

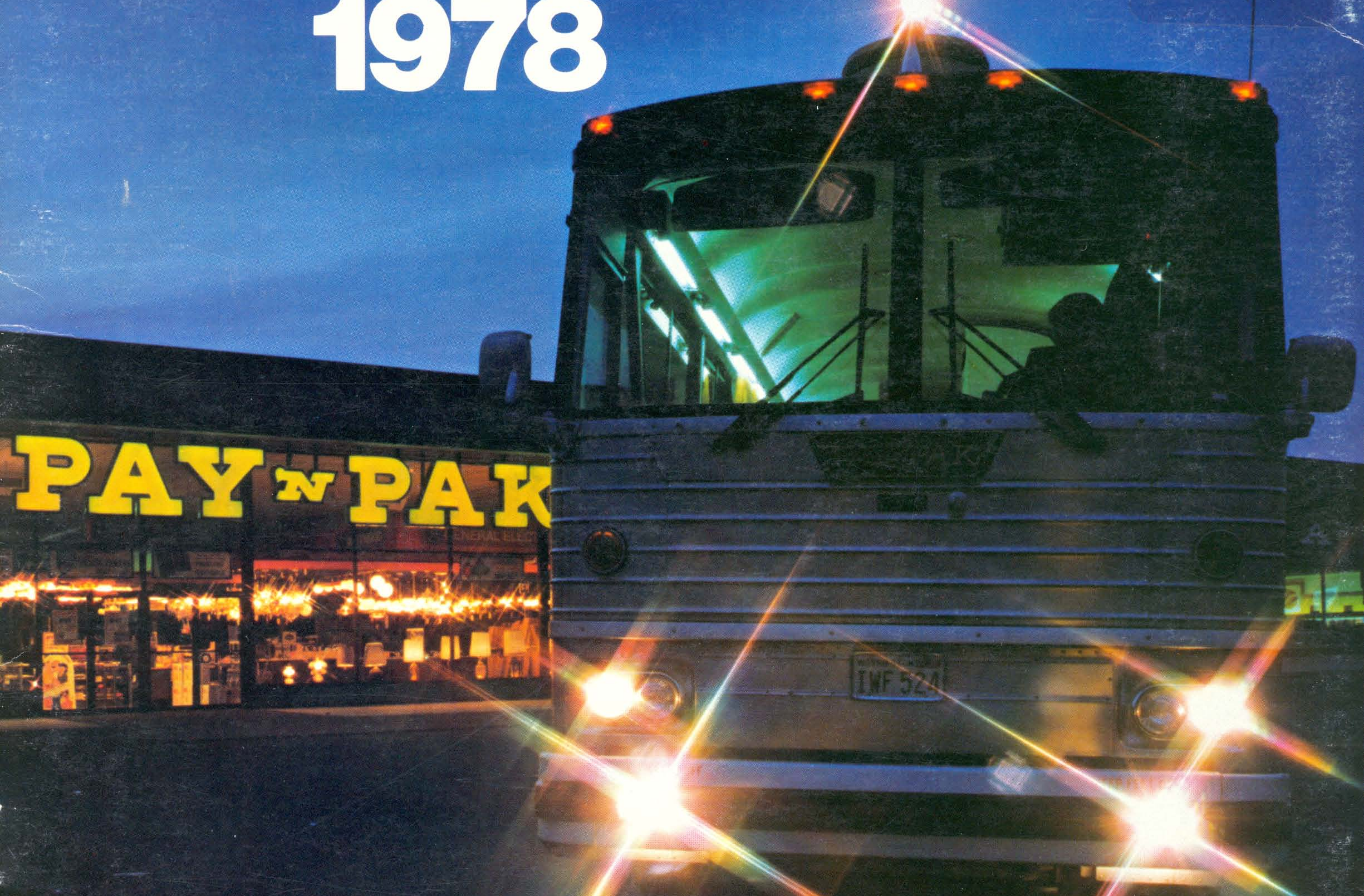
ANNUAL REPORT

ANNUAL REPORTS

PAY'n PAK Stores, Inc. 1978

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PAY^N PAK STORES, INC. ANNUAL REPORT 1978



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training our people to serve you better...



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

Jerry L. Marlow — *President
and Chief Operating Officer*

PAY'N PAK STORES, INC.

Summary of Growth Highlights

Years ended February 28 or 29	1978	1977	1976	1975	1974	1973	1972	1971	1970
OPERATIONS									
Revenues	\$98,051,888	\$80,642,749	\$73,279,952	\$61,470,839	\$51,893,886	\$42,396,952	\$30,927,898	\$21,806,396	\$18,096,799
Income before federal and state taxes	8,182,582	5,767,129	4,878,524	4,285,203	3,619,206	2,940,394	2,168,175	1,495,528	1,117,866
Net income	4,166,495(4)	3,030,823	2,574,624	2,226,045	1,857,300	1,459,801	1,132,312	663,840(5)	559,154
COMMON STOCK									
*Average number of common shares	2,413,964	2,413,964	2,491,331	2,506,805	2,506,805	2,483,965	2,429,213	2,415,297	2,025,194
*Net income per common stock	\$1.73	\$1.26	\$1.03	\$.89	\$.74	\$.59	\$.47	\$.27	\$.28
Stock dividends and stock splits	50%	10%	10%						
*Cash Dividends	\$.55	\$.36(1)	\$.28	\$.193	\$.138	\$.085	\$.083	\$.083	\$.083
FINANCIAL POSITION (END OF YEAR)									
Total assets	\$41,527,113	\$36,684,651	\$30,239,521	\$26,003,356	\$23,278,072	\$21,407,344	\$16,640,230	\$11,169,578	\$10,220,358
Stockholders' equity	\$17,517,318	\$14,229,258	\$12,120,143	\$12,439,968	\$10,697,329	\$ 9,185,319	\$ 7,786,334	\$ 6,587,708	\$ 6,122,564
Return on shareholders' equity	29.2%	25.0%	20.7%	20.8%	20.2%	18.8%	17.1%	12.5%	23.0%
Shares of common stock outstanding	2,413,964	2,413,964	2,413,964	2,506,805	2,506,805	2,506,805	2,456,438	2,415,600	2,414,874
Net asset value per share	\$7.72(2)	\$6.38(2)	\$5.35(2)	\$4.96	\$4.27	\$3.66	\$3.17	\$2.73	\$2.54
Long term debt	\$ 8,772,803	\$ 9,020,548	\$ 8,225,894	\$ 5,008,324	\$ 5,372,583	\$ 673,879	\$ 721,761	\$ 946,328	\$ 803,931
STORES IN OPERATION									
Number of stores open	69	64	59	54	48	44	40	36	31
Number of stores sold or closed	1	0	3	1	1	1	0	0	0
Stores replaced with new stores	1	2	2	0	3	5	0	0	0
Number of states in which we operated	13	13	11	11	11	11	8	6	6
Square footage of stores	1,365,182	1,260,769	1,144,847	1,030,808	890,529	783,588	584,380	465,180	358,680
Average square footage per store	19,785	19,700	19,363	19,089	18,553	17,808	14,609	12,922	11,570
Average annual inventory in stores	\$20,226,001	\$17,951,974	\$14,814,718	\$13,603,679	\$13,714,778	\$10,645,251	\$ 7,172,653	N/A	N/A
Average annual inventory total (includes warehouse)	\$24,616,742	\$21,007,255	\$16,846,580	\$14,825,123	\$14,723,192	\$11,195,251	\$ 7,397,098	\$ 4,216,209	\$ 3,200,194
STORE AVERAGES									
Average sales per store	\$ 1,421,042	\$ 1,260,042	\$ 1,242,033	\$ 1,138,348	\$ 1,081,122	\$ 963,567	\$ 773,197	\$ 605,733	\$ 583,767
Number of customers served	4,979,781	4,419,596	4,104,371	3,647,036	3,251,000	2,849,000	N/A	N/A	N/A
Average customer purchase	\$19.69	\$18.25	\$17.85	\$16.86	\$15.96	\$14.88	N/A	N/A	N/A
Sales per square foot	\$71.82	\$63.96	\$64.01	\$59.63	\$58.27	\$54.11	\$52.92	\$46.88	\$50.45
Sales per full time employee (End of Year)	\$ 115,084	\$ 108,536	\$ 103,502	\$ 88,320	\$ 91,523	\$ 83,294	\$ 74,345	N/A	N/A

* After giving retroactive effect to the 50% stock dividend paid July 29, 1977 to shareholders of record July 8, 1977

(1) In addition a \$.15 per share cash dividend for the first quarter of 1978 was declared January 14, 1977 payable April 25, 1977

(2) After giving retroactive effect to shares held by the Employee Stock Ownership Trust (ESOT) which have not been allocated to employee accounts: 224,067 shares in 1976 and 185,102 shares in 1977 and 143,806 shares in 1978

After giving effect to the 33 1/3% stock dividend paid to shareholders on April 28, 1978

