

PAY'n SAVE
CORPORATION

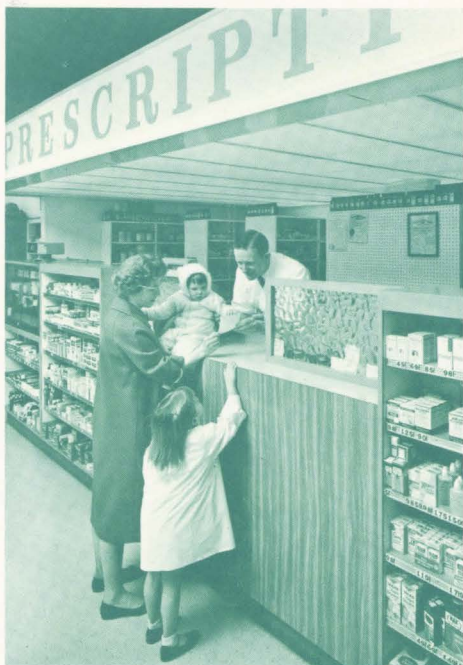
ANNUAL REPORTS
PAY'n SAVE Corp. 1966
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ANNUAL REPORT

for the year ending January 31, 1966

PAY'N SAVE DRUG STORES
ERNST HARDWARE STORES
MALMO NURSERY STORES

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More prescriptions are filled at Pay'n Save Drug Stores by our qualified professional pharmacists than by any other drug stores in the Puget Sound area. The pharmacists are helpful and friendly to customers of all ages.

During the fall of 1965 the Ernst Hardware Division added ready-mixed concrete to its growing product line of do-it-yourself merchandise. Ready-mixed concrete is available in quantities as small as $\frac{1}{4}$ yard. Trailers are furnished for the customers' convenience.



PAY'N SAVE CORPORATION

BOARD OF DIRECTORS:

Monte L. Bean
Harold E. Oneal

James H. Clawson

M. Lamont Bean
Joshua Green, Jr.

OFFICERS:

Monte L. Bean
M. Lamont Bean
Harold E. Oneal
Calvin Hendricks
John E. Ryan, Jr.
Jennie K. Hauge
E. R. Erickson

Chairman of the Board
President
Vice President
Treasurer
Secretary
Assistant Treasurer
Assistant Secretary

TRANSFER AGENT AND REGISTRAR

Peoples National Bank of Washington

COUNSEL

Ryan, Askren, Carlson, Bush & Swanson

AUDITORS

Price Waterhouse & Co.

GENERAL OFFICES

514-24 Pike Street
Seattle, Washington

TO THE STOCKHOLDERS:

Your company continued its progress with another highly successful year. Sales and income again set records. We are particularly pleased with new stores opened during the year since they were all profitable and contributed significantly to the increase in sales and net income.

SALES AND NET INCOME

Sales passed the thirty million milestone and soared to \$30,943,263 which represent a 22½% increase. The increase in sales of \$5,695,919 compares with a previous one year record increase of \$3,872,113 set last year. Net income after taxes increased 52% or from \$536,769 to \$816,235. On a per share basis on the average number of shares outstanding, the company's net income was \$1.94 as compared to \$1.43 for the previous year. Included in the current year's net income is the gain on sale of an investment in the amount of \$87,191 or 21c per share. This income is non-recurring.

DIVIDEND

The Board of Directors continued their previously established dividend policy by declaring a 5% stock dividend on March 10, 1966. The dividend is payable on April 12, 1966 at the rate of one share for every twenty shares held on March 24, 1966. Fractional shares will be paid in cash at the fair market value of the stock.

PAY'N SAVE DRUGS LTD.

Pay'n Save Drugs Limited, a Canadian Corporation with stores in Calgary, Regina and Winnipeg, Canada was purchased as of January 1, 1966. The consolidated financial statements include the Canadian operation for the month of January, 1966 only. The acquired company was purchased for 8,790 shares of Pay'n Save Corporation common stock and a promissory note in the amount of \$477,510. The Canadian stores have been in existence for approximately ten years, but have not been very successful. We are now in the process of introducing the merchandising techniques used by other Pay'n Save Drug Stores to this operation. It is not expected that the acquired stores will produce any significant amount of income in the next year or two. We do, however, believe that with the rapid growth of Canada there is a great potential for Pay'n Save Drug Stores in this country.

