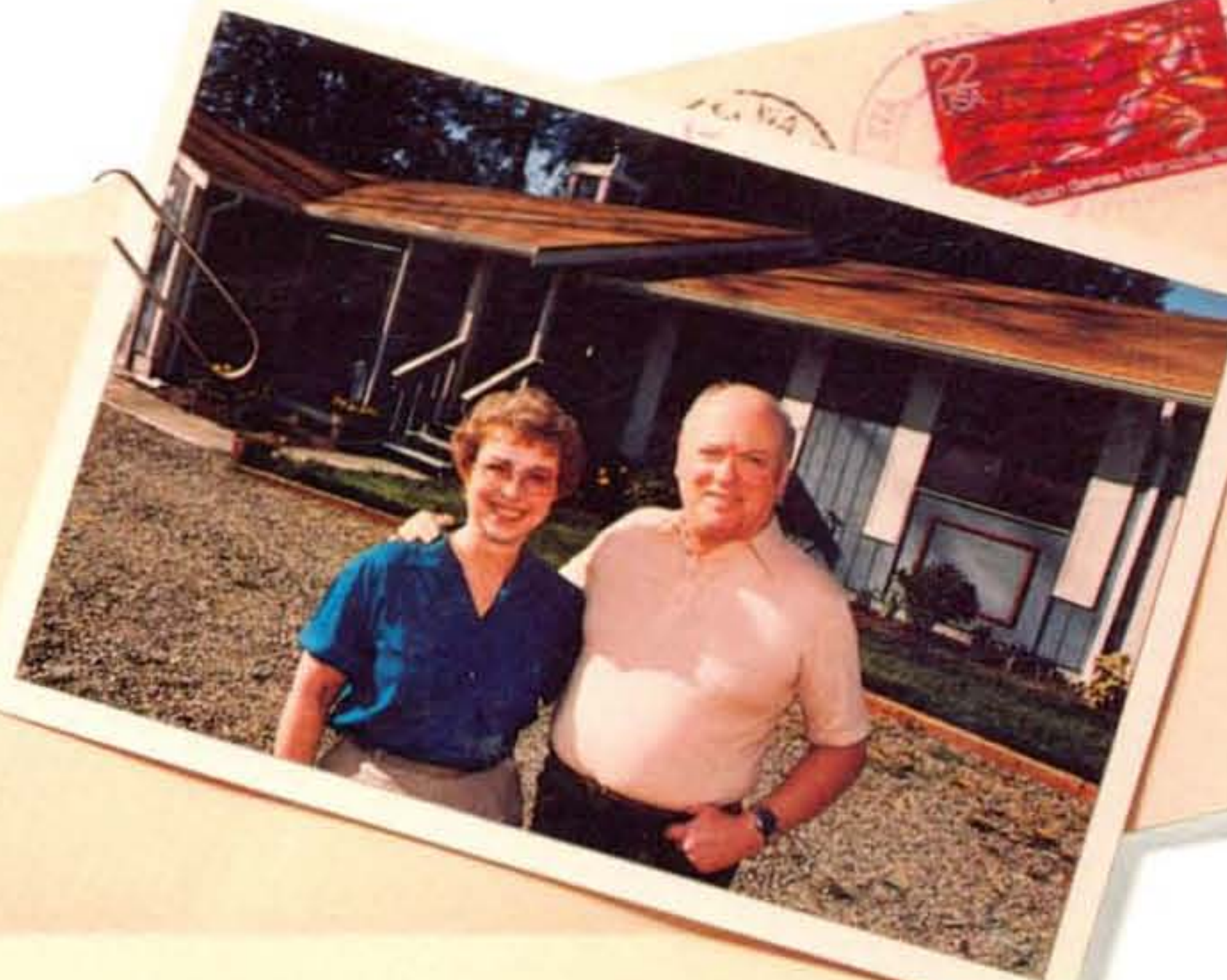


Pay 'N Pak Annual Report Fiscal 1987

1987

ANNUAL REPORTS

PAY'n PAK Stores, Inc. 1987
Foster Business Library
University of Washington



Donald J. & Marilyn Orton
5813 136th St. E.
Puyallup, WA 98373

September 24, 1986

Pay'N Pak
1209 South Central Ave.
Kent, WA 98032

Dear Sirs,

About a year ago, we built a new home for my parents. In the course of that project, we bought several thousand dollars worth of kitchen and bath fixtures, electrical supplies, plumbing hardware and lighting fixtures at your Pay'N Pak store in Puyallup. We also bought all the doors for the house at your store. This year, we are doing some extensive remodeling of our home, and, again, we have done several hundred dollars worth of business at the same store.

Of course, with that volume, we have had to make some adjustments, returns and changes. In every instance we have received the utmost courtesy and helpfulness from everyone concerned.

Too often, the customer is treated as a minor annoyance at best; this is certainly not the case with your Pay'N Pak staff.

We wanted to take this opportunity to express our appreciation for the exceptional treatment we have consistently received. Please accept our sincere thanks and gratitude, and relay our appreciation for the gracious helpfulness to the staff of the store.

In every instance - well done!

Cordially,

Mr. & Mrs. Donald J. Orton

...depends on satisfied customers. We couldn't be any better. He made phone calls to our customers to get their opinions. We've never had the pleasure of dealing with anyone like Pat. He was smiling and ready to please. Sincerely, Janice Dorraine, Robert Dorraine

Letters to the Editor a splendid examples of our me that, as in the old we also have a right this note.

Personnel Manager
Pay 'n Pak Stores, Inc.
P.O. Box 808
Kent, WA 98031

Dear Sir:

I have been a steady customer of Pay 'n Pak Stores for several years and have done many projects, both plumbing and electrical material used being supplied almost exclusively from your store.

In the Albany store a... ded to do...

Mr. Brown,
I needed to command deeper at the

Aug. 19, 1985

Noeffer, written a letter like busy to bother, recommend you and of your'll purchased many use

Barbara L. Browne
7206 W Del Rosa
Pacifica, CA 94044
January 20, 1987

Manager
PAY 'N PAK Stores, Inc.
470 Moor Ave.
So. San Francisco, CA 94080

To whom it may concern:

On January 14, 1987, I purchased an oak entry door for my home. As an older single woman, a purchase of this type is trying for me, as I lack the knowledge to make an educated decision. The gist of this letter is to let you know how much I appreciated the assistance I received at your store.

Mr. Frank Mendez assisted me in a professional, courteous, and prompt manner. In the past, I made purchases at your store on the basis of product quality and price. I am sure that you are to be commended for the excellent service you provide.

Dear Sirs,

My sister and I were in your store last week 12/10 to buy a ceiling fan as a gift for my mother. We saw a fan and light set on display that was exactly what we wanted. The fan was in stock, but the polished brass lights were sold out. Your salesman, who's name was Russ called the other store and they were also out, so he made us the set by using another set and putting the separate tulip turn... treated so... We were helped...

12-7-86

...went to the Pay-n-Pak each Hwy. Longview. We were through vanity. Mr. Jim Duby assistance with the many ed. He was so we came away vanity and a ling. impressed with his is and thought would know about your employee

John S. Dobson
86-101 Kiahiki Place
Makaha, Hawaii 96792
January 20, 1987

President
HOME IMPROVEMENT WAREHOUSE
500 North Nimitz Highway
Honolulu, Hawaii 96817

Dear Sir:

It is a great pleasure to write a company concerning an outstanding employee. During the past several months, I have purchased over \$2,000 worth of materials from your firm. Recently, I picked up my final order of materials which were damaged.

I would like to highly commend an employee. The gentleman personally delivered a new call of duty. He also called on two times prior to for me.

Considering the fact that my home is almost as old as I am, I am most impressed with the professionalism and represents. He is the personification of Home Improvement.

I am most impressed with the professionalism and represents. He is the personification of Home Improvement.

Cordially,
John S. Dobson
JDdb

John Coogan
District Manager
Pay 'n Pak
10503 K. Bar-T
Boise, Idaho 83705

Dear Mr. Coogan:

We recently remodelled two bathrooms in our house. I can't say enough positive attributes about Tan and his staff in the Billings Pay 'n Pak. We have two very nice bathrooms. To a person, the staff sells you what is right, not what will bring the company the most money. We will be doing some remodeling on our kitchen and Pay 'n Pak will get my business because the advice and service are second to none. Billings.

August 28, 1986

Dear Mr. Mandick,
Very recently, I purchased all the "fixings" for an underground sprinkler system from your Medford Pay-N-Pak store. I had no idea what I was getting into! Had it not been for the extensive and knowledgeable help of one of your employees - Nick Smart - I would have been hopelessly lost. Not only did he help me, but he also used his personal time to help me. I wish there were more like him in the job. I hope he deserves the recognition he deserves.

9/7/86

Sincerely,
Nick Smart

This year's annual report salutes our reason for being — the Pay 'N Pak customer. Every month we receive more than 100 letters from people who tell us they like the way our stores serve their needs. Each letter is promptly answered, and copies are routed to the store managers and any employees who are mentioned. All of us at Pay 'N Pak appreciate this mail, and we are proud to share some of it with our shareholders.

Financial Highlights

| <i>Fiscal years ended February 28</i> | 1987 | 1986 | % Change |
|---|------------------|-------------|---------------------|
| <i>(dollar amounts in thousands, except per share data)</i> | | | |
| Revenues | \$398,422 | \$333,782 | +19 |
| Income before income taxes | \$ 11,233 | \$ 14,463 | -22 |
| Net income | \$ 5,686 | \$ 8,168 | -30 |
| Per share of common stock: | | | |
| Net income | \$.57 | \$.82 | -30 |
| Dividends | \$.52 | \$.63 | -17 |
| Weighted average number of shares outstanding | 10,003 | 10,003 | — |
| Stockholders' equity | \$100,127 | \$ 99,643 | +1 |

Quarterly Financial Information (Unaudited)

| <i>For the year ended February 28, 1987</i> | 1st Quarter | 2nd Quarter | 3rd Quarter | 4th Quarter |
|---|--------------------|--------------------|--------------------|--------------------|
| <i>(dollar amounts in thousands, except per share data)</i> | | | | |
| Revenues | \$105,115 | \$108,687 | \$101,429 | \$83,191 |
| Gross profit on sales | \$ 35,423 | \$ 34,524 | \$ 34,912 | \$30,290 |
| Net income | \$ 2,311 | \$ 1,063 | \$ 1,183 | \$ 1,129 |
| Net income per share | \$.23 | \$.11 | \$.12 | \$.11 |

| <i>For the year ended February 28, 1986</i> | 1st Quarter | 2nd Quarter | 3rd Quarter | 4th Quarter |
|---|--------------------|--------------------|--------------------|--------------------|
| <i>(dollar amounts in thousands, except per share data)</i> | | | | |
| Revenues | \$82,733 | \$90,503 | \$86,002 | \$74,544 |
| Gross profit on sales | \$27,919 | \$31,271 | \$28,347 | \$25,325 |
| Net income | \$ 2,096 | \$ 3,011 | \$ 1,760 | \$ 1,301 |
| Net income per share | \$.21 | \$.30 | \$.18 | \$.13 |

Quarterly Low and High Common Stock Prices

| <i>For the fiscal years</i> | 1987 | 1986 |
|-----------------------------|----------------|-------------|
| First quarter | 13½-19¾ | 11½-13¾ |
| Second quarter | 13-19½ | 12¾-15¼ |
| Third quarter | 9½-15½ | 11½-13¾ |
| Fourth quarter | 11-13¼ | 12½-15 |

About the Company

Pay 'N Pak operates 107 retail home improvement centers located in 17 states throughout the western United States, including Alaska and Hawaii. Incorporated in 1961, the company sells electrical products, plumbing supplies and building materials to do-it-yourself home improvement and home maintenance customers.

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On the Cover:

As their letter states, Mr. and Mrs. Donald Orton of Puyallup, Washington, have become steady customers of their nearby Pay 'N Pak.



This new home, which they had built for Mrs. Orton's parents, contains a broad range of our products, including plumbing and lighting fixtures. After this project was complete, the Ortons remodeled their own home next door, using more home improvement values from Pay 'N Pak.

Report to Shareholders Fiscal 1987 was a good year for Pay 'N Pak sales, and for our expansion and warehouse conversion program. But some of those good things carried a price, and because of that, our earnings for the year were lower.

Fiscal 1987 revenues were \$398,422,000, another record, up 19.4% from the previous record year. Comparable store sales (stores three years old or older) increased by 8.9% over the previous year.

Our expansion and warehouse conversion program is nearly complete. During fiscal 1987 we opened two warehouse stores, one in Indio, California, and another in Bremerton, Washington. In addition, we replaced or converted ten existing stores to our warehouse format. This year, we increased our selling space by 8%. In the past three years, we have increased our average store size by 33%.

As we have reported before, the expansions and warehouse conversions have been good competitive decisions by Pay 'N Pak. Warehouse stores increase selling space, increase revenues, allow a broader selection, and enhance our reputation for value. We are satisfied that this strategy will reward Pay 'N Pak shareholders in the years to come.

But these programs — however necessary — were costly in fiscal 1987. Depreciation and interest costs totaled \$18.3 million this year and increased as a percentage of sales; the interest cost alone was \$2 million more than in fiscal 1986. There were also costs associated with the operation of seven new stores which came on line late last year. Three Portland, Oregon, stores, acquired from Handyman, required extensive remodeling and remerchandising. We kept the stores operating while that work took place — essential but costly. In the San Francisco Bay Area, promotional costs of the four stores we opened in late fiscal 1986 were high, and profits from those stores were slow to develop. All seven stores are performing better now, but the costs of their slower-than-expected startup are reflected in our fiscal 1987 earnings.

The fierce competition in our industry was also a factor in lower earnings. Our after-tax earnings for fiscal 1987 were \$5,686,000, down from the previous year's figure of \$8,168,000. Earnings per share were 57 cents, as compared to the 1986 earnings of 82 cents a share. Because earnings were lower, we chose to reduce our dividend as of the third quarter. Unfortunately, that act upstaged some of our more positive news, but members of the Board, along with company management, strongly believe that the dividend reduction was a sound business decision. As a fiscally conservative company, we believe that distributing more money than we earn — even for something so important as a shareholder dividend — is unsound. We expect improved results of operations in the future, and when appropriate, the dividend will be increased as well.

There were many things to be pleased about during fiscal 1987. We expect that vigorous competition will continue to be the norm of our industry, but that price will be less of a factor. In short, we believe some sanity has returned to the marketplace. Unilaterally, we have placed less advertising emphasis on price, while maintaining our image of value. Accordingly, our margins began to rise in the third quarter, and in the fourth quarter margins were up by 2%.

The industry has shown a new interest in customer service—a concept many larger merchandisers had abandoned in the past few years. Our \$1 million-a-year training program, our team of experienced store personnel, and our entire corporate culture is already finely tuned toward a service ethic, and we welcome the opportunity to compete in an arena we know so well.

As we have said many times, our employees' efforts, day-to-day, create our success. We share that success—and the motivation that goes with it—with an Employee Stock Ownership Plan started in 1975. After three years service, every employee annually receives up to \$3,000 in stock paid for by Pay 'N Pak. The ESOP now owns more than 14.9% of the company's stock.

We made several important moves in fiscal 1987. After a careful review of the costs, we closed our Denver, Colorado, distribution center. Deregulation of the trucking industry had changed the economics of the Denver facility; we found that the reduction in manpower and inventory costs would more than offset any increase in shipping costs.



We also added two key members to our senior staff. Richard Takata was named Senior Vice President of Merchandising, and Richard Friel was named Vice President of Marketing. Both men are part of our continuing effort to build the strongest management team in the industry.

Every year holds challenges. In a rapidly evolving industry, we are confident that we have the people, the programs and the resources to capitalize on the opportunities that will be presented in the coming year. We are grateful for the support of our shareholders and employees, and pledge to them our total efforts to make this year a satisfying one.