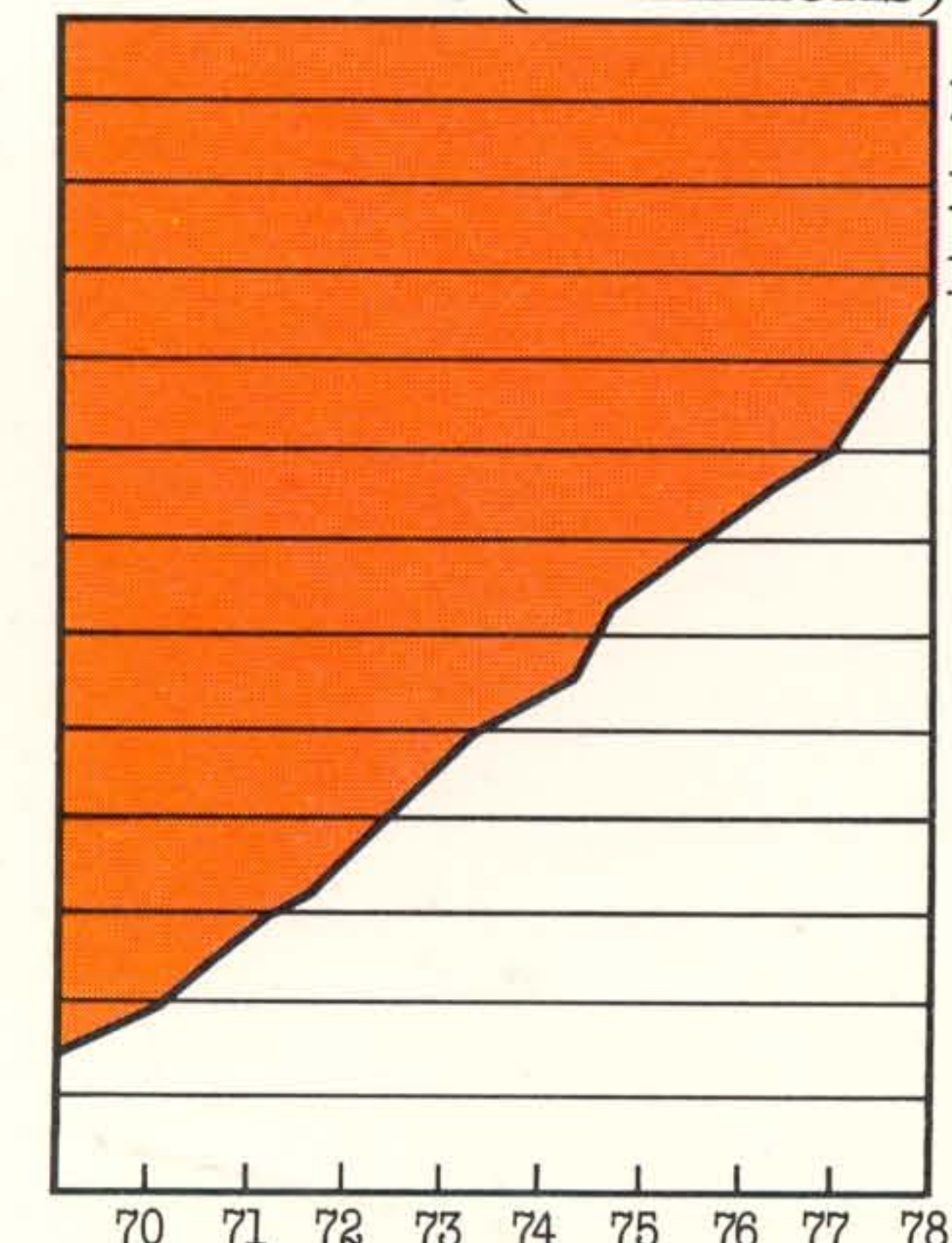
Average number of common shares	3,218,619	3,218,619	3,321,775	3,342,407	3,342,407	3,311,953	3,238,951	3,220,396	2,700,259
Net income per common share	\$1.29	\$.94	\$.78	\$.67	\$.56	\$.44	\$.35	\$.21	\$.21
Cash dividends paid per common share413	.27	.21	.145	.103	.065	.062	.062	.062
Shares of common stock outstanding	3,218,619	3,218,619	3,218,619	3,342,407	3,342,407	3,342,407	3,275,251	3,220,800	3,219,832
Net asset value per share	\$5.79(3)	\$4.79(3)	\$4.01(3)	\$3.72	\$3.20	\$2.75	\$2.38	\$2.05	\$1.90

(3) After giving effect to shares held by the ESOT which have not been allocated to employee accounts: 298,755 shares in 1976, 246,802 in 1977, 191,741 in 1978

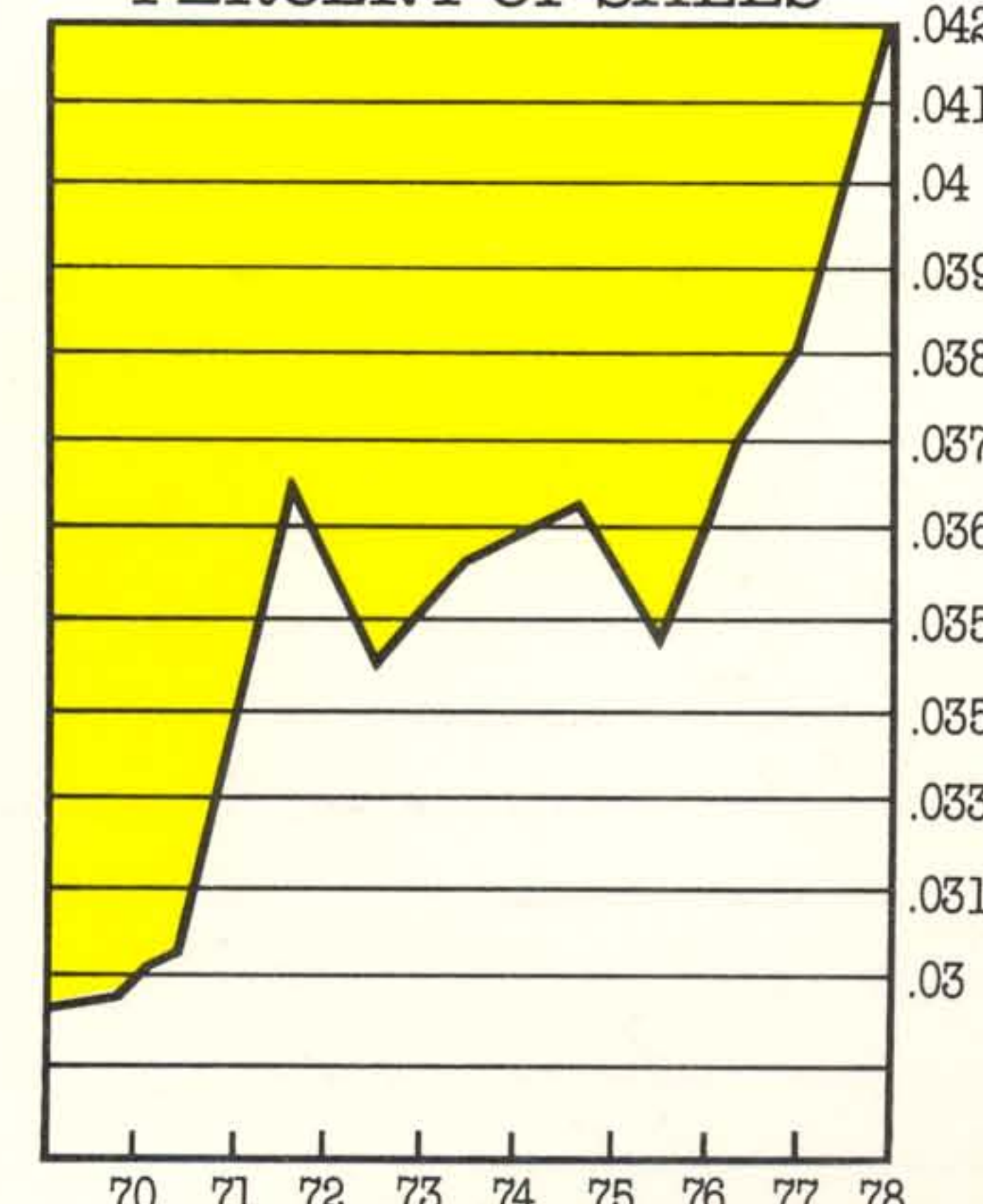
(4) Net income in 1978 includes a net reduction of \$191,337 (\$.08 per share, \$.06 per share after 1979 stock split) due to a change in the method of accounting for pre-opening costs to expensing them as incurred rather than amortizing them.

(5) Net income in 1971 includes a net reduction of \$98,692 (\$.04 per share, \$.03 per share after 1979 stock split) due to a loss from discontinued operations.

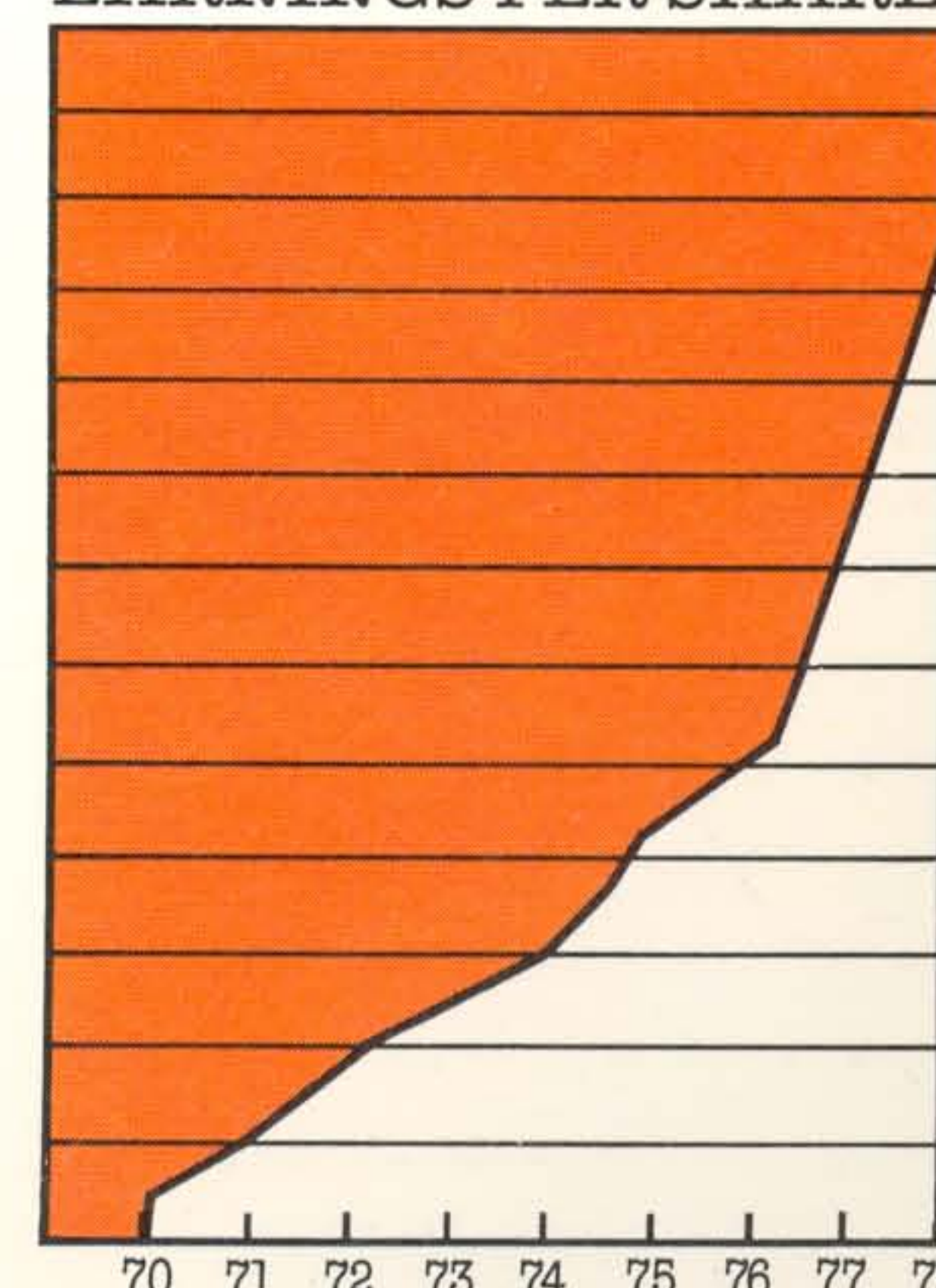
REVENUES (in millions)



