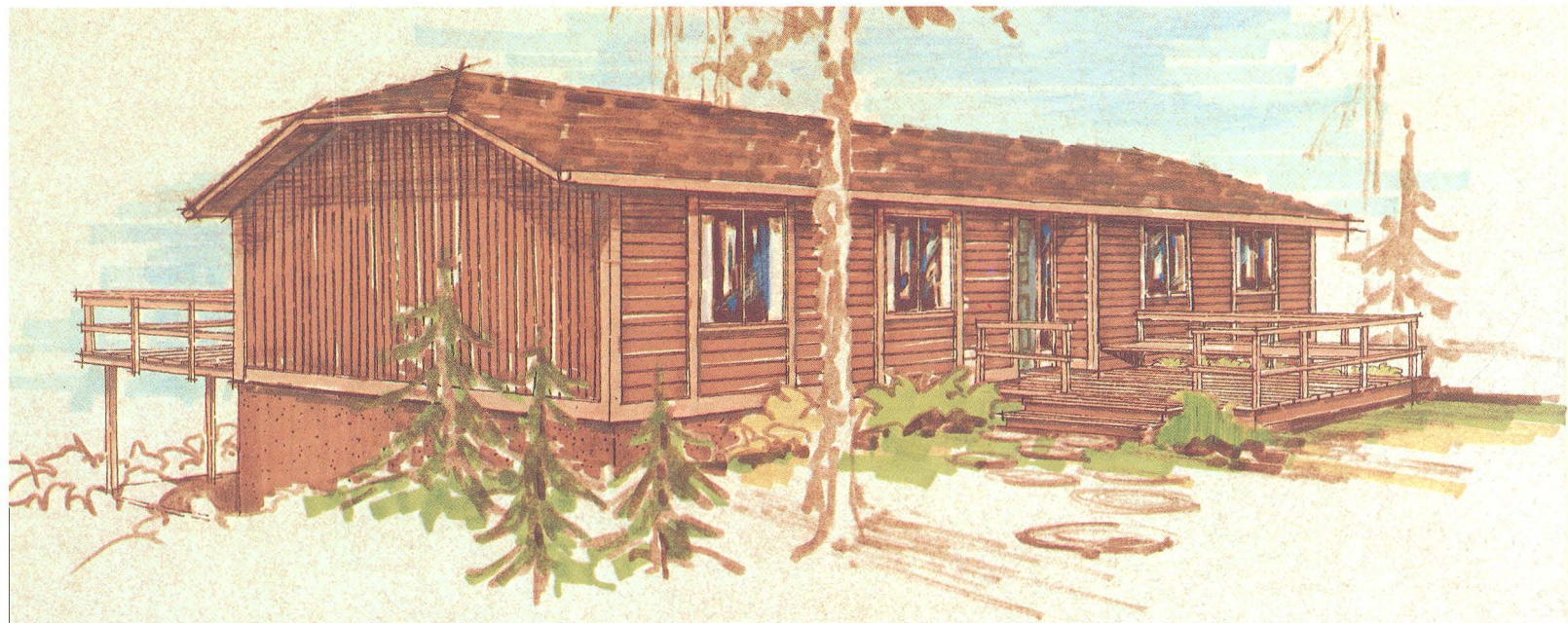
Brennan Supply is another segment of the Timberland Industries' distribution arm, offering more than 4,000 home-related products to contractors, builders and do-it-yourselfers. The division serves the Puget Sound area of Washington through three store locations.

Brennan Supply's traditional business has been to supply products for the residential building contractor. In 1979, the division expanded its commercial project division, supplying doors, door frames, hardware and related building products for office complexes and medical facilities in the Pacific Northwest region. This business has grown to account for 25 percent of sales.

With the addition in June of Brennan Supply's third outlet, the division increased its emphasis in the retail sales segment of its business. Brennan Supply offers an extensive array of products to the home remodeler: everything from mirrors, intercom systems, major appliances, to lighting fixtures. Emphasis is placed not only on the products available but also upon personal service by knowledgeable sales people. This remodeling and do-it-yourself business now accounts for 20 percent of sales.