EXPANSION

The expansion for 1966 will include two new Pay'n Save Drug Stores in the Tacoma area and one in the South Sound Shopping Center of Olympia. These stores are scheduled to open in early summer.

Ernst Hardware and Malmo Nursery Stores will open in the South Sound Shopping Center of Olympia on March 26, 1966. One additional Ernst Hardware and Malmo Nursery Complex will open in the Burien area of Seattle, Washington in late summer.

CONVERSION OF DEBENTURES

During the year, \$539,000 of convertible debentures were exchanged for 46,423 shares of common stock. There remains \$649,000 of debentures yet to be converted. It is anticipated that part of these will be converted during the year now in progress.

FINANCING

We are in the process of negotiating for additional long-term financing in the amount of \$1,500,000. The additional funds will be used to finance the inventory needs of the new stores and to repay the short-term indebtedness incurred in connection with the acquisition of Pay'n Save Drugs Ltd.

FUTURE PROGRESS

The strength of the economy of the northwest has contributed to our performance during the past year. All indications are that this strength will continue and that we will have another satisfactory year.

We express our sincere appreciation to our employees, stockholders, suppliers and the millions of customers that have contributed to a successful year.



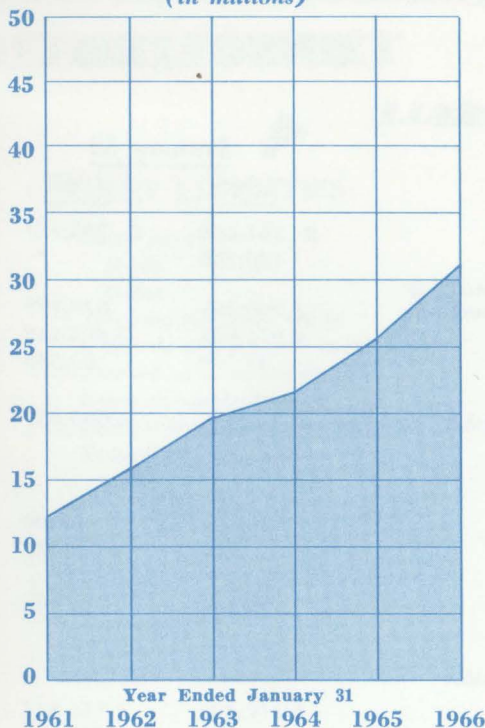
Monte L. Bean, Chairman of the Board



M. Lamont Bean, President

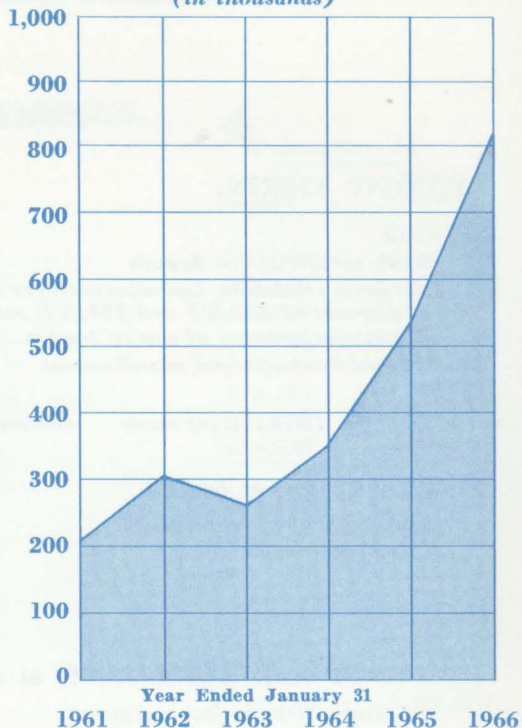
NET SALES

(in millions)



