

The PeoplesBank 1976 Annual Report

PEOPLES BANCORP. ANNUAL REPORT

1976

ANNUAL REPORTS
PEOPLES BANCORP 1976
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Peoples National Bank has grown substantially since its founding in 1889. Incorporated as a savings bank, Peoples-Bank was started by a group of Seattle pioneers including Arthur A. Denny, Jacob Furth, Bailey Gatzert, John Collins, Otto Ranke, Major J. R. Hayden and L. S. J. Hunt. The bank's first office was in the Occidental Building at the corner of Yesler and James, then the heart of downtown Seattle.

In 1926 the bank, which had grown to \$6 million in deposits with capital of nearly \$400,000, was purchased by a group of Seattle businessmen headed by Joshua Green. In 1937 the name Peoples National Bank of Washington in Seattle was adopted.

The West Seattle office was the first branch office established in 1933 by acquisition of the affiliated West Seattle Bank. That branch still enjoys the largest share of market in its area. In 1934 the conversion of three more affiliated banks in Seattle and Renton into branches of PeoplesBank set the pace for early growth of the bank. The bank continued to grow over the next eighteen years, acquiring branches in Everett, Hoquiam, Kent, Anacortes, Tacoma and Bremerton and expanding Seattle operations at various places in metropolitan Seattle.

Beginning in 1954, the bank extended its operations into the Columbia Basin and today has twelve branches in that area. A pioneer in concepts of agricultural finance in Washington, Peoples-Bank now ranks thirty-seventh in agricultural loans nationally. The bank's sixty-four branch offices serve the residents of twelve of the state's thirty-nine counties, including all but one of the five most populous counties.

In recent years, Peoples Mortgage Company and Peoples Leasing Company, wholly-owned subsidiaries, were developed and now contribute markedly to the profitability of the bank. Ownership is held by 1,300 stockholders, and we serve over 260,000 customers and have total deposits of over \$750 million.

1976 HIGHLIGHTS

For the Years Ended December 31

	1976	1975*
Total Operating Income	\$73,073,312	\$67,558,279
Total Operating Expenses	\$65,560,556	\$60,343,438
Net Operating Earnings Before Securities Losses	\$ 5,103,756	\$ 4,729,841
Net Income	\$ 5,100,459	\$ 4,467,922
Earnings Per Common Share:		
Net Income Before Securities Losses	\$6.41	\$5.95
Net Income	\$6.41	\$5.62
Cash Dividends Paid on Common Stock	\$ 1,328,056	\$ 1,081,438
Cash Dividends Paid Per Share on Common Stock (Par Value \$20)	\$1.67	\$1.70

The Year End

	1976	1975
Total Resources	\$966,722,213	\$900,288,400
Deposits	\$759,357,525	\$699,202,182
Loans (Net)	\$484,393,288	\$434,407,379
Securities	\$138,802,098	\$124,878,063
Total Capital Funds	\$ 55,160,754	\$ 44,849,504
Book Value Per Share Common Stock	\$61.19	\$56.37
Number of Common Stock Shareholders	1,290	1,296
Number of Banking Staff	1,499	1,417
Number of Banking Offices	64	63

Common Stock Information

Common Stock is traded over-the-counter locally and quoted daily in many financial publications. The market price range of Peoples National Bank Common Stock and the dividends paid during each quarter during the year 1975 and 1976 is as follows: (All 1975 and First Quarter 1976 Market Prices are prior to 25% stock dividend paid March 24, 1976.)

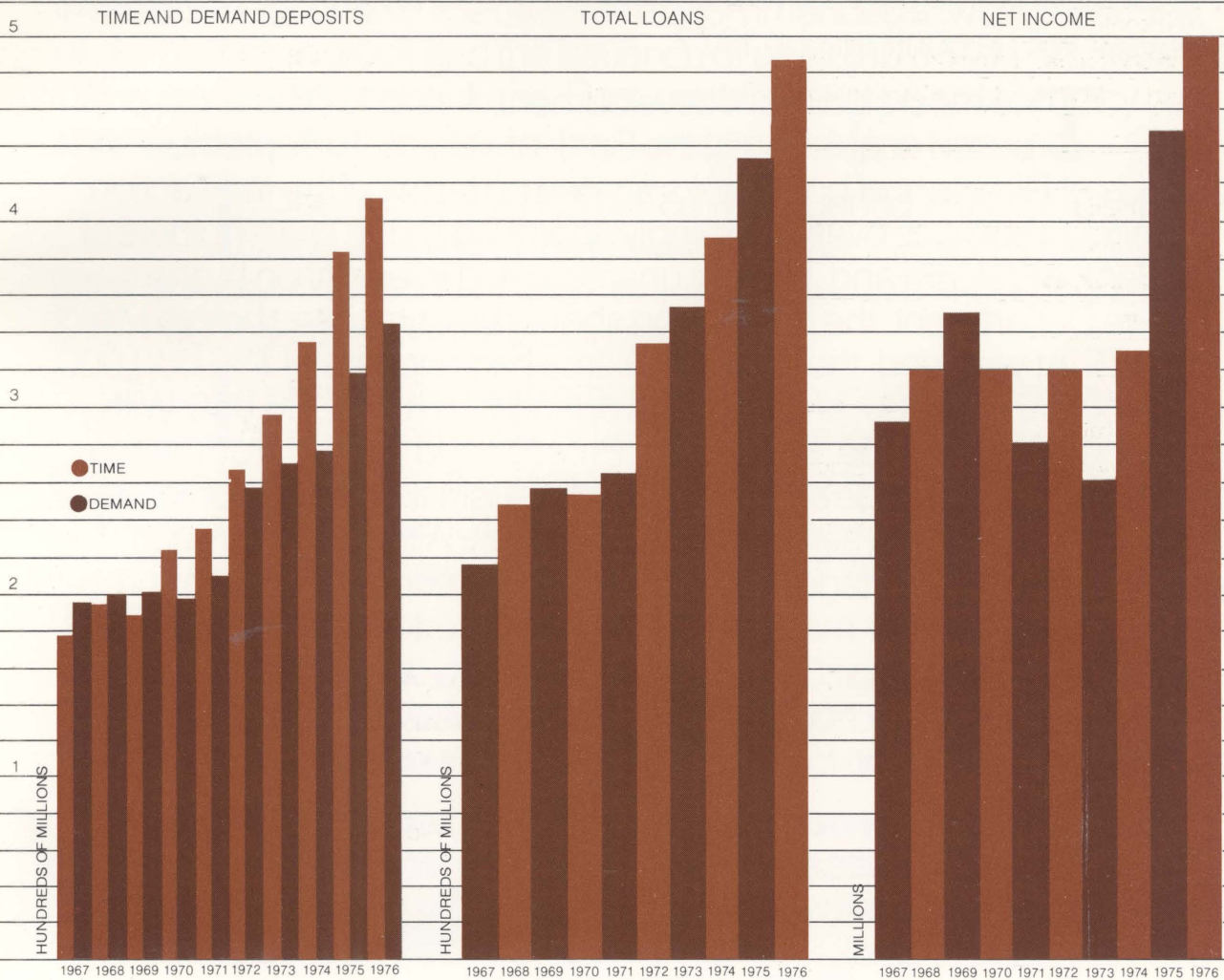
	Market Bid Price		Dividends Per Share	
	High	Low	Paid	Date
1975				
1st Quarter	30½	26½	.80	1/15
2nd Quarter	33½	30½	.30	4/15
3rd Quarter	34	32	.30	7/15
4th Quarter	37	33	.30	10/15
1976				
1st Quarter	42	36	.64**	1/15
2nd Quarter	34	30	.30	4/15
3rd Quarter	33	30	.30	7/15
4th Quarter	37	33	.43	10/15

*All per share statistics have been adjusted for the 25% stock dividend paid in March, 1976, except cash dividends paid per share in 1975.

The \$1.70 cash dividend, if restated to adjust for 1976 stock dividend of 25% would have been \$1.36 per share.

**Adjusted for the 25% stock dividend paid March 24, 1976.

TEN YEAR GROWTH RECORD



The Bank files an annual information report with the Comptroller of the Currency on Form F-2. When available, copies will be mailed to shareholders upon written request to: Mr. Robert G. Perry, Executive Vice President and Senior Financial Officer, Peoples National Bank of Washington, 1414 Fourth Avenue, Seattle, Washington 98111

In 1976, a 14% increase in profits to \$5,100,459 highlighted a very successful year. Although high-interest-cost, large certificates of deposit declined \$29 million, our total deposits increased 8.6% to \$759,357,525. Strong growth in consumer and commercial loans resulted in a total increase of 11.5% in our loan portfolio. With a stable, slow-growing economic environment, we hope and expect that PeoplesBank's three-year record of profit growth well in excess of 10% per year will be continued in 1977.

The most significant development during 1976 was the proposed acquisition of the Bank of Yakima. In September the Boards of Directors of both banks agreed on terms of the transaction. The acquisition was overwhelmingly approved by the shareholders of the Bank of Yakima and, barring unanticipated intervention by the Justice Department, the transaction should be completed before March 31, 1977. At year-end, the Bank of Yakima had deposits of \$86,600,000, loans of \$59,000,000, and earnings during 1976 of \$1,196,000. With branches in Sunnyside, Ellensburg, Prosser, and throughout Yakima, the bank covers a large agricultural and industrial-oriented portion of Washington State not served by PeoplesBank. Although the much publicized water shortage may present some serious short-term problems to this area, your management is convinced that the long-term growth and earnings of Yakima acquisition prospects provided by the Bank should have a significant, positive effect on your bank's earnings.