Utilizing its broad experience and reputation in the building products distribution field, Brennan Supply expects to continue its business growth both geographically and through continued emphasis in the commercial and retail markets.



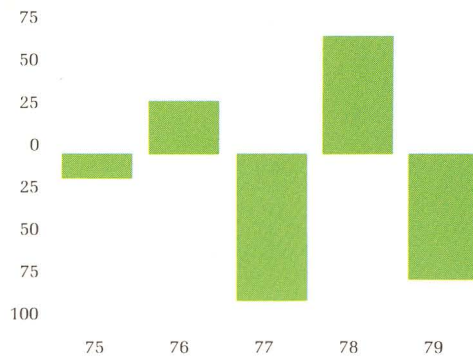


(Top) The new 1250 modular home from Timberland Homes.

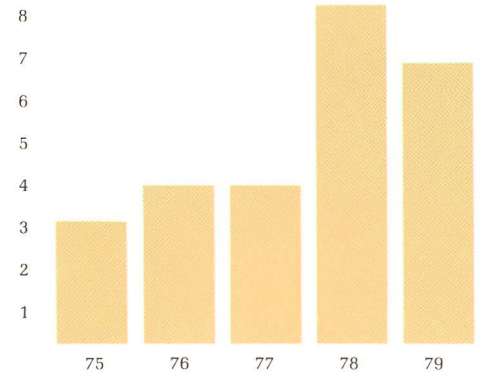
(L) Delivery and installation of a new modular home in Western Washington.

(R) Assembled homes ready for shipment to Alaska—providing homes for native Indians.

Homebuilding Income
(thousands)



Homebuilding Sales
(millions)



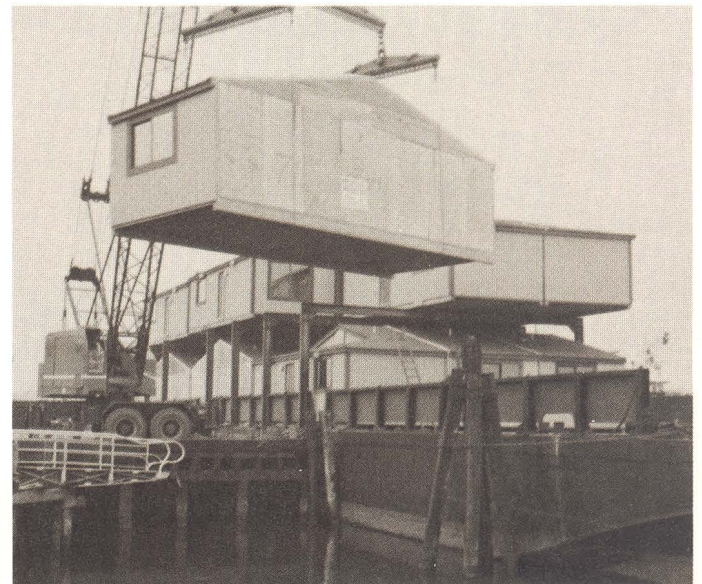
Timberland Homes produces modular homes and small modular commercial institutional buildings for its customers in Washington, Oregon and Alaska. On a selective basis, an affiliate, Timberland Erectors, undertakes contracts for the delivery, site work and installation of the buildings in remote Alaska locations.

In 1979, this division completed an 80 unit, \$4 million single family home project in Western Alaska, including delivery and installation. At year end, the company had commenced construction of 34 single family units for delivery and installation to the Aleutian Peninsula, Alaska by one of its contractor customers.

Sales of modular homes in Washington and Oregon are made through a dealer network that provides the delivery and installation functions. The King County dealership is located at the factory in Kent, Washington and is owned and operated as a pilot dealership by the company.

The modular home concept for producing single family housing has been in existence for many years but represents a very small share of the housing market. Production technology, consumer approval, building codes and financial institution acceptance have made impressive advances over these years. The labor availability and labor saving economic advantages of a factory produced home dictate the rationale for the rural, semi-rural and recreational area markets. These factors account for the high degree of acceptance in the Alaska markets.