David J. Heerensperger
Chairman and Chief Executive Officer

Jerry L. Marlow
President and Chief Operating Officer

Purchasing Pay 'N Pak customers come to our stores for many reasons. But at the heart of it, they come to buy our products. The inventory of a typical store includes some 17,000 separate products. Determining what those items should be — what brand, in what variety, at what price — is one of the keys to Pay 'N Pak's success. Staple items like building materials and supplies are important even though they yield a lower margin; they attract customers and contribute to our image as a store with a wide assortment of home maintenance, repair and renovation products. Higher margin items like plumbing and electrical — with an expanded selection of lighting fixtures — draw customers with specific needs. Bath and kitchen displays spark their imaginations, and shoppers know they can buy every necessary component, as well as the tools to install them. In most categories, whether it be tools, fixtures, cabinets, equipment or decorating items, Pay 'N Pak products are available in "good, better, best" grades of quality. Each offers value in its price range, and the higher quality goods yield a better margin. As our market demographics change, so does our product mix. Women now comprise more than 40% of our customers, buying paint, furnishings and other decorating items, lighting and plumbing fixtures, cabinets and lawn and garden items. Accordingly, these categories are being expanded in our stores. Shoppers of both sexes are short on spare time, so we now carry more kits, and home improvement items that are easily installed. And all shoppers love a bargain, so we regularly feature promotional items — goods they might not expect in a home center, such as binoculars in the spring, or a musical stuffed animal at holiday time. These specially-priced items draw customer traffic, and more importantly serve to reinforce the Pay 'N Pak image as a store that offers value. It has always been a company policy to be at the forefront of trends in the marketplace, and management decisions to add an item to inventory are made swiftly. Senior members of the Purchasing Department continually assess each vendor's wares for quality and value, as well as reliability of delivery. Secondary sources are maintained to ensure a steady supply. The customer, of course, seldom notices these efforts. What customers see is a well-stocked home center, with a complete assortment of quality goods to meet their needs, at prices that connote value. In short, they see a Pay 'N Pak store.

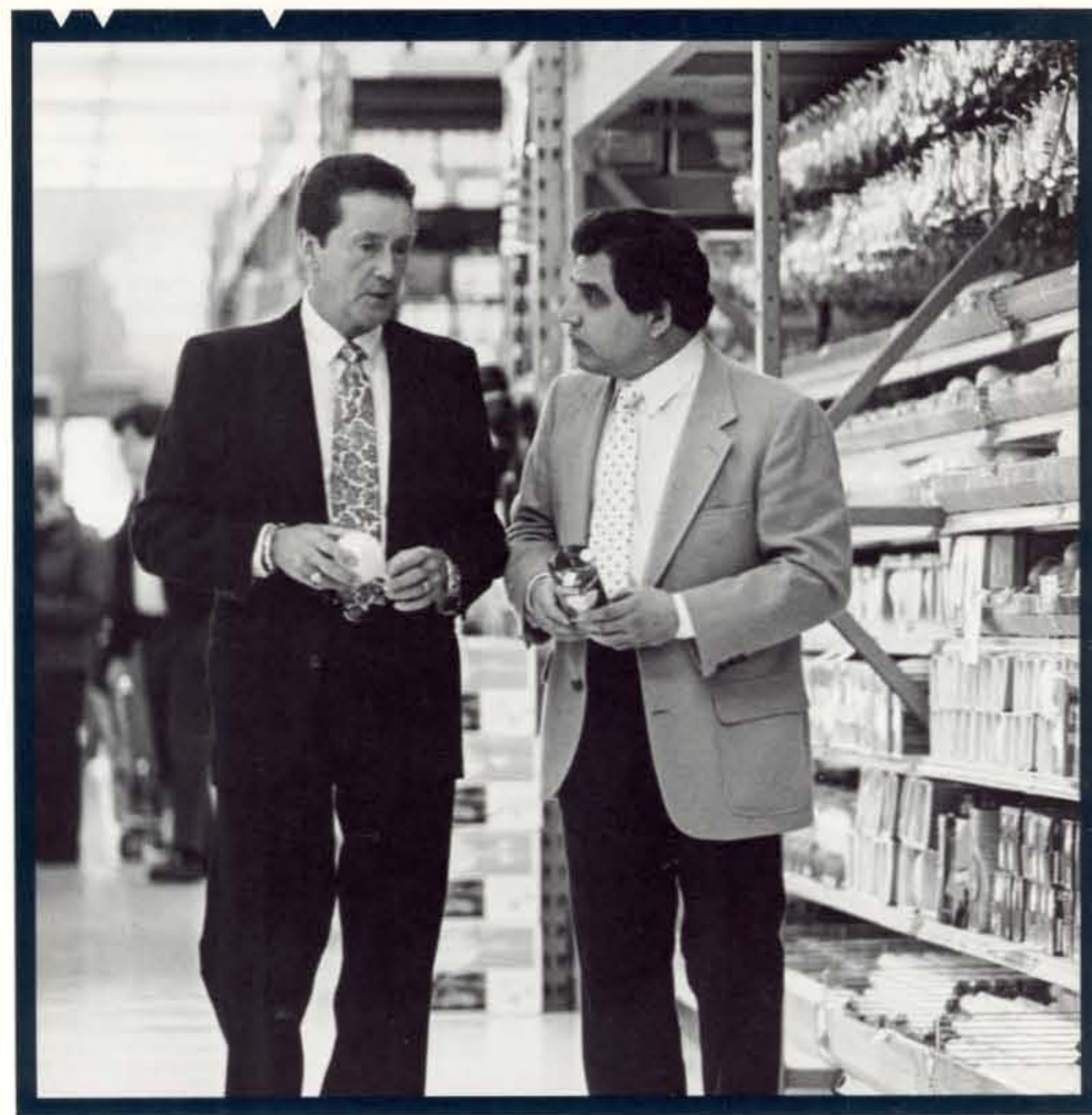
9/10/86

Dear Sirs,

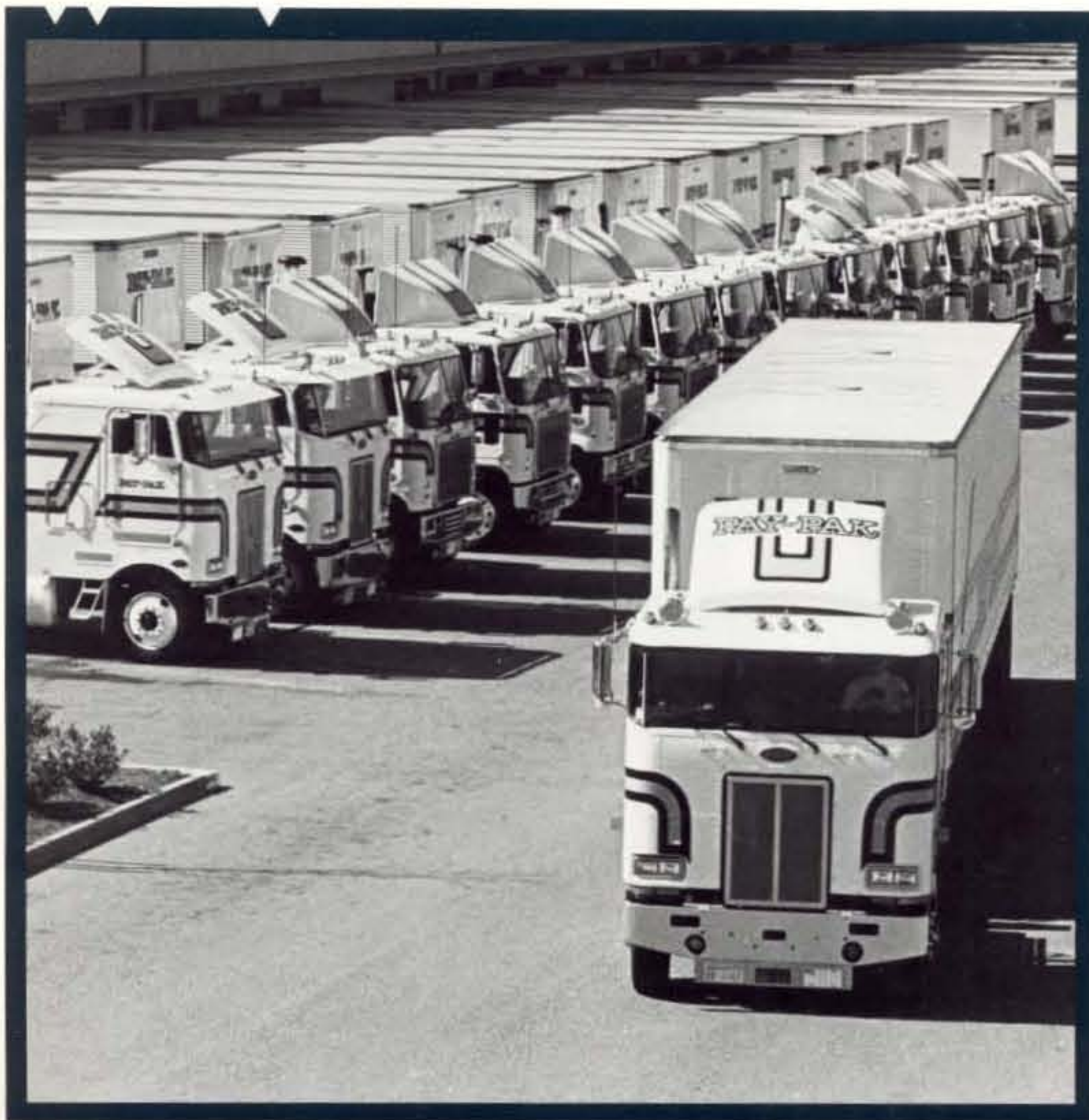
Two years ago I built a garage. This summer I am building my house. I am an amateur and need lots of advice, ideas, and patience when buying materials.

Your employees at the Eureka, CA store have been all these things and more. I have been extremely pleased with the people in this store. As a result I send all my friends there and plan to use it whenever I need supplies.

Yours Truly,
Eric Cortez
613 Singley Hill Rd.
Lolita, CA 95551



Selecting products to be offered in Pay 'N Pak stores is a never-ending process. Our Purchasing Agents spot trends for new merchandise, and continually review the product line for quality, value and usefulness.



Getting goods into 107 stores is a 24-hour-a-day job. From our fleet of trucks to our two huge distribution centers, the objective is the same: Keeping each store stocked to serve the needs of every Pay 'N Pak customer.



Distribution Like purchasing, Pay 'N Pak's distribution system is most successful when it is invisible to the customer. Yet whether they know it or not, Pay 'N Pak customers express confidence in our distribution system every time they walk into our stores. They count on Pay 'N Pak home centers to have the goods they need, in stock, in the quantities they need. And we do. It is no small task: Each one of our 107 stores orders products once a week, using a computerized list generated by the home office. The goal is to maintain a 45-day supply of goods within the store—small enough to minimize inventory costs, but large enough to ensure customer satisfaction. About 25% of our products are shipped directly to stores by the manufacturer. (As an extra margin of safety, stores maintain a 60-day supply of these items.) The remaining items are shipped from our distribution centers in Kent, Washington, (361,000 square feet) and Hayward, California, (204,000 square feet). Most items arrive at the distribution centers directly from the manufacturer, reducing our cost. Distribution centers also plan on maintaining a 30- to 45-day supply, although during busy periods the inventory of the Kent facility can turn over in less than a month. A fleet of Pay 'N Pak tractor-trailers, along with contract haulers, truck goods to our stores in the Western and Mid-western states. A typical store receives two to three full trailer loads a week. Our stores in Anchorage, Fairbanks and Honolulu receive goods by ship. A high priority in our distribution chain is the "Never-Out" list, containing some 1,000 items. Each item on the list is a key component in the success of a specific project — and we vow *never* to run out of it. That requires planning, second and third

sourcing, and creative sharing of inventories. But if emergencies occur, we do not hesitate to use air freight, or even to buy items at retail from competitors, if necessary. The point, as always, is to serve the customer, and fulfill the Pay 'N Pak promise.

Mary Kiefel
4224 SE 10th Ave.
Portland, OR 97202

December 17, 1986
Pay 'N Pak
15550 SE McLoughlin Blvd.
Milwaukie, OR 97222

Dear Sirs:

My sister and I were in your store last week to buy a ceiling fan as a gift for our mother. We saw a fan and light set on display that was exactly what we wanted. The fan was in stock, but the polished brass lights were sold out. Your salesman called the other store, and they were also out, so he made us the set by using another set and putting the separate tulip-type lights on it. We were treated so courteously and helped so promptly that I wanted to write and tell you that because of him, we were able to get just what we wanted and with a friendly smile. When Christmas is close, and everyone is in a big hurry (and your store was busy), it's nice to be waited on so politely. You can be assured we will be back to your store.

Sincerely,

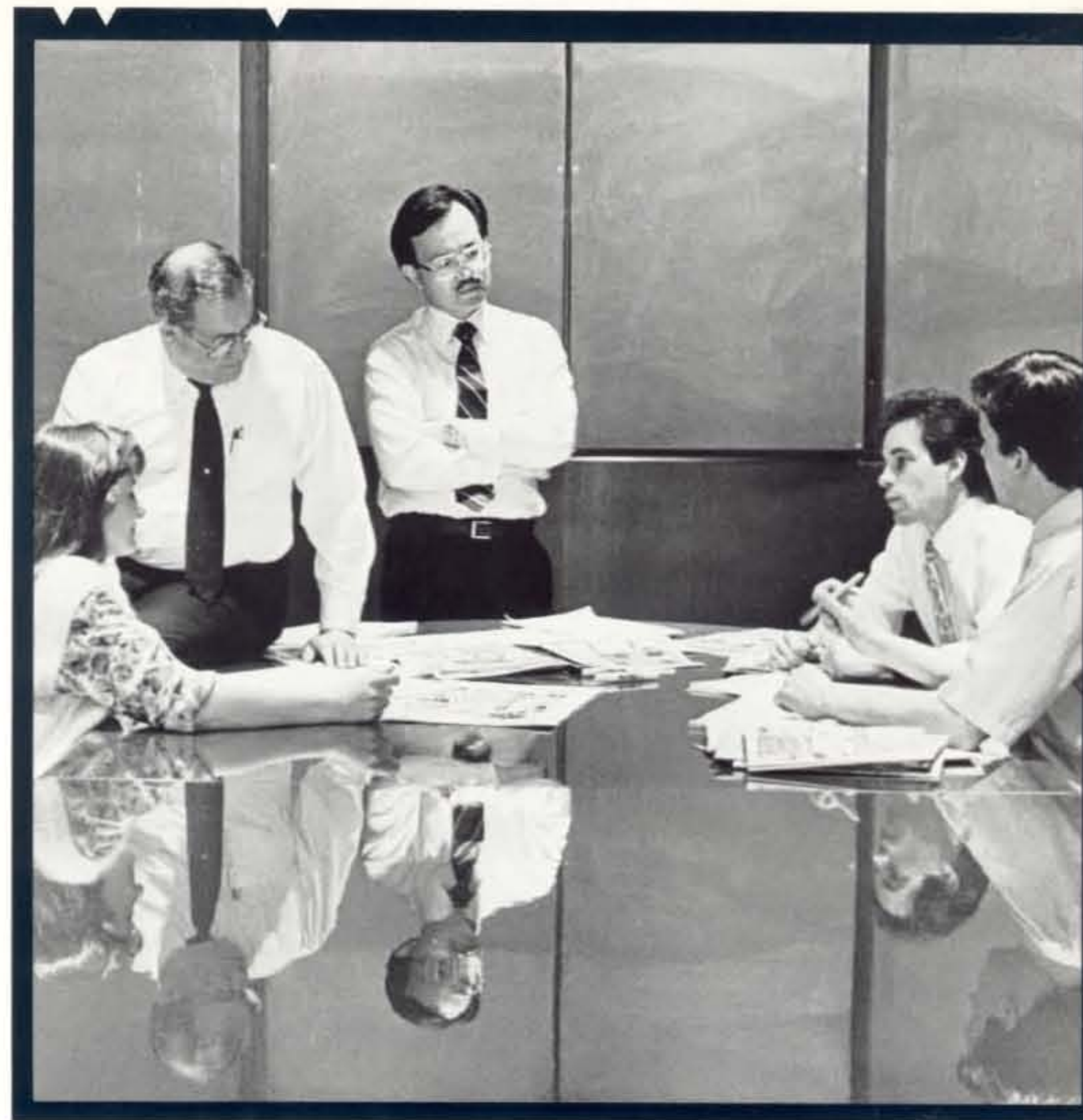
Mary Kiefel
Mary C. Kiefel
and Judith A. Schoepp