Motivated by our growth and by the need to increase capital for the Bank of Yakima acquisition, the directors recommended to stockholders several changes in our capital

structure and dividend-paying policy. This included payment of cash dividends of 43 cents per share on a uniform quarterly basis. Previously, the bank maintained a quarterly dividend of 30 cents per share, plus a special dividend of 50 cents per share paid each year in January.

Late in the year, the Board of Directors approved and placed a \$6.5 million subordinated capital note with an institutional investor. In December, the directors recommended a two-for-one split of our common stock and the issuance of up to \$10 million of convertible, subordinated debentures. Both matters must be approved by our shareholders and the Office of the Comptroller of the Currency.

In December, the HUB office was opened in the Student Union Building at the University of Washington. This office is the only banking facility on the campus and serves 34,000 students and 11,000 members of the faculty and staff.

In comparison with other banks of our size, on both a regional and national basis, our loan loss experience is exceptionally good. For the year 1976 our net loss experience was .14% of average loans outstanding, and for the last three years we averaged .06%. Emphasis on quality of the earning assets will continue to be a major objective.

Our two-year effort to rent the Head Office building was completed in December. For practical purposes, the building is now fully occupied and will have a positive effect on earnings in 1977.

Responding to public concern on the issue of redlining, the bank was a leading supporter in the effort of lenders to establish a Lenders Review Board in Seattle.



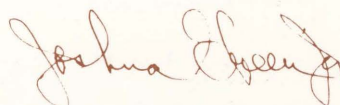
Richard Monson, vice president and manager of our Consumer Credit Division, serves as chairman of the Lenders Review Board. As it has in the past, your bank will continue to meet its social and corporate responsibilities in a forthright and truthful manner to protect the public interest.

During 1976, Robert G. Perry and E. C. Underhill, both directors and members of the Administrative Committee, were elected to the position of executive vice president.

The end of 1976 signaled an upturn in the growth of the economy nationally and regionally. Prospects appear bright for the major sectors of the Northwest, which moved slowly in 1976 from recession to recovery. However, the winter drought may have a negative economic effect on the agricultural areas of Washington and business users of hydroelectric power during 1977.

Proposed new banking legislation, both in Olympia and Washington, D.C., if passed, could create an entirely new competitive picture in the financial industry by 1978. PeoplesBank is prepared to meet this new competition and should be able to adjust in the new legislative environment without significant detrimental effect on earnings.

The management of the bank believes that 1977 will be a good earnings year and expects continued growth in deposits, loans and profit. We deeply appreciate the performance of our staff during 1976 and, with the continued support of our stockholders, customers and friends, for which we are grateful, we look ahead to a challenging and profitable year.



Joshua Green, Jr.
Chairman of the Board



Joshua Green III
President

YEAR IN REVIEW

PEOPLES BANK posted record totals in deposits, loans, and earnings in 1976 maintaining a three-year pattern of sustained financial growth.

DEPOSITS totaled \$759,357,525, an 8.6%, \$60,155,343 increase over the previous year. Demand deposits rose by 8.7% to \$344,752,107. PeoplesBank's demand deposits in the last five years have increased 65.5%. Consumer savings deposits increased 15% in 1976 to \$216,281,778. Time deposits increased fractionally as the bank sought to limit to existing customers the issuance of high-cost Certificates of Deposit. Our five-year deposit growth has been an increase of \$318,517,164, up 72.3% since 1971.

LOANS increased in 1976 to \$484,393,288. Strong loan demand in the second half of the year, strong growth in consumer loans, and our continuing low loan loss experience highlighted the past year. Five-year loan growth has been \$221,910,457, an increase of 84.5%.

YEAR-END ASSETS of Peoples National Bank totaled \$966,722,213 an increase of 7.4%. The five-year growth in total assets has been \$450,204,958.

CREDIT CARDS. 1976 was the bank's first full year as a direct issuer of BankAmericards. During this year authority to issue and process Master Charge cards also was achieved. The bank thus became the first bank in Washington State to accept both BankAmericard and Master Charge receipts in one deposit, eliminating sorting and separate totaling process by retailers.

OPERATING INCOME. During 1976 operating income reached \$73,073,312, an increase over 1975 of \$5,515,032 or 8.16%. Interest and fees on loans increased 10.86%. Leasing income increased \$1,081,269, and income from service charges, collection and exchange charges, and commissions and fees increased \$622,938.

OPERATING EXPENSES. In 1976 operating expenses totaled \$65,560,556 compared to \$60,343,438 for the previous year. Interest paid to consumer depositors increased \$3,296,136 in 1976, an increase of 24.6%. Salaries and other employee benefits amounted to \$21,811,566, an increase of 14.5%. Operating expenses included 1976 net loan losses of \$654,601, compared to \$229,111 in 1975.

EARNINGS. Income before securities losses amounted to \$5,103,756, an increase of 7.90% over the previous year. Net income was \$5,100,459, compared to \$4,467,922 in 1975. There were losses on the sale of securities of \$3,297 after applicable tax effect; in 1975, the comparable securities loss was \$261,919. In 1976, with outstanding shares of 795,285, income was \$6.41 per share, compared to \$5.62 per share in 1975. (1975 earnings per share have been restated after the 25% stock dividend paid in March 1976.) Continued income growth of our

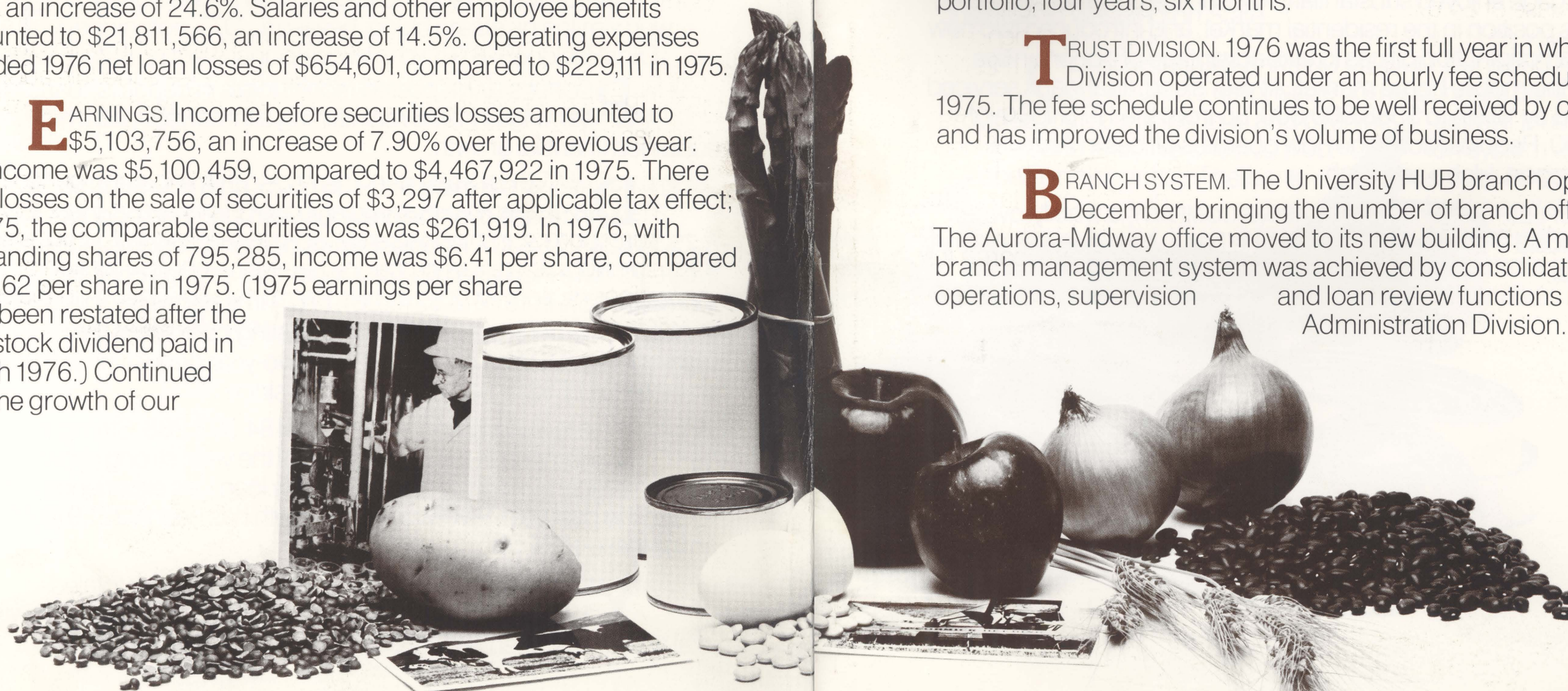
mortgage and leasing subsidiaries and a decline in some interest costs were leading factors in our improved net income for the year.

CAPITAL FUNDS. After cash dividends of \$1,328,056 on common stock and \$1,074 on preferred stock, the total capital funds at year-end were \$48,660,754, an increase of 8.50%. The book value per share on 795,285 common shares outstanding in 1976 was \$61.19, compared to \$56.37 as adjusted for 1975.

INVESTMENTS. During 1976, the total investment portfolio grew \$13,924,035 to \$138,802,098. The 1976 average portfolio yield (on a fully taxable basis) increased from 7.09% to 7.40%. Current yields on the important areas of our portfolio include the government account, 6.86%; the municipal, 8.44% (taxable equivalent); and federal agency obligations, 6.82%. Average maturity of U.S. government obligations is one year, two months; agencies, six years; and the total portfolio, four years, six months.

TRUST DIVISION. 1976 was the first full year in which the Trust Division operated under an hourly fee schedule adopted in 1975. The fee schedule continues to be well received by customers, and has improved the division's volume of business.