NET INCOME

(in thousands)



SIX YEAR SUMMARY OF OPERATIONS

JANUARY 31

		1966	1965	1964	1963	1962	1961
Net sales	*	\$30,943	\$25,247	\$21,375	\$19,956	\$15,779	\$12,879
Net income †	*	\$ 816	\$ 537	\$ 355	\$ 263	\$ 304	\$ 204
Net income per share †		\$ 1.94	\$ 1.43	\$ 1.00	\$.78	\$ 1.00	\$.69
Shares outstanding at end of year △		449	375	356	339	306	302
Stockholders equity	*	\$ 4,643	\$ 3,133	\$ 2,584	\$ 2,229	\$ 1,797	\$ 1,466
Book value per share		\$ 10.41	\$ 8.36	\$ 7.26	\$ 6.58	\$ 5.87	\$ 4.86
Working capital	*	\$ 4,897	\$ 4,132	\$ 3,684	\$ 3,347	\$ 1,809	\$ 1,708
Ratio of current assets to current liabilities		2.33	2.49	2.79	2.53	1.84	2.06
Number of stores in operation:							
Pay'n Save Drug		20	18	16	15	13	12
Pay'n Save Drugs Ltd.		3					
Ernst Hardware		13	11	10	10	9	8
Malmo Nursery		1	1	1	1	2	
Total stores		37	30	27	26	24	20

* Amount in thousands of dollars

△ Thousands of shares outstanding, adjusted to give effect to various stock splits during the six-year period

† Includes non-recurring income of \$87,191 or \$.21 per share in 1966

PAY'N SAVE CORPORATION AND SUBSIDIARY COMPANIES

CONSOLIDATED BALANCE SHEET

ASSETS

	January 31	
	1966	1965
CURRENT ASSETS:		
Cash	\$ 361,654	\$ 305,664
Bank certificates of deposit	138,750	
Accounts receivable, less allowance for doubtful accounts of \$30,253 and \$24,077, respectively	1,048,366	819,399
Inventories, at lower of cost or market	6,976,605	5,694,448
Prepaid insurance and miscellaneous	43,790	80,546
Total current assets	8,569,165	6,900,057
INVESTMENTS, at cost:		
Cash value of life insurance	11,320	8,600
Other investments	22,525	25,083
	33,845	33,683
PROPERTY AND EQUIPMENT, at cost:		
Furniture, fixtures and equipment	2,119,808	1,844,417
Leasehold improvements	515,529	422,110
	2,635,337	2,266,527
Less—Accumulated depreciation and amortization	1,512,872	1,216,627
	1,122,465	1,049,900
Land	74,615	4,400
	1,197,080	1,054,300
DEFERRED CHARGES:		
Debenture issue costs, net of amortization of \$52,947 and \$25,572, respectively	59,745	87,120
Excess of investment in subsidiary over value assigned to tangible assets, net of amortization	16,000	24,000
Deposits and miscellaneous	14,869	32,874
Organization expense	8,437	8,437
	99,051	152,431
	\$9,899,141	\$8,140,471

LIABILITIES

	January 31	
	1966	1965
CURRENT LIABILITIES:		
Notes payable—		
Bank	\$ 200,000	
Other	477,510	
Accounts payable—trade	1,482,760	\$1,363,092
Withheld and accrued taxes	357,855	291,115
Accrued salaries and bonuses	267,542	202,852
Other accrued expenses	112,109	125,257
Current instalments on long-term indebtedness	117,898	147,147
Federal income taxes	656,538	638,912
Total current liabilities	3,672,212	2,768,375
LONG-TERM INDEBTEDNESS:		
Notes payable	852,498	922,932
Debentures payable	849,238	1,463,638
	1,701,736	2,386,570
Less—Instalments due within one year classified as current liabilities	117,898	147,147
	1,583,838	2,239,423
STOCKHOLDERS' EQUITY:		
Capital stock—authorized 800,000 shares of \$2.50 par value; outstanding 449,234 and 374,770 shares, respectively	1,123,085	936,925
Capital in excess of par value	1,217,970	392,305
Retained earnings	2,302,036	1,803,443
	4,643,091	3,132,673
	\$9,899,141	\$8,140,471

