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Timberland Industries
Annual Report
1980

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Timberland Industries is a diversified manufacturer of cabinets, doors and millwork, and a wholesale distributor of builder's hardware and lighting products. The Company's operating divisions serve the residential and commercial construction and home improvement industries.

Financial Highlights

	1980	1979	1978
Total revenues	\$33,600,000	\$36,747,000	\$31,370,000
Income (loss) before income taxes			
Continuing operations	(534,000)	2,116,000	2,001,000
Discontinued operations	(1,387,000)	(515,000)	93,000
	(1,921,000)	1,601,000	2,094,000
Provision for income taxes (credits)			
Continuing operations	(351,000)	599,000	839,000
Discontinued operations	(660,000)	(242,000)	35,000
	(1,011,000)	357,000	874,000
Net income (loss)			
Continuing operations	(183,000)	1,517,000	1,162,000
Discontinued operations	(727,000)	(273,000)	58,000
	\$ (910,000)	\$1,244,000	\$1,220,000
Average shares outstanding and common stock equivalents	965,000	957,000	947,000
Net income (loss) per share			
Continuing operations	\$(.19)	\$1.58	\$1.23
Discontinued operations	(.75)	(.28)	.06
	(.94)	1.30	1.29
Total assets	\$18,820,000	\$21,894,000	\$22,568,000
Shareholders' equity	\$ 6,793,000	\$ 7,804,000	\$ 6,696,000
Return on shareholders' equity	(11.7)%	18.6%	22.1%
Book value per outstanding share	\$7.05	\$8.46	\$7.36
Cash dividends per share	\$.20	\$.19	\$.15
Stock dividends per share	None	20%	5%

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

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The Company

Timberland Industries
Annual Report
1980

To our shareholders:

Throughout 1980 our company, and the entire housing industry, fought an uphill battle against the most difficult economic conditions we have faced since 1970. Indeed, as I write this message to you we are in the 18th month of a recession in the housing industry. All of the factors that have caused the industry downturn — inflation, high interest rates, lack of mortgage funds — contributed to a very poor year for Timberland Industries.

Our net loss for 1980 was \$910,000, \$.94 per share, compared to net income of \$1,244,000, \$1.30 per share in 1979. Almost 80% of the 1980 losses were from operations that we discontinued during the year, namely plywood distribution and modular homes manufacturing, and related contingency reserves. The Company's continuing operations — Western Cabinet & Millwork, Cal-Wood Door and Brennan Supply — recorded losses of \$183,000, \$.19 per share during 1980, compared to net income of \$1,517,000, \$1.58 per share in 1979. Sales from these operations decreased 9% from \$36.6 million in 1979 to \$33.4 million in 1980. This lower sales volume, combined with lower utilization of manufacturing capacity, competitive price pressure and higher interest costs all contributed to the decline in profitability.

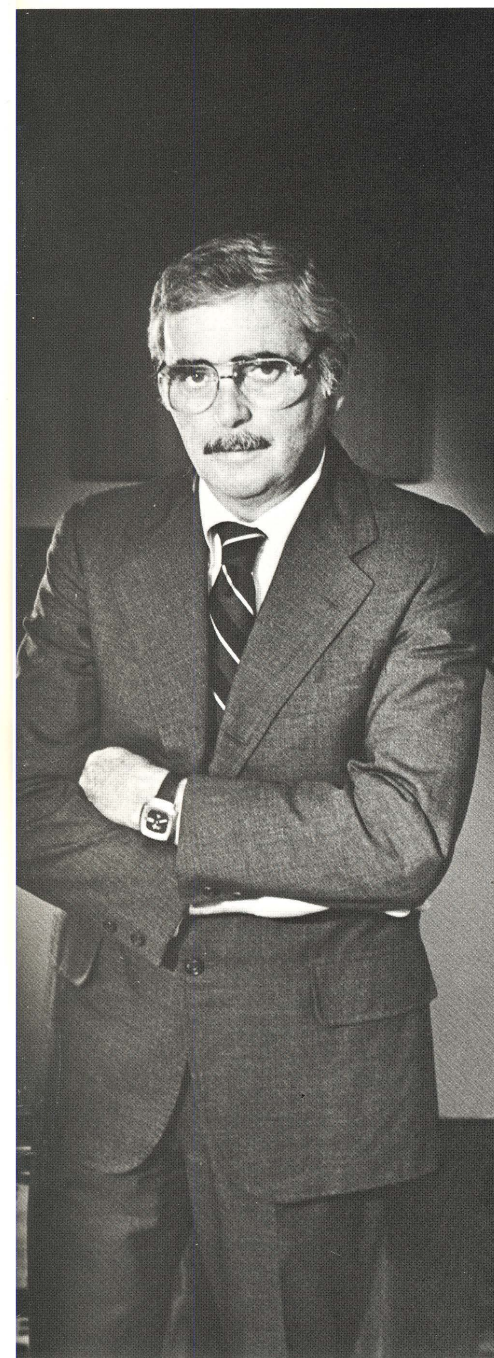
Despite the negative operating results for the year, we took a number of important steps that we are confident will lead us to be a stronger and more profitable company in the future. The most visible steps involved the liquidation of our plywood wholesaling division, Timberland Forest Products, and the sale of our modular home manufacturing division, Timberland Homes. The decision to close Timberland Forest Products was a difficult one. This operation had been a major factor in the Company's success over the past decade. The operating losses incurred during 1979 and the first half of 1980, relating principally to depressed prices for commodity-type plywood products, were important factors in our decision. Just as important, however, was our analysis of the national plywood distribution system that indicated continuing pressure on profitability. The concentration of production and distribution in the hands of a few giant, fully integrated wood products companies, and the loss of favorable rail transportation rates combined to present a