BRANCH SYSTEM. The University HUB branch opened in December, bringing the number of branch offices to 64. The Aurora-Midway office moved to its new building. A more efficient branch management system was achieved by consolidation of operations, supervision and loan review functions in the Branch Administration Division.



There are 13 PocketBanker cash machines operating in the bank system, and 111,000 PocketBanker cards now in use. Research showed heaviest usage in Northgate, Renton, Ballard, West Seattle and First Hill locations, with usage trends moving upward.

CONSUMER CREDIT. In addition to an increase in BankAmericard subscribers and obtaining a Master Charge franchise, the Consumer Credit Division was very active in 1976. Installment loan volume increased by 50%, and now represents 16.38% of the bank's loan portfolio. In 1975, consumer loans represented 11.68% of the bank's loan portfolio.

PEOPLES MORTGAGE COMPANY, at year-end 1976, was the nation's 63rd largest mortgage banking firm. This wholly-owned subsidiary posted record gains this year. Net income was up 26.7% to \$601,866. New mortgage loans totaled \$155,500,000, a 10.3% increase. Peoples Mortgage enjoyed substantial growth in the commercial sector, broadened its position in the residential market, and introduced two new full service loan origination offices to take advantage of opportunities for growth in the mobile home market. At year's end, total loans serviced had increased by 18.9% to \$588,000,000, up from the 1975 figure of \$473,000,000. Peoples Mortgage now operates offices in Arizona, Colorado, Oregon, Idaho and Utah.

PEOPLES LEASING COMPANY, a wholly-owned subsidiary of the bank, continued to expand in 1976. Dealer participation

increased to 310 active new car dealerships, compared to 157 in 1975. At year-end, there were approximately 4,700 active automobile leases representing \$23,000,000 versus 3,200 and \$14,200,000 at the end of 1975. In addition, the company carries equipment leases in excess of \$5,000,000.

PERSONNEL. At year's end, there were 1,499 employees of the bank. The bank's employee pension plan approved in 1975 was implemented this year, and reflected the current government regulations controlling such plans. Our commitment to Affirmative Action was restated in 1976—four minority staff members and 24 women achieved officer status this year.

NATIONAL DIVISION. Although 1976 was a year when major corporations displayed considerable liquidity, the National Division fared well in retention of loan commitments and showed increases in deposits. The bank serves over 250 national firms doing business in Washington State.

CORRESPONDENT BANKING DIVISION. During 1976, we continued to emphasize correspondent bank services and provided loan participations and overline activity, plus investment services, and effective check collection system and operating counsel. The bank serves 82 correspondent banks and provides 20 of these with complete data processing service.



Strength in the fourth quarter of 1976 portends a healthy economic environment for Washington State in 1977.

Major elements of the state's diversified economy expected to strengthen in 1977 are forest products; manufactured products, particularly transportation equipment; and distributive commerce.

Permits for new housing units in Washington totaled 42,000 at the end of November, higher than any full calendar year since 1968. The value of new construction contracts in the state was over \$3.3 billion, boosted by a nuclear generating plant in Benton County and the Trident Submarine Support Base in Kitsap County.

Boeing reached \$3.9 billion in firm, but unfilled orders at year-end 1976. Production of 707s, 727s, 737s, and 747s will increase from 9.5 to 15 per month by year-end 1977. Employment at Boeing is expected to increase 5-10% during 1977, an encouraging note for the region.

The Seattle Harbor now ranks among the ten most significant harbors in the United States in terms of general cargo in both tonnage and value.



The Port of Seattle showed a 20% annual increase in total tonnage and edged out Oakland to become number two in the nation behind the New York-New Jersey complex in number of containers handled.

Agriculture, which employs one out of every five workers in the state directly or in related industries, experienced a drop in the gross value of its agricultural commodities due to a price decline in farm products, particularly for wheat, cattle, potatoes, sugar beets and processed vegetables. Nevertheless, the total yields of commodities produced were up, and the state led the nation in the production of apples, hops, sweet cherries and dry edible peas. The Columbia Basin Irrigation Project water reserves are reported to be sufficient to maintain current production; therefore, the winter drought is not expected to affect this important area of the state's economy.

Retail sales in Washington increased 13% in 1976 and are expected to increase 12.1% in 1977. Total employment in the state rose 3% during 1976. However, possible water shortage makes the supply of hydro-electric power for industry uncertain and may have a negative impact on employment in 1977.

The gains experienced by the state in 1976 in construction and industry signal a good year in 1977, and the bank looks forward to participating in this growth.



PEOPLES NATIONAL BANK OF WASHINGTON AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEET

	December 31	
	1976	1975
RECEIVED		
Assets—Note 1		
Cash and Due From Banks	\$132,500,576	\$110,563,940
Time Deposits With Other Banks		13,399,210
Investment Securities—Note 3		
U.S. Government	53,517,379	46,556,919
State, County and Municipal	52,491,427	47,344,539
U.S. Government Agencies and Corporations	24,490,863	28,615,253
Other Securities	1,391,904	1,251,409
Trading Account Securities	6,910,525	1,109,943
Total Securities	138,802,098	124,878,063
Federal Funds Sold and Securities Purchased Under Agreement to Resell	98,987,500	122,323,984
Loans and Discounts net of Reserve for Loan Losses of \$4,212,274 in 1976 and 1975—Notes 4&5	484,393,288	434,407,379
Bank Premises and Equipment Net of Depreciation—Note 2	31,399,255	31,606,499
Direct Lease Financing	27,862,926	21,420,857
Customers' Acceptance Liability and Letters of Credit	38,069,378	26,436,917
Other Assets	14,707,192	15,251,551
Total Assets	\$966,722,213	\$900,288,400
Liabilities		
Demand Deposits	\$344,752,107	\$317,267,027
Savings Deposits	216,281,778	188,158,025
Time Deposits—Over \$100,000	58,410,627	85,824,000
Time Deposits—Under \$100,000	139,913,013	107,953,130
Total Deposits	759,357,525	699,202,182
Federal Funds Purchased and Securities Sold Under Agreement to Repurchase	79,928,000	97,693,000
Other Liabilities for Borrowed Money	19,376,662	20,596,741
Bank Acceptances and Letters of Credit Outstanding	38,069,378	26,436,917
Other Liabilities	14,829,894	11,510,056
Total Liabilities	911,561,459	855,438,896
Subordinated Notes and Debentures—Note 8	6,500,000	
Stockholders' Equity		
Capital Stock		
Preferred Stock (\$75 Par Value, 340 and 380 shares outstanding in 1976 and 1975 respectively)	25,500	28,500
Common Stock (\$20 Par Value; 800,182 shares are authorized, with 795,285 and 636,184 shares outstanding in 1976 and 1975)	15,905,700	12,723,680
TOTAL CAPITAL STOCK	15,931,200	12,752,180
Surplus	15,905,700	14,447,820
Undivided Profits	14,368,421	14,910,324
Reserve for Contingencies	2,455,433	2,739,180
Total Stockholders' Equity	48,660,754	44,849,504
Total Liabilities and Stockholders' Equity	\$966,722,213	\$900,288,400

See accompanying notes to consolidated financial statements.

PEOPLES NATIONAL BANK OF WASHINGTON
CONSOLIDATED STATEMENT OF EARNINGS

	Year Ended December 31	
	1976	1975
Operating Income		
Interest and Fees on Loans	\$48,313,193	\$43,582,241
Income on Federal Funds Sold and Securities Purchased		
Under Agreement to Resell	4,250,016	5,195,187
Interest and Dividends on Securities		
Interest on U.S. Treasury Securities	3,522,040	2,550,381
Interest on Obligations of Other U.S. Government Agencies and Corporations	1,312,663	1,854,143
Interest on Obligations of States and Political Subdivisions of the U.S.	2,131,062	1,904,210
Other Securities	74,856	64,153
Income from Direct Lease Financing	3,640,441	2,580,947
Income from Fiduciary Activities	1,820,660	1,420,900
Service Charges on Deposit Accounts	3,416,796	3,227,266
Other Service Charges, Commissions, and Fees	3,743,641	3,310,233
Other Income	847,944	1,868,618
Total Operating Income	<u>73,073,312</u>	<u>67,558,279</u>
Operating Expenses		
Salaries and Employee Benefits — Note 6	21,811,566	19,051,906
Interest on Time Certificates of Deposit of \$100,000 or More	4,243,157	7,029,060
Interest on Other Deposits	16,712,051	13,415,915
Interest on Federal Funds Purchased and Securities Sold		
Under Agreement to Repurchase	4,389,552	5,301,572
Interest on Borrowed Money	1,353,993	1,327,216
Net Occupancy Expense of Bank Premises		
(Net of Rental Income of \$988,019 and \$783,919 respectively) — Note 2	3,252,798	3,039,900
Furniture and Equipment Expense	3,726,007	2,912,989
Provision for Loan Losses — Note 5	654,601	229,111
Other Expenses	9,416,831	8,035,769
Total Operating Expenses	<u>65,560,556</u>	<u>60,343,438</u>
Income Before Income Taxes and Securities Gains or Losses	7,512,756	7,214,841
Applicable Income Taxes — Note 7	2,409,000	2,485,000
Income Before Securities Gains or Losses	5,103,756	4,729,841
Security Losses Less Related Tax Effect of \$2,944 and \$241,770	(3,297)	(261,919)
Net Income	<u>\$ 5,100,459</u>	<u>\$ 4,467,922</u>
Earnings Per Common Share:		
Income Before Securities Losses	<u>6.41</u>	<u>5.95</u>
Net Income	<u>6.41</u>	<u>5.62</u>

1975 earnings per share have been adjusted to give retroactive effect to the 25% stock dividend paid March 24, 1976.

See accompanying notes to consolidated financial statements.