In the recent past, design improvements resulting from professional designer and architectural involvement have made great strides in providing attractive homes to meet many of the aesthetic demands of the new home buyer. These advances combined with factory built advantages of seeing what you are buying, on-your-lot delivery, no construction financing, short construction time and efficient labor utilization, over time should result in greater penetration of the new home market. The trend toward smaller more affordable homes in the 960 to 1,600 square foot size, and in the \$30,000 to \$50,000 price range should also enhance the modular home business.





Western Cabinet and Millworks new 140,000 square foot production and distribution facility in Woodinville, Washington.

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

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

*Jack H. Canvin,
Vice-President
Financial Analysis & Planning
Bank of America (Banking)

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

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

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

Ian MacDonald,
President
Cal-Wood Door

*J. Allan MacDonald,
President
Timberland Industries, Inc.

*Delos W. McNutt,
Management of Personal
Investments

Milton D. Skutle,
President
Western Cabinet & Millwork

*Member of the Audit Committee and Compensation Committee

TIMBERLAND INDUSTRIES

P.O. Box 3546 Bellevue, WA 98009
(206) 828-3565



FINANCIAL REPORT 1979



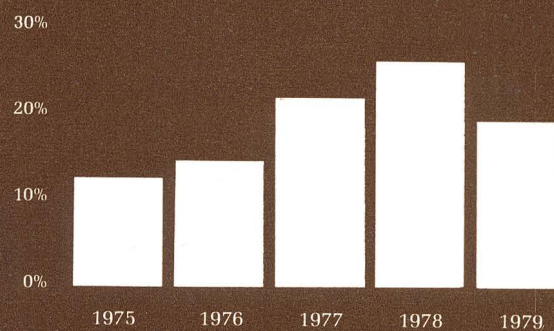
TIMBERLAND INDUSTRIES, INC.

Financial Review

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F-2	Management's Discussion and Analysis
F-3	Five-Year Summary of Operations
F-4	Consolidated Balance Sheet
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F-9	Notes to Consolidated Financial Statements
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Return on Shareholders Equity



Analysis of Sales and Net Income by Line of Business

Timberland Industries, Inc. and Subsidiaries

F-1

	1979 (in thousands)	1978	1977	1976	1975
Manufacturing					
Sales	\$32,900	\$30,500	\$24,500	\$19,200	\$14,200
Income from continuing operations	1,428	1,020	872	303	262
Distribution					
Sales	59,700	54,500	36,000	21,900	13,500
Income from continuing operations	(53)	319	379	276	147
Homebuilding					
Sales	6,800	8,300	4,000	4,000	3,200
Income from continuing operations	(75)	73	(95)	28	(17)
TOTAL					
Sales	\$99,400	\$93,300	\$64,500	\$45,100	\$30,900
Income from continuing operations	1,300	1,412	1,156	607	392

Management's Discussion and Analysis

1979 Compared to 1978

During 1979 total company sales increased about 6.5%. Manufacturing increased 7.9%. Distribution increased 9.4% while Housing decreased 16.9%. The decline in housing sales reflected completion of larger projects in Alaska. The housing division is attempting to concentrate more on single family units, which carry higher profit margins.

The Company's gross profit margin over all was 10.1% as compared to 11% in 1978. The decline is primarily attributable to lower margins in plywood distribution. This operation suffered from erratic pricing and unstable markets during the second half of the year. Profit margins in manufacturing remained about the same, while cost overruns in the housing division caused declines in gross profit margins at that operation. Selling and administrative expenses increased 5%. This is primarily attributable to higher salary costs. Interest expense increased nearly 40% reflecting increases in interest rates. Total borrowing at year end was down reflecting lower inventories at December 31, 1979.

Net income from continuing operations was down 8% from 1978 due primarily to operating losses in the plywood distribution subsidiary. Net income for the year was up slightly, due to reduction in costs related to discontinued operations and to tax credits available from new manufacturing facilities constructed during the year.