The accompanying notes are an integral part of these financial statements

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PAY'N SAVE CORPORATION AND SUBSIDIARY COMPANIES

STATEMENT OF CONSOLIDATED INCOME AND RETAINED EARNINGS

Year Ended January 31 

	<u>1966</u>	<u>1965</u>
<i>Sales and other revenues:</i>		
<i>Net sales</i>	\$30,943,263	\$25,247,344
<i>Interest and other income</i>	98,106	74,474
	<u>31,041,369</u>	<u>25,321,818</u>
<i>Costs and expenses:</i>		
<i>Cost of merchandise sold</i>	21,839,214	17,750,370
<i>Operating and administrative expenses</i>	7,716,706	6,376,498
<i>Interest</i>	146,405	152,181
	<u>29,702,325</u>	<u>24,279,049</u>
<i>Income before federal income taxes and special item</i>	1,339,044	1,042,769
<i>Provision for federal income taxes</i>	610,000	506,000
<i>Net income before special item</i>	729,044	536,769
<i>Gain on sale of investment, net of federal income taxes</i>	87,191	
<i>Net income for the year</i>	816,235	536,769
<i>Retained earnings at beginning of year</i>	1,803,443	1,435,765
<i>Stock dividend—5%</i>	(317,642)	(169,091)
<i>Retained earnings at end of year</i>	<u>\$ 2,302,036</u>	<u>\$ 1,803,443</u>

Provision for depreciation and amortization of property and equipment amounted to \$231,629 in 1966 and \$232,190 in 1965.

The accompanying notes are an integral part of these financial statements

NOTES TO FINANCIAL STATEMENTS

JANUARY 31, 1966

NOTE 1—BASIS OF CONSOLIDATION:

The financial statements include the accounts of Pay'n Save Corporation and its wholly-owned subsidiaries, Seattle Wholesale Nurseries Co. and Pay'n Save Drugs Limited.

Pay'n Save Drugs Limited (a Canadian corporation) was acquired by purchase on January 1, 1966; accordingly the financial statements include only January, 1966 operations of the subsidiary. The acquired company was purchased for 8,790 shares of Pay'n Save Corporation common stock and a promissory note in the amount of \$477,510, payable July 10, 1966 with interest at 3% per annum.

NOTE 2—LONG TERM INDEBTEDNESS:

Long-term indebtedness comprised the following:

	January 31	
	1966	1965
Notes payable to:		
Bankers Life Company	\$800,000	\$ 800,000
Others	52,498	122,932
	<u>\$852,498</u>	<u>\$ 922,932</u>
6% subordinated debentures	\$200,238	\$ 275,638
5½% convertible subordinated debentures	649,000	1,188,000
	<u>\$849,238</u>	<u>\$1,463,638</u>

With minor exceptions, the notes and debentures are unsecured. The various financing agreements place certain restrictions upon the creation of additional debt, require the maintenance of at least \$2,500,000 of working capital and limit the payment of cash dividends and the purchase or redemption of capital stock to an amount equal to the excess of retained earnings over \$889,260.

The note payable to Bankers Life Company is due in annual instalments beginning August 1, 1966, and ranging from \$25,000 to \$100,000 through August 1, 1977. The note agreement permits advance payments without premium under certain circumstances. The other notes payable are also due in instalments.

The 6% subordinated debentures mature serially at the rate of \$75,400 on each December 31 through 1967 with the balance maturing in 1968.

The 5½% convertible subordinated debentures mature August 1, 1977. The company is obligated to make payments of \$90,000 annually, July 31, 1967 through July 31, 1976, to a sinking fund for bond redemption; at its option, the company may make additional payments to the sinking fund up to \$90,000. Redemption through the sinking fund is at par; redemption may be made otherwise at 105% of principal amount to July 31, 1966 and thereafter at declining premiums. The debentures may be converted into common stock at \$11.50 per share to July 31, 1967, and at increasing amounts thereafter to July 15, 1977; these amounts are subject to adjustment in certain cases. During the current year \$539,000 of the original debentures were converted to capital stock.