PEOPLES NATIONAL BANK OF WASHINGTON
CONSOLIDATED STATEMENT OF CHANGES IN CAPITAL ACCOUNTS

	Preferred Stock	Common Stock	Surplus	Undivided Profits	Reserve for Contingencies	Total
Balance at December 31, 1974	<u>\$31,500</u>	<u>\$12,722,800</u>	<u>\$14,445,700</u>	<u>\$12,525,011</u>	<u>\$2,073,447</u>	<u>\$41,798,458</u>
Net Income for the Year 1975				4,467,922		4,467,922
Transfer to Investment Reserve				(55,000)	55,000	
Cash Dividends Declared				(891,923)		(891,923)
Transfer to Deferred Income Tax Expense				(81,000)		(81,000)
Transferred to Contingency Reserve for Possible Loan Losses				(399,543)	399,543	
Transferred Net to Reserve for Contingencies				(211,190)	211,190	
Amortization of Premium of Acquisition of Olympic National Bank				(15,526)		(15,526)
Excess of Purchase Cost Over Allowed Carrying Value of Bank Assets Acquired in American National Bank Acquisition				(428,426)		(428,427)
Conversion of 40 Shares of Preferred Stock to 44 Shares of Common Stock	(3,000)	880	2,120			
Balance at December 31, 1975	<u>\$28,500</u>	<u>\$12,723,680</u>	<u>\$14,447,820</u>	<u>\$14,910,324</u>	<u>\$2,739,180</u>	<u>\$44,849,504</u>
Net Income for the Year 1976				5,100,459		5,100,459
Transfer to Investment Reserve				(55,000)	55,000	
Cash Dividends Declared				(1,162,188)		(1,162,188)
Amortization of Deferred Income Tax				(81,000)		(81,000)
Transferred to Contingency Reserve for Possible Loan Losses				(378,000)	378,000	
Transferred Net from Reserve for Contingencies				749,154	(749,154)	
Excess Purchase Price Over Allowed Carrying Value of Bank Assets Acquired				(78,428)		(78,428)
Transfer from Reserve for Taxes on Federal Income Tax Settlement					32,407	32,407
Conversion of 40 Shares of Preferred Stock to 44 Shares of Common Stock	(3,000)	880	2,120			
25% Stock Dividend		3,181,140		(3,181,140)		
Transfer to Surplus			1,455,760	(1,455,760)		
Balance at December 31, 1976	<u>\$25,500</u>	<u>\$15,905,700</u>	<u>\$15,905,700</u>	<u>\$14,368,421</u>	<u>\$2,455,433</u>	<u>\$48,660,754</u>

See accompanying notes to consolidated financial statements.

PEOPLES NATIONAL BANK OF WASHINGTON
CONSOLIDATED STATEMENT OF CHANGES IN FINANCIAL POSITION

	Year Ended December 31	
	1976	1975
Source of Funds		
Net Income	\$ 5,100,459	\$ 4,467,922
Provision for Depreciation	2,259,580	1,971,193
Provided from Operations	7,360,039	6,439,115
Increase In:		
Deposits	60,155,342	83,770,929
Federal Funds Purchased and Securities Sold		
Under Agreement to Repurchase		4,920,029
Subordinated Capital Notes	6,500,000	
Other Funds Borrowed		2,817,164
Other Liabilities	3,438,187	1,081,569
Decrease In:		
Time Deposits with Other Banks	13,399,210	
Federal Funds Sold and Securities Purchased		
Under Agreement to Resell	23,336,484	
Other Assets	544,360	
Total Source of Funds	\$114,733,622	\$ 99,028,806
Application of Funds		
Increase In:		
Cash and Due from Banks	\$ 21,936,636	\$ 19,499,012
Time Deposits with Other Banks		4,399,210
Investments and Trading Securities	13,924,035	3,964,051
Loans	49,985,909	48,123,585
Federal Funds Sold and Securities Purchased		
Under Agreement to Resell		10,503,589
Direct Lease Financing	6,442,069	5,475,201
Bank Premises	2,052,336	2,711,684
Other Assets		2,841,284
Decrease In:		
Other Funds Borrowed	1,220,079	
Federal Funds Purchased and Securities Sold		
Under Agreement to Repurchase	17,765,000	
Cash Dividends Paid	1,329,130	1,082,762
Excess of Cost Over Bank Value of Assets Acquired	78,428	428,428
Total Application of Funds	\$114,733,622	\$ 99,028,806

See accompanying notes to consolidated financial statements.

PEOPLES NATIONAL BANK OF WASHINGTON
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 1976 & 1975

Note 1—Summary of Significant Accounting Policies.

The accounting and reporting policies of Peoples National Bank of Washington and its subsidiaries conform to generally accepted accounting principles and to predominant practice within the banking industry. A description of the more significant accounting policies follows:

Consolidation—The consolidated financial statements of Peoples National Bank of Washington include the accounts of the Bank and its wholly-owned subsidiaries: Peoples Mortgage Company, Peoples Leasing Company, Peoples Service Company and Western States Mortgage Company. All significant intercompany transactions and balances have been eliminated in consolidation.

Securities—Investment securities are stated at cost, adjusted for amortization of premiums and accretion of discount. Since these securities are purchased for investment purposes and the quoted market values fluctuate during the investment period, gains or losses are recognized in the accounts only upon realization and are shown separately in the statement of income. Trading account securities are carried at cost.

Reserve for Possible Loan Losses—The reserve method is used to account for loan losses. The provision for loan losses charged to operating expenses is based on actual net charge-offs.

Income Taxes—The provisions for income taxes are based on income and expense reported for financial statement purposes after adjustment for tax exempt income, principally interest on securities of state and political subdivisions. The Bank accounts for certain income and expense items in different time periods for financial reporting purposes than for income tax purposes. Provisions for deferred taxes are made in recognition of such differences.

Investment tax credits from assets acquired by the Bank are accounted for under the "flow-through" method which recognizes the benefit in the year in which the asset is placed in service.

Changes in Financial Statement Presentation—At December 31, 1975, Peoples National Bank of Washington made certain changes in presentation of its financial statements which were recommended for 1975 and required in 1976 by the banking regulatory authorities and the American Institute of Certified Public Accountants. The changes, which did not effect net income, resulted in the following reclassified balance sheet accounts: Direct Lease Financing Net of Unearned Finance Income; Loans Net of Unearned Income and the Valuation Reserve for Possible Loan Losses; Deferred Income Tax Portion of the Reserve for Possible Loan Losses as an addition to Other Liabilities and the Contingency Portion of the Reserve for Possible Loan Losses as an addition to the Reserve for Contingencies in Capital Funds.

Other—Earnings per share are computed based on the weighted average number of shares outstanding during the year, adjusted for stock dividends.

Securities and other property held by the Trust Department in a fiduciary or agency capacity are not included in the consolidated balance sheets, since such items are not assets of the Bank. In accordance with long-established practice, the Bank's Trust Department income is reported on a cash basis. This method of reporting does not materially affect net income in comparison to reporting on the accrual basis.

Interest income on discount-basis loans is deferred and subsequently credited to income by the sum of the months-digits method over the outstanding period of related loans.

Note 2—Premises and Equipment. Premises and equipment are stated at cost less accumulated depreciation and amortization. Depreciation for financial reporting purposes is computed under the straight-line and accelerated methods over the estimated useful lives of the assets. Leasehold improvements are amortized over the terms of the respective leases or the estimated useful lives of the improvements, whichever is less. Maintenance and repairs are charged to operating expense, and improvements are capitalized. Gains and losses on dispositions are reflected in current operations. An analysis of premises and equipment follows:

	Estimated Useful Life	December 31	
		1976	1975
Land and Buildings	5-45 Years	\$23,574,809	\$24,144,876
Leasehold Improvements	Life of Lease	2,580,585	2,405,926
Furniture and Fixtures	10-15 Years	5,243,861	5,055,697
Total Net Book Value		<u>\$31,399,255</u>	<u>\$31,606,499</u>
Rental Expense of Premises & Equipment		3,316,424	2,695,638
Less Rental Income of Premises		988,019	783,919
Net Rental Expense		<u>2,328,405</u>	<u>1,911,719</u>
Depreciation Expense on Premises and Equipment		<u>2,259,580</u>	<u>1,971,193</u>

Note 3—Securities Book values and estimated market values of investment securities for the years ended December 31, are as follows:

December 31, 1975	Maturity				Total
	Within 1 yr.	1-5 years	5-10 years	Over 10 yrs.	
U.S. Treasury Obligations					
Par Value	\$18,000,000	\$28,000,000	\$ 1,000,000		\$47,000,000
Book Value	17,401,612	28,150,449	1,004,858		46,556,919
Market Value	17,486,375	28,123,750	982,813		46,592,938
U.S. Government Agency Obligations					
Par Value	4,000,000	7,000,000	8,910,200	\$ 8,603,379	28,513,579
Book Value	4,002,397	7,065,850	8,943,627	8,603,380	28,615,253
Market Value	4,007,500	7,111,875	7,914,878	7,938,323	26,972,576
State and Political Subdivisions					
Par Value	8,038,534	7,646,000	15,358,000	16,161,000	47,203,534
Book Value	8,037,657	7,699,466	15,355,802	16,251,614	47,344,539
Market Value	8,024,732	7,396,880	13,276,023	13,382,932	42,080,567
December 31, 1976					
U.S. Treasury Obligations					
Par Value	\$25,000,000	\$29,000,000			\$54,000,000
Book Value	24,388,629	29,128,750			53,517,379
Market Value	24,519,652	29,840,938			54,360,590
U.S. Government Agency Obligations					
Par Value	7,000,000	4,013,680	\$ 5,462,309	\$ 7,965,268	24,441,257
Book Value	7,028,714	4,020,636	5,491,245	7,950,268	24,490,863
Market Value	7,088,125	4,023,646	5,154,948	7,360,469	23,627,188
State and Political Subdivisions					
Par Value	7,348,601	10,790,000	21,073,000	12,887,000	52,098,601
Book Value	7,349,248	10,948,867	21,217,975	12,975,337	52,491,427
Market Value	7,348,057	11,119,019	20,261,736	12,258,466	50,987,278