doubtful future for Timberland Forest Products. On balance we decided that the \$1.3 million we had invested in this business could be put to use more profitably in our other operations.

The decision to sell Timberland Homes had been under consideration for some time. Since we started this operation in 1975, we had achieved some modest successes, but we also encountered our share of problems. Our major market was Alaska, and although the opportunities in that state are many, we found that major projects in remote locations under difficult environmental conditions held more risk of loss than potential for profitable reward.

The other steps we have taken this past year are not as visible nor dramatic, but even more important in terms of our long-range profitability. During the first quarter of 1980, Western Cabinet & Millwork began full operations in its new 140,000 square foot manufacturing and warehouse facility in Woodinville, Washington. The capacity of this new plant was not tested in 1980 because of the low level of housing starts in the Pacific Northwest, but the productivity gains and cost saving efficiencies are at anticipated levels. Our marketing efforts were concentrated in two areas. First, we worked hard to maintain and expand our share of the market for new construction of single- and multi-family residences. Second, we undertook our planned entry into the large home repair and remodeling market by distributing our manufactured kitchen and vanity cabinet products through retail dealers. The same high quality, competitively priced products and services we have offered to builders in the Pacific Northwest for many years are now available to individual consumers through a group of selected retail home improvement centers.

Cal-Wood Door, our wood flush door manufacturing division, located in Santa Rosa, California, continued to expand its penetration into domestic and overseas markets for commercial door products, becoming the West Coast's leading manufacturer of wood doors for office buildings, schools, hospitals, hotels and high rise residential buildings. Door products for single- and multi-family residences are still a very important part of our business, but with the recession in housing this past year, our major efforts have been to grow in areas where our marketing, technical and manufacturing skills will produce returns above those



available from the housing sensitive commodity door business. To support and allow further expansion of our marketing program, the Company has committed \$700,000 over the past year to the acquisition of new and highly productive manufacturing equipment and support systems. This project will be complete and operational early in the third quarter of this year.

Brennan Supply, our Seattle-area distributor of lighting, hardware, cabinets and related products, countered the slow down in residential building activity with expansion of its sales to commercial users, and emphasis on retail home improvement sales through its three locations in Seattle, Redmond and Federal Way, Washington. Brennan Supply also installed a new data processing system that improves our management of multi-location inventories and speeds up customer services.

In addition to decisions that impact division operations, we also face issues of an overall corporate nature. One of the very important steps we have taken is to suspend the Company's quarterly cash dividend. Given the losses incurred in 1980, we believe it is imperative that the Company retain its available capital to finance operations, particularly in view of current high interest rates. We look forward to paying a cash dividend again, at the earliest possible date.

These decisions and many more, whether representing a shift of marketing emphasis, a redeployment of funds, or acquisition of equipment and facilities, have all been made with two equally important objectives in mind. First, to improve our current performance and second, to enhance our long-range profitability and return on the shareholders' investment. We are confident that the downturn in the Company's operating performance experienced in 1980 will be short-lived. Although we are still facing difficult economic conditions in the housing industry, we are working hard for a return to profitability in 1981.

Sincerely,

J. Allan MacDonald

J. Allan MacDonald
President



Business:

Western Cabinet is a leading manufacturer and distributor of kitchen cabinets, bathroom vanities, prehung interior and exterior doors, related millwork products and residential hardware.

Markets:

The Company sells directly to builders of single family homes, apartments and condominiums, principally in Washington and Idaho, and to wholesale/retail distributors of home improvement products in Washington, Oregon, Idaho, Montana and Hawaii.

Locations:

Western Cabinet's main manufacturing and distribution facility is located in Woodinville, Washington. Branch sales and distribution outlets are located in Boise, Idaho, and Richland and Gig Harbor, Washington.