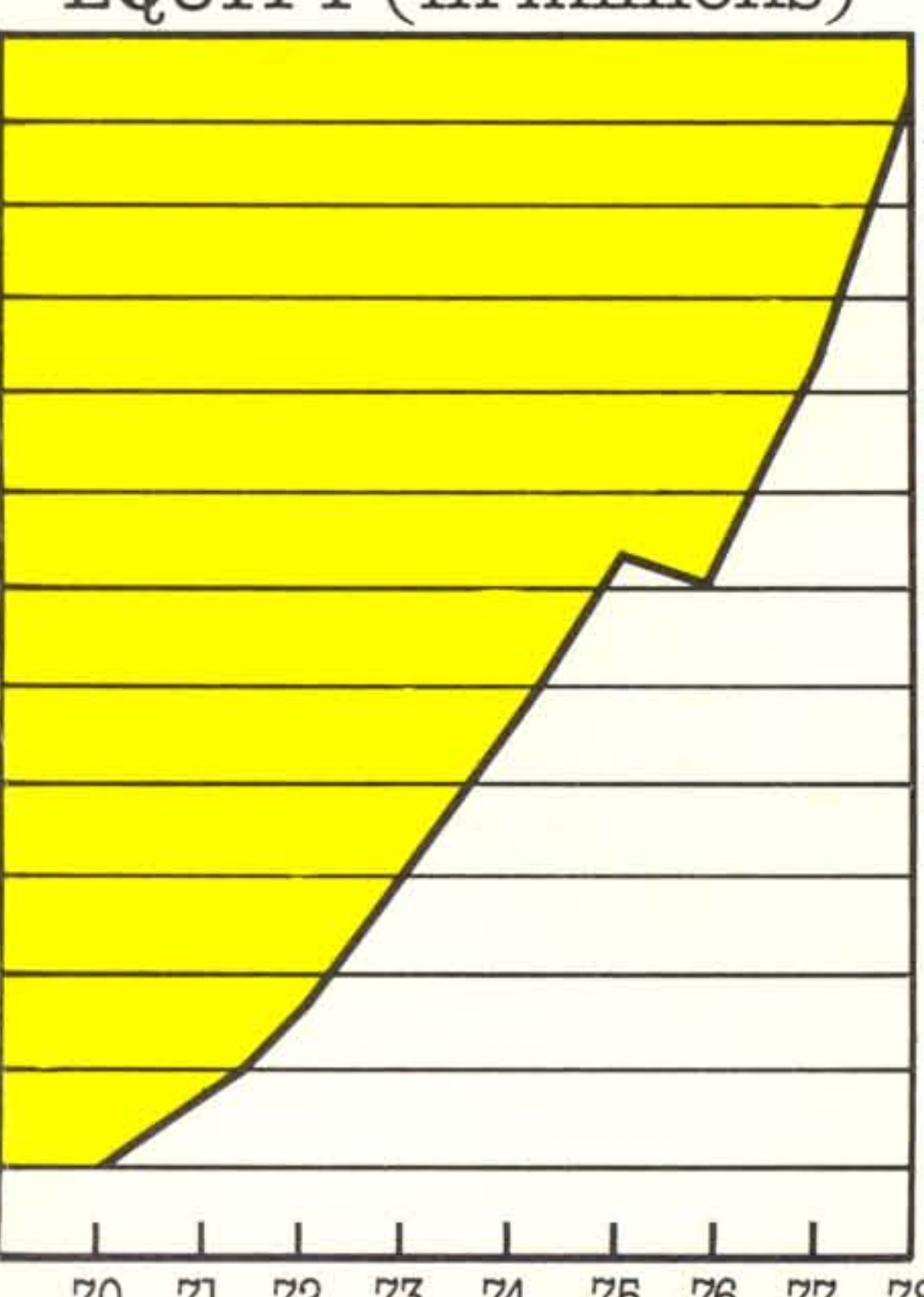
NET INCOME AS A PERCENT OF SALES



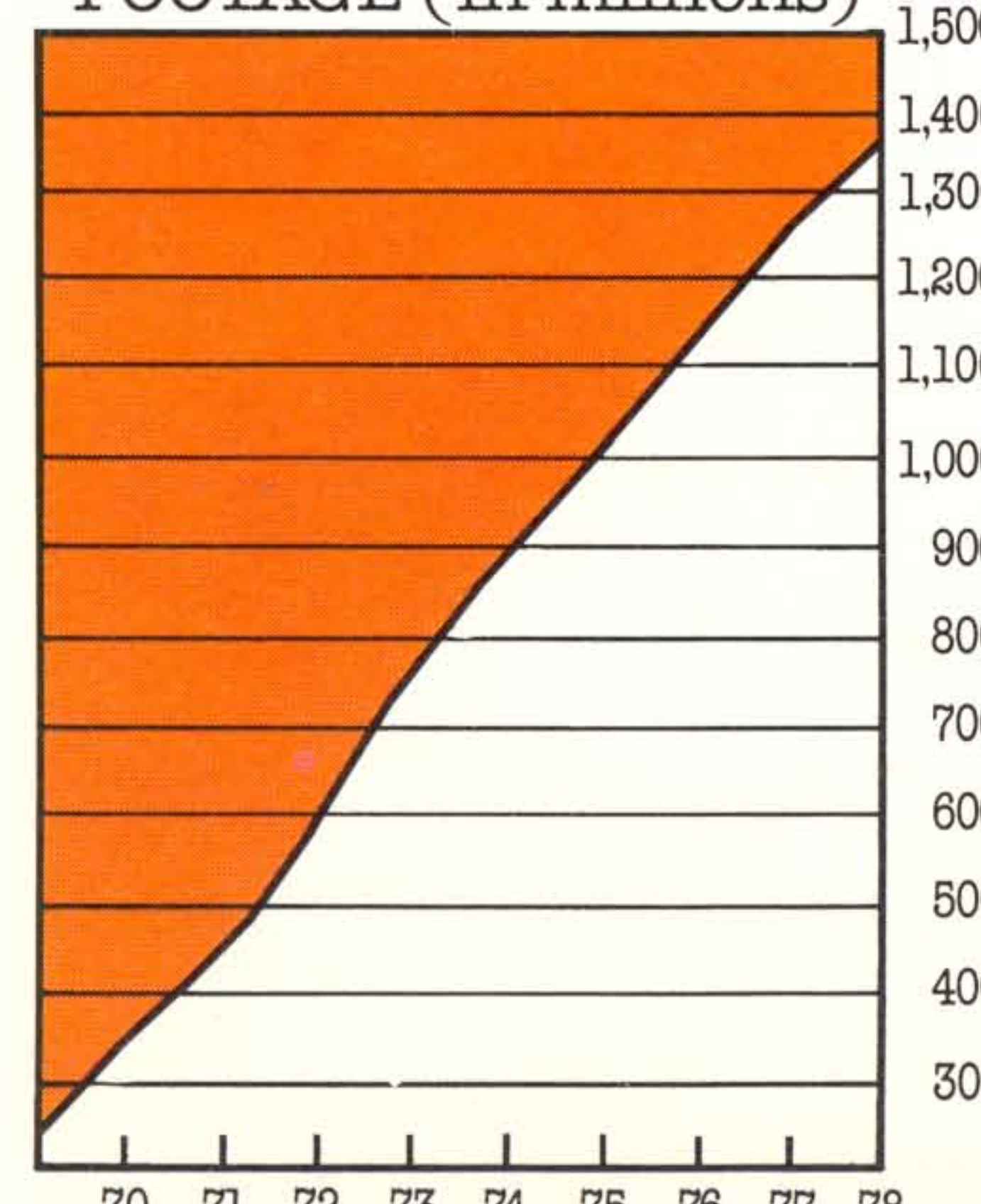
EARNINGS PER SHARE



STOCKHOLDERS' EQUITY (in millions)



STORES SQUARE FOOTAGE (in millions)



THE COVER STORY

The Pay 'N Pak Mobile Training Unit, a standard size 40 foot bus made by a subsidiary of Greyhound Lines, is completely outfitted as a mobile classroom. This is the latest step in our continuing dedication to training our people to better serve the do-it-yourselfer.

PAY'NPAK STORES, INC.

Pay 'N Pak Stores, Inc. operates 69 stores in 51 cities in 13 western and midwestern states.

The Company caters to the do-it-yourself home improvement market through the sale of electrical, lighting, plumbing and building materials on a cash and carry basis. Eleven stores feature automotive parts, and accessories and sporting goods.

The corporate headquarters are located at 1209 South Central Avenue in Kent, near Seattle, Washington.

Report to the shareholders:

Fiscal year 1978 was another year of continued growth and increased profitability for Pay 'N Pak Stores, Inc. This is the eighth consecutive year of increased revenues and earnings.

Revenues for fiscal 1978 were \$98,051,888, an increase of 22% over the prior fiscal year. Net income, after taxes, was \$4,166,495, an increase of 37% over 1977. Per share income was \$1.73 as compared to \$1.26 in the prior fiscal year. We are particularly proud of the fact that your company earned 4.2% on gross sales on an after tax basis, up from 3.8% the previous year. This is a key measure of the company's operating efficiency.

Another figure that pleases us is the fact that store-for-store sales in our established units (stores 3 years old or older) increased 11% over the previous year. While inflation is a factor, the size of the increase demonstrates the effectiveness of our advertising and sales programs.

Perhaps the most important statistic of all is the fact that your company showed a 29% return on equity.

As your company grows, it requires greater management depth and we took some very important steps in that direction last year. In December, your Board of Directors named Jerry L. Marlow (formerly vice president of operations) president and chief operating officer. David J. Heerensperger relinquished the office of president but remains chairman of the board and chief executive officer.

At the same time the board elected four new vice presidents and named Harold F. Bacon (formerly vice president for merchandising) executive vice president. Mr. Marlow and Mr. Bacon were elected to the Board of Directors increasing the number of directors from five to seven.