An analysis of investment securities and other securities follows:

	December 31, 1976		December 31, 1975	
	Book Value	Market Value	Book Value	Market Value
Bonds, Notes and Debentures	\$ 15,000	\$ 15,000	\$ 15,000	\$ 15,000
Stocks of FRB	955,150	955,150	816,000	816,000
Other Stocks	421,754	486,646	420,409	430,748
Total	\$ 1,391,904	\$ 1,456,796	\$ 1,251,409	\$ 1,261,748
Bond Trading Securities	\$ 6,910,525	\$ 6,927,921	\$ 1,109,943	\$ 1,037,809

NOTES:

- (1) Securities are stated at cost less amortization of premium or at cost where purchased at a discount.
- (2) All securities are "investment grade."
- (3) The principal amount of stock of Federal Reserve Bank is based on an aggregate par value of \$1,910,300 of which fifty percent (50%) is paid in.
- (4) On December 31, 1976, United States Government Obligations with a par value of \$3,185,000 and State and Political Subdivisions with a par of \$23,341,000 were pledged to secure deposits of public and trust funds as required by law.

PEOPLES NATIONAL BANK OF WASHINGTON
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 1976 & 1975

Note 4—Loans. A distribution of consolidated loans is summarized as follows:

	December 31 1976	December 31 1975
	(Dollars in Millions)	
Real Estate Loans		
Including Insured or Guaranteed by the U.S. Government or Its Agencies	\$193,781	\$178,142
Commercial and Industrial Loans	176,028	190,927
Loans to Individuals for household, family and other consumer expenditures	130,316	75,554
All other loans	9,184	5,344
Total Loans	509,309	449,967
Less Unearned Discount on Loans	20,703	11,348
Subtotal	488,606	438,619
Less Reserve for Bad Debts	4,212	4,212
LOANS	<u>\$484,394</u>	<u>\$434,407</u>

In the normal course of business, there are outstanding loan commitments for credit which are not reflected in the accompanying consolidated balance sheet. At December 31, 1976 the unused credit line on loans over \$100,000 amounted to \$186,970,000.

Note 5—Reserve for Possible Loan Losses.

	For Years Ended December 31	
	1976	1975
Balance Beginning of the Period	\$4,212,274	\$4,212,274
Provision Charged Against Earnings	654,601	229,111
Recoveries Credited to Reserve	575,267	848,215
Loans Charged-off	<u>(1,229,868)</u>	<u>(1,077,326)</u>
Total Allowance For Possible Loan Losses	<u>\$4,212,274</u>	<u>\$4,212,274</u>

The provision for loan losses charged to operating expense is based on the actual net charge-offs during the year. Transfers from undivided profits represents the difference, net of related income tax effect, between loan loss deductions allowable for Federal Income Tax purposes and provisions charged to operations. The reserve component has been deducted from loans.

Note 6—Retirement Plans. In November of 1975 the Board of Directors of Peoples National Bank of Washington authorized the establishment of a non-contributory Pension Plan for employees. This Pension Plan replaced the deferred compensation and profit sharing plans in effect for years prior to 1976. The amount necessary to fund the Pension Plan with respect to past services is \$9,300,000 which will be paid over a period of 30 years. The total pension expense for 1975 and 1976 amounted to \$835,000 and \$997,500 respectively.

Note 7—Income Taxes. The Bank files a consolidated income tax return including all subsidiaries. An analysis of the difference between the effective tax rate for income taxes applicable to net income and the U.S. Federal income tax rate follows:

	For Years Ended December 31	
	1976	1975
U.S. Federal Income Tax Rate	48.0%	48.0%
Reductions in Income Tax Resulting From:		
Tax Exempt Income	(12.7)	(12.7)
Investment Tax Credits	<u>(3.2)</u>	<u>(.9)</u>
Effective Tax Rate	<u>32.1%</u>	<u>34.4%</u>

The components of deferred income taxes for the years ended December 31, 1976 and 1975 resulting from timing differences in the recognition of revenue and expense for tax and financial reporting purposes are:

	For Years Ended December 31	
	1976	1975
Excess of Tax over Financial Statement Provision for Possible Loan Losses.....		\$ 368,000
Leasing Income Recognized on Level Rate of Return on Net Investments for Financial Reporting Purposes and Recognized on Operating Method for Income Tax Purposes	\$ (98,000)	324,000
Income and Expenses Recognized on an Accrual Method for Financial Reporting Purposes and Recognized on Cash Method for Income Tax Purposes	1,518,000	813,000
Excess of Tax over Financial Statements Provision for Depreciation	49,000	95,000
Deferred Federal Income Tax	1,469,000	1,600,000
Current Federal Income Tax	940,000	885,000
Federal Income Tax Expense	\$2,409,000	\$2,485,000

Note 8—Commitments and Contingencies. Senior Subordinated Capital Note—On December 29, 1976 Peoples National Bank sold a \$6,500,000 Capital Note payable to Security Pacific National Bank. This note is unsecured and subordinated to deposits and certain other liabilities. The note bears interest at 8.75% per annum on the unpaid principal balance. The bank is obligated to pay principal of \$1,000,000 on December 31, 1983, semi-annual equal increments of \$500,000 for the next two and one-half years and the remaining balance of \$3,000,000 due and payable on December 31, 1986.

Lease Commitments—Minimum net rental commitments under noncancellable leases having an original term of more than one year are as follows as of December 31, 1976:

1977	1,825,000
1978	1,485,000
1979	1,108,000
1980	1,095,000
1981	899,000
1982-1986	3,726,000
1987-1991	1,159,000
1992-1996	337,000
1997 and Subsequent	88,000

Certain of these leases contain renewal options from 5 to 20 years and escalation clauses based upon increases in property taxes and other costs. These commitments have been reduced by rentals to be received from existing non-cancellable subleases (the total amount of which is immaterial).

Standby Letters of Credit—At December 31, 1976 and 1975, standby Letters of Credit amounted to \$2,525,750 and \$2,781,448 respectively.

Short-term Commercial Paper—During 1976 and 1975 the Bank's subsidiaries have issued commercial paper guaranteed by the Bank. Commercial paper maturities range from 30 days to 270 days and during the two years the rates have varied from 5¼% to 6¾%.

Acquisition of the Bank of Yakima—On February 10, 1977, 89.5% of the Bank of Yakima proxies were voted in favor of selling the Bank of Yakima to Peoples National Bank of Washington. In consideration for its purchase of the assets, PeoplesBank has agreed to assume the banking liabilities of and to pay to the Bank of Yakima a maximum sum of \$13,113,577. This amount is based on twice the book value of the Bank of Yakima as of June 30, 1976. On December 31, 1976 the Bank of Yakima had total assets of \$94,771,445, total deposits of \$86,610,242 and total capital funds of \$7,085,470. This acquisition is subject to approval from the various regulatory authorities having jurisdiction over the two Banks.

PEOPLES NATIONAL BANK OF WASHINGTON
CONSOLIDATED STATISTICAL DATA

Balance Sheet Statistics — Year End	1976	1975	1974	1973	1972	1971
Total Loans						
(Net of Unearned Discount)	\$488,605,562	\$438,619,653	\$390,496,068	\$352,006,136	\$333,579,276	\$262,482,831
U.S. Government Securities	53,517,379	46,556,919	36,108,273	47,988,929	36,502,307	47,203,940
State, County and						
Municipal Securities	52,491,427	47,344,539	45,688,437	56,989,467	50,555,944	57,450,350
Other Securities	32,793,292	30,976,605	39,117,302	37,930,938	24,625,177	6,606,538
Total Securities	138,802,098	124,878,064	120,914,012	142,909,334	111,683,428	111,260,828
Demand Deposits	344,752,107	317,267,027	275,491,175	269,328,197	258,022,682	208,344,611
Time Deposits	414,605,418	381,935,155	339,940,078	295,435,531	264,727,710	232,495,750
Total Deposits	759,357,525	699,202,182	615,431,253	564,763,728	522,750,392	440,840,361
Capital Funds	48,660,754	44,849,504	41,798,458	39,617,877	38,172,461	34,931,575
Total Resources	966,722,213	900,288,400	802,833,203	720,816,033	597,350,822	516,517,255
Earnings and Dividend Statistics — Year End						
Interest and Fees on Loans						
Including Federal Funds	\$ 52,563,209	\$ 48,777,428	\$ 45,228,512	\$ 33,522,966	\$ 24,525,290	\$ 21,890,751
Interest and Dividends on Securities	7,040,621	6,372,887	5,443,240	5,244,794	5,830,544	5,538,842
Trust Department and Other						
Operating Income	13,469,482	12,407,964	8,980,728	6,625,270	5,924,028	5,341,436
Total Operating Income	73,073,312	67,558,279	59,652,480	45,393,030	36,279,862	32,771,029
Salaries and Benefits	21,811,566	19,051,906	15,756,948	13,835,102	11,718,206	10,376,637
Interest Paid	26,698,753	27,073,762	27,584,891	18,760,508	12,444,852	11,626,986
Other Operating Expenses	17,050,237	14,217,770	11,993,136	9,553,891	8,508,819	8,555,103
Total Operating Expenses	65,560,556	60,343,438	55,334,975	42,149,501	32,671,877	30,558,726
Income Before Securities Gains						
or Losses	5,103,756	4,729,841	3,271,505	2,733,529	3,128,985	2,123,303
Net Income	5,100,459	4,467,922	3,325,921	2,606,679	3,198,875	2,754,192
Cash Dividends Paid	1,329,130	1,082,761	1,082,761	1,082,761	996,413	937,800
Stock Dividends Paid	3,181,140	—	—	—	—	—
Per Share Statistics (Adjusted for Stock Dividends)						
Income Before Securities						
Gains or Losses	\$ 6.41	\$ 5.95	\$ 4.11	\$ 3.44	\$ 3.94	\$ 2.90
Net Income	6.41	5.62	4.18	3.28	4.03	3.76
Cash Dividends Paid (1)	1.67	1.70	1.70	1.70	1.70	1.60
Book Value	61.19	56.37	52.52	49.78	47.97	47.68
Number of Common Shareholders —						
Year End	1,290	1,296	1,292	1,285	1,278	1,256
Average Earning Rates (Fully Taxable Basis)						
Total Loans	8.90%	8.91%	8.89%	7.84%	7.10%	7.66%
U.S. Government Securities	6.86	6.51	6.01	6.08	5.50	5.80
State, County and Municipal						
Securities	8.44	8.22	8.07	7.86	8.15	7.99
Gross Rate on Earning Assets	8.20	8.23	8.69	7.71	6.83	6.93
Key Percentages — Year End						
Income Before Securities Gains or						
Losses to Total Resources53%	.53%	.41%	.38%	.52%	.41%
Income Before Securities Gains or						
Losses to Capital Funds	11.38	11.32	8.26	7.16	8.96	6.32
Capital Funds to Deposits	6.41	6.41	6.79	7.01	7.30	7.92
Capital Funds to Loans	9.96	10.23	10.70	11.25	11.44	13.31
Loans to Deposits	64.34	62.73	63.45	62.33	63.81	59.54