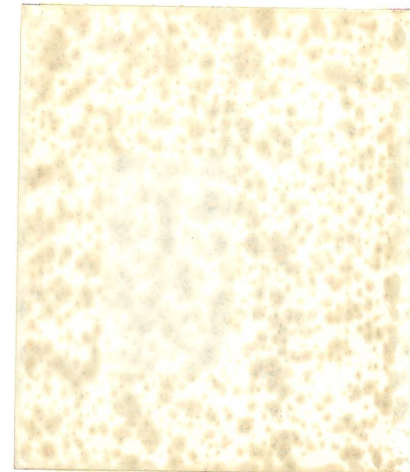
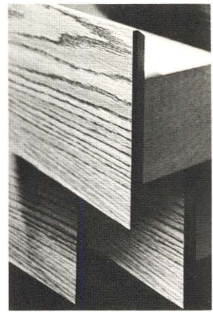
Officers:

Milton D. Skutle
President

Gary W. Hogue
Vice President, Sales

Henry W. Schmidt
Vice President, Manufacturing

C. J. Mikkelsen
Controller



*Western Cabinet
& Millwork*



Business:

Brennan Supply is a Seattle-area wholesale/retail distributor of a wide range of residential hardware, lighting, millwork, appliances and related specialty products, and products for commercial construction including hardware, doors and frames.

Markets:

The Company serves the residential builder of single-family homes, condominiums and apartment houses, remodeling contractors and consumers in the Greater Seattle area. The Company's commercial department works with general contractors on projects such as suburban office parks, medical clinics and nursing homes.

Locations:

Brennan Supply operates from three stores — Seattle, Redmond and Federal Way, Washington. Each store maintains inventories to service residential contractors and consumers. The commercial department and administrative offices are housed in the Redmond facility.

Officers:

Alfred W. Finch
President
Michael S. Estes
Vice President, Sales
Geary L. Epperson
Controller



Brennan
Supply



Business:

Cal-Wood Door is a major West Coast manufacturer of commercial and residential flush wood doors, including fire resistant doors, specializing in high quality prefinished and machined products.

Markets:

The Company sells to a wide variety of construction industry customers, principally in the Western United States and Hawaii, including residential and commercial door distributors and millwork houses, commercial hardware distributors, and exporters. Doors are produced for such diverse projects as high-rise office buildings and condominiums, single-family homes, hospitals, hotels, apartments and military installations.

Location:

Cal-Wood Door's manufacturing and distribution facility is located in Santa Rosa, California and the Company maintains sales offices in Los Angeles, California, Seattle, Washington, Salt Lake City, Utah and Honolulu, Hawaii.

Officers:

Ian MacDonald

President

Charles F. Lohman

Vice President, Sales

V. R. Johnson

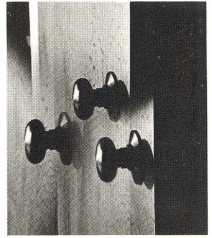
Vice President, Manufacturing

Edwin N. Naslund

Vice President, Operations

P.E. Balmer

Controller



Cal-Wood Door

The following comments refer to and summarize information presented in the Company's Five Year Summary of Operations and Financial Statements.

Results of Operations

Revenues declined by 8.6% in 1980 reflecting the recession in the housing industry, particularly new residential construction. Lower industry activity resulted in competitive price pressure and lower utilization of manufacturing capacity which reduced gross profit margins from 23% in 1979 to 19.3% in 1980. Increased interest costs, caused primarily by higher interest rates and an increase in new facilities mortgage debt, were also a major contributor to the reduced net income. The average interest cost for all long-term debt was 12% in 1980 compared to 12.1% in 1979 and 9.8% in 1978. The average cost of short-term funds increased more dramatically, to 17.1% in 1980, from 13.75% in 1979 and 10.3% in 1978.

The Company's selling and administrative expenses increased only marginally in 1980, but they did increase as a percentage of sales to 15.6%, from 14.2% in 1979 and 15.0% in 1978. The higher expenditures relative to revenues reflects continuing efforts to expand marketing activity in order to minimize the impact of lower new construction activity. Expenditures were increased significantly in programs to expand export activity, and distribute the Company's products to the home repair and improvement industry.

Depreciation charges increased by 55% in 1980 to \$746,000 reflecting mainly the Company's 1979-1980 investment in Western Cabinet & Millwork's new facility in Woodinville, Washington, and related manufacturing equipment. The provision for 1980 income tax refunds represents the effect of the year's net operating loss being carried back to prior years for federal income tax purposes. The refunds, generally at 48%, and the carryback of certain tax credits, serve to increase the overall effective rate of refundable taxes above the normal statutory rate. For 1979, the federal income tax rate was substantially below the statutory rate due to investment and energy tax credits from the new Western Cabinet & Millwork facility.

Discontinued operations accounted for 79.9% of the Company's net loss in 1980. These operations included the plywood distribution business, which incurred significant losses in

the first half of 1980, and the modular home manufacturing and contracting operation that was sold in mid-1980.