A summary of maturities of long-term indebtedness for the five years ending January 31, 1971 follows:

Year ending January 31	Notes	Subordinated debentures	Convertible subordinated debentures	Together
1967	\$ 42,498	\$ 75,400		\$117,898
1968	32,000	75,400	\$ 90,000	197,400
1969	57,000	49,438	90,000	196,438
1970	57,000		90,000	147,000
1971	57,000		90,000	147,000
	<u>\$245,498</u>	<u>\$200,238</u>	<u>\$360,000</u>	<u>\$805,736</u>

NOTE 3—FEDERAL INCOME TAXES:

The Internal Revenue Service has assessed substantial additional income taxes for the years ended January 31, 1961, 1962 and 1963. The company is contesting the assessments and management is of the opinion that adequate provision has been made in the accounts for additional income taxes, if any, which may ultimately be paid.

Inventories of Seattle Wholesale Nurseries Co., a subsidiary company, are substantially less for federal income tax purposes than for financial reporting purposes; accordingly, the excess of federal income taxes of the subsidiary, based on income for financial reporting purposes, over actual taxes payable have been accrued and included in federal income taxes payable.

NOTE 4—EMPLOYEE STOCK OPTION PLAN:

The company has an employee stock option plan under which 28,938 shares of its common stock are reserved. The purchase price under the option may not be less than 95% of the fair market value of common stock at the time of granting the option except that, as to a grantee owning 10% or more of the company's common stock, the option price will be at least 110% of the fair market value. Option periods may not exceed five years; options may not be granted for an aggregate of more than 5,788 shares in any fiscal year and options may not be granted to one individual for an aggregate of more than 11,576 shares. On February 1, 1965, options were granted for 4,626 shares at \$16.90 and 1,162 shares at \$14.59. The fair market value of the stock at the time the options were granted after giving effect to a stock dividend was \$15.36. At January 31, 1966, options had been granted for an aggregate of 23,152 shares at prices which, after giving effect to stock dividends, ranged from \$6.90 to \$16.90. No options were exercised during the year.

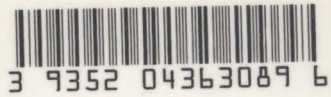
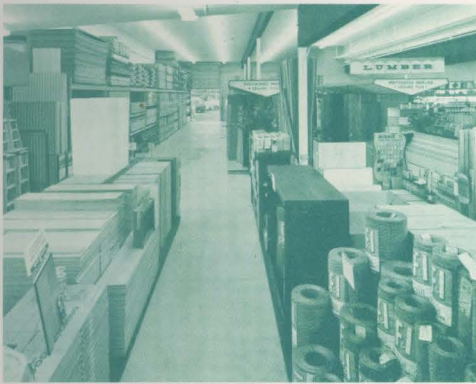
NOTE 5—LEASE COMMITMENTS:

The company's operations are conducted on leased premises. Leases are generally for periods of from ten to twenty years and, in most cases, provide for minimum rentals plus additional amounts based on a percentage of sales. The company also leases certain store fixtures and equipment; such leases are for periods of ten years. Minimum annual rentals under the terms of leases in effect at January 31, 1966 are approximately \$1,120,000.

NOTE 6—CAPITAL STOCK AND CAPITAL IN EXCESS OF PAR VALUE:

Transactions in capital stock and capital in excess of par value during the year ended January 31, 1966 are summarized below:

	Capital stock		Capital in excess of par value
	Shares	Amount	
Balance, January 31, 1965	374,770	\$ 936,925	\$ 392,305
April, 1965 stock dividend— 5% at fair market value	19,251	48,128	269,514
Conversion of \$539,000 of debentures, at conversion prices net of initial debenture issue costs	46,423	116,057	402,326
Acquisition of Pay'n Save Drugs Limited at agreed price (approximates market)—Note 1	8,790	21,975	153,825
Balance, January 31, 1966	449,234	\$1,123,085	\$1,217,970



The newer Ernst Hardware Stores include complete lumber departments which feature paneling, shelving, plywood, siding, roofing materials, flooring and all the related materials and equipment.