(1) It was the bank's policy in 1976 to declare and pay cash dividends of \$1.72 per share. These cash dividends were effected by the 25% stock dividend paid in March 1976. In October 1976, the Board of Directors of Peoples National Bank adopted a policy of equal quarterly dividends which were at the rate of \$.43 per share.

PEOPLES NATIONAL BANK OF WASHINGTON

BOARD OF DIRECTORS

PERSONNEL

Joshua Green, Jr., Chairman of the Board and Chief Executive Officer

Joshua Green III, President

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R.G. Bourgaize, President, University Place Corporation

* **Ben E. Bowling**, Executive Vice President, The Seattle Foundation

Charles P. Burnett, III, Investor

Louis K. Bye, Investments

Sidney D. Campbell, Chairman of the Board, Foss Launch & Tug Co., A Division of Dillingham Corporation

Garrett Eddy, President, Eddy Investment Company; President, Port Blakely Mill Company

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* **F.S. Foster**, Hoquiam

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* **J.A. Green**, Everett

Howard E. Lovejoy, President and General Manager, Puget Sound Freight Lines

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Robert G. Perry, Executive Vice President and Secretary to the Board

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John H. Sellen, Chairman of the Board, Sellen Construction Co., Inc.

John E. Steiner, Vice President/Corporate Product Evaluation, The Boeing Company

S.C. "Syd" Tozier, President, Syd Tozier & Associates Insurance Brokers, Inc.

E.C. Underhill, Executive Vice President

A. Dean Worthington, Senior Vice President

* **Walter L. Wyckoff**, Chairman, Wyckoff Company

Thomas P. Youell, President, Convoy Company; President, Canadian Auto Carriers, Ltd.

* Advisory Directors to the Board

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Joshua Green III*, President

Robert G. Perry*, Executive Vice President and Secretary to the Board

E.C. Underhill*, Executive Vice President

Elmer Anderson, Senior Vice President

Woolsey Bingay, Senior Vice President and Cashier

J.G. Cairns, Jr., Senior Vice President and Manager, Operations Administration

Donald Greenfield, Senior Vice President

John C. Laughlin, Senior Vice President

Stanley M. Holifield, Asst. Vice President and Supervisor, Affirmative Action

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Bruce Broughton, Vice President

William Harisberger, Vice President

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John T. Stevens, Vice President and Manager, Bank Real Estate Department

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Madeleine R. Pettitt, Vice President

Richard C. Strand, Vice President

Consumer Credit Division

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Credit Card Department

Collin G. McKenny, Asst. Vice President and Manager

International Division

Gregory A. Magee, Asst. Vice President and Manager

William F. Breiten, Vice President

Investment Division

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Vincent J. Jollo, Manager

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Bradley N. Bishop, Manager

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Telephone: 345-2551
Robert B. Smock
Vice President and Manager

The following offices are
presently served on a set schedule
of two or more hours a day, two
or more days a week:

Basin City, George, Mattawa and
Wilson Creek

Agricultural Representatives
Serving the Columbia Basin Area:
Howard V. Copenhaver, Asst.
Vice President (c/o Moses
Lake Office)
David J. McKinney, Farm Services
Representative (c/o Pasco Office)

PEOPLES MORTGAGE COMPANY
CONSOLIDATED STATEMENT OF INCOME AND RETAINED EARNINGS

	Year ended December 31	
	1976	1975
Income:		
Loan servicing fees— Note 8	\$1,775,764	\$1,423,747
Loan origination and related fees	2,298,146	1,843,565
Interest on notes and mortgage loans	2,044,148	1,978,983
Other	45,379	40,978
	<u>6,163,437</u>	<u>5,287,273</u>
Expenses:		
Salaries and bonuses	1,904,967	1,366,535
Other employee benefits	258,321	241,471
Interest	970,350	1,188,429
Depreciation and amortization	97,982	46,355
Management fee to Peoples National Bank	36,000	36,000
Provision for loan losses	222,726	311,585
Other operating expenses including amortization of mortgage service acquisition costs— Notes 3 and 8	1,477,225	1,213,864
	<u>4,967,571</u>	<u>4,404,239</u>
Income from operations before provision for federal income taxes and cumulative effect of change in accounting principle to reflect adoption of Statement of Position	1,195,866	883,034
Provision for federal income taxes— Note 1	542,000	408,000
Income before cumulative effect of change in accounting principle to reflect adoption of Statement of Position	653,866	475,034
Cumulative effect to December 31, 1975 of change in accounting principle to reflect adoption of Statement of Position during 1976— Note 2	(52,000)	
Net income	601,866	475,034
Retained earnings, beginning of year	171,347	146,313
Dividends, \$40.00 and \$45.00 per share— Note 6	(600,000)	(450,000)
Retained earnings, end of year	<u>\$ 173,213</u>	<u>\$ 171,347</u>
Pro-forma net income assuming adoption of the Statement of Position was applied retroactively— Note 2	<u>\$ 653,866</u>	<u>\$ 527,034</u>

See accompanying notes to consolidated financial statements.

PEOPLES MORTGAGE COMPANY
CONSOLIDATED BALANCE SHEET

	December 31	
	1976	1975
Assets— Note 1		
Current Assets:		
Cash on hand and in banks	\$ 127,879	\$ 123,348
First mortgage loans in process (net of undisbursed loan funds of \$9,752,805 and \$7,668,845) or held for resale (net of discounts of \$702,062 and \$606,404) at December 31, 1976 and 1975, respectively	\$44,541,089	\$39,930,885
Accrued interest receivable	366,389	322,505
	<u>44,907,478</u>	<u>40,253,390</u>
Less— Participations sold to—		
Peoples National Bank— Note 8	24,265,081	21,688,553
Other banks	<u>5,131,580</u>	<u>18,564,837</u>
Real estate held for resale	85,147	217,315
Reserve for possible losses	(160,000)	(135,000)
Notes and accounts receivable	228,890	188,846
Prepaid expenses and deposits	<u>302,189</u>	<u>261,059</u>
	<u>16,094,922</u>	<u>19,220,405</u>
Trust Funds:		
Cash in bank	6,868,711	6,280,274
Less— Contra liability	<u>(6,868,711)</u>	<u>(6,280,274)</u>
Fixed Assets , at cost (net of accumulated depreciation and amortization of \$271,401 and \$194,536, respectively)	150,423	179,956
Investments:		
FNMA stock, at cost, market value, \$352,193 and \$296,295, respectively	287,301	285,956
Other Assets— Note 3	<u>418,389</u>	<u>457,758</u>
	<u>\$16,951,035</u>	<u>\$20,144,075</u>
Liabilities and Stockholder's Equity		
Current Liabilities:		
Notes payable— Note 4	\$13,856,198	\$17,256,748
Accrued interest payable	188,879	228,198
Accounts payable and accrued expenses	547,772	263,920
Payable for Federal Income Taxes— Note 1	484,973	524,236
Deferred fees and interest	<u>200,000</u>	<u>199,626</u>
	<u>15,277,822</u>	<u>18,472,728</u>
Stockholder's Equity:		
Common stock, \$100 par value—		
15,000 shares authorized and outstanding at December 31, 1976 and 1975— Note 6	\$ 1,500,000	\$ 1,500,000
Retained earnings—		
Unappropriated	153,213	151,347
Appropriated for contingencies	<u>20,000</u>	<u>20,000</u>
	<u>1,673,213</u>	<u>1,671,347</u>
Commitments and Contingent Liabilities— Note 7	<u>\$16,951,035</u>	<u>\$20,144,075</u>

See accompanying notes to consolidated financial statements.