Financial Position

The Company's working capital funds declined significantly in 1980 after steady increases in prior years. The decline was the result of the year's operating loss and investments in capital assets. Even though the amount of working capital was reduced, the working capital, or current ratio, improved to 1.56 to 1 at the end of 1980, from 1.51 to 1 and 1.29 to 1 at the ends of 1979 and 1978 respectively. The improved ratio was due to the lower levels of assets and liabilities following the sale of the modular home manufacturing and contracting business, and the discontinuance of the plywood distribution activity. The discontinuance of these operations reduced the needs for short-term borrowing which provide a substantial amount of the Company's liquidity. Average short-term borrowing levels were \$3.4 million in 1980 compared to \$6.8 million in 1979 and \$5.8 million in 1978.

Short-term borrowing combined with long-term debt provides a large portion of the Company's financing. At the end of 1980, this debt financing totaled \$8.5 million, down from \$8.7 million at the end of 1979. These debt levels were 1.25 times equity at the end of 1980 and 1.19 times equity at the end of 1979.

The Company undertook a significant capital investment program in 1979 and 1980 principally represented by the expansion of its Western Cabinet & Millwork division. This program has been financed mainly with long-term mortgage and equipment financing. For 1981, financing of capital improvements will be principally from working capital until such time as interest rates stabilize and long-term financing becomes more viable. The Company has no plans for entering capital markets for either debt or equity financing in 1981 other than to finance working capital requirements through its revolving short-term credit lines.

	1980	1979	1978	1977	1976
Net Sales	\$33,410,000	\$36,602,000	\$31,123,000	\$27,035,000	\$19,886,000
Other income	190,000	145,000	247,000		37,000
Total revenue	33,600,000	36,747,000	31,370,000	27,035,000	19,923,000
Costs and expenses					
Cost of sales	27,108,000	28,298,000	23,675,000	20,677,000	15,741,000
Selling and administrative	5,238,000	5,213,000	4,735,000	3,881,000	2,599,000
Interest	1,042,000	638,000	551,000	369,000	267,000
Depreciation and amortization	746,000	482,000	408,000	336,000	261,000
	34,134,000	34,631,000	29,369,000	25,263,000	18,868,000
Income (loss) from continuing operations before income taxes	(534,000)	2,116,000	2,001,000	1,772,000	1,055,000
Provision for income taxes (credits)	(351,000)	599,000	839,000	818,000	525,000
Income (loss) from continuing operations	(183,000)	1,517,000	1,162,000	954,000	530,000
Income (loss) from discontinued operations	(727,000)	(273,000)	58,000	162,000	77,000
Net income (loss)	\$ (910,000)	\$ 1,244,000	\$ 1,220,000	\$ 1,116,000	\$ 607,000
Weighted average shares outstanding and common stock equivalents (Adjusted for stock dividends)	965,000	957,000	947,000	928,000	832,000
Net income (loss) per share					
From continuing operations	\$(.19)	\$1.58	\$1.23	\$1.03	\$.64
From discontinued operations	(.75)	(.28)	.06	.17	.09
	\$(.94)	\$1.30	\$1.29	\$1.20	\$.73
Dividends					
Cash dividends per outstanding share	\$.20	\$.19	\$.15	\$.09	
Stock dividends		20%	5%		
Financial position at year end					
Total assets	\$18,820,000	\$21,894,000	\$22,568,000	\$21,797,000	\$14,958,000
Long-term debt	4,460,000	4,233,000	1,662,000	1,746,000	842,000
Working capital	3,827,000	4,785,000	4,021,000	3,683,000	3,032,000
Shareholders' equity	6,793,000	7,804,000	6,696,000	5,515,000	4,456,000

Five-Year Summary
of Operations

Assets

	December 31,	
	1980	1979
Current Assets		
Cash	\$ —	\$ 648,000
Receivables, principally trade accounts, less allowances for doubtful accounts of \$677,000 in 1980 and \$284,000 in 1979 (Note 2)	4,193,000	6,364,000
Refundable federal income taxes	916,000	—
Inventories (Notes 1 and 2)	5,400,000	6,679,000
Account balances with brokers	—	260,000
Prepaid expenses	115,000	154,000
Total Current Assets	10,624,000	14,105,000
Land, buildings, and equipment — at cost (Notes 1, 2, and 3)		
Land	561,000	558,000
Buildings	4,493,000	4,233,000
Equipment	4,526,000	3,634,000
Automotive	560,000	732,000
Leasehold improvements	117,000	308,000
	10,257,000	9,465,000
Less accumulated depreciation and amortization	(2,643,000)	(2,325,000)
Excess of cost of investment in subsidiary over the net asset value at date of acquisition (Note 1)	7,614,000	7,140,000
Notes receivable (Note 2)	436,000	457,000
	146,000	192,000
	<u>\$18,820,000</u>	<u>\$21,894,000</u>