Marketing If the fruits of our efforts are to be enjoyed, the shopper must make one affirmative act: Come to a Pay 'N Pak store. Attracting the *potential* customer is one of the most challenging and rewarding assignments we face. One of our first responsibilities is to accurately tell the would-be customer exactly what Pay 'N Pak is. There is, of course, no average customer, but research identifies three broad groups whose needs match the Pay 'N Pak promise: (I) The new family, living in their first house, ages 25-35. (II) The established family, by now in a larger home and working to make it match their dreams, ages 35-45. (III) The mature couple, children

away, remodeling their home to fit a new lifestyle, or making the house ready for sale. Pay 'N Pak addresses each of these potential customer groups through advertising, most of it carried in newspapers. Readers in most store areas see Pay 'N Pak ads or insert sections once a week, and four times a year we publish special 20-page month-long sale sections in full color. But as the habits of our market base change, so must our advertising. Accordingly, we are increasing our efforts in television advertising, using it to reinforce our printed messages. We are exploring radio and outdoor (billboard) advertising as well. This media synergy vastly increases the potential customer's awareness of what Pay 'N Pak has to offer. "Offer" means much more than the products on the page, of course; Pay 'N Pak advertising also conveys more subtle messages about the quality of the merchandise, the breadth of selection, and the competitive nature of the pricing. The stores themselves tell potential customers about Pay 'N Pak — one reason they are kept neat, clean and well-lit. Store design, merchandising and product selection continue to evolve, as the market evolves. One definition of marketing is "doing everything the way the customer wants it." To understand what the customer wants, Pay 'N Pak increasingly keeps track of its customers, through surveys and other information-gathering methods. Women now shop Pay 'N Pak in ever-growing numbers; today more than 27% of America's households are headed by women. In a pilot project in our Indio store, a customer "lounge" where important family buying decisions can be mulled over has been very well-received. Evolutionary changes like this are inevitable in a company that listens to its market. Wisely executed, these changes add a greater bond of loyalty between the Pay 'N Pak store and its customers.



Dear Pay'n Pak, 9/7/85
Very recently, I purchased all my "fixings" for an underground sprinkler system from your Medford Pay'n Pak store. I had no idea what I was getting into! Had not been for the extensive and knowledgeable help of one of your employees — I would have been hopelessly lost. Not only did he help me in the store (several hours worth), but he even used his personal time on the project. I wish there were more people like him on the job. I hope he gets the recognition he deserves.
Very Sincerely,
Mrs. Carol Putnam



In all our markets, we tell our story through the media. Print advertising and television commercials are created and carefully reviewed to ensure the clarity of the Pay 'N Pak message: selection, quality, value and service.



PAY 'N PAK HOME IMPROVEMENT WAREHOUSE OUTLET



In many markets, the Pay 'N Pak warehouse format makes our stores even more competitive, and gives customers a better look at our product selection. The format also enhances our reputation as a value-conscious company.



Warehouse Conversions People either like Pay 'N Pak warehouse stores, or they hate them. Our customers like them. Our competitors hate them. Pay 'N Pak began developing the warehouse concept in fiscal 1984. In going to a warehouse approach, we felt it was important to be able to meet the competition from large national chains, while at the same time providing customers with the level of service and convenience they had always experienced at Pay 'N Pak. Warehouse-style stores offer real benefits to customers; they provide a greater range of assortment, and an increased depth-of-inventory. They also benefit Pay 'N Pak,

by allowing us stronger presentation of our merchandise, and by generating more profit, particularly in larger markets. Equally important, the plain racks and warehouse "feel" reinforce customers' beliefs that they are getting the lowest prices possible. This reminder that Pay 'N Pak stores are competitive—offering quality at a value—is an important piece of the Pay 'N Pak message. But price isn't everything; many companies who have tried a warehouse approach have had less success than Pay 'N Pak. Along with the efficiency and economy of a warehouse look, customers also want the reassurance of a friendly and helpful sales staff. As of the end of the fiscal year, 48 of our stores are operating as either warehouse or "mini-warehouse" stores, depending on their size. But even as we approach our goal of 60 warehouse conversions, we are exploring new ways to make these stores even more inviting. We are rearranging the high racks, providing more and better lighting, and departmentalizing some areas. And we plan to give more prominence to our showcase displays—lighting fixtures, baths and kitchens. Within the next year, more than half our stores will feature a computergraphics

workstation where Pay 'N Pak salespeople will help customers design kitchens on screen, then print out the results in minutes. The warehouse concept—like most of what Pay 'N Pak does—is aimed at two things: remaining profitable for the benefit of our shareholders, and doing so by remaining important to our customers.

December 8, 1986
Pay 'N Pak
District Manager
P.O. Box 8170
Wichita, KS 67208

Diane Albert
915 N.E. 35th
Topeka, KS 66617

Dear Sir:

I would like to take this opportunity to thank you for allowing your customers to comment on the performance of employees of Pay 'N Pak stores throughout this area. I do not often respond to such opportunities but felt my recent experience in your Topeka store was deserving of a letter.

I was recently in the Topeka store at closing time. Very often, the average employee of any store would be more interested in going home than helping a frazzled woman at closing time! To my surprise this day, I was greeted with a helpful smile and was quickly given everything I needed to put together a broken shower which would have had to wait through the weekend had it not been for this outstanding service.

It has been some time since I was greeted with such genuine interest. This is the kind of service that keeps customers coming back ... and I'll be back!

Sincerely,

Diane Albert

Diane Albert



Training Customers in Pay 'N Pak stores sometimes wonder where we find so many knowledgeable salespeople. The answer is simple: We don't find them—we train them. Before any employee comes in contact with a customer, he or she receives at least eight straight hours of in-store schooling. This training continues throughout the employee's career with us. New cashiers and purchasing employees continue their training while working with a supervisor. So do salespeople, who undergo a 12-week course on products and salesmanship, conducted in hour-long sessions three times a week. Pay 'N Pak considers these lessons a part of the job, and in return expects the trainee's full attention. Store managers conduct

most of the training, which adds an extra incentive for these managers to hire top quality candidates. Basic training, of course, is just the beginning. Each week in every Pay 'N Pak store, a product "seminar" is conducted by an employee chosen by the manager. Attendance is mandatory. Once or twice a year, every store is visited by the Pay 'N Pak training coach—a remodeled passenger bus, outfitted as a classroom to give employees "hands-on" lessons in electrical, plumbing, cabinets and countertops. (The coach is also used to conduct intensive training sessions prior to new store openings, where new employees receive as many as 40 hours of instruction before the store opens.) Each store also has a video "teaching station," where employees take individual tutoring from among two dozen training tapes. The fully interactive video equipment quizzes the student at various points, and gives a grade at the end. All training, including the interactive video, is documented and the results become part of the employee's training record at company headquarters. Even on the job, store managers rotate salespeople from department to department. When not selling, salespeople are expected to refill product bins, stock shelves and "face up" displays; before long, every employee knows first-hand where every item in the store is located. The objective is to create and maintain a cadre of generalists, all knowledgeable in every product the store carries. The benefit, of course, flows to the customer, who is consistently reminded that the difference between our stores and those of our competitors is the famous Pay 'N Pak customer service.

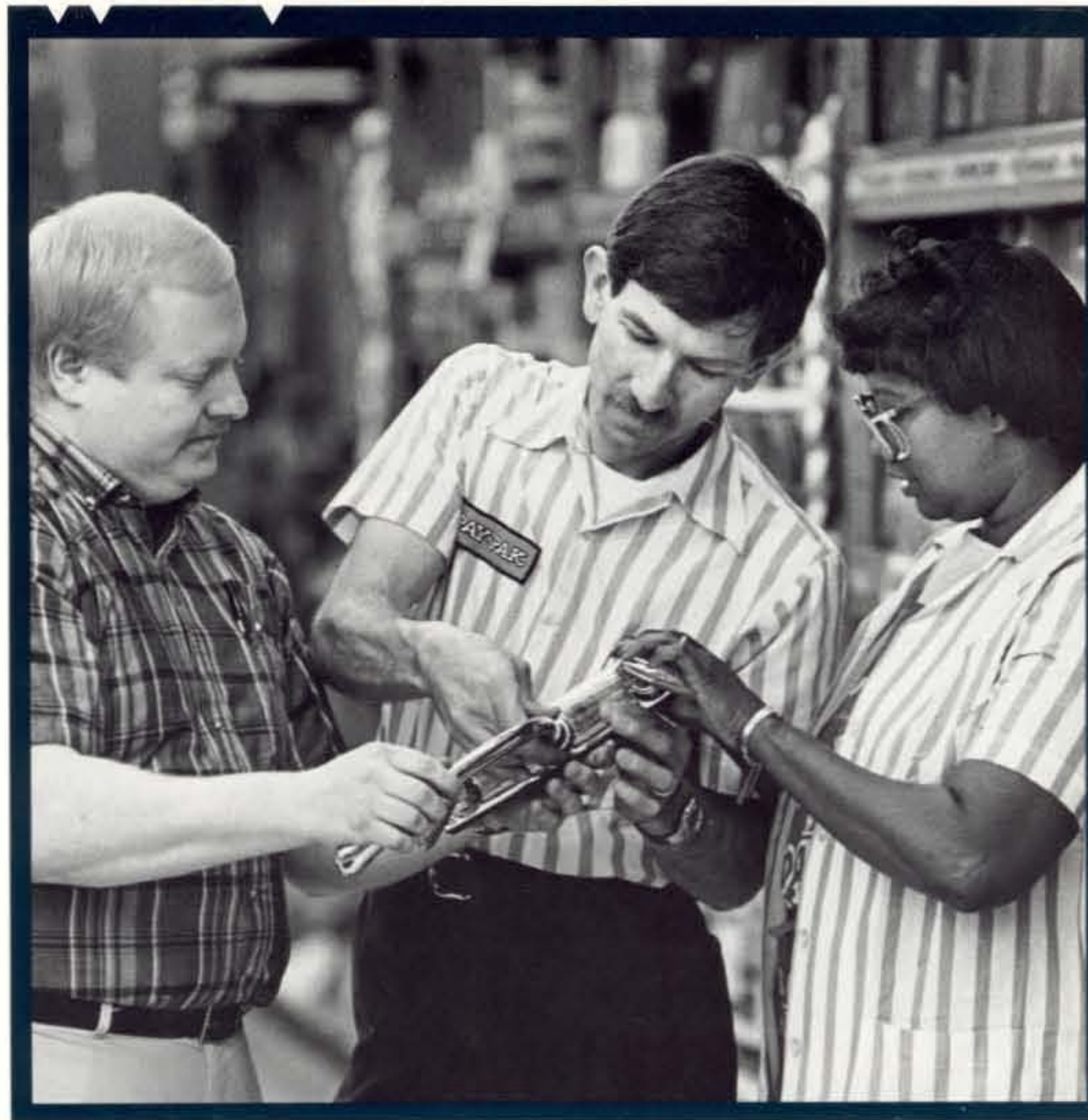


August 1, 1986

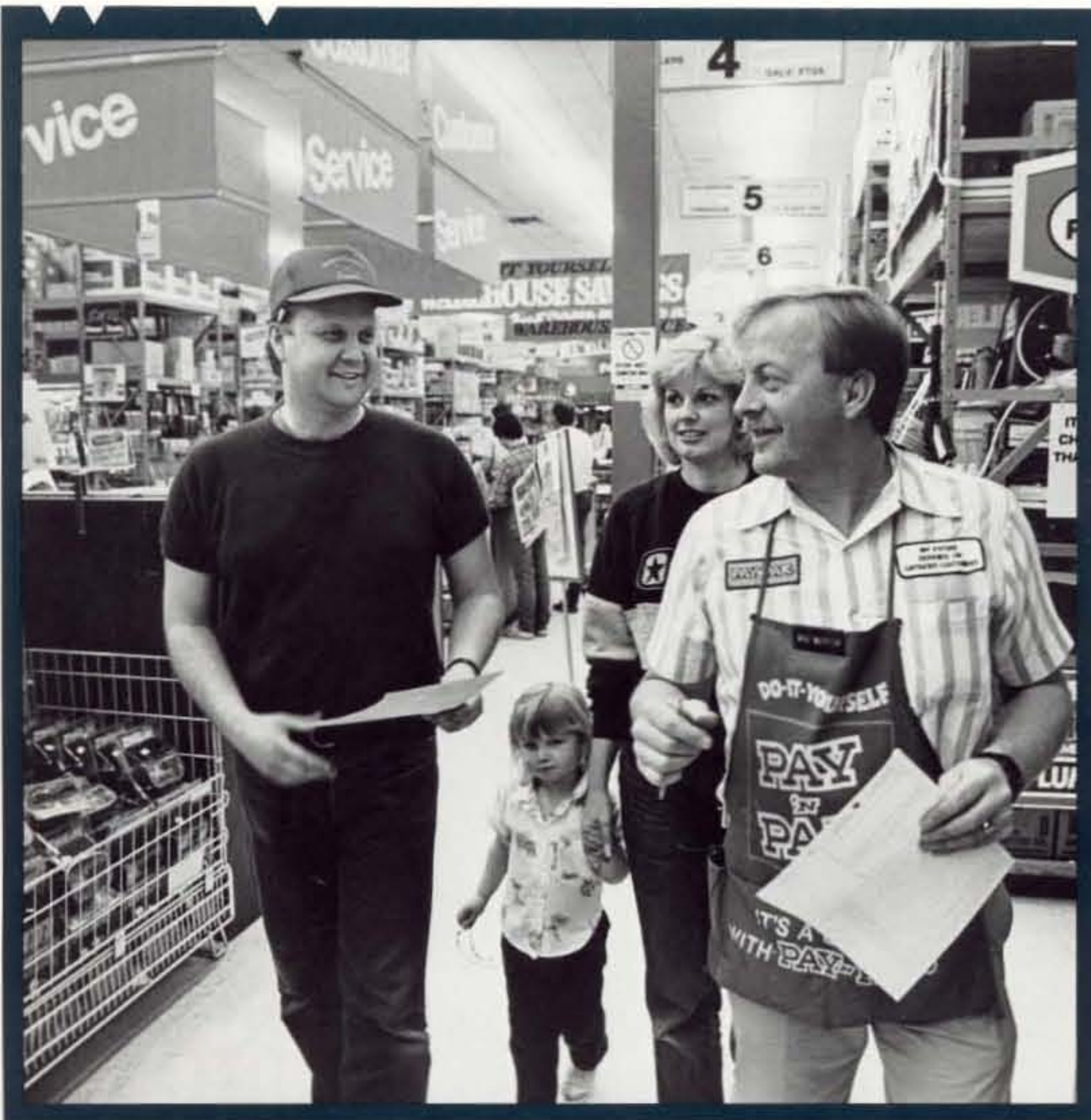
Jane Hernandez
11376 Hearst Ave
Berkeley, CA 947

Dear Pay'n Pak,
I've never written a letter like this because I'm too busy to bother. However, I wish to commend you for the quality of your El Cerrito store. Recently I phased a house and needed to buy my items. I went to Pay'n Pak because of the June Sale & as advertised and have returned many times since. When I went to Seattle a few weeks ago I took my brother to the Pay'n Pak there also. You have many individuals in your El Cerrito store who have given me exceptionally courteous service.