1978 Compared to 1977

During 1978, sales increased 41 percent reflecting the growth of the Company's market area and continued strong demand for wood and building products despite high interest rates in the home mortgage markets. All segments contributed to the increase. 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.

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 41 percent sales increase, reflecting continuing increased marketing activities, higher borrowing costs, and higher depreciation charges on asset additions.

Net income from operations was up 22 percent. All operations except distribution contributed to the increase.

Five-Year Summary of Operations

Timberland Industries, Inc. and Subsidiaries

F-3

	1979	1978	1977	1976	1975
Net sales	\$99,395,000	\$93,352,000	\$64,494,000	\$43,763,000	\$30,534,000
Other income	176,000	275,000	35,000	48,000	117,000
Total revenue	99,571,000	93,627,000	64,529,000	43,811,000	30,651,000
Cost and expenses					
Cost of sales	89,553,000	83,598,000	56,282,000	37,903,000	26,242,000
Selling and administrative	6,559,000	6,244,000	5,112,000	3,640,000	2,962,000
Interest	1,164,000	833,000	590,000	403,000	345,000
Depreciation and amortization	591,000	488,000	393,000	304,000	240,000
	97,867,000	91,163,000	62,377,000	42,250,000	29,789,000
Income from continuing operations before income taxes	1,704,000	2,464,000	2,152,000	1,561,000	862,000
Provision for income taxes	404,000	1,052,000	996,000	751,000	380,000
Income from continuing operations	1,300,000	1,412,000	1,156,000	810,000	482,000
Discontinued operations (Loss) from operations of discontinued Divisions	(56,000)	(192,000)	(40,000)	(203,000)	(47,000)
Net Income	\$ 1,244,000	\$1,220,000	\$1,116,000	\$ 607,000	\$ 435,000
Weighted average shares outstanding and common stock equivalents: (Adjusted for stock dividends)	957,000	947,000	928,000	832,000	834,000
Net income (Loss) per share (Based on average shares outstanding and common stock equivalents)					
From continuing operations	\$1.36	\$1.49	\$1.24	\$.97	\$.58
From discontinued operations	(.06)	(.20)	(.04)	(.24)	(.06)
NET INCOME PER SHARE	\$1.30	\$1.29	\$1.20	\$.73	\$.52
Dividends					
Cash dividends per share	\$0.19	\$.15	\$.09		
Stock	20%	5%			10%

Consolidated Balance Sheet

Timberland Industries Inc. and Subsidiaries

Assets

	December 31,	
	1979	1978
Current Assets		
Cash (Note 2)	\$ 648,000	\$ 538,000
Receivables, principally trade accounts, less allowances for doubtful accounts of \$284,000 in 1979 and \$281,000 in 1978 (Note 2)	6,364,000	7,408,000
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)	6,679,000	8,661,000
Account balances with brokers (Note 8)	260,000	72,000
Prepaid expenses	154,000	202,000
Total current assets	14,105,000	17,754,000
Land, buildings, and equipment — at cost (Notes 1, 2, and 3)		
Land	558,000	552,000
Buildings	4,233,000	1,721,000
Equipment	3,634,000	2,516,000
Automotive	732,000	710,000
Leasehold improvements	308,000	275,000
	9,465,000	5,774,000
Less accumulated depreciation and amortization	(2,325,000)	(1,907,000)
	7,140,000	3,867,000
Excess of cost of investment in subsidiary over the net asset value at date of acquisition (Note 1)	457,000	477,000
Notes receivable (Note 2)	192,000	470,000
	\$21,894,000	\$22,568,000