New stores were opened this year in Denver, Colorado; Topeka, Kansas; Ontario, Oregon; plus Puyallup and Marysville in Washington. Another old, outmoded store in Denver was replaced. All four stores in Denver now are typical large Pay 'N Pak facilities. These new and replacement stores increased the square footage by 104,413 square feet, an increase of 8%.

In fiscal 1979 the company has additional stores planned for Cheyenne, Wyoming; Hutchinson, Kansas; Coeur d'Alene, Idaho; Grand Forks, North Dakota; Fort Collins, Colorado; Kalispell, Montana and Spanaway and Federal Way in Washington. We plan to remodel and add additional space to our Kennewick, Washington store and replace our Redding, California store with a newer, larger unit. It is our plan to open as many as 8 to 9 new units in fiscal 1979. The increased capability of our real estate and construction department under the direction of a vice president enables us to accomplish this growth.

In February your company opened a new 79,000 square foot warehouse in Denver, Colorado to service our stores in the midwest. This was a very important move because it cuts down on our freight and other service costs to this geographic area.

In fiscal 1978 we intensified our training programs and this year's Annual Report cover highlights a new addition to these programs, the mobile training unit. This program is covered at greater length in the corporate profile.

On July 29, 1977 your company paid a 50% stock dividend. This year the company paid a 33⅓% stock dividend on April 28, 1978. On both dividends the company maintained the current annual cash dividend rate of \$.60 per share. These actions, of course, increased our dividend payout substantially, and yet we were able to handle our fiscal requirements as to growth and debt service quite easily.

Overall we were very pleased with the performance of the company and we trust that our stockholders share this feeling. Your management and your Board of Directors try to keep the interests of the shareholders always in mind, and we are gratified by the many expressions of support that we have received. We look forward to another good year.

David J. Heerensperger

David J. Heerensperger
Chairman of the Board

Jerry L. Marlow

Jerry L. Marlow
President

BOARD OF DIRECTORS

David J. Heerensperger
Chairman of the Board

Jerry L. Marlow
President

Harold F. Bacon
Executive Vice President

Halvor Knudtzon, Jr.
Secretary-Treasurer, Controller

Curtis L. Rhodes
Vice President, Director of Purchasing

Woodrow C. Button
*Vice Chairman, Old National Bank,
Seattle, Washington*

Marshall J. Weigel
*Independent Corporate
Finance Specialist*



Left to right, standing: Rhodes, Heerensperger, Marlow, Knudtson, Bacon; seated: Gallina, Lucero and Crosswhite

OFFICERS

David J. Heerensperger
Chairman of the Board
Jerry L. Marlow
President
Harold F. Bacon
Executive Vice President
Halvor Knudtson, Jr.
Secretary-Treasurer
Terri L. Lucero
Vice President-Personnel
Peter W. Gallina
*Vice President-Real Estate
and Store Development*
Curtis L. Rhodes
Vice President-Purchasing
Victor W. (Bill) Crosswhite
*Vice President-Midwest
Merchandising*

STAFF AND ASSISTANTS

Ralph Beniasch,
Purchasing Agent
Rod Cosgriff
Purchasing Agent
Larry Elliott,
Purchasing Agent
William Gottbreht,
Office Manager
George Johnson,
Advertising Director
Bud Larsen,
Purchasing Agent
Monte Leen,
Purchasing Agent
George Smith,
Training Director
Tom McCloskey,
Assistant Controller
Clem Erlander,
Advertising Assistant
Paul Morris,
Design Assistant

DISTRICT MANAGERS

Bud Brown,
Midwest-North
Warren Jones,
Southwest Washington
Gene Kasper,
Midwest-South
Mel Kelley,
Oregon/Alaska
Mike Mandick,
Automotive/Sporting Goods
Larry Marlow,
Eastern Washington
John Schweitzer,
California/Nevada
Wally Tesch,
Western Washington



Left to right, standing: Schweitzer, Brown, Kelly, L. Marlow, Kasper; seated: Mandick, Tesch and Jones

Corporate profile

The corporate changes discussed in the progress report to shareholders required top management to strengthen the central administration team.

Curtis L. Rhodes was elected a vice president and continues as director of purchasing; Peter W. Gallina was elected vice president with responsibilities for real estate and store development; Ms. Terri Lucero became vice president and continues as personnel director and Victor W. "Bill" Crosswhite became vice president for midwest merchandising. The company has grown to the 100 million dollar sales level and these promotions provide the management depth needed to continue the company's aggressive growth patterns as it expands into new markets.

The stores are divided into seven operating districts, each with a district manager. Additionally, one district manager supervises the eleven automotive and sporting goods operations.

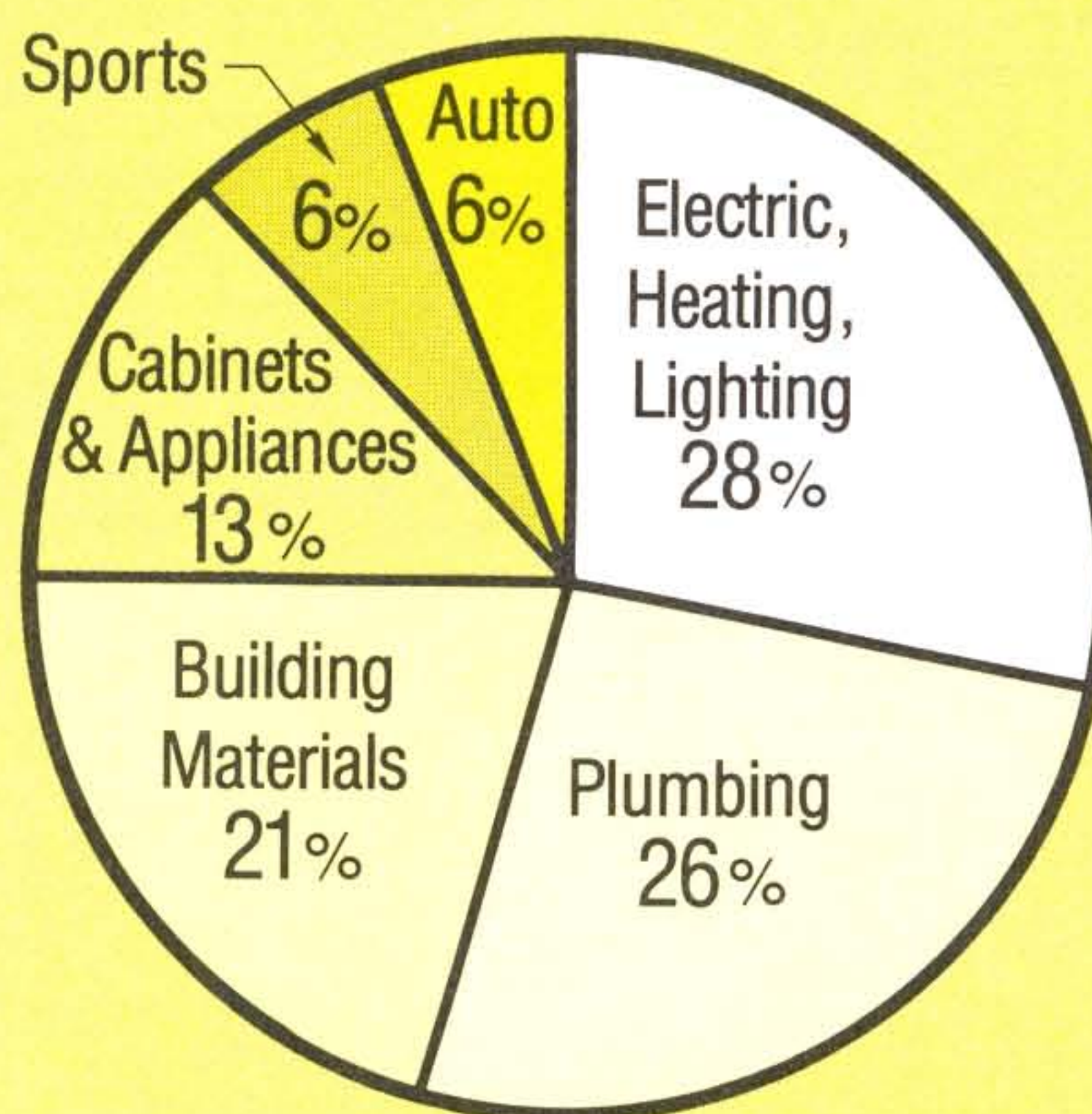
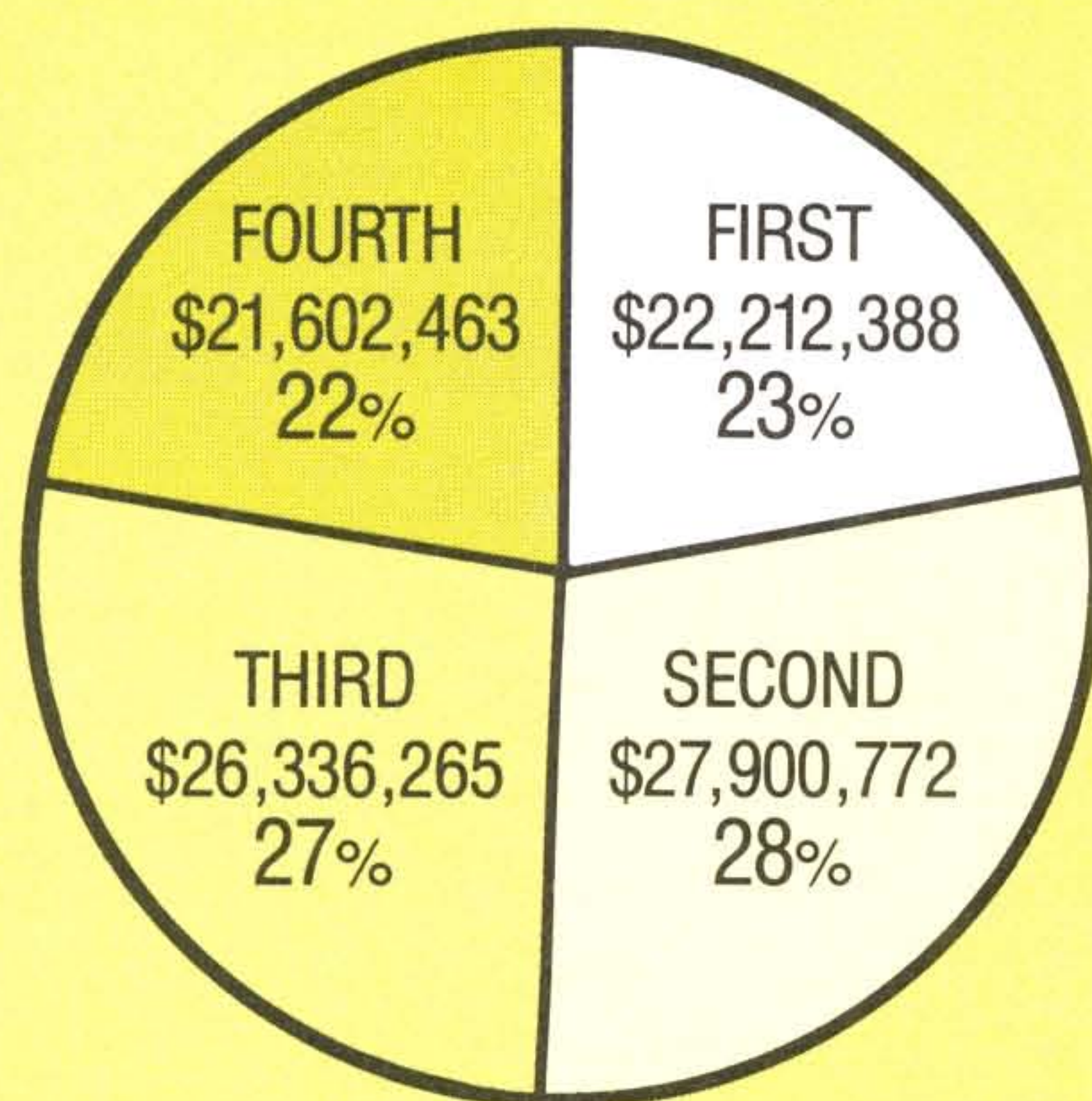
The company conducts one managers meeting each year where all managers and headquarters staff are brought together. There are at least three additional managers meetings per year at central locations within each district. These are conducted by Jerry Marlow and the central operations team.