Sincerely,
Jane Hernandez



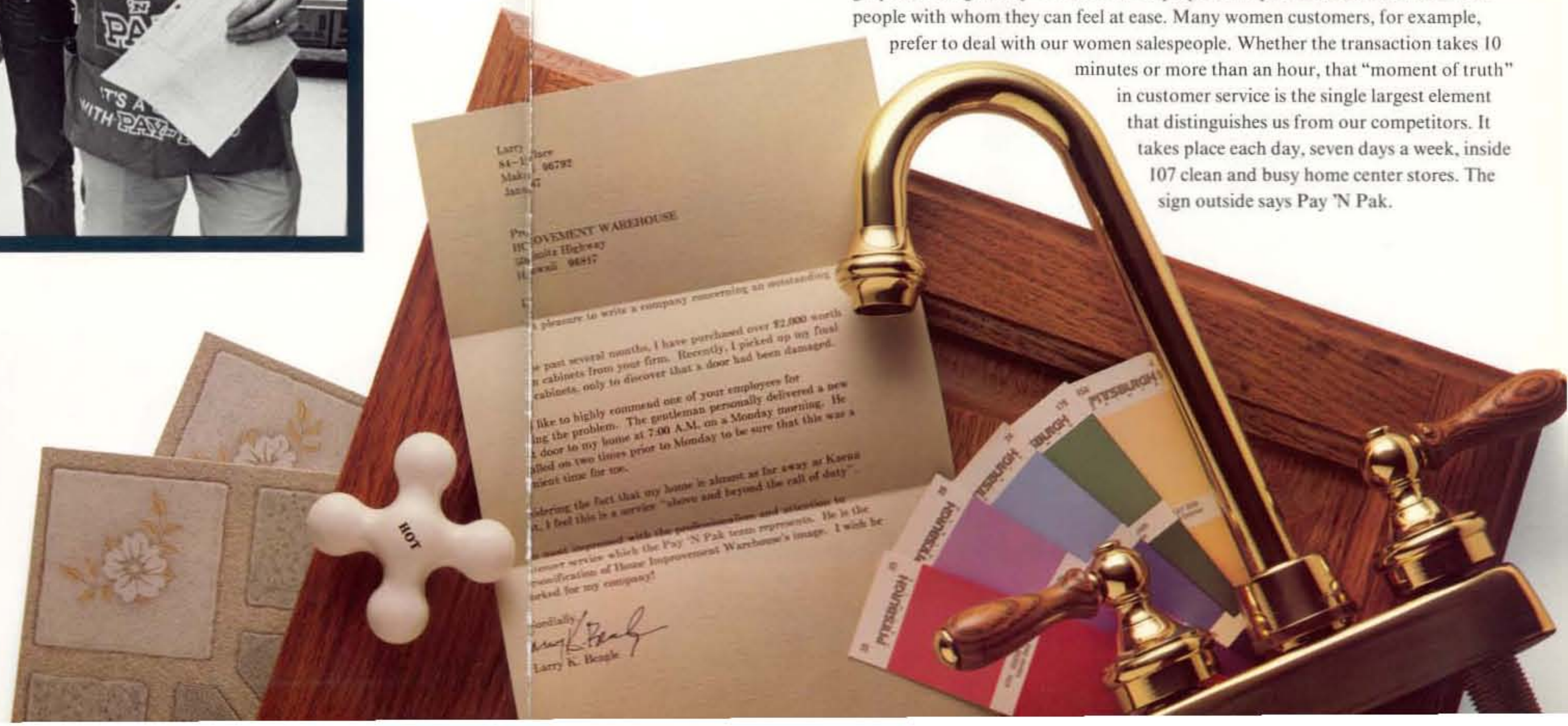
At each Pay 'N Pak store, management continually trains our salespeople, using classes, video, the mobile training unit and impromptu lessons in every product's features and benefits. The objective: the best in customer service.



Whether it is as simple as a quick friendly answer, or as sophisticated as our new computerized kitchen design center, the key to Pay 'N Pak success is individual attention. When customers write, most thank us for our service.



Customer Service At the focal point of all our effort, there stands just one person: A customer. He or she has heard our message, and has come to our store for what we offer. The moment of truth is now: In the next few minutes, the Pay 'N Pak promise will be tested. Time after time, in store after store, it is fulfilled. By training and temperament, our employees are cheerful and helpful. By their experience, they know their products, the ways in which they can be used, and the tools necessary to make a given project happen. By motivation, they are good at selling; each Pay 'N Pak employee qualifies for a *monthly* bonus, which is based on that month's job performance and is calculated, in part, on the store's gross margin. Employees with three years' experience have even more motivation; each is given stock in the company under an Employee Stock Ownership Plan. These incentives give all of the salespeople at Pay 'N Pak an understanding of the importance of the product and the customer. But however much it is valued by us, it is not the employee's productivity to Pay 'N Pak that brings the customer to our store. It is the employee's value to the *customer*. Many of the people who shop our stores do so to be educated—to be guided, to be advised, and to be *reassured* that they can, in fact, perform the task they've chosen. Interestingly enough, Pay 'N Pak salespeople have found that they must guard against appearing to know too much; for while the employee's product training builds considerable knowledge, the customer may be starting at square one. And so the salespeople are taught to listen carefully to each customer. As the mix in customer demographics changes, Pay 'N Pak must be prepared to provide customers with salespeople with whom they can feel at ease. Many women customers, for example, prefer to deal with our women salespeople. Whether the transaction takes 10 minutes or more than an hour, that "moment of truth" in customer service is the single largest element that distinguishes us from our competitors. It takes place each day, seven days a week, inside 107 clean and busy home center stores. The sign outside says Pay 'N Pak.



Board of Directors



Woodrow C. Button
Retired Vice Chairman
Old National Bank
Seattle, WA

Marshall J. Weigel
Vice Chairman
of the Board and
Independent Corporate
Finance Specialist
San Francisco, CA

**David J.
Heerensperger**
Chairman of the
Board and Chief
Executive Officer

Jerry L. Marlow
President and
Chief Operating Officer

Jerry D. Horn
Chairman of the Board
President and
Chief Executive Officer
General Nutrition, Inc.
Pittsburgh, PA

Officers

(L-R) **Herbert E. McCleary**
Vice President
Advertising

Richard T. Takata
Senior Vice President
Store Merchandising

Richard E. Friel
Vice President
Marketing

Victor W. Crosswhite
Vice President
Purchasing



(L-R) **Calvin E. Karbowski**
Vice President
Distribution

Peter W. Gallina
Senior Vice President
Real Estate and
Store Development

Paul B. Morris
Vice President
Store Planning
and Design



Douglas G. Southern
Vice President Finance
Secretary-Treasurer

Fred R. Brotherton
Vice President
Controller



George E. Smith
Vice President
Training

Barbara I. Collett
Vice President
Personnel and
Labor Relations

District Managers

(Not Shown)

Bud Brown
Oregon,
Southern Washington

John Coogan
Mountain States

Dale Craker
Southwestern Washington

Dan Fissel
Midwest, South

Doug Williams
Midwest, North

Kirk Knapp
Alaska, Hawaii

Mike Mandick
Oregon, California

Carl Fritts
Eastern Washington
Northern Idaho

Rick Noegel
California

John Schweitzer
California

Wally Tesch
Western Washington

Ten Year Summary of Growth Highlights

Pay 'N Pak Stores, Inc.

Years ended February 28 or 29

| | 1987 | 1986 | 1985 | 1984 | 1983 | 1982 | 1981 | 1980 | 1979 | 1978 | 1977 |
|---|---------------|---------------|---------------|---------------|---------------|---------------|---------------|---------------------|---------------------|---------------------------|---------------------|
| Operations | | | | | | | | | | | |
| Revenues | \$398,422,000 | \$333,782,000 | \$305,185,000 | \$250,040,000 | \$187,338,000 | \$180,974,000 | \$151,765,000 | \$138,361,000 | \$117,688,000 | \$98,052,000 | \$80,643,000 |
| Income before income taxes | \$ 11,233,000 | \$ 14,463,000 | \$ 18,420,000 | \$ 17,851,000 | \$ 11,085,000 | \$ 13,049,000 | \$ 11,575,000 | \$ 11,471,000 | \$ 10,199,000 | \$ 7,882,000 | \$ 5,464,000 |
| Net income | \$ 5,686,000 | \$ 8,168,000 | \$ 10,105,000 | \$ 10,025,000 | \$ 6,368,000 | \$ 7,199,000 | \$ 6,449,000 | \$ 6,313,000 | \$ 5,403,000 | \$ 4,006,000 ² | \$ 2,871,000 |
| Common Stock | | | | | | | | | | | |
| Average number of common shares | 10,002,832 | 10,002,832 | 10,002,832 | 9,033,023 | 7,327,392 | 7,303,464 | 7,303,464 | 7,303,464 | 6,688,990 | 6,372,865 | 6,372,865 |
| Net income per common share ³ | \$.57 | \$.82 | \$1.01 | \$1.11 | \$.87 | \$.99 | \$.88 | \$.86 | \$.81 | \$.63 ² | \$.45 |
| Stock dividends and stock splits | — | — | — | 50% | 10% | — | — | 20% | 33 1/3% | 50% | 10% |
| Cash dividend paid per common share ³ | \$.52 | \$.63 | \$.60 | \$.56 | \$.507 | \$.461 | \$.412 | \$.363 | \$.299 | \$.209 | \$.137 |
| Financial Position | | | | | | | | | | | |
| Total assets | \$230,109,000 | \$223,014,000 | \$190,769,000 | \$164,481,000 | \$119,531,000 | \$ 97,800,000 | \$ 90,273,000 | \$ 81,902,000 | \$ 70,314,000 | \$50,483,000 | \$45,833,000 |
| Stockholders' equity | \$100,127,000 | \$ 99,643,000 | \$ 97,776,000 | \$ 93,673,000 | \$ 47,430,000 | \$ 40,162,000 | \$ 36,213,000 | \$ 32,224,000 | \$ 28,228,000 | \$16,447,000 | \$13,566,000 |
| Return on stockholders' equity ⁴ | 5.7% | 8.4% | 10.8% | 13.2 | 15.9% | 19.9% | 20.0% | 22.4% | 32.9% | 29.5% | 24.7% |
| Shares of common stock outstanding (end of year) | 10,002,832 | 10,002,832 | 10,002,832 | 10,002,832 | 7,652,830 | 7,303,464 | 7,303,464 | 7,303,464 | 7,303,464 | 6,372,865 | 6,372,865 |
| Net book value per share | \$10.01 | \$9.96 | \$9.77 | \$9.36 | \$6.20 | \$5.50 | \$4.96 | \$4.48 ¹ | \$4.00 ¹ | \$2.74 ¹ | \$2.31 ¹ |
| Long-term debt | \$ 60,948,000 | \$ 64,270,000 | \$ 41,641,000 | \$ 28,449,000 | \$ 34,879,000 | \$ 26,470,000 | \$ 27,979,000 | \$ 28,680,000 | \$ 23,848,000 | \$18,467,000 | \$19,125,000 |
| Stores in Operation | | | | | | | | | | | |
| Number of stores open | 107 | 106 | 101 | 100 | 98 | 88 | 84 | 78 | 70 | 65 | 60 |
| New stores opened or acquired | 7 | 10 | 7 | 2 | 11 | 4 | 6 | 9 | 7 | 6 | 7 |
| Number of stores sold or closed | 1 | 2 | 1 | 0 | 1 | 0 | 0 | 0 | 1 | 0 | 0 |
| Stores replaced with new stores | 5 | 3 | 5 | 0 | 0 | 0 | 0 | 1 | 1 | 1 | 2 |
| Number of states in which we operated | 17 | 17 | 17 | 16 | 16 | 15 | 15 | 15 | 14 | 13 | 13 |
| Square footage of stores | 3,158,000 | 2,928,000 | 2,468,000 | 2,224,000 | 2,168,000 | 1,891,000 | 1,812,000 | 1,688,000 | 1,497,000 | 1,365,000 | 1,261,000 |
| Average square footage per store | 29,500 | 27,600 | 24,400 | 22,200 | 22,100 | 21,500 | 21,600 | 21,600 | 21,400 | 21,000 | 21,000 |
| Average annual inventory in stores | \$ 73,437,000 | \$ 68,242,000 | \$ 62,970,000 | \$ 50,464,000 | \$ 35,485,000 | \$ 36,247,000 | \$ 31,419,000 | \$ 28,610,000 | \$ 23,302,000 | \$20,226,000 | \$17,952,000 |
| Average annual inventory total (includes distribution centers) | \$100,080,000 | \$ 99,305,000 | \$ 92,651,000 | \$ 74,352,000 | \$ 54,175,000 | \$ 53,429,000 | \$ 43,724,000 | \$ 39,143,000 | \$ 31,253,000 | \$24,617,000 | \$21,007,000 |
| Store Averages | | | | | | | | | | | |
| Average sales per store | \$ 3,750,000 | \$ 3,137,000 | \$ 3,020,000 | \$ 2,495,000 | \$ 2,009,000 | \$ 2,050,000 | \$ 1,806,000 | \$ 1,768,000 | \$ 1,676,000 | \$ 1,508,000 | \$ 1,343,000 |
| Number of customers served | 18,921,000 | 14,545,000 | 12,623,000 | 10,105,000 | 7,311,000 | 6,941,000 | 6,415,000 | 5,928,000 | 5,469,000 | 4,980,000 | 4,420,000 |
| Average customer purchase | \$ 21.04 | \$ 22.86 | \$ 24.16 | \$ 24.69 | \$25.60 | \$25.99 | \$23.64 | \$23.26 | \$21.52 | \$19.69 | \$18.25 |
| Sales per square foot | \$126.09 | \$113.57 | \$123.59 | \$112.17 | \$92.73 | \$95.40 | \$88.73 | \$81.67 | \$78.63 | \$71.82 | \$63.96 |
| Sales per full time employee (end of year) | \$ 168,000 | \$ 182,000 | \$ 185,000 | \$ 167,000 | \$ 159,000 | \$ 151,000 | \$ 139,000 | \$ 129,000 | \$ 113,000 | \$ 115,000 | \$ 109,000 |

¹After giving effect to shares held by ESOT which had been allocated to employee accounts.

²Net income in 1978 includes a net reduction of \$191,000 (\$.03 per share) due to a change in the method of accounting for pre-opening costs to expensing them as incurred rather than amortizing them.

³Restated for stock dividends and stock splits in fiscal years 1984, 1983, 1980, 1979, 1978 and 1977.

⁴Computed using weighted average stockholders' equity in fiscal year 1984 and beginning of year stockholders' equity in all other years.

Locations

• Stores

★ Distribution Centers

Alaska

Anchorage
Fairbanks

California

Campbell
Chico
El Cerrito
Eureka
Indio
Modesto
Newark
Rancho Cordova
Redding
Roseville
Sacramento (3)
San Francisco
San Jose (2)
San Leandro
Santa Clara
South San Francisco
Sunnyvale
Yuba City

Colorado

Aurora
Colorado Springs
Denver (2)
Fort Collins
Grand Junction
Greeley
Pueblo
Wheat Ridge

Hawaii

Honolulu

Idaho

Boise
Coeur d'Alene
Lewiston
Pocatello

Iowa

Sioux City

Kansas

Hutchinson
Topeka
Wichita (2)

Montana

Billings

Nebraska

North Platte
Scottsbluff

Nevada

Carson City
Las Vegas
Reno

North Dakota

Grand Forks

Oklahoma

Oklahoma City South
Oklahoma City West

Oregon

Albany
Beaverton (2)
Bend
Eugene
Medford
Milwaukie
Ontario
Pendleton
Portland (5)
Salem

South Dakota

Rapid City
Sioux Falls

Utah

Ogden
Orem
Salt Lake City
Sandy
Woods Cross

Washington

Aberdeen
Bellingham
Bothell
Bremerton (2)
Everett
Federal Way
Kennewick
Kent
Longview
Lynnwood
Marysville
Moses Lake
Mt. Vernon
Olympia
Puyallup
Redmond
Renton
Seattle (5)
Spokane (2)
Tacoma (3)
Vancouver
Walla Walla
Wenatchee
Yakima

Wyoming

Casper
Cheyenne

Distribution Centers

Kent, WA
Hayward, CA

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-K

Annual Report Pursuant to Section 13 or 15(d) of
the Securities Exchange Act of 1934

For the fiscal year ended February 28, 1987
Commission file number 0-4967

PAY 'N PAK STORES, INC.