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

Liabilities and Shareholders' Equity

	December 31,	
	1979	1978
Current liabilities		
Notes payable		
Bank (Note 2)	\$ 4,401,000	\$ 7,000,000
Other	107,000	131,000
Current portion of long-term obligations (Note 3)	516,000	246,000
Accounts payable		
Trade	2,694,000	4,240,000
Drafts	—	463,000
Accrued liabilities	1,406,000	1,491,000
Customer Deposits	53,000	57,000
Federal and State Income Taxes Payable (Notes 1 and 6)	143,000	105,000
Total Current Liabilities	9,320,000	13,733,000
Long-term obligations, less current portion shown above (Note 3)	4,233,000	1,662,000
Deferred income and state excise taxes (Notes 1 and 6)	537,000	441,000
Deferred income	—	36,000
Commitments and contingencies (Notes 4 and 8)	—	—
Shareholders' equity (Notes 2 and 5)		
Common stock, authorized 2,500,000 shares of \$.16 par value; issue and outstanding 922,000 shares in 1979, 758,000 shares in 1978	148,000	121,000
Additional paid-in capital	2,876,000	1,940,000
Retained earnings	4,780,000	4,635,000
Total Shareholders' Equity	7,804,000	6,696,000
	\$21,894,000	\$22,568,000

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

Consolidated Statement of Income

Timberland Industries, Inc. and Subsidiaries

	Years Ended December 31,	
	1979	1978
Net sales	\$99,395,000	\$93,352,000
Other income	176,000	275,000
Total revenues	99,571,000	93,627,000
Cost and expenses		
Cost of sales	89,553,000	83,598,000
Selling and administrative expense	6,559,000	6,244,000
Interest (Note 1)	1,164,000	833,000
Depreciation and amortization	591,000	488,000
Total costs and expenses	97,867,000	91,163,000
Income from continuing operations before provision for income taxes	1,704,000	2,464,000
Provision for income taxes (Notes 1 and 6)	404,000	1,052,000
Income from continuing operations	1,300,000	1,412,000
Loss incurred from discontinued operation, net of tax benefits of \$135,000 in 1978 (Note 7)	—	(146,000)
Loss on disposition of discontinued operation, net of tax benefits of \$47,000 in 1979 and \$43,000 in 1978 (Note 7)	(56,000)	(46,000)
Net Income	\$ 1,244,000	\$ 1,220,000
Net income (Loss) per common share (Note 1)		
Continuing operations	\$1.36	\$1.49
Discontinued operations	(.06)	(.20)
Net Income Per Share	\$1.30	\$1.29

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

Consolidated Statement of Shareholders' 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, 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
Exercise of stock options	12,000	2,000	30,000	—
Stock dividend paid (20%), at fair market value	152,000	25,000	906,000	(931,000)
Cash dividends paid (\$.19 per share)	—	—	—	(168,000)
Net income	—	—	—	1,244,000
Balance at December 31, 1979	922,000	\$148,000	\$2,876,000	\$4,780,000

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,	
	1979	1978
Financial resources provided by:		
Income from continuing operations	\$1,300,000	\$1,412,000
Add items not requiring the use of working capital		
Depreciation and amortization	591,000	488,000
Deferral of Federal income taxes	(37,000)	84,000
Working capital provided by continuing operations	1,854,000	1,984,000
Loss from discontinued operation	(56,000)	(192,000)
Items not requiring working capital		
Depreciation	—	27,000
Working capital used by discontinued operation	(56,000)	(165,000)
Total working capital provided by operations	1,798,000	1,819,000
Proceeds from disposition of equipment	50,000	184,000
Deferral of state excise tax	133,000	—
Exercise of stock options	32,000	74,000
Changes in long-term receivables	278,000	(215,000)
Long-term obligations incurred	3,600,000	88,000
	5,891,000	1,950,000
Financial resources applied to:		
Acquisition of land, building and equipment	3,892,000	1,319,000
Reduction of long-term obligations	1,031,000	172,000
Cash dividends paid	168,000	113,000
Reduction in deferred income	36,000	8,000
	5,127,000	1,612,000
Increase in Working Capital	\$ 764,000	\$ 338,000
Changes in components of working capital		
Increases (decreases) in current assets		
Cash	\$ 110,000	\$ 269,000
Receivables	(1,044,000)	1,133,000
Costs and estimated earnings in excess of billings on long-term construction contracts	(873,000)	873,000
Inventories	(1,982,000)	(2,344,000)
Account balances with brokers	188,000	(116,000)
Prepaid expenses	(48,000)	121,000
	(3,649,000)	(64,000)
Increases (decreases) in current liabilities		
Notes payable	(2,623,000)	112,000
Current portion of long-term obligations	270,000	15,000
Accounts payable and deposits	(2,013,000)	(523,000)
Accrued liabilities	(85,000)	259,000
Federal and State income taxes payable	38,000	(265,000)
	(4,413,000)	(402,000)
Increase in working capital	\$ 764,000	\$ 338,000