PEOPLES MORTGAGE COMPANY
CONSOLIDATED STATEMENT OF CHANGES IN FINANCIAL POSITION

	Year ended December 31	
	1976	1975
Financial resources were provided by:		
Net income	\$ 601,866	\$ 475,034
Add back charges not representing a use of financial resources —		
Depreciation and amortization	\$ 97,982	\$ 46,355
Amortization of mortgage servicing premium	109,682	174,288
	207,664	220,643
	809,530	695,677
Reclassification of prepaid taxes		41,285
Sale of fixed assets	1,552	1,803
Proceeds from issuance of common stock		500,000
	811,082	1,238,765
Financial resources were used for:		
Acquisition of fixed assets	56,627	64,832
Additions to other assets	83,687	22,274
Additions to investments	1,345	25,917
Dividends	600,000	450,000
	741,659	563,023
Net increase in working capital	\$ 69,423	\$ 675,742
Analysis of Changes in Working Capital		
Increase (decrease) in current assets:		
Cash on hand and in banks	\$ 4,531	\$ 72,334
First mortgage loans in process	4,610,204	7,750,351
Accrued interest receivable	43,884	(109,476)
Participations sold to Peoples National Bank and other banks	(7,708,108)	(4,488,486)
Real estate held for resale	(132,168)	(330,796)
Reserve for possible loss	(25,000)	(72,427)
Notes and accounts receivable	40,044	127,693
GNMA securities		(945,034)
Prepaid expenses and deposits	41,130	132,342
	(3,125,483)	2,136,501
(Increase) decrease in current liabilities:		
Notes payable	3,400,550	(974,477)
Accrued interest payable	39,319	80,334
Accounts payable and accrued expenses	(283,852)	(8,440)
Payable for federal income taxes	39,263	(358,550)
Deferred fees and interest	(374)	(199,626)
	3,194,906	(1,460,759)
Net increase in working capital	\$ 69,423	\$ 675,742

See accompanying notes to consolidated financial statements.

PEOPLES MORTGAGE COMPANY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 1976 & 1975

Note 1 — Ownership and Summary of Significant Accounting Policies: Peoples Mortgage Company is engaged in the mortgage banking business including the servicing of mortgage loans for others under agreements with various investors.

The accounting and reporting policies of Peoples Mortgage Company conform to generally accepted accounting principles and to predominant practices within the mortgage industry.

Corporate ownership — Peoples Mortgage Company is a wholly owned subsidiary of Peoples National Bank of Washington (Note 8).

In 1976, Western States Mortgage Company was organized by Peoples Mortgage Company as a wholly owned subsidiary. This subsidiary operates in various states as an approved mortgagee for the purpose of originating mortgage loans.

Principles of consolidation — The consolidated financial statements of Peoples Mortgage Company include the accounts of the company and its subsidiary, Western States Mortgage Company. All significant intercompany transactions and balances have been eliminated.

Fixed assets — Property and equipment are stated at cost less accumulated depreciation and amortization. The company provides for depreciation and amortization of fixed assets over their estimated useful lives as follows:

	Method	Years
Furniture and fixtures	Declining-balance	5-10
Leasehold improvements	Straight-line	(Life of lease)
Automobile equipment	Straight-line	3

Gains and losses on routine dispositions are reflected in current operations. Maintenance and repairs are charged to operating expenses and betterments are capitalized.

Investments — In order to maintain the right to service FNMA-owned loans, the company is required to hold FNMA stock. At December 31, 1976, substantially all shares owned by the company are required to continue this servicing.

Federal income taxes — The company files a consolidated tax return with its parent company. Accordingly, the federal income tax provision is based on financial reported income computed at a statutory rate of 48% and amounts currently due are paid to the parent company. Deferred taxes are provided for timing differences between financial reporting and income tax reporting. The tax effects of these timing differences, primarily arising from differences in recording of deferred interest income and commitment fees for book and tax purposes, are reflected as prepaid income taxes and are included in prepaid expenses and deposits. Investment tax credits are realized at the time of property acquisitions utilizing the flow-through method of accounting.

Note 2 — Change in Accounting Principle: During the current year, the company adopted the accounting recommendation in the "Statement of Position on Accounting for Origination Costs and Loan and Commitment Fees in the Mortgage Banking Industry." The new method was adopted to match more closely commitment fee income with the term of interim loans. The effect of the change in 1976 was to decrease income before cumulative effect of change in accounting principle by approximately \$100,000. The adjustment of \$52,000 (net of \$48,000 in taxes) to apply retroactively the new method is included as an expense in 1976. The pro forma amounts shown on the income statement have been adjusted for the effect of retroactive application of the new accounting principle, net of tax.

Note 3 — Other Assets: In prior years, the company acquired nonaffiliated mortgage companies and the right to service loan portfolios. The cost of the right to service loan portfolios acquired is being amortized over the expected average life of portfolios. The unamortized servicing acquisition costs, included in other assets, at December 31, 1976 and 1975 amounted to \$417,139 and \$443,133, respectively.

Note 4 — Notes Payable: Notes payable are comprised of:

	December 31	
	1976	1975
Peoples National Bank, payable on demand, bearing interest at 6% per annum in 1975		\$ 2,000,000
Commercial Paper, generally payable within 90 days, at rates varying from 5% to 7¼% per annum	\$13,856,198	\$15,256,748
	<u>\$13,856,198</u>	<u>\$17,256,748</u>

Note 5 — Retirement Plans: Effective December 31, 1975, the company discontinued contributions to its profit-sharing plan, terminated its deferred compensation plan and adopted a new pension plan covering substantially all of its employees. Amounts previously accrued under the deferred compensation plan were applied to the new pension plan. It is the company's policy to fund pension costs accrued. At December 31, 1975, the unfunded past service costs of the pension plan amounted to approximately \$195,000. The pension expense in 1976 and 1975 amounted to \$62,520 and \$59,615, respectively, including amortization of past service cost over a 30-year period.

Note 6 — Common Stock: At December 31, 1975, the company issued 5,000 common shares at \$100 par value to Peoples National Bank of Washington in exchange for cash. The dividends paid in 1975 were on the 10,000 shares of stock outstanding during 1975.

PEOPLES MORTGAGE COMPANY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 1976 & 1975

Note 7—Commitments and Contingent Liabilities:

At December 31, 1976, the company was obligated under the provisions of long-term leases of buildings with approximate minimum rentals as follows:

Year ended December 31	Rentals
1977	\$ 93,000
1978	149,000
1979	145,000
1980	156,000
1981	157,000
1982-1987	891,000

Rental expense for the years ended December 31, 1976 and 1975 included in the accompanying statement of income and retained earnings is approximately \$157,000 and \$72,000, respectively

Note 8—Related-Party Transactions:

Peoples National Bank of Washington —

The company is a party to agreements with Peoples National Bank of Washington whereby it has sold at market value, at negotiated interest rates, its equity in loans in process and GNMA mortgage-backed securities. The bank has discretionary power with respect to loans and

other securities offered, but once accepted, its recourse is limited to its pro rata equity in the loans and securities; however, the mortgage company may repurchase such loans and securities at a negotiated rate. The mortgage company continues to manage these loans and receives a fee for this service.

The company issues commercial paper which is guaranteed by an irrevocable letter of credit of Peoples National Bank of Washington.

Peoples National Bank provides loans and computer services to the mortgage company. Peoples Mortgage Company services real estate loans owned by Peoples National Bank.

A summary of the servicing fees received and expenses paid by the company are as follows:

	December 31	
	1976	1975
Classified on the accompanying financial statements as:		
Loan servicing fees	\$353,000	\$339,000
Interest — Peoples National Bank	47,000	229,000
Other operating expenses	247,000	179,600

REPORT OF INDEPENDENT ACCOUNTANTS

The Board of Directors of
Peoples Mortgage Company

We have examined the consolidated balance sheets of Peoples Mortgage Company and its subsidiary as of December 31, 1976 and 1975, and the related consolidated statements of income and retained earnings and of changes in financial position for the years then ended. 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.

The method of accounting for loan origination costs and loan and commitment fees was changed in 1976 to reflect adoption of the "Statement of Position on Accounting for Origination Costs and Loan and Commitment Fees in the Mortgage Banking Industry" issued by the American Institute of Certified Public Accountants on August 25, 1976 and as more fully discussed in Note 2 to the financial statements.

In our opinion, the consolidated financial statements examined by us present fairly the financial position of Peoples Mortgage Company and its subsidiary at December 31, 1976 and 1975, and the results of their operations

and changes in financial position for the years then ended, in conformity with generally accepted accounting principles consistently applied, except for the change with which we concur, in the method of accounting for loan origination costs and loan and commitment fees, referred to in the preceding paragraph.

January 11, 1977
Seattle, Washington

Price Waterhouse & Co.