Washington
(State of incorporation)

91-0729852
(I.R.S. Employer I.D. No.)

1209 South Central, Kent, Washington 98032
Telephone: (206) 854-5450

SECURITIES REGISTERED PURSUANT TO SECTION 12(b) OF THE ACT:

| <u>Title of each class</u> | <u>Name of each exchange on which registered</u> |
|----------------------------|--|
| Common Stock | New York Stock Exchange |

SECURITIES REGISTERED PURSUANT TO SECTION 12(g) OF THE ACT:

Common Stock

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes X

No _____

Aggregate market value of common stock held by nonaffiliates at April 23, 1987 - \$158,422,231

Common stock outstanding at April 23, 1987 - 10,002,832 shares.

DOCUMENTS INCORPORATED BY REFERENCE

Proxy statement to be filed in connection with Annual Meeting of Shareholders to be held on June 16, 1987, is incorporated into Part III.

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PART I

ITEM I - Business

(a) *General development of business.* Pay 'N Pak Stores, Inc. (the "Company") was incorporated in 1961 under the laws of the State of Washington, as the successor to a partnership formed in 1953 to engage in the retail sale of home improvement products, principally electric and plumbing supplies. The Company in its present form evolved from a merger in 1969 of three groups of similar stores in adjacent geographic areas. Immediately after the merger, the Company had 22 stores in three western states, Washington, California and Colorado. Following the merger, the company undertook a store expansion program that has continued to the present time. The Company currently operates 107 stores in 17 states, all west of the Mississippi River, although over half of the stores are located on the West Coast with 32 stores in Washington, 15 stores in Oregon and 21 stores in California.

ITEM I - Business, continued

In March 1983, the Company began a program to remerchandise its entire chain of stores by raising the height of merchandise display racks, thereby allowing a 30% increase in the number of stock keeping units ("SKU's"). The decision to remerchandise the stores grew out of the Company's successful experience replacing auto and sporting goods merchandise in 11 stores with additional SKU's in the home improvement line. By February 1984, all of the Company's stores were completely remerchandised.

In the fall of 1983, the Company began to implement a "warehouse" concept for some of its larger stores. The Company based its decision to implement this concept in part upon the experience of other retailers who have successfully utilized this format. Warehouse stores are significantly larger than the Company's traditional stores, stocking greater quantities of merchandise. Merchandise which would otherwise be kept in storerooms is displayed in customer areas and stacked to the ceiling. In contrast to warehouse approaches used by some retailers, the Company's warehouse stores are well-lit, feature attractive merchandise displays and are fully staffed by trained employees to ensure the same level of service as the Company's traditional stores.

The conversion of the Company's Kent, Washington, store into the first warehouse store was completed in October 1983. By the end of the past fiscal year ended February 28, 1987, the Company had replaced or converted 37 other traditional stores into warehouse stores and had also opened 11 new warehouse stores. The Company currently intends to establish an additional 12 or so warehouse stores during the fiscal year ending February 29, 1988, for a total of 60 warehouse stores by fiscal year end. Of these 12 additional warehouse stores 10 will be replacements or conversions of traditional stores currently operated by the Company.

(b) Industry segments; lines of business. The Company has only one industry segment and is engaged in only one line of business - retail sales of home improvement products.

(c) (i) Description of business. The Company caters to the do-it-yourself home improvement market. Home improvement products include electrical products, plumbing supplies, building materials, kitchen cabinets and built-in appliances. The Company specializes in products and supplies for the remodeling and improvement of kitchens and bathrooms. For several years the Company operated sporting goods and automotive parts and accessories departments in 11 stores but during fiscal year 1983 these departments were phased out to provide additional space for home improvement products.

All but four stores are operated under the name "Pay 'N Pak". Three stores located in Idaho and Oregon are operated under the name "Eagle Electric & Plumbing Supply" and a warehouse store in Honolulu operates under the name "Home Improvement Warehouse."

The Company's sole method of distribution of merchandise to customers is through sales at its retail stores, all of which are operated by the Company.

The Company's marketing efforts are primarily directed toward homeowners and other do-it-yourself customers. The Company estimates that over 95% of sales of home improvement products were made to do-it-yourself customers in fiscal 1987, with professional builders and others accounting for less than 5%.

The approximate contribution, as a percent of the Company's net sales, of each of the major product categories during the last five fiscal years was as follows:

| | <u>1987</u> | <u>1986</u> | <u>1985</u> | <u>1984</u> | <u>1983</u> |
|-------------------------------------|-------------|-------------|-------------|-------------|-------------|
| Electrical | 21% | 21% | 25% | 28% | 31% |
| Plumbing | 20 | 22 | 22 | 23 | 25 |
| Building Materials | 51 | 52 | 50 | 49 | 41 |
| Garden Supplies | 8 | 5 | 3 | --- | --- |
| Automotive and Sporting Goods | --- | --- | --- | --- | 3 |
| Total | 100% | 100% | 100% | 100% | 100% |

ITEM I - Business, continued

The Company uses modern merchandising and marketing techniques in the operation of its retail stores. Store lay-out, merchandise organization and merchandise signs are designed by the Company's corporate staff and are essentially consistent throughout its stores. Merchandise is conveniently arranged and displayed in well-lighted stores, with emphasis placed on displays which illustrate how the product will look in the customer's own home. Many brand name products are carried by the stores, particularly where the Company believes such brand names are recognized by the customer as indicative of quality and reliability. The Company also carries private label merchandise, some of which is the manufacturers' standard merchandise and some of which is designed and manufactured to the Company's specifications. The Company attempts to charge competitive prices with respect to the merchandise sold through its stores, particularly on high volume, commodity products. Such pricing is facilitated by the Company's ability to purchase certain products in volume directly from manufacturers. Sales are predominately on a cash and carry basis, which includes sales made through the use of bank credit cards by customers. The Company estimates that during fiscal 1987, sales on which it directly extended credit accounted for less than 1% of sales. The Company maintains a liberal merchandise return policy, with full refunds given under most circumstances to customers who return products.

The Company believes that a key feature in its marketing program is the ability of sales personnel to advise customers how to select, install and use products for home improvement and maintenance projects. The Company places particular emphasis on the training of its sales personnel to accomplish this objective. Although the Company does not deliver or install the products it sells, it continually trains its sales personnel so that they may advise customers regarding the selection and use of the products sold and so that they may give step-by-step instructions regarding the installation of such products. The Company has a Vice President-Training and staff, and uses training video programs and meetings to qualify employees in product knowledge and selling skills. The Company also owns a 40-foot bus that is specially equipped and used as a mobile training classroom for its sales personnel.

The Company has a store expansion and development program to increase, replace, convert and expand its stores each year. The exact number of new stores opened in any period will depend on many factors, including the availability of suitable locations and general business conditions.

During the fiscal year ended February 28, 1987, the Company opened new warehouse concept stores in Bremerton, Washington, and Indio, California, and also either replaced or converted 10 existing stores to the home improvement warehouse format.

The following table summarizes the Company's growth in numbers of stores during the past five years.:

| | Years Ended February 28 or 29, | | | | |
|--|--------------------------------|-------------|-------------|-------------|-------------|
| | <u>1987</u> | <u>1986</u> | <u>1985</u> | <u>1984</u> | <u>1983</u> |
| Stores in operation at beginning of year | 106 | 101 | 100 | 98 | 88 |
| New stores opened or acquired | 7 | 10 | 7 | 2 | 11 |
| Stores replaced by new stores | (5) | (3) | (5) | — | — |
| Stores sold or closed | <u>(1)</u> | <u>(2)</u> | <u>(1)</u> | <u>—</u> | <u>(1)</u> |
| Stores in operation at end of year | <u>107</u> | <u>106</u> | <u>101</u> | <u>100</u> | <u>98</u> |

ITEM I - Business, continued

The Company is continually investigating locations for the establishment of new stores. Each location is investigated with respect to population and population trends, competition in the trading area and other pertinent factors in order to analyze its sales potential. The Company attempts to locate its stores in areas which are convenient to the do-it-yourself customer, principally in small cities and in suburban areas of larger cities. In selecting locations for future stores, the Company plans to concentrate on trading areas in the western part of the United States.

During the fiscal year ending February 29, 1988, the Company plans to open 2 new warehouse concept stores and also plans to replace or convert 10 existing traditional stores to warehouse concept stores.

(ii) New product or industry segment. The Company has not recently introduced a new product or begun to do business in a new industry segment which will require the investment of a material amount of the Company's assets.

(iii) Raw materials. The Company buys its merchandise from several hundred independent suppliers, including manufacturers and importers, none of which accounts for more than 8% of the Company's purchases.

Approximately 25% of the merchandise is shipped by suppliers directly to the Company's stores. The Company also warehouses merchandise and supplies its stores through two central distribution centers: 360,889 square feet in Kent, Washington, and 204,600 square feet in Hayward, California. In May, 1986, the Company closed its distribution center in Denver, Colorado, and now services the stores in that region from its Kent and Hayward distribution centers.

(iv) Patents, etc. The Company holds no material patents, trademarks, licenses, franchises or concessions.

(v) Seasonal business. No material portion of the Company's business is seasonal, except to the extent that sales of home improvement products tend to be slightly lower during the winter season.

ITEM I - Business, continued

(vi) Working capital items. The Company attempts to carry sufficient amounts of inventory in stock to meet customer demand and to allow sufficient delivery time for new orders from the factories. The Company engages in volume buying direct from factories as much as possible not only to obtain the benefit of lower unit prices, but also in anticipation of potential shortages and inflationary price increases. This helps to assure the Company of a continuous allotment of goods from suppliers and sometimes results in the Company carrying significant amounts of inventory.

The Company sells most of its goods on a cash or bank credit card basis; the company does not provide extended payment terms to customers.

(vii) Dependence upon few customers. The business of the Company is not dependent upon a single customer or a few customers, the loss of any one or more of whom would have an adverse effect on the Company.

(viii) Backlog orders. The Company does not at any time have a significant backlog of orders.

(ix) Government contracts. No portion of the Company's business is subject to renegotiation of profits or termination of contracts or subcontracts at the election of the U.S. Government.

(x) Competitive conditions. The retail sales business engaged in by the Company is highly competitive. Competition is based primarily on breadth of product line, service, advertising, price and convenience of location. The Company competes with numerous retail organizations, including integrated department stores such as Sears, home improvement centers and other building materials retailers, and, to a lesser extent, large and small hardware and lumber stores. The Company's competitors, some of which have substantially greater financial resources, are continually expanding and opening new stores in market areas in which the Company has existing stores as well as in new market areas in which the Company plans to expand. Because of the variety of products sold by the Company and the number and variety of its competitors, it is virtually impossible to determine a competitive position for the company.

(xi) Research and development activities. The Company has engaged in research and development activities relating to the improvement of services to its customers, through the development of product knowledge training videos, a Retail Selling Skills program, the holding of in-store training meetings, and a 40-foot mobile training bus, all of which are designed to constantly update product knowledge and selling skills. The goal of the program is to have the Company's sales people completely qualified to explain to customers how to install or use all of the products that the Company sells. The amount spent by the Company on such activities during each of the last three fiscal years is approximately \$438,000 in 1987, \$424,000 in 1986, and \$408,000 in 1985.

(xii) Environmental laws. The Company is not aware of any environmental protection laws, compliance with which may have a material effect upon the capital expenditures, earnings and competitive position of the Company and its subsidiaries.

(xiii) Number of employees. The Company currently employs approximately 2,286 full-time persons and 392 part-time persons.

(d) Foreign and domestic operations; export sales. The Company's revenue, profitability and identifiable assets are attributable to only one geographic area, the western part of the United States, and although the Company is a large importer of foreign goods, it does not have any foreign operations or engage in any export sales.

ITEM 2 - Properties

Of the Company's 107 stores, 32 are located in the state of Washington, 15 in Oregon, 21 in California, 3 in Nevada, 4 in Idaho, 1 in Montana, 5 in Utah, 9 in Colorado, 4 in Kansas, 2 in Oklahoma, 2 in Alaska, 2 in Wyoming, 2 in South Dakota, 1 in North Dakota, 2 in Nebraska, 1 in Iowa and 1 in Hawaii. Most of the Company's stores are leased under long-term leases. Many of these leases contain percentage rental clauses and options to renew. Operations of the Company are directed from its head office in Kent, Washington, a Seattle suburb, where all administrative functions, including accounting, merchandising, purchasing and advertising, are performed. The head office is leased under a lease expiring in 1995. The Company also leases a 360,889 sq. ft. distribution center in Kent and a distribution center in Hayward, California, under a lease that expires in August, 1993. These leases contain options to renew.

The Company owns its store properties in Fairbanks, Alaska; Pocatello, Idaho; Fort Collins, Colorado; North Platte, Nebraska; Honolulu, Hawaii; San Francisco, and Indio, California; Reno, Nevada; two stores in the Portland, Oregon, area and two stores in San Jose, California. The Fairbanks and Pocatello stores, the two San Jose stores, the Reno store and the Honolulu store are encumbered by mortgages but the remainder are not presently subject to any mortgages or other encumbrances.

All of the Company's buildings are of concrete masonry construction except for three stores, two of which are of frame construction and the other is a steel building. The buildings contain all of the fixtures and improvements which the Company believes are necessary in its business. Many of the Company's present stores were formerly supermarkets, as their size, structure and location made them easy and appropriate to convert to Pay 'N Pak stores. Adequate off-street parking is provided adjacent to all stores.

ITEM 3 - Legal Proceedings

On September 5, 1984, an antitrust suit was brought against the Company in the United States District Court for the Western District of Washington by Thurman Industries, Inc., a small Seattle-based chain of competing stores owned by a former officer and director of the Company. The complaint alleges that Pay 'N Pak has engaged in predatory price reductions, has negotiated with suppliers to obtain favorable terms of dealing which discriminate against Thurman, has induced suppliers not to deal with Thurman through exclusive dealing arrangements and otherwise, and has interfered with Thurman's contractual and business relationships. The conduct is alleged to violate federal and state antitrust laws and common law principles. The complaint seeks both injunctive relief and damages, as well as costs and attorneys' fees. Plaintiff has claimed damages of approximately \$2,500,000 in the aggregate before trebling. Plaintiff has also, through its counsel, contended that the practices challenged in the suit continue to take place and that if Plaintiff prevails at trial, it may seek further damages for the period of time subsequent to the filing of the suit in September, 1984. Both Plaintiff and the Company have engaged in extensive discovery and document production. Trial is scheduled to begin in mid-June, 1987. The suit will be tried before a jury and the outcome is therefore unpredictable. However, management continues to believe the claim lacks substantial merit and is defending against it vigorously.

ITEM 4 - Submission of Matters to a Vote of Security Holders

No matter was submitted to a vote of security holders during the fourth quarter of the Company's fiscal year covered by this report.