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

Notes to Consolidated Financial Statements December 31, 1979 and 1978

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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, 1979, were as follows:

	<u>1979</u>	<u>1978</u>	<u>1977</u>
Distribution merchandise	\$2,470,000	\$4,015,000	\$ 6,411,000
Manufacturing inventories			
Finished goods	1,303,000	1,621,000	2,206,000
Work-in-process	939,000	673,000	—
Raw materials	1,628,000	1,704,000	1,920,000
Home building, principally raw materials	339,000	648,000	468,000
	<u>\$6,679,000</u>	<u>\$8,661,000</u>	<u>\$11,005,000</u>

- (c) Depreciation Policies — The cost of buildings 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	20-40
Equipment	5-8
Automotive	3-5

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 a subsidiary over net assets acquired is being amortized over 30 years. Accordingly, \$21,000 has been charged to operations in 1979 and 1978.
- (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 and energy credits (\$235,000 in 1979 and \$69,000 in 1978) accounted for by the flow-through method. In 1978 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 period in which revisions become known.

- (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. The following reconciles the number of shares outstanding with the number of shares used in computing earnings per share:

	<u>1979</u>	<u>1978</u>
Common shares outstanding	922,000	758,000
Effect of stock dividend paid in 1979	—	152,000
Effect of using weighted average common shares outstanding	(9,000)	(18,000)
Effect of shares issuable under stock option plans as determined by the treasury stock method	<u>44,000</u>	<u>55,000</u>
Shares used in computing earnings per share	<u>957,000</u>	<u>947,000</u>

- (i) Interest costs — Interest costs associated with the acquisition of assets used in the operations of the company are capitalized in accordance with Statement of Financial Accounting Standards No. 34. Application of this statement is permitted, but not required, in financial statements for fiscal years beginning before December 16, 1979. The Company has elected early application of the statement for the year ending December 31, 1979. Total interest costs for the year amount to \$1,296,000, of which \$132,000 was capitalized as described.

NOTE 2 — NOTES PAYABLE TO BANK

	<u>1979</u>	<u>1978</u>
Revolving credit lines	\$10,500,000	\$7,000,000
Interest rate	1% to 1-3/4% over prime lending rate	
Interest rate at December 31	16-1/4 to 17%	13%
Maximum outstanding during the year	\$8,000,000	\$7,000,000
Approximate average month end borrowings	\$6,800,000	\$5,800,000
Approximate weighted average interest rate	13.75%	10.3%

Such borrowings are collateralized by accounts and notes receivable, inventories and equipment, and are subject to provisions of loan agreements which require:

(a) Maintenance of up to 10% compensating balances or fees in lieu thereof (applicable to the smaller of the two credit lines).

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

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

(d) Restrictions of cash dividend payments to 20% of the previous year's annual net income.

As of January 1, 1980 total lines were reduced to \$8,000,000 bearing interest at prime plus 1-1/2% to 1-3/4% with 5% compensating balances.

NOTE 3 — LONG-TERM OBLIGATIONS:

Long-term obligations consist of the following at December 31:

	<u>1979</u>	<u>1978</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 from 1981 to 1992	\$1,190,000	\$1,358,000
Term note payable to bank, bearing interest at 2% over the prime rate, requiring quarterly payments of \$93,750, and monthly interest payments with final payment due in 1984.	1,500,000	—
Term note 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. Replaced in 1979 by \$1.5 million term note described above.	—	550,000
Construction loan collateralized by construction of new manufacturing plant. Interest at 1-1/2% over prime. Commitment on hand to convert to permanent mortgage at 10-1/4%, 29 year amortization, callable at 15 years.	1,360,000	—
Lease-purchase financing on capitalized equipment, collateralization by capitalized equipment costing \$717,000. Payable in monthly installments over 7 years from dates of acquisition of equipment with interest at 11-1/2%.	699,000	—
	4,749,000	1,908,000
	516,000	246,000
Less current portion	\$4,233,000	\$1,662,000

The term note payable to bank is subject to the provisions of the agreement mentioned in Note 2.