Liabilities and Shareholders' Equity

	December 31,	
	1980	1979
Current Liabilities		
Notes payable		
Bank (Note 2)	\$ 3,413,000	\$ 4,401,000
Other	31,000	107,000
Current portion of long-term obligations (Note 3)	575,000	516,000
Accounts payable, trade	1,724,000	2,694,000
Accrued liabilities	1,054,000	1,406,000
Customer Deposits	—	53,000
Federal and State Income Taxes Payable (Notes 1 and 6)	—	143,000
Total Current Liabilities	6,797,000	9,320,000
Long-term obligations, less current portion shown above (Note 3)	4,460,000	4,233,000
Deferred income and state excise taxes	770,000	537,000
Commitments (Notes 4 and 8)		
Shareholders' equity (Notes 2 and 5)		
Common stock, authorized 2,500,000 shares of \$.16 par value; issued and outstand- ing 964,000 shares in 1980, 922,000 shares in 1979	154,000	148,000
Additional paid-in capital	2,961,000	2,876,000
Retained earnings	3,678,000	4,780,000
Total Shareholders' Equity	6,793,000	7,804,000
	<u>\$18,820,000</u>	<u>\$21,894,000</u>

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

	Years Ended December 31,		
	1980	1979	1978
Net sales	\$33,410,000	\$36,602,000	\$31,123,000
Other income	190,000	145,000	247,000
Total revenues	33,600,000	36,747,000	31,370,000
Cost and expenses			
Cost of sales	27,108,000	28,298,000	23,675,000
Selling and administrative expense	5,238,000	5,213,000	4,735,000
Interest (Note 1)	1,042,000	638,000	551,000
Depreciation and amortization	746,000	482,000	408,000
Total costs and expenses	34,134,000	34,631,000	29,369,000
Income (loss) from continuing operations before provision (credit) for income taxes	(534,000)	2,116,000	2,001,000
Provision (credit) for income taxes (Notes 1 and 6)	(351,000)	599,000	839,000
Income (loss) from continuing operations	(183,000)	1,517,000	1,162,000
Income (loss) incurred from discontinued operations, net of tax benefits of \$382,000 in 1980, and \$195,000 in 1979 and tax of \$78,000 in 1978 (Notes 6 and 7)	(449,000)	(217,000)	104,000
Income (loss) on disposition of discontinued operations, net of tax benefits of \$278,000, in 1980, \$47,000 in 1979 and \$43,000 in 1978 (Notes 6 and 7)	(278,000)	(56,000)	(46,000)
Net Income (Loss)	\$ (910,000)	\$1,244,000	\$1,220,000
Net income (Loss) per common share (Note 1)			
Continuing operations	\$(0.19)	\$1.58	\$1.23
Discontinued operations	(0.75)	(.28)	.06
Net Income (Loss) Per Share	\$(0.94)	\$1.30	\$1.29

Consolidated Statement
of Income

	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
Exercise of stock options	42,000	6,000	85,000	—
Cash dividends paid (\$.20 per share)	—	—	—	(192,000)
Net (Loss)	—	—	—	(910,000)
BALANCE at December 31, 1980	964,000	\$154,000	\$2,961,000	\$3,678,000

Consolidated Statement of
Shareholders' Equity

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

	Years Ended December 31,		
	1980	1979	1978
Financial resources provided (used) by			
Income (loss) from continuing operations	\$ (183,000)	\$1,517,000	\$1,162,000
Add items not requiring the use of working capital			
Depreciation and amortization	746,000	482,000	408,000
Deferral of federal income taxes	233,000	(37,000)	84,000
Working capital provided by continuing operations	796,000	1,962,000	1,654,000
Income (loss) from discontinued operations	(727,000)	(273,000)	58,000
Depreciation not requiring working capital	63,000	109,000	107,000
Working capital provided (used) by discontinued operations	(664,000)	(164,000)	165,000
Total working capital provided by operations	132,000	1,798,000	1,819,000
Proceeds from disposition of equipment	64,000	50,000	184,000
Deferral of state excise tax	—	133,000	—
Exercise of stock options	91,000	32,000	74,000
Changes in long-term receivables	46,000	278,000	(215,000)
Long-term obligations incurred	821,000	3,600,000	88,000
	1,154,000	5,891,000	1,950,000
Financial resources applied to			
Acquisition of land, building and equipment	1,326,000	3,892,000	1,319,000
Reduction of long-term obligations	594,000	1,031,000	172,000
Cash dividends paid	192,000	168,000	113,000
Reduction in deferred income	—	36,000	8,000
	2,112,000	5,127,000	1,612,000
Increase (decrease) in working capital	\$ (958,000)	\$ 764,000	\$ 338,000
Changes in components of working capital			
Increases (decreases) in current assets			
Cash	\$ (648,000)	\$ 110,000	\$ 269,000
Receivables	(2,171,000)	(1,044,000)	1,133,000
Costs and estimated earnings in excess of billings on long-term construction contracts	—	(873,000)	873,000
Refundable federal income taxes	916,000	—	—
Inventories	(1,279,000)	(1,982,000)	(2,344,000)
Account balances with brokers	(260,000)	188,000	(116,000)
Prepaid expenses	(39,000)	(48,000)	121,000
	(3,481,000)	(3,649,000)	(64,000)
Increases (decreases) in current liabilities			
Notes payable	(1,064,000)	(2,623,000)	112,000
Current portion of long-term obligations	59,000	270,000	15,000
Accounts payable and deposits	(1,023,000)	(2,013,000)	(523,000)
Accrued liabilities	(352,000)	(85,000)	259,000
Federal and state income taxes payable	(143,000)	38,000	(265,000)
	(2,523,000)	(4,413,000)	(402,000)
Increase (decrease) in working capital	\$ (958,000)	\$ 764,000	\$ 338,000

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

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 are valued at the lower of cost (principally average cost and first-in, first-out basis) or market.