**PEOPLES MORTGAGE COMPANY
OFFICERS AND DIRECTORS**

ADDRESSES

Joshua Green, Jr., Chairman of the Board
and Director
Joshua Green III, President and Director
Robert G. Perry, Secretary/Treasurer
and Director
E.C. Underhill, Executive Vice President
and Director
J.G. Cairns, Jr., Senior Vice President
and Director
Dean M. Olson, Senior Vice President,
Director and Manager
David E. Thatcher, Senior Vice President
and Director
Elmer Anderson, Director
Larry Kelley, Vice President
David G. Mullins, Vice President
Charles W. Moore, Vice President
James H. McMahan, Vice President
Muriel H. Nelson, Vice President
William H. Nyberg, Vice President
Gordon W. Schlicke, Vice President
H. Roger Van Valkenburgh, Vice President
Jay C. Williams, Vice President
Fred C. Banks, Assistant Vice President
Carl Bixler, Assistant Vice President
Dan L. Carlo, Assistant Vice President
Richard Hooper, Assistant Vice President
Russell A. Jacobson, Assistant Vice
President
Carolynne Dow, Assistant Vice President
Carol Smallwood, Assistant Vice President
Clifford A. Peterson, Assistant Vice
President
Zella G. Christopher, Accounting Officer
Bonita Butcher, Loan Servicing Officer
Stephen G. Hess, Loan Servicing Officer
Julie Richwine, Loan Servicing Officer
Karen Reed, Production Servicing Officer
Phyllis Updegrave, Personnel Director

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Commercial Loan Department

Plaza 600 Building
Seattle, Washington 98101

Peoples Service Corporation

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Virginia W. Johnson, Assistant Vice
President and Manager
Margie E. Patterson, Assistant Vice
President
Adrianne Tollefsen, Secretary
Pamela Frey, Assistant Secretary
(Vancouver)
Hazle Kelley, Escrow Officer (Vancouver)
Arlene Kuk, Escrow Officer (Bellevue)

PEOPLES LEASING COMPANY, INC.
STATEMENT OF INCOME AND RETAINED EARNINGS

	Year ended December 31	
	1976	1975
Income:		
Personal property lease revenue	\$3,258,943	\$2,356,466
Fees	245,623	123,111
Other	124,318	68,038
	<u>3,628,884</u>	<u>2,547,615</u>
Expenses:		
Interest	2,030,372	1,458,714
Salaries and bonuses	329,376	214,762
Other employee benefits— Note 3	49,992	56,779
Depreciation and amortization	54,692	14,753
Management fee to Peoples National Bank	12,000	12,000
Provision for bad debts	97,813	40,890
Other operating expenses	361,686	242,673
	<u>2,935,931</u>	<u>2,040,571</u>
Income before provision for federal income taxes— Note 1	692,953	507,044
Provision for federal income taxes— Note 1	<u>326,410</u>	<u>239,176</u>
Net income	366,543	267,868
Retained earnings, beginning of year	95,397	22,529
Dividends, \$65.00 and \$39.00 per share	(325,000)	(195,000)
Retained earnings, end of year	<u>\$ 136,940</u>	<u>\$ 95,397</u>

See accompanying notes to financial statements.

PEOPLES LEASING COMPANY, INC.
BALANCE SHEET

	December 31	
	1976	1975
Assets— Note 1		
Cash on hand and in bank	—	\$ 5,024
Personal property lease receivables (net of unearned lease revenue of \$5,799,199 and \$4,890,881 and allowance for doubtful lease receivables of \$140,000 and \$80,000, respectively)	\$28,492,441	21,469,524
Inventory of reacquired personal property, at cost, which approximates market	76,992	84,188
Prepaid expenses	9,833	5,314
Fixed assets, at cost (net of accumulated depreciation and amortization of \$79,355 and \$24,733, respectively)	53,521	86,927
Other assets	2,647	4,483
	<u>\$28,635,434</u>	<u>\$21,655,460</u>
Liabilities and Stockholder's Equity		
Liabilities		
Notes payable— Note 2	\$27,522,482	\$20,956,151
Accrued interest payable	54,820	189,355
Accounts payable and accrued expenses	177,287	60,728
Customer deposits	175,596	112,485
Total liabilities	<u>27,930,185</u>	<u>21,318,719</u>
Deferred Federal Income Tax— Note 1	<u>518,309</u>	<u>191,344</u>
Stockholder's Equity:		
Common stock, stated value \$10— 5,000 shares authorized and outstanding at December 31, 1976 and 1975	50,000	50,000
Retained earnings— Unappropriated	86,940	45,397
Appropriated for contingencies	50,000	50,000
Total stockholder's equity	<u>186,940</u>	<u>145,397</u>
	<u>\$28,635,434</u>	<u>\$21,655,460</u>

See accompanying notes to financial statements.

PEOPLES LEASING COMPANY, INC.
STATEMENT OF CHANGES IN FINANCIAL POSITION

	Year ended December 31,	
	1976	1975
Financial resources were provided by: (Note 1)		
Current operations—		
Net income for the year	\$ 366,543	\$ 267,868
Deferred income tax	326,965	239,176
Depreciation and amortization	54,692	14,753
	<u>748,200</u>	<u>521,797</u>
Net increase (decrease) in liabilities—		
Notes payable	6,566,331	5,229,358
Accrued interest payable	(134,535)	23,694
Accounts payable	116,559	40,861
Customer deposits	63,111	80,937
Decrease in reacquired personal property	7,196	114,238
Total funds provided	<u>\$7,366,862</u>	<u>\$6,010,885</u>
Financial resources were applied to:		
Net increase (decrease) in assets—		
Investment in lease contracts, net of unearned income	\$7,022,917	\$5,548,780
Furniture and fixtures	21,287	55,462
Cash	(5,024)	3,774
Other	2,682	207,869
Dividends paid to Peoples National Bank	325,000	195,000
Total funds applied	<u>\$7,366,862</u>	<u>\$6,010,885</u>

See accompanying notes to financial statements.

PEOPLES LEASING COMPANY, INC.
NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 1976 & 1975

Note 1 — Ownership and Summary of Significant Accounting Policies: Corporate ownership — Peoples Leasing Company is a wholly owned subsidiary of Peoples National Bank of Washington (Note 4).

Accounting for leases—The company accounts for personal property leases (equipment and automobile) under the financing method. Under this method, the excess of aggregate lease rentals receivable over the cost of the related personal property, reduced by the estimated residual value at the termination of the lease, is recorded as unearned revenue. The salvage value on the equipment lease contracts receivable is approximately \$400,000 at December 31, 1976. Revenue is recognized on a declining basis over the life of the lease in proportion to the unrecovered investment.

Vehicle leases are payable in monthly instalments and have maturities from one to three years. Substantially all equipment leases are payable monthly and have maturities from three to seven years.

Fixed assets—Property and equipment are stated at cost less accumulated depreciation and amortization. The company provides for depreciation of furniture and fixtures over their estimated useful lives and for amortization of leasehold improvements over the remaining life of the lease as follows:

	Method	Years
Furniture and fixtures	Declining Balance	3-10
Leasehold improvements	Straight-line	Life of lease

Gains and losses on routine dispositions are reflected in current operations. Maintenance and repairs are charged to operating expenses and betterments are capitalized.

Federal income taxes—The company files a consolidated return with its parent company. Accordingly, the federal income tax provision is based on financially reported income computed at a statutory rate of 48% and amounts currently due are paid to the parent company. Deferred taxes are provided for timing differences between financial reporting and income tax reporting, primarily the conversion of equipment leases from the financing method of accounting to the operating method for taxes. Investment tax credits utilized by the company are realized at the time of property acquisitions utilizing the flow-through method of accounting.

Note 2 — Notes Payable: Notes payable are comprised of:

	December 31	
	1976	1975
Peoples National Bank (Note 4), payable on demand, bearing interest at rates varying from 6% to 10.5% per annum	\$22,276,990	\$15,606,158
Commercial paper, payable at maturity dates ranging from 30 to 270 days, bearing interest at rates varying from 5% to 6.5% per annum	5,245,492	5,349,993
	<u>\$27,522,482</u>	<u>\$20,956,151</u>

Note 3 — Retirement Plan: Effective December 31, 1975, the company discontinued contributions to its profit-sharing plan and adopted a new pension plan covering substantially all of its employees. It is the company's policy to fund pension costs accrued. At December 31, 1975, the unfunded past service costs of the pension plan amounted to approximately \$30,000. The pension expense in 1976 amounted to \$9,800 including amortization of past service cost over a 30-year period. The profit-sharing expense in 1975 amounted to \$26,500 and there was no pension expense.

Note 4 — Related-Party Transactions: Peoples National Bank of Washington—The company issues commercial paper which is guaranteed by an irrevocable letter of credit of Peoples National Bank of Washington.

Peoples National Bank provides loans and computer services to the company.

A summary of amounts paid by the company to Peoples National Bank are as follows:

	December 31	
	1976	1975
Classified on the accompanying financial statements as:		
Interest—Peoples National Bank (Note 2)	\$1,654,327	\$1,119,142
Other operating expenses	12,779	2,671

REPORT OF INDEPENDENT ACCOUNTANTS

To the Board of Directors Peoples Leasing Company, Inc.

In our opinion, the accompanying balance sheets and related statements of income and retained earnings and of changes in financial position present fairly the financial position of Peoples Leasing Company, Inc. at December 31, 1976 and 1975, the results of its operations and the changes in financial position for the years then ended, in conformity with generally accepted accounting principles consistently applied. Our examinations of these statements 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.

January 10, 1977
Seattle, Washington

Price Waterhouse & Co.

PEOPLES LEASING COMPANY, INC.
OFFICERS AND DIRECTORS

ADDRESSES

Joshua Green, Jr., Chairman of the Board
and Director
Joshua Green III, President and Director
Robert G. Perry, Secretary/Treasurer
and Director
E. C. Underhill, Executive Vice President
and Director
J. G. Cairns, Jr., Senior Vice President
and Director
Elmer M. Anderson, Director
Donald Greenfield, Director
E. J. Curre, Vice President
and Acting Manager
Cheryl D. Strickert, Assistant Vice President
Nancy M. Vasconi, Assistant Vice President
Linda A. Shurtleff, Assistant Vice President
Frank L. Anderson, Assistant Vice President
Judith L. Krause, Corporate Officer
William H. Bartell, Corporate Officer

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515 Union Street
Seattle, Washington 98101
(206) 344-2370

Peoples Leasing Company, Inc.
500 N. E. Multnomah
Lloyd Building, Suite 900
Portland, Oregon 97232
(503) 238-6500

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~~DEC 14 1981~~

~~DEC 10 1981 REID~~

Peoples National Bank

1414 Fourth Avenue, Seattle, Washington 98111
Member FDIC