The company's commitment to the do-it-yourself home improvement market should continue to pay dividends. The Bureau of Building Market Research estimates that this year the do-it-yourself sales volume

(an estimated \$18.4 billion) will surpass for the first time the professional home improvement market (an estimated \$18.1 billion). The reason for this, of course, is the cost of hiring plumbers, electricians and other professionals. In reporting on skilled tradesmen's rates and their effect on who does home improvement work, Building Supply News reported hourly rates across the nation at an average of \$12.08 for electricians and \$12.36 for plumbers.

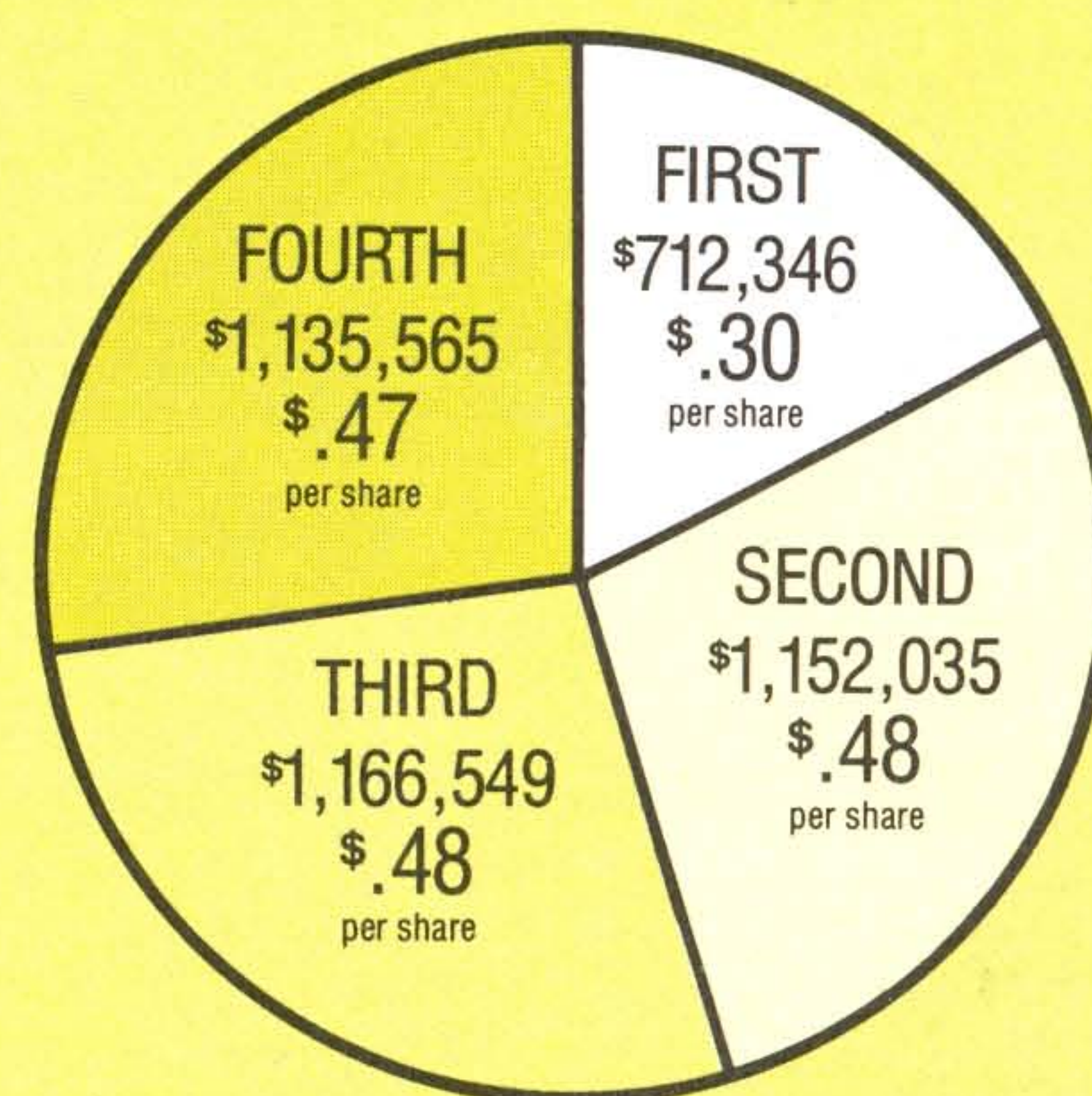
It has been said the biggest leisure-time activity in America today isn't tennis, jogging, golf or fishing; it's do-it-yourselfing. Better Homes and Gardens suggests: "It might even pay a homeowner to take off a few days or a week from work at no pay, to do essential high cost