	<u>1980</u>	<u>1979</u>
Distribution merchandise	\$ 803,000	\$2,470,000
Manufacturing inventories		
Finished goods	1,659,000	1,303,000
Work-in-process	382,000	939,000
Raw materials	2,456,000	1,628,000
Home building	100,000	339,000
	<u>\$5,400,000</u>	<u>\$6,679,000</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 1980, 1979 and 1978.
- (e) Income tax expense (refund) is computed on the basis of transactions entering into the operating results from continuing operations before tax, and reflects investment tax and energy credits (\$101,000 in 1980, \$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) Pension plan costs are determined actuarially. The amounts charged against earnings include current costs and amortization, generally over 30 years, of prior service costs. Pension costs are generally funded annually in the same amount as the charge against earnings (see Note 4).
- (g) Net (loss) income per share has been computed based on the weighted average number of common shares and common equivalent shares outstanding during each period. Common equivalent shares consist of dilutive outstanding stock options under the treasury stock method.

	<u>1980</u>	<u>1979</u>
Common shares outstanding	964,000	922,000
Effect of using weighted average common shares outstanding	(7,000)	(9,000)
Effect of shares issuable under stock option plans as determined by the treasury stock method	7,500	44,000
Shares used in computing earnings per share	<u>964,500</u>	<u>957,000</u>

- (h) 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. Total interest costs for 1979 were \$1,296,000, of which \$132,000 was capitalized. For 1980, no interest was capitalized. The company elected early application of the statement in 1979.

Notes to Consolidated
Financial Statements
December 31, 1980, 1979 and 1978

Note 2 — Notes Payable to Bank

	<u>1980</u>	<u>1979</u>	<u>1978</u>
Revolving credit lines	\$5,500,000	\$10,500,000	\$7,000,000
Interest rate	1½%	1%-1¾%	1%-1¾%
	Over prime	Over prime	Over prime
Interest rate at December 31	23¼%	16¼ to 17%	13%
Maximum outstanding during the year	\$4,699,000	\$ 8,000,000	\$7,000,000
Approximate average month end borrowings	\$3,385,000	\$ 6,800,000	\$5,800,000
Approximate weighted average interest rate	17½%	13¾%	10½%
Unused credit lines at December 31	\$2,087,000	\$ 6,099,000	None

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

- (a) Bank approval for certain transactions including the acquisition of other businesses or engagement in any other business activity, and acquisition of fixed assets in excess of certain limits.
- (b) Restriction of cash dividend payments to 20% of the previous year's net income.
- (c) Maintenance of minimum specified amounts of working capital and shareholders' equity.

Note 3 — Long-Term Obligations

Long-term obligations consist of the following at December 31

	<u>1980</u>	<u>1979</u>	<u>1978</u>
Mortgage notes and other contracts collateralized by certain land, buildings and equipment bearing interest rates from 7% to 12% payable in monthly installments, including interest, with final payments due from 1981 to 2002	\$1,113,000	\$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.	1,125,000	1,500,000	—
Term note payable to bank. Replaced in 1979 by \$1.5 million term note described above.	—	—	550,000
Long-term note collateralized by mortgage on new manufacturing facility. Interest at 10¼%, 29 year amortization, callable at 15 years.	2,091,000	1,360,000	—
Lease-purchase financing on capitalized equipment, collateralized by capitalized equipment costing \$797,000. Payable in monthly installments over 7 years from dates of acquisition of equipment with interest at 11½% to 14%.	706,000	699,000	—
	<u>5,035,000</u>	<u>4,749,000</u>	<u>1,908,000</u>
Less current portion	<u>575,000</u>	<u>516,000</u>	<u>246,000</u>
	<u>\$4,460,000</u>	<u>\$4,233,000</u>	<u>\$1,662,000</u>

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, 1980, to be made during the following five years, are approximately as follows: 1981-\$575,000; 1982-\$546,000; 1983-\$556,000; 1984-\$204,000; 1985-\$215,000.