Executive Officers of the Company

| <u>Name</u> | <u>Age</u> | <u>Positions and Offices</u> |
|------------------------|-------------------|---|
| David J. Heerensperger | 50 | Chairman of the Board and Chief Executive Officer; Director |
| Marshall J. Weigel | 66 | Vice Chairman of the Board; Director |
| Jerry L. Marlow | 51 | President and Chief Operating Officer; Director |
| Douglas G. Southern | 44 | Vice President-Finance and Secretary-Treasurer |
| Peter W. Gallina | 51 | Senior Vice President-Real Estate and Store Development |
| Richard T. Takata | 37 | Senior Vice President - Merchandising |
| Fred R. Brotherton | 42 | Vice President and Controller |
| Victor W. Crosswhite | 50 | Vice President-Purchasing |
| Calvin E. Karbowski | 49 | Vice President-Distribution |
| George E. Smith | 51 | Vice President-Training |
| Barbara I. Collett | 30 | Vice President-Personnel and Labor Relations |
| Herbert E. McCleary | 55 | Vice President-Advertising |
| Paul B. Morris | 45 | Vice President-Store Planning and Design |
| Richard E. Friel | 52 | Vice President-Marketing |

The term of office of each of the above officers is until the next annual meeting of the Board of Directors of the Company following the annual meeting of shareholders held on the third Tuesday in June of each year. Mr. Heerensperger has served as Chairman of the Board since February 1970. Mr. Weigel was elected Vice Chairman in March 1984. Mr. Marlow and Mr. Gallina have served in their respective offices since December 1977 although Mr. Gallina was promoted to Senior Vice President in April 1985. Mr. Crosswhite and Mr. Karbowski have served in their respective offices since February 1980. Mr. Smith was elected a Vice President in June 1983. Mr. Southern and Mr. Brotherton were elected to their positions in December 1985. Mr. Friel and Mr. Takata were elected to their positions in June and July, 1986, respectively. The other Vice Presidents were elected in April 1985. There are no arrangements or understanding between any of the above officers and any other person pursuant to which he or she was elected as an officer.

There are no family relationships among the officers except that Mr. Crosswhite's wife and Mr. Heerensperger are first cousins.

ITEM 4 - Submission of Matters to a Vote of Security Holders continued

During the past five years, the business experience of the executive officers is as follows:

All of the above officers except Mr. Southern, Mr. Brotherton, Mr. Weigel, Mr. Friel and Mr. Takata have been employed by the Company during the past five years. David J. Heerensperger has served the Company as Chairman of the Board and chief executive officer. Marshall J. Weigel is a self-employed corporate finance specialist and has served as Vice Chairman of its board since March, 1984. Jerry L. Marlow has served the Company as President and chief operating officer. Douglas G. Southern was a partner at Arthur Young & Company prior to joining the Company in December 1985 and Fred R. Brotherton was a principal with the same firm prior to joining the Company in September, 1982. Peter W. Gallina, prior to his election as Senior Vice President-Real Estate and Store Development in April, 1985, served the Company as Vice President-Real Estate and Store Development. Victor W. Crosswhite has served the Company as Vice President-Purchasing. Calvin E. Karbowski has served the Company as Vice President-Distribution. George E. Smith, prior to his election as Vice President-Training in June, 1983, served the Company as director of its training department. Richard E. Friel was Senior Accounts Manager at John Brown & Partners, Inc. prior to joining the Company in June, 1986. Richard T. Takata was Corporate Merchandise Manager at Grace Home Centers West prior to joining the Company in July, 1986. Barbara I. Collett, Herbert E. McCleary and Paul B. Morris, prior to their election as Vice Presidents in April, 1985, served the Company in the areas of responsibility indicated by their respective titles.

Part II

ITEM 5 - Market for the Company's Common Equity and Related Stockholder Matters

The common stock of Pay 'N Pak Stores, Inc. is listed and traded on the New York Stock Exchange (NYSE). As of March 31, 1987, there were approximately 3,046 holders of record of the Company's common stock.

The range of the reported last sales prices of the Company's stock during each quarter of the last two fiscal years as reported by the NYSE is shown below. The quarterly cash dividends paid by the Company are also shown for each quarter of the last two fiscal years.

NYSE Symbol: PNP

Quarterly High and Low Sales Prices

| <u>Years ended February 28</u> | <u>1987</u> | <u>1986</u> |
|--------------------------------|-------------------|-------------------|
| 1st quarter | \$19 3/8 - 13 1/2 | \$13 7/8 - 11 1/2 |
| 2nd quarter | \$19 1/8 - 13 | \$15 1/4 - 12 3/4 |
| 3rd quarter | \$15 1/8 - 9 1/2 | \$13 3/8 - 11 5/8 |
| 4th quarter | \$13 1/4 - 11 | \$15 - 12 1/8 |

Quarterly Dividends

| <u>Years ended February 28</u> | <u>1987</u> | <u>1986</u> |
|--------------------------------|-------------|-------------|
| 1st quarter | \$.16 | \$.15 |
| 2nd quarter | \$.16 | \$.16 |
| 3rd quarter | \$.10 | \$.16 |
| 4th quarter | \$.10 | \$.16 |

ITEM 6 - Selected Financial Data

In thousands, except per share data.

| | <u>Years Ended February 28 or 29,</u> | | | | |
|---------------------------|---------------------------------------|-------------|-------------|-------------|-------------|
| | <u>1987</u> | <u>1986</u> | <u>1985</u> | <u>1984</u> | <u>1983</u> |
| Operating results: | | | | | |
| Net sales | \$398,144 | \$332,546 | \$305,026 | \$249,491 | \$187,172 |
| Income before | | | | | |
| income taxes | \$ 11,233 | \$ 14,463 | \$ 18,420 | \$ 17,851 | \$ 11,085 |
| Net income | \$ 5,686 | \$ 8,168 | \$ 10,105 | \$ 10,025 | \$ 6,368 |
| Per common share(1): | | | | | |
| Net income | \$.57 | \$.82 | \$1.01 | \$1.11 | \$.87 |
| Cash dividends | \$.52 | \$.63 | \$.60 | \$.56 | \$.507 |
| At year-end: | | | | | |
| Total assets | \$230,109 | \$223,014 | \$190,769 | \$164,481 | \$119,531 |
| Long-term debt | \$ 60,948 | \$ 64,270 | \$ 41,641 | \$ 28,448 | \$ 34,879 |

(1) See Note 2 in the Notes to Consolidated Financial Statements in Item 8.

ITEM 7 - Management's Discussion and Analysis of Financial Condition and Results of Operations

Results of operations

Net sales increased from \$332.5 million in fiscal 1986 to \$398.1 million in fiscal 1987 an increase of 19.7%. The increase in net sales is primarily attributable to the Company's nine newest stores, seven of which were opened late in fiscal 1986 and two of which were opened during the fourth quarter of fiscal 1987. Sales also increased in the stores open for a period of longer than two years due to the conversion of certain stores to a warehouse style format. At the end of February 1987 the Company had 48 of its 107 stores operating using its warehouse format which utilizes steel warehouse shelving to display and place more merchandise onto the sales floor. During the last three years, as a result of the store expansion and conversion program, the average store has increased in size, in terms of square feet, by over 33%. Fiscal 1986 sales increased by 9% over fiscal 1985 due primarily to the impact of the warehouse store conversions completed during that year and, to a lesser extent, the new stores opened during the year.

The sales changes by age of store were as follows during the last two fiscal years:

| | (000's omitted) | |
|--|-----------------|-----------------|
| | 1986 to 1987 | 1985 to 1986 |
| Net sales of stores opened less than one year* | \$38,404 | \$12,081 |
| Increase in net sales of stores open over one but less than two years | 535 | 5,906 |
| Increase in net sales over the preceding year of stores opened over two full years | 27,506 | 13,892 |
| Decrease in net sales for stores closed | (847) | (4,359) |
| | <u>\$65,598</u> | <u>\$27,520</u> |

Cost of sales remained the same as a percentage of sales in fiscal 1987 as compared to fiscal 1986 with margins improving during the latter part of the year offset by a decrease in the second quarter caused by the margins at certain new stores. The higher margins were achieved due primarily to selective price increases that the Company was able to achieve in most of its markets during the later portion of the year. Margins had been decreasing for the past two fiscal years due to what the Company viewed as excessive price competition by some of the new competitors in the industry. During fiscal 1988, the Company will attempt to improve its margins further, but will be influenced by the actions of the competitors in its various markets.

Selling and administrative expenses increased as a percentage of sales in fiscal 1987 due primarily to an increase in the number of hours that most stores remained open, especially during the summer months, which increased payroll costs. The Company expects payroll costs to decrease as a percentage of sales during the next fiscal year. The sum of occupancy and depreciation costs, as a percentage of sales, increased slightly as compared with the prior year. Interest expense on both long and short term debt increased in fiscal 1987 over 1986. In 1987 the Company had the interest cost for twenty-four million dollars of long term notes that were outstanding for only part of one quarter during the prior fiscal year. Short term debt increased during the latter half of fiscal 1987 due to funds required for construction and remodeling projects in process. Fiscal 1986 selling and administrative costs increased over 1985 due to increases in advertising costs due to the competitive environment as well as new store opening costs for the seven stores opened that year.

The provision for income taxes required a 49.4% effective tax rate for fiscal 1987 and a 43.5% effective tax rate for fiscal 1986. The rate for fiscal 1986 was low because of the high investment credits generated by the large capital expenditures during that year and capital gains rates on other income. In fiscal 1987 the increase in rate is caused by the new tax law passed by the Congress and signed by the President in October 1986. The new law, among other things, has retroactive provisions which rescinded the investment credit provisions to January 1, 1986. As a result, when the law was finally passed, the Company recorded a tax charge of \$702,000 (7 cents per share) to reflect these costs. As other provisions of the new law become effective, the Company expects its effective tax rate to decrease. Under the provisions of the new law, the Company expects an effective rate of approximately 41.5% in fiscal 1988 and 37.6% in fiscal 1989 when the new rates become fully effective for the Company.

Net income decreased in both fiscal 1987 and 1986 from the previous year. The decreases are a result of the factors discussed above, principally, selling costs and tax rates in 1987 and margins, selling costs and interest in 1986.

*Does not include net sales of replacement stores. Net sales of such replacement stores are treated as if the stores were equivalent in age to the older stores they replaced.

ITEM 7 - Management's Discussion and Analysis of Financial Condition and Results of Operations

continued

Liquidity and Capital Resources

The Company's principal sources of funds to finance expansion of assets have been operating activities, inventory management and in fiscal 1986 long term debt. In addition, during fiscal 1987 the sale/leaseback of three stores provided \$9.8 million of funds to the company. During the year ended February 28, 1987, the company purchased a total of \$27.2 million of fixed assets after purchasing \$46.2 million in the prior fiscal year.

The Company currently intends to open two new stores and to convert 10 stores to the warehouse outlet format during the next fiscal year, the same number as during fiscal 1987. Management of the Company anticipates that future needs for capital resources will be provided by operations, asset management and available bank lines. The Company currently has available credit facilities totaling \$63 million consisting of bank lines, letter of credit arrangements and a revolving credit agreement, of which \$22.2 million of short term notes and \$8.6 million of letters of credit were outstanding at February 28, 1987, leaving \$32.2 million unused. Under restrictions included in current loan agreements, no more than \$30 million of the available short term debt facilities may be used concurrently and letters of credit outstanding are to be no more than \$16 million at any one time.

Effects of Inflation

The Company believes that there has not been major impact from inflation on the revenues and costs incurred by the Company during the past three years.

ITEM 8 - Financial Statements and Supplementary Data

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ITEM 9 - Changes in and Disagreements With Accountants on Accounting and Financial Disclosure

None.

PAY 'N PAK STORES, INC.

REPORT OF CERTIFIED PUBLIC ACCOUNTANTS

The Board of Directors and Stockholders
Pay 'N Pak Stores, Inc.

We have examined the accompanying consolidated financial statements of Pay 'N Pak Stores, Inc. listed in the index to consolidated financial statements and financial statement schedules in Item 14(a). Our examinations were 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 listed in the index to consolidated financial statements and financial statement schedules in Item 14(a) present fairly the consolidated financial position of Pay 'N Pak Stores, Inc. at February 28, 1987 and 1986, and the consolidated results of its operations and changes in its financial position for each of the three years in the period ended February 28, 1987, in conformity with generally accepted accounting principles applied on a consistent basis during the period.

Arthur Young & Company

Seattle, Washington
March 25, 1987

PAY 'N PAK STORES, INC.
CONSOLIDATED STATEMENTS OF INCOME

Years ended February 28, 1987, 1986 and 1985

| | <u>1987</u> | <u>1986</u> | <u>1985</u> |
|---|---------------------|---------------------|----------------------|
| REVENUES: | | | |
| Net sales | \$398,144,000 | \$332,546,000 | \$305,026,000 |
| Interest | 60,000 | 56,000 | 34,000 |
| Rentals and other | 218,000 | 1,180,000 | 125,000 |
| | <u>398,422,000</u> | <u>333,782,000</u> | <u>305,185,000</u> |
| COSTS AND EXPENSES: | | | |
| Cost of sales | 262,995,000 | 219,684,000 | 200,681,000 |
| Selling and administrative | 96,080,000 | 77,763,000 | 69,167,000 |
| Rent | 9,854,000 | 7,524,000 | 6,297,000 |
| Depreciation | 10,110,000 | 8,260,000 | 6,873,000 |
| Interest on long-term debt | 7,379,000 | 5,432,000 | 3,161,000 |
| Other interest | 771,000 | 656,000 | 586,000 |
| | <u>387,189,000</u> | <u>319,319,000</u> | <u>286,765,000</u> |
| INCOME BEFORE INCOME TAXES | 11,233,000 | 14,463,000 | 18,420,000 |
| PROVISION FOR INCOME TAXES (Note 4) | <u>5,547,000</u> | <u>6,295,000</u> | <u>8,315,000</u> |
| NET INCOME | <u>\$ 5,686,000</u> | <u>\$ 8,168,000</u> | <u>\$ 10,105,000</u> |
| PER COMMON SHARE: | | | |
| Net income | <u>\$.57</u> | <u>\$.82</u> | <u>\$1.01</u> |
| Cash dividends paid | <u>\$.52</u> | <u>\$.63</u> | <u>\$.60</u> |

See accompanying notes.

PAY 'N PAK STORES, INC.
CONSOLIDATED BALANCE SHEETS

February 28, 1987 and 1986

| ASSETS | | | |
|--|----|----------------------|----------------------|
| | | <u>1987</u> | <u>1986</u> |
| CURRENT ASSETS: | | | |
| Cash | \$ | 5,791,000 | \$ 3,723,000 |
| Receivables | | 2,199,000 | 2,954,000 |
| Income taxes receivable | | — | 1,169,000 |
| Merchandise inventories | | 106,493,000 | 107,127,000 |
| Prepaid expenses | | <u>1,735,000</u> | <u>1,535,000</u> |
| Total current assets | | 116,218,000 | 116,508,000 |
| PROPERTY, PLANT AND EQUIPMENT, AT COST | | | |
| (Notes 2 and 5): | | | |
| Land | | 16,619,000 | 16,750,000 |
| Buildings | | 29,560,000 | 26,280,000 |
| Leasehold rights and improvements | | 44,395,000 | 41,924,000 |
| Store equipment | | 54,516,000 | 46,314,000 |
| Transportation equipment | | 3,788,000 | 3,788,000 |
| Construction in progress | | <u>5,026,000</u> | <u>5,092,000</u> |
| | | 153,904,000 | 140,148,000 |
| Less accumulated depreciation and amortization | | <u>42,316,000</u> | <u>35,373,000</u> |
| Net property, plant and equipment | | 111,588,000 | 104,775,000 |
| OTHER ASSETS | | <u>2,303,000</u> | <u>1,731,000</u> |
| | | <u>\$230,109,000</u> | <u>\$223,014,000</u> |

See accompanying notes.

PAY 'N PAK STORES, INC.