Annual payments on long-term debt outstanding at December 31, 1979, to be made during the following five years, are approximately as follows: 1980 — \$516,000; 1981 — \$554,000; 1982 — \$540,000; 1983 — \$549,000; 1984 — \$184,000.

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 \$452,000 on December 31, 1979, are amortized and funded generally over a period of 20 years. Pension costs of the two company-administered plans charged to operations in 1979 and 1978 were \$101,000 and \$133,000, 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 \$359,000.

The Company has an executive bonus plan 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 1979 and 1978 totaled \$296,000 and \$257,000, respectively.

NOTE 5 — STOCK OPTIONS

The Company has a qualified stock option plan under which common shares are 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 are exercisable at the date of grant. All share amounts and prices in the following summaries reflect the 20% stock dividend in 1979 and the 5% stock dividend in 1978.

Option activity (in shares) under the plan was:

	<u>1979</u>	<u>1978</u>
Outstanding, January 1	<u>22,200</u>	26,580
Exercised	<u>(2,400)</u>	(4,380)
Granted	<u>7,800</u>	—
Outstanding and exercisable at December 31 (at \$2.29 to \$6.12 per share)	<u>27,600</u>	<u>22,200</u>

At December 31, 1979, 2,820 shares remained available for future options. Options outstanding at December 31, 1979 expire at various dates to August 30, 1984.

At December 31, 1979, nonqualified stock options were outstanding to nine members of the Board of Directors and a former employee to purchase an aggregate of 50,750 shares, of which options to purchase 26,000 shares were held by the Board members. The Board members' options were granted at various dates from 1975, are exercisable at prices ranging from \$2.1875 per share to \$6.667 per share and expire at various dates to May 12, 1984. The former employee was granted an option for 33,000 shares (adjusted) in 1974 at \$2.27 per share, of which 24,750 are outstanding and exercisable.

Activity in nonqualified stock options was:

	(in shares)	
	<u>1979</u>	<u>1978</u>
Outstanding, January 1	<u>57,420</u>	88,920
Exercised	<u>(10,450)</u>	(28,680)
Granted	<u>3,780</u>	3,780
Cancelled	<u>—</u>	(6,600)
Outstanding, December 31	<u>50,750</u>	<u>57,420</u>

NOTE 6 — INCOME TAXES

The provision for taxes on income consists of the following:

	<u>1979</u>	<u>1978</u>
Continuing Operations		
Amounts currently payable, net of investment, energy and new jobs tax credits of \$235,000 and \$121,000 in 1979 and 1978 respectively	<u>\$393,000</u>	\$740,000
Net additions to deferred income taxes current and deferred	<u>11,000</u>	312,000
	<u>\$404,000</u>	<u>\$1,052,000</u>
Discontinued Operations		
Current tax benefit	<u>\$ (47,000)</u>	<u>\$ (178,000)</u>

Deferred income taxes result from timing differences in the recognition of depreciation and interest 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 and the effective tax rates for the years ended December 31:

	<u>1979</u>	<u>1978</u>
Statutory rate	<u>46.0%</u>	48.0%
Investment, jobs and energy credits	<u>(14.7)</u>	(5.8)
Other items, including amortization of a deferred tax liability associated with the partial liquidation of a subsidiary company during 1975	<u>(9.1)</u>	(.5)
Effective rate including tax benefits of discontinued operations	<u>22.2%</u>	<u>41.7%</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 were valued at their net realizable value, as of December 31, 1978.