Note 4 — Employee Benefit Plans

The company and its subsidiaries have pension plans covering substantially all of their employees. Pension expense was \$127,000 in 1980, \$101,000 in 1979, and \$133,000 in 1978. The company makes annual contributions to the plans equal to the amounts accrued for pension expense, including amortization of past service cost over 30 years. Accumulated plan benefit information, as estimated by consulting actuaries, and plan net assets for the company's plans are

	<u>1980</u>	<u>1979</u>
Actuarial present value of accumulated vested plan benefits	\$464,000	\$359,000
Net assets available for benefits	346,000	206,000

The weighted average assumed rate of return used in determining the actuarial present value of accumulated plan benefits was 6½% for both 1980 and 1979.

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.

Option activity (in shares) under the plan was

	<u>1980</u>	<u>1979</u>	<u>1978</u>
Outstanding, January 1	27,600	22,200	26,580
Exercised	(4,800)	(2,400)	(4,380)
Granted	2,800	7,800	—
Cancelled	(2,900)	—	—
Outstanding and exercisable at December 31 (at \$2.29 to \$7.75 per share)	<u>22,700</u>	<u>27,600</u>	<u>22,200</u>

At December 31, 1980, no shares were available for future options. Options outstanding at December 31, 1980, expire at various dates to August 30, 1985.

At December 31, 1980, nonqualified stock options were outstanding to nine members of the Board of Directors to purchase an aggregate of 20,080 shares. The options were granted at various dates from 1976, are exercisable at prices ranging from \$2.292 per share to \$6.667 per share and expire at various dates to 1990.

Option activity (in shares) under the plan was

	<u>1980</u>	<u>1979</u>	<u>1978</u>
Outstanding, January 1	50,750	57,420	88,920
Exercised	(36,970)	(10,450)	(28,680)
Granted	6,300	3,780	3,780
Cancelled	—	—	(6,600)
Outstanding December 31	<u>20,080</u>	<u>50,750</u>	<u>57,420</u>

Notes to Consolidated
Financial Statements

Following is a summary of the activity with respect to qualified and nonqualified stock options during the two years ended December 31, 1980:

	Number of Shares	Option Price		Market Price	
		Per Share	Total	Per Share	Total
Year ended December 31, 1979					
Outstanding at end of year (granted 1973 through 1979).					
All are exercisable	78,350	\$1.988 to \$6.67	\$246,617	\$1.988 to \$6.67 ¹	\$246,617
Became exercisable	18,180	\$2.27 to \$6.67	\$ 87,575	\$6.00 to \$6.67 ²	\$112,176
Exercised	12,850	\$1.988 to \$4.48	\$ 31,515	\$5.87 to \$6.75 ³	\$ 84,063
Year ended December 31, 1980					
Outstanding at end of year (granted 1976 through 1980).					
All are exercisable	42,780	\$2.292 to \$7.75	\$195,318	\$2.292 ¹ to \$7.75	\$195,318
Became exercisable	9,100	\$5.375 to \$7.75	\$ 55,562	\$5.375 ² to \$7.75	\$ 5,562
Exercised	41,770	\$1.988 to \$2.292	\$ 91,561	\$4.625 ³ to \$7.125	\$227,974

¹ At the dates options were granted.

² At the dates options became exercisable.

³ At the dates options were exercised.

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

Note 6 — Income Taxes

The provision for taxes on income consists of the following:

	1980	1979	1978
Continuing Operations			
Amounts currently payable (refundable) net of investment, energy and new jobs tax credits of \$101,000 in 1980, \$235,000 in 1979 and \$121,000 in 1978	\$(372,000)	\$588,000	\$527,000
Net additions to deferred income taxes current and deferred	21,000	11,000	312,000
	<u>\$(351,000)</u>	<u>\$599,000</u>	<u>\$839,000</u>
Discontinued Operations			
Current tax effect	<u>\$(660,000)</u>	<u>\$(242,000)</u>	<u>\$ 35,000</u>

Deferred income taxes result from timing differences in the recognition of depreciation, gain on sale of land, and interest expense.

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

	1980	1979	1978
Statutory rate (1980 reflects carry back to 1977)	(48.0%)	46.0%	48.0%
Investment, jobs and energy credits	(4.3%)	(14.7)%	(5.8)%
Other items, including amortization of a deferred tax liability associated with the partial liquidation of a subsidiary company during 1975	—	(9.1)%	(.5)%
Effective rate including tax benefits of discontinued operations	<u>(52.3%)</u>	<u>22.2%</u>	<u>41.7%</u>

Note 7 — Discontinued Operations

In 1980, the Company discontinued three of its operations; plywood distribution, modular home manufacturing and related modular home contracting. The results of all discontinued operations have been segregated below for the years 1980, 1979 and 1978.

	(in thousands)		
	Year Ended December 31,		
	1980	1979	1978
Net revenues	\$11,166	\$62,792	\$63,900
Costs and expenses	12,552	63,307	63,806
Income tax benefit	660	242	(36)
Income (loss)	(727)	(273)	58

Note 8 — Commitments

The Company leases certain properties used in its operations. Total rental expense for 1980 and 1979 was less than 1 percent of the revenues.