Pay'n Save Drug Stores provide complete cosmetic service. Modern well lighted displays, include all major product lines such as Revlon, Max Factor, Coty, Dorothy Gray, Yardsley and many others.



TO THE STOCKHOLDERS OF PAY'N SAVE CORPORATION

In our opinion, the accompanying consolidated balance sheet and related statement of consolidated income and retained earnings present fairly the financial position of Pay'n Save Corporation and its subsidiaries at January 31, 1966 and the result of their operations for the year then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year. Our examination of these statements 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.

Price Waterhouse & Co.

*Seattle, Washington
March 7, 1966*

PAY'N SAVE CORPORATION

STORE LOCATIONS

PAY'N SAVE DRUG STORES:

STORE NUMBER	STORE ADDRESS	
1	319 Pike Street	Seattle, Wn.
2	2711 Colby Avenue	Everett, Wn.
3	4535 University Way	Seattle, Wn.
4	412 Northgate Mall	Seattle, Wn.
5	1423 Market Street N.W. (Ballard)	Seattle, Wn.
6	1400 Cornwall	Bellingham, Wn.
7	250 S.W. 152nd Street (Burien)	Seattle, Wn.
8	201 S. Broadway	Aberdeen, Wn.
9	8500 35th N.E. (Wedgwood)	Seattle, Wn.
10	20220 Aurora Ave. N. (Aurora Village)	Seattle, Wn.
11	1421 Lloyd Center	Portland, Ore.
12	4100 S.E. 82nd Ave. (Eastport Plaza)	Portland, Ore.
13	Triangle Shopping Center	Longview, Wn.
14	7707 S.E. 27th	Mercer Island, Wn.
15	120 106th Ave. N.E.	Bellevue, Wn.
16	2707 Rainier Avenue S.	Seattle, Wn.
17	202 Cross Street S.E.	Auburn, Wn.
18	17171 Bothell Way N.E. (Forest Park) (1)	Seattle, Wn.
19	40 Grady Way (Renton Village)	Renton, Wn.
20	9071 Westwood Village S.W.	Seattle, Wn.

PAY'N SAVE DRUGS LTD:

1	326 7th Avenue West	Calgary, Alberta
2	318 Donald Street	Winnipeg, Manitoba
3	1926 Hamilton Street	Regina, Saskatchewan

ERNST HARDWARE STORES:

1	6th and Pike Street	Seattle, Wn.
2	4314 W. Alaska (West Seattle) (1)	Seattle, Wn.
3	4704 25th N.E. (University Village) (1) (2)	Seattle, Wn.
4	414 Northgate Mall (1) (2)	Seattle, Wn.
5	1740 Market Street N.W. (Ballard)	Seattle, Wn.
6	815 First Avenue	Seattle, Wn.
7	125 106th N.E. (1) (2)	Bellevue, Wn.
8	20205 Aurora Village Square N.	Seattle, Wn.
9	333 Westlake Ave. N.	Seattle, Wn.
10	4920 Evergreen Way (1) (2)	Everett, Wn.
11	10419 Plaza Dr. S.W. (Villa Plaza in Lakewood) (1) (2)	Tacoma, Wn.
12	9109 Westwood Village S.W. (1) (2)	Seattle, Wn.
13	60 Grady Way (Renton Village) (1) (2)	Renton, Wn.
14	25 South Sound Center (1) (2)	Olympia, Wn.

MALMO NURSERY STORE:

1	150th and Aurora Avenue North	Seattle, Wn.
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SEATTLE WHOLESALE NURSERIES Co.:

1	14900 Stone Avenue	Seattle, Wn.
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- (1) Store includes Malmo Nursery department
 (2) Store includes Pre-Cut Lumber department