The 1979 results of the Panel business have been segregated in the Consolidated Statement of Income in order to show results of continuing operations separately. Similarly, 1978 and prior consolidated Statements of Income have been restated to show the same segregation. The results of operations of the panel business include:

	Years Ended December 31,	
	1979	1978
Net revenues	\$ —	\$1,643,000
Costs and expenses	103,000	2,012,000
Income tax benefit	47,000	177,000
Loss	(56,000)	(192,000)

NOTE 8 — COMMITMENTS AND CONTINGENCIES

A subsidiary of the Company trades in the plywood futures market for its own account in hedging transactions through The Chicago Board of Trade in order to minimize its risk due to market fluctuations. Account balances with brokers represent principally margin deposits.

A civil action involving a subsidiary of the Company, which was mentioned as a contingency in the December 31, 1978 financial statements, was settled out of court for an amount having no material adverse effect upon the consolidated financial statements.

The Company leases certain properties used in its operations. Total rental expense for 1979 was less than 1 percent of revenues.

NOTE 9 — QUARTERLY RESULTS

SUMMARY OF QUARTERLY DATA (Unaudited)

(Dollars in thousands except per share figures)	1979			
	First	Second	Third	Fourth
Net sales	\$22,931	\$24,993	\$30,776	\$20,871
Gross margin	2,055	2,210	3,062	2,690
Income from continuing operations	112	137	524	527
Loss from discontinued operations	(24)	(16)	(13)	(3)
Net income	88	121	511	524
Net income (loss) per common share				
Continuing operations	.11	.15	.55	.55
Discontinued operations	(.02)	(.02)	(.01)	(.01)
Net income per common share	<u>\$.09</u>	<u>\$.13</u>	<u>\$.54</u>	<u>\$.54</u>

Results for the fourth quarter include the effects of investment and energy credits of \$165,000, or \$.17 per share related to facilities and equipment for which the completion date was uncertain when previous quarterly results were issued.

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, millwork 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.

Total revenue includes sales to unaffiliated customers, as reported in the Company's consolidated income statement. Intersegment sales 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 used in each line of business. Corporate assets are principally cash and notes receivable.

BUSINESS SEGMENTS

	Manu- facturing	Distri- bution	Housing	Elimi- nations	Consoli- dated
(Thousands of Dollars)					
Sales to Unaffiliated Customers					
1979	\$33,025	\$59,671	\$6,875		\$99,571
1978	30,748	54,534	8,345		93,627
Intersegment Sales					
1979	\$ 328	\$ 211		\$ (539)	
1978	352	425		(777)	
Total Revenue					
1979	\$33,353	\$59,882	\$6,875	\$ (539)	\$99,571
1978	31,100	54,959	8,345	(777)	93,627
Operating Profit					
1979	\$ 2,817	\$ 381	\$ 111		\$ 3,309
1978	2,570	797	327		3,694
General Corporate and Interest Expense					
1979					\$ 1,605
1978					1,230
Income from Continuing Operations Before Provision for Income Taxes					
1979					\$ 1,704
1978					2,464
Identifiable Assets					
1979	\$14,588	\$ 5,191	\$1,981	\$ 18	\$21,778
1978	11,489	7,244	3,817	(30)	22,520
Corporate Assets					
1979					\$ 116
1978					48
Total Assets					
1979					\$21,894
1978					22,568
Depreciation and Amortization					
1979	\$ 456	\$ 42	\$ 93		\$ 591
1978	389	36	63		488
Capital Expenditures					
1979	\$ 3,816	\$ 50	\$ 26		\$ 3,892
1978	996	50	273		1,319

During 1979 sales to two distribution customers amounted to \$19,137 and \$19,062 respectively and in 1978 were \$13,852 and \$11,376.

Accountants' Opinion

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

We have examined the consolidated balance sheet of Timberland Industries, Inc. and subsidiaries as of December 31, 1979 and 1978, and the related consolidated statements of income, shareholders' 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, 1979 and 1978, and the results of their operations and changes in their financial position for the years then ended, in conformity with generally accepted accounting principles consistently applied during the period, except for the change, with which we concur, in the method of accounting for interest costs, as described in Note 1 to the Financial Statements.

Mass, Adams & Co.

Seattle, Washington
March 13, 1980