1978 REVENUES BY QUARTER



1978 SALES BY CATEGORY

1978 EARNINGS BY QUARTERS

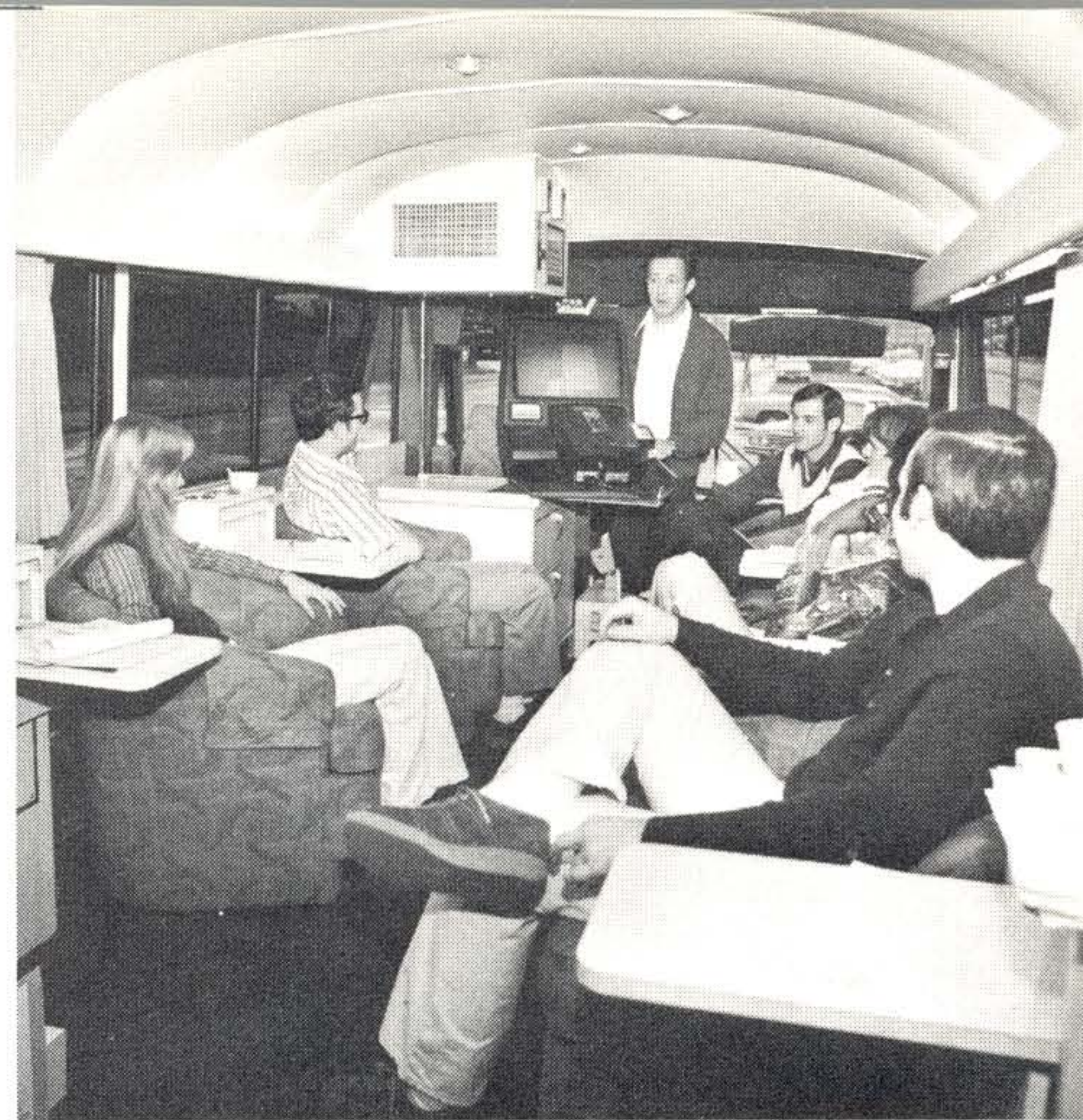




In-store product training meeting



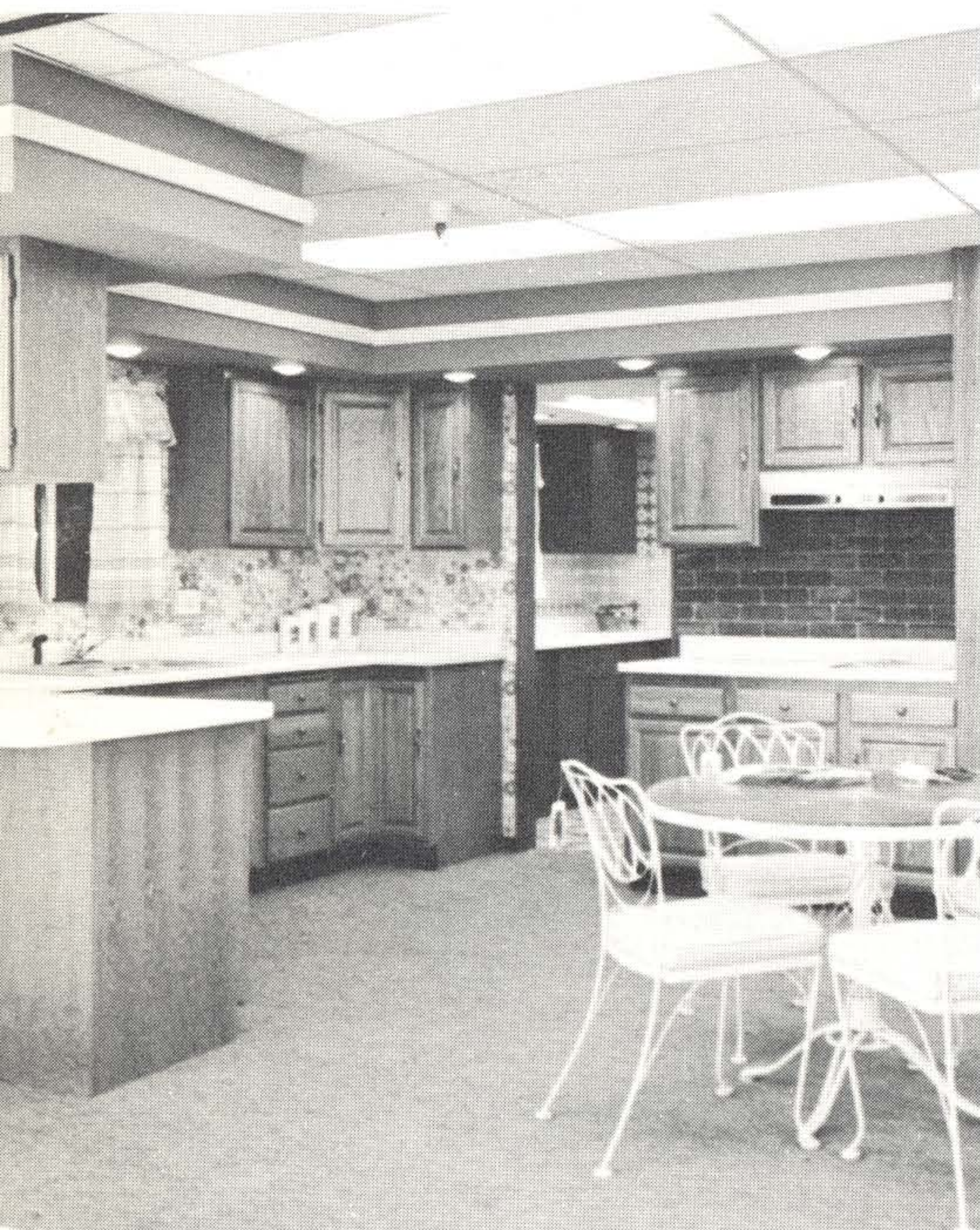
The Mobile Training Unit



The class room on wheels



Inside the stores a wealth of do-it-yourself ideas fully dramatized



Kitchen cabinets displayed the way they will look in the home



A typical Pay 'N Pak store

home improvement work. If a homeowner is in the 30 to 35% income tax bracket, for example, his or her net savings after taxes for an expensive labor job could be from \$5 to \$10 an hour or as much as \$400 a week, sometimes more."

Training

These trends highlight our continuing emphasis on training our people to be better able to help the burgeoning army of do-it-yourself amateurs. A trained salesperson can show today's do-it-yourselfer how to approach home improvement projects with confidence. Our training director administers the company's continuing program of product training meetings as well as its training theatre and retail selling skills program.

The new and sophisticated addition to the company's training program is accented by the

Employees can actually work with the product in a classroom environment. The electrical training aids are "hot" in that they are fully wired, the plumbing aids work and the students can, in fact, learn by doing. Two instructor drivers alternate as the mobile unit makes a training campus out of every store parking lot in the company.

Additionally there are many other specific training programs. There are special training programs to assist all new employees, such as cashiers, freight persons and purchasing agents. Product training meet-



field are continually updating our interior store displays. Our bathroom and kitchen displays are recognized as the most outstanding in the industry. Most importantly, our customers visualize them as the way they want their rooms to look.

Advertising

A consistent advertising program must keep the name and products of the company before the do-it-yourselfer all the time and with authoritative strength. The company's weekly program of innovative large space advertising is augmented by 4 big special sales each year with pre-print tabloids inserted in newspapers in every market in which we operate. These distinctive, hard-hitting pre-prints have a combined reach of 5 million households. Each of these weekly promotions and special promotions are meticulously planned with



cover picture of this Annual Report. The 40 foot motor coach was specially constructed as a mobile training classroom. It is outfitted with complete training aids to teach electrical, plumbing and kitchen cabinets "how-to" knowledge in great depth.

ings are conducted by manufacturers representatives. Saturday morning meetings for the entire store staff covering both store procedures and product knowledge are held weekly and a continuing assistant manager training program is aimed at developing new store managers.

Store Development

Our continuing expansion requires that the company have knowledgeable career people in our real estate department and store design. New locations are continually analyzed by these experts. Several teams in the



complete in-store merchandising co-ordination.

Merchandising

The company stores, which average 19,785 square feet, offer a full selection of electrical,

PAY 'N PAK COUNTRY

ALASKA

- Anchorage
- Fairbanks

CALIFORNIA

- Redding
- Roseville
- Sacramento
- Sacramento
- Yuba City
- Modesto

COLORADO

- Aurora
- Denver
- Denver
- Denver
- Pueblo
- Colorado Springs
- Grand Junction
- Greeley
- Fort Collins
- Boulder

IDAHO

- Lewiston
- Pocatello
- Boise
- Coeur d' Alene

KANSAS

- Wichita
- Topeka
- Hutchinson
- Wichita

MONTANA

- Billings
- Missoula
- Kalispell

NEBRASKA

- North Platte

NEVADA

- Las Vegas
- Reno

NORTH DAKOTA

- Grand Forks
- Bismark
- Minot

OKLAHOMA

- Oklahoma City
- Oklahoma City
- Tulsa
- Tulsa

OREGON

- Albany
- Eugene
- Milwaukie
- Portland
- Portland
- Portland
- Salem
- Ontario
- Medford

SOUTH DAKOTA

- Sioux Falls
- Rapid City

UTAH

- Salt Lake City
- Ogden
- Salt Lake City
- Provo

WASHINGTON

- Bellevue
- Bellingham
- Bremerton
- Everett
- Kennewick
- Kent
- Longview
- Lynnwood
- Marysville
- Moses Lake
- Mt. Vernon
- Olympia
- Puyallup
- Redmond
- Renton
- Seattle
- Seattle
- Seattle
- Spokane
- Spokane
- Spokane
- Tacoma
- Tacoma
- Walla Walla
- Wenatchee
- White Center
- Yakima
- Aberdeen/Hoquiam
- Bothell
- Federal Way
- Spanaway

WYOMING

- Casper
- Cheyenne

- present location
- planned future locations

lighting, heating and plumbing supplies and most of the essential things in building materials that the do-it-yourselfer will need. A large percentage of our products are purchased direct from the manufacturer. The company is a large importer and buyers are regularly overseas for procurement. We search the world for fine merchandise at competitive prices.

In the last two years every one of the company's stores have



been re-merchandised and the company's sign program and display programs have been upgraded.

Controls

The retail industry today demands sophisticated programs. The central accounting department, directly under the control and supervision of the secretary-treasurer, has the com-

puterized facilities to cope with the company's growth. Record keeping programs, management information systems, and use of the company computer guarantee a prompt and dependable flow of information on all vital statistics that management needs on a daily basis.

Motivating our People

The heart of our business is our people. Our top priority is



dedicated to developing people to meet the challenges of growth. In our company we want people growing in their jobs so they are ready to move ahead. Things like age, sex, and color don't matter. But ability, enthusiasm and commitment really do. Almost all our management people have progressed through the Pay 'N Pak training levels. Each person is trained to have his or her

replacement ready to move up. It works.

Every company must have more than just sales and earnings and a growth record to motivate its people. The company's Employee Stock Ownership Plan (ESOP) provides employees with an individual sense of ownership, responsibility and participation. This program, and a strong medical and dental plan, with life insurance provisions as well as several individual recognition awards all add up to strong incentives for people to stay with the company. To further bolster this desire for growth within the company each store is on an incentive bonus plan, in which the store manager and the entire crew share. Additionally, the staff has a bonus plan based on profits. We care about the people who work at Pay 'N Pak and we think our progress reflects this concern.

Transfer Agents and Registrars

Citibank, N.A.
New York, New York

Peoples National Bank of Washington
Seattle, Washington

Banks

Peoples National Bank of Washington
Seattle, Washington

Old National Bank of Washington
Spokane, Washington

Market and Dividend Information

Pay 'N Pak Stores, Inc. this year 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 usual Annual Report.

This 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 herein.

The stock of Pay 'N Pak Stores, Inc. is traded actively in the over-the-counter (OTC) market. Prices are quoted by the National Association of Security Dealers (NASD), as reported by NASDAQ, and published daily in the over-the-counter market sections of various financial publications and financial pages of many daily newspapers.

The range of bid and asked quotations of the company's stock during each quarter of the last 2 fiscal years is shown below. The quarterly cash dividends paid by the company are also shown for each quarter of the last 2 fiscal years.