CONSOLIDATED BALANCE SHEETS

February 28, 1987 and 1986

LIABILITIES AND STOCKHOLDERS' EQUITY

| | <u>1987</u> | <u>1986</u> |
|--|----------------------|----------------------|
| CURRENT LIABILITIES: | | |
| Payable to bank | \$ 522,000 | \$ 6,325,000 |
| Notes payable (Note 2) | 22,255,000 | 20,475,000 |
| Accounts payable | 28,830,000 | 16,124,000 |
| Income taxes (Note 4) | 566,000 | 312,000 |
| Accrued liabilities: | | |
| Payroll and profit sharing | 2,837,000 | 3,885,000 |
| Taxes, other than income | 3,198,000 | 2,103,000 |
| Interest and other | <u>1,583,000</u> | <u>1,657,000</u> |
| | 7,618,000 | 7,645,000 |
| Long-term debt due within one year (Note 2) | <u>1,842,000</u> | <u>1,801,000</u> |
| Total current liabilities | 61,633,000 | 52,682,000 |
| LONG-TERM DEBT (Note 2) | 60,948,000 | 64,270,000 |
| DEFERRED INCOME TAXES (Note 4) | 6,067,000 | 5,338,000 |
| DEFERRED INCOME | 1,334,000 | 1,081,000 |
| COMMITMENTS AND CONTINGENCIES (Note 5) | | |
| STOCKHOLDERS' EQUITY: | | |
| Preferred stock, without par value, 1,000,000 shares authorized, none issued | — | — |
| Common stock, \$.10 par value, 20,000,000 shares authorized, 10,002,832 shares issued | 67,722,000 | 67,722,000 |
| Retained earnings (Note 2) | <u>32,405,000</u> | <u>31,921,000</u> |
| Total stockholders' equity | <u>100,127,000</u> | <u>99,643,000</u> |
| | <u>\$230,109,000</u> | <u>\$223,014,000</u> |

PAY 'N PAK STORES, INC.
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

Years ended February 28, 1987, 1986 and 1985

| | <u>Common stock</u> | <u>Retained earnings</u> | <u>Total</u> |
|----------------------------|-------------------------|------------------------------|----------------------|
| BALANCE, February 29, 1984 | \$67,722,000 | \$25,951,000 | \$93,673,000 |
| Net income | | 10,105,000 | 10,105,000 |
| Cash dividends | | <u>(6,002,000)</u> | <u>(6,002,000)</u> |
| BALANCE, February 28, 1985 | 67,722,000 | 30,054,000 | 97,776,000 |
| Net income | | 8,168,000 | 8,168,000 |
| Cash dividends | | <u>(6,301,000)</u> | <u>(6,301,000)</u> |
| BALANCE, February 28, 1986 | 67,722,000 | 31,921,000 | 99,643,000 |
| Net income | | 5,686,000 | 5,686,000 |
| Cash dividends | | <u>(5,202,000)</u> | <u>(5,202,000)</u> |
| BALANCE, February 28, 1987 | <u>\$67,722,000</u> | <u>\$32,405,000</u> | <u>\$100,127,000</u> |

See accompanying notes.

PAY 'N PAK STORES, INC.
CONSOLIDATED STATEMENTS OF CHANGES IN FINANCIAL POSITION
Years ended February 28, 1987, 1986 and 1985

| | <u>1987</u> | <u>1986</u> | <u>1985</u> |
|--|-----------------------|---------------------|---------------------|
| OPERATING ACTIVITIES: | | | |
| Net income | \$ 5,686,000 | \$ 8,168,000 | \$10,105,000 |
| Charges (credits) to earnings not affecting cash: | | | |
| Depreciation and amortization | 10,288,000 | 8,354,000 | 6,913,000 |
| Deferred income taxes | 729,000 | 3,057,000 | 1,456,000 |
| (Gain) loss on sale of assets | 12,000 | (962,000) | 243,000 |
| Decrease (increase) in working capital (excluding cash and borrowings) | <u>15,291,000</u> | <u>(18,230,000)</u> | <u>(1,746,000)</u> |
| Cash provided by operations | 32,006,000 | 387,000 | 16,971,000 |
| Additions to property, plant and equipment | (27,155,000) | (46,178,000) | (28,836,000) |
| Other | <u>(767,000)</u> | <u>(1,041,000)</u> | <u>(110,000)</u> |
| Increase (decrease) in cash before financing activities | <u>4,084,000</u> | <u>(46,832,000)</u> | <u>(11,975,000)</u> |
| FINANCING ACTIVITIES: | | | |
| Increase (decrease) in short-term borrowings | (4,023,000) | 9,561,000 | 6,039,000 |
| Increase (decrease) in long-term debt (including current portion) | (2,827,000) | 23,313,000 | 13,193,000 |
| Proceeds from sale of assets and sale and leaseback of properties | 10,036,000 | 21,207,000 | 984,000 |
| Cash dividends paid | <u>(5,202,000)</u> | <u>(6,301,000)</u> | <u>(6,002,000)</u> |
| Cash provided (used) by financing activities | <u>(2,016,000)</u> | <u>47,780,000</u> | <u>14,214,000</u> |
| Increase in cash | 2,068,000 | 948,000 | 2,239,000 |
| CASH, BEGINNING OF YEAR | <u>3,723,000</u> | <u>2,775,000</u> | <u>536,000</u> |
| CASH, END OF YEAR | <u>\$ 5,791,000</u> | <u>\$ 3,723,000</u> | <u>\$ 2,775,000</u> |
| DETAIL OF CHANGES IN WORKING CAPITAL (excluding cash and borrowings): | | | |
| Receivables | \$(1,924,000) | \$ 2,361,000 | \$ (125,000) |
| Merchandise inventories | (634,000) | 10,874,000 | 2,340,000 |
| Prepaid expenses | 200,000 | (872,000) | 1,059,000 |
| Accounts payable | (12,706,000) | 6,669,000 | (1,480,000) |
| Income taxes | (254,000) | 116,000 | 209,000 |
| Accrued liabilities | <u>27,000</u> | <u>(918,000)</u> | <u>(257,000)</u> |
| INCREASE (DECREASE) IN WORKING CAPITAL (excluding cash and borrowings) | <u>\$(15,291,000)</u> | <u>\$18,230,000</u> | <u>\$ 1,746,000</u> |

See accompanying notes.

PAY 'N PAK STORES, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

February 28, 1987, 1986 and 1985

1. Description of the Company and significant accounting policies

The Company is engaged in retail selling of home improvement products, including electrical products, plumbing supplies, building materials, cabinets and built-in appliances.

(a) **Presentation**-The financial statements include the accounts of the parent company and its subsidiaries. All intercompany transactions and balances have been eliminated.

(b) **Inventories**-Merchandise inventories are stated at the lower of cost (first-in, first-out), or market.

(c) **Property, plant and equipment**-Depreciation of property, plant and equipment is provided principally on the straight-line method. Estimated useful lives are as follows: buildings-40 years; leasehold rights and improvements-the lesser of 10 to 20 years or life of the lease (principally 15 to 25 years) and equipment-3 to 10 years.

When assets are sold and leased back the gain/loss is deferred and credited/charged to income over the period of the lease.

(d) **Income taxes**-Deferred income taxes are provided in the accompanying consolidated financial statements for differences in the timing of reporting income and expenses for financial statement and income tax purposes (See Note 4).

Investment tax credits are deducted from the federal income tax provision using the flow-through method.

(e) **Pre-opening costs**-Pre-opening costs are charged to expense as incurred.

(f) **Interest capitalization**-The Company capitalizes interest incurred related to the construction of property, plant and equipment. Interest costs of \$416,000, \$1,142,000 and \$864,000 were capitalized in fiscal years 1987, 1986 and 1985, respectively. Total interest costs for the three years were \$8,566,000, \$7,230,000 and \$4,611,000, respectively.

(g) **Per share data**-Per common share amounts were determined on the weighted average number of shares outstanding of 10,002,832 during the entire period.

PAY 'N PAK STORES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

February 28, 1987, 1986 and 1985

2. Bank credit arrangements and long-term debt

At February 28, 1987, the Company has available unused lines-of-credit for working capital and letter of credit purchases of \$17,170,000 under agreements with banks, which expire from May through July, 1987. Interest on borrowings under these agreements is charged at prime rate or less. The weighted average interest rate for notes payable at February 28, 1987, is 6.9%. The Company is charged a commitment fee of 1/4 of one percent per annum on the unused balance of certain lines-of-credit.

In addition, the Company has a credit agreement with a bank which allows borrowings of up to \$15,000,000 at interest rates based on the bank's cost of funds. The Company is charged a commitment fee of 1/2 of one percent per annum on the unused balance. The agreement terminates in December, 1987, at which time the Company has the option to extend the short term commitment or to convert any outstanding borrowing into a term loan. There were no borrowings under this agreement at February 28, 1987.

Long-term debt outstanding at February 28, 1987, and 1986 is shown on the following summary:

| | <u>1987</u> | <u>1986</u> |
|--|---------------------|---------------------|
| 11-1/4% notes payable due 1995, interest due annually, first principal payment in 1990 | \$24,000,000 | \$24,000,000 |
| 10-1/8% note payable to insurance company, due \$1,075,000 annually to 1994, plus interest | 7,525,000 | 9,675,000 |
| 11-7/8% mortgage payable, due interest only until 1991, then \$3,860,000 annually until 1996 | 14,500,000 | 14,500,000 |
| 8-1/4% to 11.0% (average 9.2%) mortgage notes payable, due \$132,000 including interest in 1988 and reduced amounts to 2002; notes with a balance of \$1,699,000 are subject to call by holders in 1992 | 3,392,000 | 3,512,000 |
| Capitalized lease obligations (\$29,663,000), less imputed interest (\$16,579,000) payable approximately \$2,015,000 per year including imputed interest, weighted average 12.2%, final payment in January 2012 | 13,084,000 | 13,967,000 |
| Other | 289,000 | 417,000 |
| | <u>62,790,000</u> | <u>66,071,000</u> |
| Less amounts due within one year | 1,842,000 | 1,801,000 |
| | <u>\$60,948,000</u> | <u>\$64,270,000</u> |

Payments on the principal of long-term debt and capitalized lease obligations for the four years ending February 29, 1992 are required as follows: 1989-\$1,872,000; 1990-\$4,325,000; 1991-\$7,019,000 and 1992-\$8,042,000.

The loan agreement covering the note payable and one line of credit agreement, contain among other matters, restrictions on working capital, the payment of cash dividends and redemption or reacquisition of the Company's stock. At February 28, 1987, retained earnings of approximately \$1,666,000 was not restricted.

Operating plant and equipment having a net book value of \$22,332,000 at February 28, 1987, are pledged as collateral for the mortgage notes and contracts payable.

PAY 'N PAK STORES, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

February 28, 1987, 1986 and 1985

3. Employee benefit plan

After three years of employment, all employees participate in the Company's Employee Stock Ownership plan. The Company contributes 10% of an employee's eligible compensation, with a maximum contribution of \$3,000 per employee per year. Total contribution was \$1,818,000, \$1,634,000, and \$1,565,000 for fiscal years 1987, 1986 and 1985, respectively.

4. Income taxes

The provision for income taxes is comprised of the following:

| | Year ended February 28 | | |
|-------------------------------------|------------------------|--------------------|--------------------|
| | 1987 | 1986 | 1985 |
| Current federal income tax: | | | |
| Provision | \$3,265,000 | \$3,225,000 | \$6,639,000 |
| Investment tax credit | (649,000) | (737,000) | (580,000) |
| | 2,616,000 | 2,488,000 | 6,059,000 |
| Retroactive effect of tax act | 702,000 | — | — |
| State income taxes | 525,000 | 750,000 | 800,000 |
| Deferred income taxes | 1,704,000 | 3,057,000 | 1,456,000 |
| | <u>\$5,547,000</u> | <u>\$6,295,000</u> | <u>\$8,315,000</u> |

The effective tax rate differs from that statutory federal income tax rate due primarily to the effects of the investment tax credit, state income taxes and certain income being taxed at lower capital gain rates. Certain provisions of the Tax Reform Act of 1986 are retroactive from the date of enactment, thus a provision, primarily related to investment tax credit, was recorded in the current year.

Deferred taxes result from the federal and state income tax effects of the following timing differences:

| | 1987 | 1986 | 1985 |
|--|--------------------|--------------------|--------------------|
| Depreciation deducted for tax in excess of book expense | \$1,867,000 | \$2,861,000 | \$1,344,000 |
| Capitalized lease items | (36,000) | (14,000) | (133,000) |
| Installment sale, capitalized interest and other | (127,000) | 210,000 | 245,000 |
| | <u>\$1,704,000</u> | <u>\$3,057,000</u> | <u>\$1,456,000</u> |

PAY 'N PAK STORES, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

February 28, 1987, 1986 and 1985

5. Leases and contingencies

The Company leases substantially all retail store facilities and its two warehouses. Certain of these leases have been capitalized (See Note 2). Leasehold rights and improvements included \$15,821,000 (\$16,706,000 in 1986) for capitalized leases for retail stores and computer equipment and accumulated depreciation and amortization included \$6,673,000 (\$6,597,000 in 1986) applicable thereto.

Most lease arrangements provide for minimum rental payments on the basis of lapse of time, with many leases providing the additional percentage rentals based on individual stores' annual sales in excess of a specified amount. The Company has options to renew most leases for three to five year periods at agreed amounts. In some cases, rent is subject to renegotiation in the event the Company exercises its option to renew. There are no existing options to purchase leased property.

Rental expense for operating leases, except those with terms of a year or less, was \$9,854,000, \$7,656,000, and \$6,546,000 for fiscal years 1987, 1986 and 1985, respectively. Included in expense for each of the three years are percentage rentals of \$733,000, \$721,000 and \$676,000, respectively.

Minimum annual rental commitments, exclusive of insurance and property taxes, under non-cancellable operating leases are payable as follows:

| <u>Year ending</u> <u>February 28 or 29,</u> | |
|---|----------------------|
| 1988 | \$ 8,243,000 |
| 1989 | 7,829,000 |
| 1990 | 7,813,000 |
| 1991 | 7,797,000 |
| 1992 | 7,655,000 |
| Later years | <u>80,878,000</u> |
| | <u>\$120,215,000</u> |

In September, 1984 an antitrust suit was brought against the Company by a competitor with stores located primarily in Western Washington. The complaint alleges that the Company has engaged in predatory price reductions, interfered with suppliers, as well as other matters. The complaint seeks injunctive relief and damages; it is scheduled for trial beginning in June, 1987. Plaintiff has claimed damages of approximately \$2,500,000 in the aggregate before trebling. Various other claims, suits and complaints arising in the ordinary course of business are pending against the Company. In all of these cases the Company is defending them vigorously. In the opinion of management, all such matters are either adequately covered by insurance, are without substantial merit or involve such amounts as would not have a significant effect on the financial position or results of operations of the Company. However, the antitrust suit will be tried before a jury and the outcome is therefore unpredictable.

PAY 'N PAK STORES, INC.

SUPPLEMENTARY DATA

February 28, 1987, 1986 and 1985

Quarterly financial data (unaudited)

| | Quarter ended | | | |
|--|---------------|-----------|-----------|-----------|
| | May 31 | Aug. 31 | Nov. 30 | Feb. 28 |
| (In thousands, except per share amounts) | | | | |
| 1987 | | | | |
| Revenues | \$105,115 | \$108,687 | \$101,429 | \$ 83,191 |
| Gross profit on sales | \$ 35,423 | \$ 34,524 | \$ 34,912 | \$ 30,290 |
| Net income | \$ 2,311 | \$ 1,063 | \$ 1,183 | \$ 1,129 |
| Net income per share | \$.23 | \$.11 | \$.12 | \$.11 |
| 1986 | | | | |
| Revenues | \$ 82,733 | \$ 90,503 | \$ 86,002 | \$ 74,544 |
| Gross profit on sales | \$ 27,919 | \$ 31,271 | \$ 28,347 | \$ 25,325 |
| Net income | \$ 2,096 | \$ 3,011 | \$ 1,760 | \$ 1,301 |
| Net income per share | \$.21 | \$.30 | \$.18 | \$.13 |

PART III

Item 10-Directors and Executive Officers of the Company

Incorporated by reference from the definitive proxy statement to be filed with the Securities and Exchange Commission, except information regarding executive officers which appears under Part I, on page 8.

Item 11-Executive Compensation

Incorporated by reference from the definitive proxy statement to be filed with the Securities and Exchange Commission.

Item 12-Security Ownership of Certain Beneficial Owners and Management

Incorporated by reference from the definitive proxy statement to be filed with the Securities and Exchange Commission.

Item 13-Certain Relationships and Related Transactions

Incorporated by reference from the definitive proxy statement to be filed with the Securities and Exchange Commission.