Note 9 — Quarterly Results

SUMMARY OF QUARTERLY DATA (Unaudited)

	1979			
(Dollars in thousands except per share figures)	First	Second	Third	Fourth
Total revenue	\$7,292	\$9,796	\$10,305	\$9,354
Gross margin	1,520	2,216	2,290	2,423
Income from continuing operations	115	410	384	609
Income (loss) from discontinued operations	(27)	(289)	128	(85)
Net income	\$ 88	\$ 121	\$ 512	\$ 524
Net income (loss) per common share				
Continuing operations	\$.12	\$.44	\$.40	\$.64
Discontinued operations	(.03)	(.31)	.14	(.10)
Net income per common share	\$.09	\$.13	\$.54	\$.54

	1980			
(Dollars in thousands except per share figures)	First	Second	Third	Fourth
Total revenue	\$7,493	\$8,249	\$8,896	\$8,962
Gross margin	1,602	1,805	1,620	1,465
Income (loss) from continuing operations	(35)	14	9	(171)
Loss from discontinued operations	(275)	(170)	21	(303)
Net income (loss)	\$ (310)	\$ (156)	\$ 30	\$ (474)
Net income (loss) per common share				
Continuing operations	\$ (.04)	\$.02	\$.01	\$ (.18)
Discontinued operations	(.29)	(.18)	.02	(.31)
Net income (loss) per common share	\$ (.33)	\$ (.16)	\$.03	\$ (.49)

Note 10 — Information By Line of Business

The Company operates in one principal line of business; manufacturing. Operations in manufacturing involve production and sale of cabinets, millwork and doors.

Notes to Consolidated
Financial Statements

Note 11 — Related Parties

A prefinished wood molding supplier to the Company is owned by a brother of J. Allan MacDonald, President of the Company. A supplier of doors to the company's Western Cabinet & Millwork Division is owned by a brother-in-law of J. Allan MacDonald. J. Allan MacDonald has no financial interest direct or indirect in either of these companies. Combined purchases from these two companies were \$2,035,000 in 1980, \$2,899,000 in 1979 and \$2,820,000 in 1978. Prices and quality are continually checked and compared with competition. Substantial amounts of similar products manufactured by competitors of these two suppliers are purchased and used in the companies' product line. Purchase decisions in all of Timberland's companies are made at the division level based on product quality, price, service and availability.

Amounts payable to these two suppliers were \$28,000 at December 31, 1980 and \$77,000 at December 31, 1979. Terms are generally payment in 30 days.

Included in accounts receivable is a \$100,000 loan to Donald S. Hansen, former President of Timberland Forest Products and a Director of the Company. The loan is due December 1, 1981 and bears no interest. It was made as part of the termination agreement with Mr. Hansen when Timberland Forest Products ceased doing business as a continuing operation.

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

We have examined the consolidated balance sheet of Timberland Industries, Inc. as of December 31, 1980 and 1979, and the related consolidated statements of income, shareholders' equity and changes in financial position for each of the three years ended December 31, 1980. 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 consolidated financial statements referred to above present fairly the consolidated financial position of Timberland Industries, Inc. at December 31, 1980 and 1979, and the results of its operations and the changes in its financial position for each of the three years ended December 31, 1980, in conformity with generally accepted accounting principles consistently applied during the periods, except for the change in 1979, 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, 1981

Annual Meeting

June 2, 1981 at 3:00 p.m.
Arcade Level Auditorium
Seattle-First National Bank Building
1001 4th Avenue
Seattle, Washington

Form 10-K

The Timberland Industries Form 10-K report filed with the Securities and Exchange Commission is available to shareholders at no cost upon written request to:

Stanley Gillman
Treasurer
Timberland Industries, Inc.
P.O. Box 3546
Bellevue, Washington 98009

Registrar and Transfer Agent

Rainier National Bank
Corporate Trust and Agency
P.O. Box 24407
Seattle, Washington 98124

Legal Counsel

Foster, Pepper & Riviera
1111 Third Avenue
Seattle, Washington 98101

Company Operations

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Corporate Offices
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Bellevue, Washington 98009
(206) 828-3565

Western Cabinet & Millwork
15300 Woodinville/Redmond Rd. N.E.
Woodinville, Washington 98072
(206) 823-4141

Cal-Wood Door
P.O. Box 3546
Santa Rosa, California 95402
(707) 584-9663

Brennan Supply Company
2260-152nd N.E.
Redmond, Washington 98052
(206) 747-9300

Officers

J. Allan MacDonald,
President

Milton D. Skutle,
Vice President

Ian MacDonald,
Vice President

Donald S. Hansen,
Vice President

James A. MacDonald, Jr.,
Vice President

Stanley Gillman,
Secretary and Treasurer

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,
Vice President
Timberland Industries, 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,
Personal Investments

Milton D. Skutle,
President
Western Cabinet & Millwork

*Member of the Audit Committee and
Compensation Committee