Quarterly High and Low Bid Prices

(Asked prices are $\frac{1}{2}$ point more)

	LAST TWO FISCAL YEARS	
Years ended February 28th	1978	1977
1st quarter*	16 $\frac{5}{8}$ -13	15 $\frac{5}{8}$ -12 $\frac{1}{8}$
2nd quarter**	18 $\frac{1}{2}$ -11 $\frac{3}{8}$	10 $\frac{7}{8}$ -10 $\frac{1}{4}$
3rd quarter	14 $\frac{1}{4}$ -11 $\frac{1}{2}$	11 $\frac{7}{8}$ -11 $\frac{1}{4}$
4th quarter	14 $\frac{1}{2}$ -12	14 $\frac{5}{8}$ -13 $\frac{3}{8}$

Quarterly Dividends

	LAST TWO FISCAL YEARS	
Years ended February 28th	1978***	1977***
1st quarter	.074	.06
2nd quarter	.113	.06
3rd quarter	.113	.075
4th quarter	.113	.075

*A market adjustment to a 10% stock dividend paid on May 10, 1976 occurred in this quarter in fiscal 1977.

**A market adjustment to a 50% stock dividend paid on July 29, 1977 occurred in this quarter in fiscal 1978.

***After giving retroactive effect to the 50% stock dividend paid on July 29, 1977 and after giving retroactive effect to the 33 $\frac{1}{3}$ % stock dividend paid on April 28, 1978.

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, 1978

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 98031

Telephone: (206) 854-5450

Common stock outstanding at February 28, 1978 — 2,413,964 shares.

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

Title of each class
None

Name of each exchange
on which registered
None

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

Common Stock
(Title of Class)

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

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Part II:	
14. thru 18. are omitted as the required information will be furnished in the Company's proxy statement.	

Part I

Item 1 — Business

(a) Pay 'N Pak Stores, Inc. (the "Company") and its subsidiaries are engaged in retail selling of home improvement products, including electric and plumbing supplies, heating and lighting fixtures, building materials, cabinets and built-in appliances, and floor covering. Several stores carry complete lines of automotive parts and accessories and sporting goods. Most sales are made to homeowners and other do-it-yourself customers, and primarily on a cash basis. Although the Company does not deliver, install or service such products, its employees are trained to instruct customers as to how to install and use the products.

As of April 15, 1978, the Company and its subsidiaries operated 69 stores located in the states of Washington, Oregon, California, Colorado, Nevada, Montana, Alaska, Oklahoma, Kansas, Idaho, Utah, Wyoming and South Dakota. All of the stores are leased except that the Fairbanks, Alaska, Pocatello, Idaho and Casper, Wyoming stores are owned by the Company. The Company has long-term mortgage loans on these three stores. During its fiscal year ended February 28, 1978, the Company entered new market areas in Marysville, Washington, Ontario, Oregon, Puyallup, Washington and Topeka, Kansas, and opened its fourth store in the Denver, Colorado area. During this same period of time, the Company also replaced a smaller store in Denver, Colorado with a new, larger store.

Additional information regarding the Company's stores for the past five years is set forth below as follows:

	<u>Year ended February 28 or 29</u>				
	<u>1978</u>	<u>1977</u>	<u>1976</u>	<u>1975</u>	<u>1974</u>
Stores in operation at beginning of year	64	59	54	48	44
Stores opened	6	7	9	7	8
Stores reacquired			1		
Stores sold or closed			(3)	(1)	(1)
Stores replaced with new stores	(1)	(2)	(2)		(3)
Stores in operation at end of year	<u>69</u>	<u>64</u>	<u>59</u>	<u>54</u>	<u>48</u>

The Company has also entered into leases and plans to open new stores later this year in Cheyenne, Wyoming, Hutchinson, Kansas, Coeur d' Alene, Idaho, Redding, California, a newer, larger replacement store, and Grand Forks, North Dakota, which will be its first entry into North Dakota. The Company also plans to add additional square footage to its Kennewick, Washington store later this year and has acquired undeveloped real property in Fort Collins, Colorado upon which it intends to construct a new store later this year. The Company has also acquired undeveloped real property adjacent to its main offices and shopping mall in Kent, Washington in connection with its plans to eventually construct new main offices or expand its present offices. The Company is also presently negotiating a lease for a new store in Spanaway (Tacoma area), Washington and the purchase of land in North Platte, Nebraska upon which it plans to construct a new store, which will be its first entry into Nebraska.

The Company's sole method of distribution is through sales at its retail stores, all of which are operated by the Company. Although the Company formerly used the franchise method of distribution to a limited extent, this method has not been used since approximately October, 1971, and the Company has no plans to grant franchises in the future.

(b) (1) The retail sales business engaged in by the Company is highly competitive. The Company competes with numerous retail organizations, including integrated department stores such as Sears and Montgomery Ward, as well as large and small hardware and lumber stores, auto supply stores, and sporting goods stores. Some of these competitors have substantially greater financial resources and more complete product warranties than the Company. The Company's competitors 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.

Item 1 — Business, continued

The Company attempts to charge competitive prices with respect to the merchandise sold through its stores and whenever possible engages in volume buying directly from factories to obtain lower unit costs. The Company places particular emphasis on the training of its sales people in an effort to offer improved service to its customers. The Company has a full-time product training director and also utilizes a training film program and seminars to qualify its employees in product knowledge and selling skills. During the past fiscal year, the Company acquired a 40-foot bus that is specially equipped and used as a mobile training classroom. This training enables the Company's sales people to explain and instruct customers as to how to install and use the products that are sold throughout the Company's stores.

(2) The business of the Company is not dependent upon a single customer or a few customers, whereby the loss of any one would have a material effect on the Company.

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

(4) The Company buys its merchandise from several hundred independent suppliers, no one of which supplies a significant portion of the products sold by the Company. It is estimated that no supplier provides more than 10% of the Company's merchandise. The Company sells most of its goods on a cash and carry basis and to a limited extent under installment sales contracts that are sold to finance companies, and 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 maintains a 121,500 square foot central warehouse in Kent, Washington, where it stores and delivers merchandise to various stores in the chain. In early 1978, the Company opened a 78,900 square foot regional distribution center and warehouse in Denver, Colorado, to service the Company's 21 stores located in Colorado, Kansas, Montana, Oklahoma, South Dakota, Utah and Wyoming. The Company does very little other warehousing. The Company engages in volume buying direct from factories as much as possible to obtain the benefits of lower unit prices, as well as 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 for the above-described purposes.

(5) The Company holds no material patents, trademarks, licenses, franchises or concessions.

(6) The Company has incurred research expenses relating to the improvement of services to its customers, through the development of product knowledge training films, a Retail Selling Skills program, the holding of training seminars, and the acquisition of a 40-foot mobile training bus, all of which are designed to constantly update product knowledge and selling skills. The goal of this 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 two fiscal years is estimated at approximately \$52,000 and \$208,386 in 1977 and 1978, respectively.

(7) 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.

(8) The Company currently employs approximately 852 full-time persons.

(9) 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, and sales of sporting goods, particularly skis and ski equipment, tend to be higher during the winter season.

(c) (1) Information as to lines of business. The Company is engaged in only one line of business — retail sales.

Item 2 — Summary of operations, continued

CONSOLIDATED STATEMENT OF INCOME

	Year ended February 28 or 29				
	1974	1975	1976	1977	1978
Revenues:					
Net sales	\$51,832,114	\$61,379,628	\$73,221,950	\$80,592,395	\$98,000,321
Interest	5,949	61,633	25,394	32,080	42,201
Rentals and other	55,823	29,578	32,608	18,274	9,366
	<u>51,893,886</u>	<u>61,470,839</u>	<u>73,279,952</u>	<u>80,642,749</u>	<u>98,051,888</u>
Costs and expenses:					
Cost of sales (a)	33,588,811	40,190,618	48,783,406	51,859,031	62,958,711
Selling and administrative	11,779,911	13,913,074	15,918,996	18,603,799	21,918,015
Rent	1,594,893	1,797,397	2,142,797	2,389,895	2,694,108
Depreciation	793,170	806,028	973,628	1,166,003	1,373,182
Interest on long-term debt	289,294	461,886	484,458	802,917	911,198
Other interest	228,601	16,633	98,143	53,975	14,092
	<u>48,274,680</u>	<u>57,185,636</u>	<u>68,401,428</u>	<u>74,875,620</u>	<u>89,869,306</u>
Income before income taxes	3,619,206	4,285,203	4,878,524	5,767,129	8,182,582
Provision for income taxes (b)	1,748,438	2,037,068	2,303,900	2,736,306	3,824,750
	<u>1,870,768</u>	<u>2,248,135</u>	<u>2,574,624</u>	<u>3,030,823</u>	<u>4,357,832</u>
Minority interest	13,468	22,090			
Income before cumulative effect of change in accounting principle .	1,857,300	2,226,045	2,574,624	3,030,823	4,357,832
Cumulative effect on prior years (to February 28, 1977) of change in accounting principle (e)					(191,337)
Net income	<u>\$ 1,857,300</u>	<u>\$ 2,226,045</u>	<u>\$ 2,574,624</u>	<u>\$ 3,030,823</u>	<u>\$ 4,166,495</u>
Before 1979 stock split (c):					
Average number of common shares	<u>2,506,805</u>	<u>2,506,805</u>	<u>2,491,331</u>	<u>2,413,964</u>	<u>2,413,964</u>
Per common shares:					
Income before cumulative effect of change in accounting principle	\$.74	\$.89	\$1.03	\$1.26	\$1.81
Cumulative effect of change in accounting principle					(.08)
Net income	<u>\$.74</u>	<u>\$.89</u>	<u>\$1.03</u>	<u>\$1.26</u>	<u>\$1.73</u>
Dividends per common share (d):					
Cash paid	<u>\$.138</u>	<u>\$.193</u>	<u>\$.28</u>	<u>\$.36</u>	<u>\$.55</u>
Stock			<u>10%</u>	<u>10%</u>	
After 1979 stock split (c):					
Average number of common shares	<u>3,342,407</u>	<u>3,342,407</u>	<u>3,321,775</u>	<u>3,218,619</u>	<u>3,218,619</u>
Per common shares (e):					
Income before cumulative effect of change in accounting principle	\$.56	\$.67	\$.78	\$.94	\$1.35
Cumulative effect of change in accounting principle					(.06)
Net income	<u>\$.56</u>	<u>\$.67</u>	<u>\$.78</u>	<u>\$.94</u>	<u>\$1.29</u>
Dividends per common share (d):					
Cash paid	<u>\$.103</u>	<u>\$.145</u>	<u>\$.21</u>	<u>\$.27</u>	<u>\$.413</u>
Stock			<u>10%</u>	<u>10%</u>	

(See notes to consolidated statement of income on the following page.)

Item 2 — Summary of operations, continued

Notes to consolidated statement of income

- (a) The Company's significant accounting policies are set forth in Note 1 of Notes to Consolidated Financial Statements.