PART IV

Item 14-Exhibits, Financial Statement Schedules and Reports on Form 8-K

(a) *Financial Statements.*

The financial statements and schedules listed in the accompanying index to consolidated financial statements and financial statement schedules are filed as part of the Annual Report on Form 10-K.

(b) *Exhibits.* See page 28 for index to exhibits.

(c) *Reports on Form 8-K.* No reports on Form 8-K were filed during the last quarter of the period covered by this report.

PAY 'N PAK STORES, INC.
INDEX TO CONSOLIDATED FINANCIAL STATEMENTS AND
FINANCIAL STATEMENT SCHEDULES

(Item 14(a))

| | Page |
|---|-------|
| Consolidated statements of income for each of the three years in the period ended February 28, 1987 | 13 |
| Consolidated balance sheets at February 28, 1987 and 1986 | 14-15 |
| Consolidated statements of stockholders' equity for each of the three years in the period ended February 28, 1987 | 16 |
| Consolidated statements of changes in financial position for each of the three years in the period ending February 28, 1987 | 17 |
| Notes to consolidated financial statements | 18-21 |
| Supplementary data (unaudited) | 22 |
| Schedules for each of the three years in the period ended February 28, 1987: | |
| V - Property, plant and equipment | 25 |
| VI - Accumulated depreciation of property, plant and equipment | 26 |
| VIII - Valuation and qualifying accounts | 26 |
| IX - Short-term borrowings | 27 |
| X - Supplementary income statement information | 27 |

All other schedules are omitted since the required information is not present or is not present in amounts sufficient to require submission of the schedule, or because the information required is included in the consolidated financial statements and notes thereto.

PAY 'N PAK STORES, INC.
SCHEDULE V - PROPERTY, PLANT AND EQUIPMENT

Years ended February 28, 1987, 1986 and 1985

| | Balance at beginning of year | Additions, transfers at cost | Retirements or sales | Balance at end of year |
|--|------------------------------------|------------------------------------|-------------------------|------------------------------|
| 1987 | | | | |
| Land | \$ 16,750,000 | \$ 3,235,000 | \$ 3,366,000 | \$ 16,619,000 |
| Buildings | 26,280,000 | 9,353,000 | 6,073,000 | 29,560,000 |
| Leasehold rights and improvements | 41,924,000 | 4,202,000 | 1,731,000 | 44,395,000 |
| Store equipment | 46,314,000 | 10,431,000 | 2,229,000 | 54,516,000 |
| Transportation equipment | 3,788,000 | — | — | 3,788,000 |
| Construction in progress | 5,092,000 | (66,000) | — | 5,026,000 |
| | <u>\$140,148,000</u> | <u>\$ 27,155,000</u> | <u>\$ 13,399,000</u> | <u>\$153,904,000</u> |
| 1986 | | | | |
| Land | \$ 8,939,000 | \$13,955,000 | \$ 6,144,000 | \$16,750,000 |
| Buildings | 18,428,000 | 20,292,000 | 12,440,000 | 26,280,000 |
| Leasehold rights and improvements | 36,590,000 | 7,797,000 | 2,463,000 | 41,924,000 |
| Store equipment | 36,492,000 | 11,664,000 | 1,842,000 | 46,314,000 |
| Transportation equipment | 3,612,000 | 448,000 | 272,000 | 3,788,000 |
| Construction in progress | 13,070,000 | (7,978,000) | — | 5,092,000 |
| | 117,131,000 | 46,178,000 | 23,161,000 | 140,148,000 |
| Properties held for development .. | 355,000 | — | 355,000 | — |
| | <u>\$117,486,000</u> | <u>\$ 46,178,000</u> | <u>\$ 23,516,000</u> | <u>\$140,148,000</u> |
| 1985 | | | | |
| Land | \$ 2,567,000 | \$ 6,707,000 | \$ 335,000 | \$ 8,939,000 |
| Buildings | 9,119,000 | 9,875,000 | 566,000 | 18,428,000 |
| Leasehold rights and improvements | 32,857,000 | 4,844,000 | 1,111,000 | 36,590,000 |
| Store equipment | 30,334,000 | 7,530,000 | 1,372,000 | 36,492,000 |
| Transportation equipment | 3,373,000 | 244,000 | 5,000 | 3,612,000 |
| Construction in progress | 11,465,000 | 1,605,000 | — | 13,070,000 |
| | 89,715,000 | 30,805,000 | 3,389,000 | 117,131,000 |
| Properties held for development .. | 2,324,000 | (1,969,000) | — | 355,000 |
| | <u>\$ 92,039,000</u> | <u>\$ 28,836,000</u> | <u>\$ 3,389,000</u> | <u>\$117,486,000</u> |

PAY 'N PAK STORES, INC.
SCHEDULE VI - ACCUMULATED DEPRECIATION OF
PROPERTY, PLANT AND EQUIPMENT

Years ended February 28, 1987, 1986 and 1985

| Description | Balance at beginning of year | Additions charged to income | Retirements or sales | Balance at end of year |
|---|------------------------------------|-----------------------------------|-------------------------|------------------------------|
| 1987 | | | | |
| Buildings | \$ 1,393,000 | \$ 718,000 | \$ 106,000 | \$ 2,005,000 |
| Leashold rights and improvements | 14,599,000 | 2,720,000 | 1,081,000 | 16,238,000 |
| Store equipment | 17,421,000 | 6,176,000 | 1,980,000 | 21,617,000 |
| Transportation equipment | 1,960,000 | 496,000 | — | 2,456,000 |
| | <u>\$35,373,000</u> | <u>\$ 10,110,000</u> | <u>\$ 3,167,000</u> | <u>\$ 42,316,000</u> |
| 1986 | | | | |
| Buildings | \$ 1,305,000 | \$ 546,000 | \$ 458,000 | \$ 1,393,000 |
| Leashold rights and improvements | 12,965,000 | 2,428,000 | 794,000 | 14,599,000 |
| Store equipment | 14,262,000 | 4,811,000 | 1,652,000 | 17,421,000 |
| Transportation equipment | 1,673,000 | 475,000 | 188,000 | 1,960,000 |
| | <u>\$30,205,000</u> | <u>\$8,260,000</u> | <u>\$3,092,000</u> | <u>\$35,373,000</u> |
| 1985 | | | | |
| Buildings | \$ 970,000 | \$ 337,000 | \$ 2,000 | \$ 1,305,000 |
| Leashold rights and improvements | 11,755,000 | 2,092,000 | 882,000 | 12,965,000 |
| Store equipment | 11,619,000 | 3,921,000 | 1,278,000 | 14,262,000 |
| Transportation equipment | 1,151,000 | 523,000 | 1,000 | 1,673,000 |
| | <u>\$25,495,000</u> | <u>\$6,873,000</u> | <u>\$2,163,000</u> | <u>\$30,205,000</u> |

PAY 'N PAK STORES, INC.
SCHEDULE VIII - VALUATION AND QUALIFYING ACCOUNTS

Years ended February 28, 1987, 1986 and 1985

| | Balance at beginning of year | Additions charged to income | Deductions* | Balance at end of year |
|--|------------------------------------|-----------------------------------|-------------|------------------------------|
| Allowance for doubtful accounts deducted from the asset to which it applies: | | | | |
| 1987 | \$65,000 | \$249,000 | \$249,000 | \$65,000 |
| 1986 | \$65,000 | \$224,000 | \$224,000 | \$65,000 |
| 1985 | \$60,000 | \$242,000 | \$237,000 | \$65,000 |

*Accounts written off against the reserve.

PAY 'N PAK STORES, INC.
SCHEDULE IX - SHORT-TERM BORROWINGS

Years ended February 28, 1987, 1986 and 1985

| | Balance at end of year | Weighted average interest rate at end of year | Maximum amount outstanding at any month- end during the year | Average amount outstanding during the year | Weighted average interest rate during the year |
|---------------------------|------------------------------|--|---|--|--|
| Notes payable to banks: | | | | | |
| 1987 | \$22,255,000 | 6.9% | \$22,270,000 | \$11,914,000 | 6.8% |
| 1986 | \$20,475,000 | 8.7% | \$26,591,000 | \$12,491,000 | 8.8% |
| 1985 | \$11,602,000 | 9.2% | \$14,600,000 | \$8,594,000 | 11.5% |
| Revolving line of credit: | | | | | |
| 1987 | \$ — | — % | \$ — | \$ — | — % |
| 1986 | \$ — | — % | \$15,000,000 | \$5,910,000 | 10.23% |
| 1985 | \$ — | — % | \$ 8,000,000 | \$1,372,000 | 14.9% |

Notes payable to banks represent obligations payable under several credit agreements to various banks. The average amount outstanding for each period was computed by averaging the daily balances during the year. The weighted average interest rate for each period was computed by dividing interest incurred by the average amount outstanding.

PAY 'N PAK STORES, INC.
SCHEDULE X - SUPPLEMENTARY INCOME STATEMENT INFORMATION

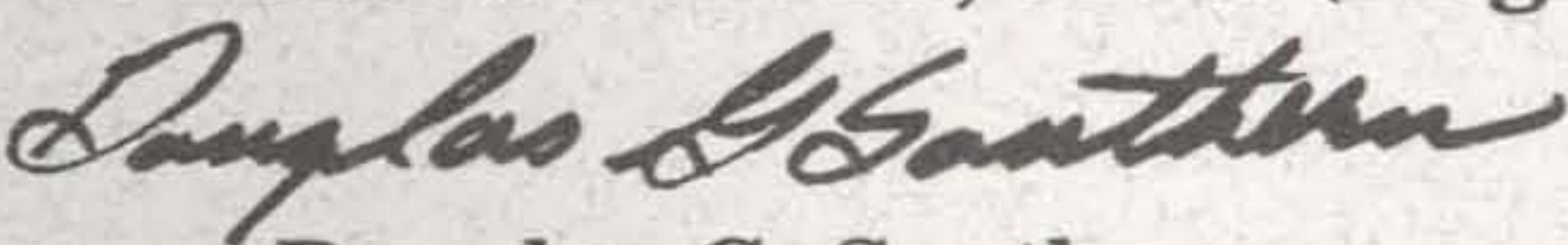
Years ended February 28, 1987, 1986 and 1985

| | <u>Charged to costs and expenses</u> | | |
|-------------------------|--------------------------------------|--------------|--------------|
| | <u>1987</u> | <u>1986</u> | <u>1985</u> |
| Advertising costs | \$14,269,000 | \$12,767,000 | \$10,468,000 |

SIGNATURE

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Company has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

PAY 'N PAK STORES, INC. (Registrant)

By 
Douglas G. Southern
Vice President-Finance and
Secretary-Treasurer

Dated: April 23, 1987

Pursuant to the requirements of the Securities Exchange Act of 1934, this Report has been signed below by the following persons on behalf of the Company in the capacities and on the dates indicated.

PAY 'N PAK STORES, INC. (Registrant)

Dated: April 23, 1987

By *David J. Heerensperger*
David J. Heerensperger
Director and Chairman
of the Board
(Principal Executive Officer)

Dated: April 23, 1987

By *Douglas G. Southern*
Douglas G. Southern
Vice President-Finance and
Secretary-Treasurer
(Principal Financial and
Accounting Officer)

Dated: April 23, 1987

By *Jerry L. Marlow*
Jerry L. Marlow
Director and President

Dated: April 23, 1987

By *Marshall J. Weigel*
Marshall J. Weigel
Director and Vice Chairman

Majority of Board of Directors

EXHIBIT INDEX

- (3) Bylaws as Amended. Restated Articles of Incorporation as amended are incorporated by reference from the Registrant's Form 10-K filed for the fiscal year ended February 29, 1984.
- (4) Note Agreement with The Prudential Insurance Company of America dated August 15, 1979, as amended, is incorporated by reference from the Registrant's Form 10-K filed for the fiscal year ended February 28, 1986.
- (5) Credit Agreement with PruFunding, Inc., dated November 1, 1983, as amended, Note Agreement with National Life Insurance Company, the Franklin Life Insurance Company, Southland Life Insurance Company and Columbia Mutual Life Insurance Company dated as of October 15, 1985, and Credit Agreement with Bankers Trust Company dated as of December 23, 1985, are incorporated by reference from the Registrant's Form 10-K filed for the fiscal year ended February 28, 1986.
- (22) Subsidiaries of the Registrant are incorporated by reference from the Registrant's Form 10-K filed for the fiscal year ended February 28, 1981.

Copies of the above exhibits may be obtained from the Securities and Exchange Commission or the Registrant by written request.

Corporate Information

Pay 'N Pak Stores, Inc. has combined the Company's annual report with its Form 10-K report that is filed annually with the Securities and Exchange Commission. The Form 10-K provides more detailed information about the Company than does the annual report.

The Form 10-K has not been approved or disapproved by the Securities and Exchange Commission nor has the Commission passed upon the accuracy or adequacy of the data included therein.

The common stock of Pay 'N Pak Stores, Inc. is listed and traded on the New York Stock Exchange. As of March 31, 1987, there were approximately 3,046 holders of record of the Company's common stock.

Banks

Old National Bank of Washington
Spokane, Washington

First Security Bank of Idaho
Boise, Idaho

Bankers Trust Company
New York, New York

Transfer Agent and Registrar

Security Pacific National Bank
Los Angeles, California

Legal Counsel

Davis Wright & Jones
Seattle, Washington

Auditors

Arthur Young & Company
Seattle, Washington

Notice of Annual Meeting of Stockholders

The annual meeting of stockholders of Pay 'N Pak Stores, Inc. will be held on June 16, 1987, at 9:30 a.m. at the Marriott Hotel, 3201 S. 176th Street, Seattle, Washington.

Financial Statements

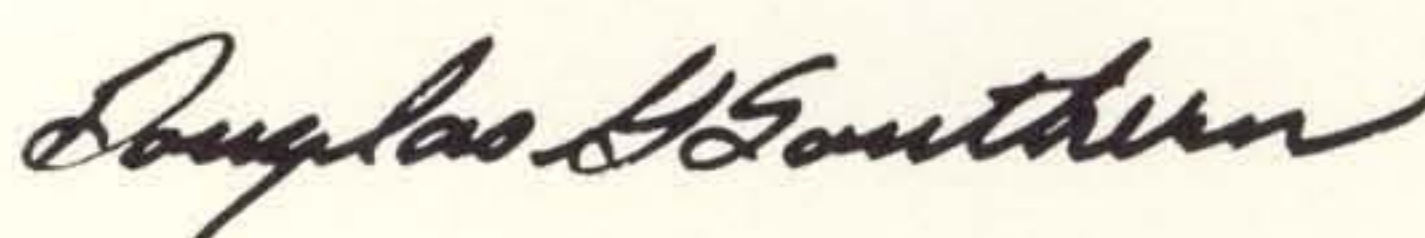
Responsibility for Financial Statements

The accompanying balance sheets of Pay 'N Pak Stores, Inc. at February 28, 1987 and 1986, and the related statements of income, stockholders' equity and changes in financial position for each of the three years in the period ended February 28, 1987, were prepared by management in conformance with generally accepted accounting principles appropriate in the circumstances.

The management of Pay 'N Pak Stores, Inc. is responsible for the integrity and objectivity of the financial statements, which are presented on the accrual basis of accounting and, accordingly, include some amounts based upon judgment. Other financial information in the annual report is consistent with that in the financial statements. The accounting plan and related system of internal controls are designed to assure that the books and records reflect the transactions of the Company in accordance with established policies and procedures as implemented by qualified personnel.

The board of directors monitors the financial and accounting operations of the Company, including the review and discussion of periodic financial statements and the basis of engagement and report of independent public accountants.

Arthur Young & Company, independent public accountants, have examined the above mentioned financial statements of Pay 'N Pak Stores, Inc. and their report is included herein. The auditors met with members of the audit committee of the board of directors to discuss the results of their examination, and were afforded an opportunity to present their opinions in the absence of management personnel with respect to the adequacy of internal controls and the quality of financial reporting of the Company.



Douglas G. Southern
Vice President, Finance, Chief Financial Officer