Inventories of merchandise used in the computation of cost of sales were as follows: February 28, 1973 — \$13,925,388; February 28, 1974 — \$15,273,351; February 28, 1975 — \$15,460,230; February 29, 1976 — \$17,691,688; February 28, 1977 — \$24,042,732; February 28, 1978 — \$27,457,883.

- (b) The provision for income taxes is comprised of the following:

	<u>1974</u>	<u>1975</u>	<u>1976</u>	<u>1977</u>	<u>1978</u>
Current federal income tax	\$1,696,728	\$1,956,954	\$2,108,967	\$2,510,725	\$3,762,303
Investment tax credit	(54,045)	(75,167)	(101,905)	(120,125)	(157,502)
Tax effect of jobs credit . . .					(52,000)
Deferred income tax	1,749	30,945	163,648	187,487	49,921
State income taxes	104,006	124,336	133,190	158,219	222,028
	<u>\$1,748,438</u>	<u>\$2,037,068</u>	<u>\$2,303,900</u>	<u>\$2,736,306</u>	<u>\$3,824,750</u>

The effective tax rate in all years differs from the 48% statutory federal income tax rate due primarily to the effect of the investment credit, new jobs credit and state income taxes shown above.

The provision for deferred income taxes reflects timing differences between income and expenses reported for financial statement purposes and income tax purposes. The federal and state income tax effect of these differences are as follows: gain on the sale of properties sold and leased back (\$1,749 — 1974 through 1978), which gain is being amortized over the period of the leases; depreciation deducted for tax purposes in excess of the amount deducted for accounting purposes (1975 — \$58,179; 1976 — \$132,916; 1977 — \$179,825 and 1978 — \$191,365); pre-opening expenses deducted for book purposes in excess of (less than) the amount deducted for tax purposes (\$148,515 in 1978 and \$(5,741) in 1977); \$28,983 of airplane repair costs accrued for accounting purposes in 1975 and deducted for tax purposes in 1976 when paid.

- (c) Before 1979 stock split per common share amounts were determined on the weighted average number of such shares outstanding during each period after giving effect to the 10% stock dividends declared on March 13, 1975 and on March 16, 1976 and retroactive effect to the 3 for 2 stock split declared in fiscal year 1978. After 1979 stock split per common share amounts give retroactive effect to the 4 for 3 stock split declared March 14, 1978, which is issuable in the form of a 33⅓% stock dividend on April 28, 1978 to stockholders of record April 10, 1978.
- (d) Cash dividends paid per common share are stated at amounts after giving retroactive effect to stock dividends and splits described in Note (c). A \$.10 per share (\$.075 per share after stock split) cash dividend for the first quarter of 1978 was declared January 14, 1977 payable April 29, 1977. See Note 2 of Notes to Consolidated Financial Statements for restrictions on payment of cash dividends.

Item 2 — Summary of operations, continued

Notes to consolidated statement of income, continued

(e) Quarterly financial data (unaudited)

Quarterly financial data for the years ended February 28, 1978 and 1977 are presented below.

(000's omitted, except for per share amounts)

	Quarter ended							
	May 31,		August 31,		November 30,		February 28,	
	1977	1976	1977	1976	1977	1976	1978	1977
Net sales	\$22,212	\$17,441	\$27,901	\$22,396	\$26,336	\$22,578	\$21,603	\$18,228
Gross profit	\$ 8,112	\$ 6,260	\$ 9,722	\$ 7,741	\$ 9,444	\$ 7,898	\$ 7,763	\$ 6,885
Income before cumulative effect of change in accounting principle .	\$ 903	\$ 605	\$ 1,152	\$ 858	\$ 1,166	\$ 895	\$ 1,136	\$ 673
Cumulative effect on prior years (to February 28, 1977) of change in accounting principle (Note 1(d))	(191)							
Net income	\$ 712	\$ 605	\$ 1,152	\$ 858	\$ 1,166	\$ 895	\$ 1,136	\$ 673
Before 1979 stock split per share amounts (c):								
Income before cumulative effect of change in accounting principle	\$.38	\$.25	\$.48	\$.36	\$.48	\$.37	\$.47	\$.28
Cumulative effect of change in accounting principle	(.08)							
Net income	\$.30	\$.25	\$.48	\$.36	\$.48	\$.37	\$.47	\$.28
After 1979 stock split per share amounts (c):								
Income before cumulative effect of change in accounting principle	\$.28	\$.19	\$.36	\$.27	\$.36	\$.28	\$.35	\$.21
Cumulative effect of change in accounting principle	(.06)							
Net income	\$.22	\$.19	\$.36	\$.27	\$.36	\$.28	\$.35	\$.21

Operating results for each of the first three fiscal quarters in 1978 has been restated from that previously published to give retroactive effect to the change in accounting described in Note 1(d) of Notes to Consolidated Financial Statements. The effects of the change were as follows:

	1978 Quarter ended			
	May 31	Aug. 31	Nov. 31	Feb. 28
	Increase (decrease)			
Effect of accounting change on:				
Income before cumulative effect of change in accounting principle	\$ 29	\$ (1)	\$ 6	\$ 24
Per share (Before and after 1979 split) (c)	\$.01	\$ —	\$ —	\$.01

Management's Discussion and Analysis of the Consolidated Statement of Income

Net sales in 1978 and 1977 increased over the 1977 and 1976 levels by \$7,370,000 for 1977 over 1976 and \$17,408,000 for 1978 over 1977 or 10.1% and 21.6% respectively. These increases were attributable to the following:

	Increase (decrease) in 1978 over 1977		Increase (decrease) in 1977 over 1976	
	Amount	%	Amount	%
	(In thousands, except %)			
Net sales of stores opened during the year	\$ 2,721	16	\$2,983	40
Increase in net sales over the preceding year of stores in their first full year of operation . .	4,323	25	3,666	50
Net increase in sales of stores opened for over 2 years	10,364	59	2,500	34
Decrease in net sales for stores closed or sold	-0-	-0-	(1,779)	(24)
	<u>\$17,408</u>	<u>100</u>	<u>\$7,370</u>	<u>100</u>

Interest revenue increased in 1978 as compared to 1977 as a result of investment of excess funds in short-term securities.

Cost of sales and selling and administrative expense increased due primarily to the increased sales volume.

Rent expense increased during the periods due principally to new store additions or replacement.

Depreciation expense increased in 1978 as compared to 1977 due primarily to new store expansion and the modernization of existing stores.

Interest on long-term debt increased in 1978 as compared to 1977 due primarily to our obtaining mortgages on store properties at Fairbanks, Alaska; Pocatello, Idaho and Casper, Wyoming. The mortgages on these properties were obtained in February 1977.

CONSOLIDATED STATEMENT OF RETAINED EARNINGS

	Year ended February 28 or 29				
	1974	1975	1976	1977	1978
Balance at beginning of year .	\$5,258,486	\$6,770,496	\$8,513,135	\$8,203,053	\$ 8,312,979
Add (deduct):					
Net income	1,857,300	2,226,045	2,574,624	3,030,823	4,166,495
Dividends:					
Cash	(345,290)	(483,406)	(692,114)	(1,110,423) (b)	(1,086,285)
10% stock at fair market value at date of issuance			(2,192,592)	(1,810,474)	
Balance at February 28 or 29 (a)	<u>\$6,770,496</u>	<u>\$8,513,135</u>	<u>\$8,203,053</u>	<u>\$8,312,979</u>	<u>\$11,393,189</u>

(a) See Note 2 of Notes to Consolidated Financial Statements for restrictions on the payment of cash dividends.

(b) Includes cash dividends of \$.36 per share paid in 1977 and in addition a \$.10 per share cash dividend for the first quarter of 1978 declared January 14, 1977 payable April 29, 1977.

CONSOLIDATED STATEMENT OF CAPITAL IN EXCESS OF PAR VALUE

	Year ended February 28 or 29				
	1974	1975	1976	1977	1978
Balance at beginning of year .	\$3,788,717	\$3,788,717	\$3,788,717	\$5,967,497	\$7,216,633
Add (deduct):					
Excess of fair market value over par value of 10% stock dividends			2,178,780	1,795,844	
Retirement of treasury stock				(546,708)	
50% stock split at par value					(80,465)
Balance at February 28 or 29	<u>\$3,788,717</u>	<u>\$3,788,717</u>	<u>\$5,967,497</u>	<u>\$7,216,633</u>	<u>\$7,136,168</u>

Item 3 — Properties

Of the Company's 69 stores, 31 are located in the State of Washington, 8 in Oregon, 5 in California, 2 in Nevada, 3 in Idaho, 1 in Montana, 2 in Utah, 7 in Colorado, 2 in Kansas, 4 in Oklahoma, 2 in Alaska, 1 in Wyoming, and 1 in South Dakota. All of the Company's stores except three are leased under leases expiring at various times between September 30, 1978 and January 31, 2002. Many of the leases contain options to renew. Operations of the Company are directed from its main offices in Kent, Washington, a Seattle suburb, where all administrative functions, including accounting, merchandising, purchasing and advertising are performed. The main offices are leased under a lease expiring in 1995. The Company also leases a large central warehouse in Kent, Washington, under two leases that expire in 1979 and 1983, respectively. In addition, the Company also leases a large regional warehouse in Denver, Colorado, under a lease that expires in 1982 and from which the Company's midwest merchandising is conducted. These leases contain options to renew.

In addition to the properties and buildings used in the Company's daily business operations, the Company owns approximately 20 acres in Spokane, Washington, 5 acres adjacent to its Kent Mall and a parcel in Fort Collins, Colorado. These properties are either being developed for new stores or held for investment and possible future expansion.

The Company presently owns its stores in Fairbanks, Alaska, Pocatello, Idaho, and Casper, Wyoming. The Company obtained long-term mortgage financing on these properties during the fiscal year ended February 28, 1977.

All of the Company's buildings are of concrete or concrete block construction except for three stores, two of which are of frame construction and the other is a steel building. The Company has replaced and modernized most of its older, smaller stores during the past few years with larger, new stores. The buildings contain all of the fixtures and improvements which the Company believes are necessary in its business. Adequate off-street parking is provided adjacent to all stores.

Item 4 — Parents and Subsidiaries

There are no parents of the Company. Following is a list setting forth the Company and its subsidiaries as of April 15, 1978:

Company:	Pay 'N Pak Stores, Inc. a Washington corporation
Subsidiaries:	(a) Pay 'N Pak Properties, Inc. a Washington corporation 100% owned by the Company
	(b) Eagle Electric & Plumbing Supply, Inc. a Washington corporation 100% owned by the Company

There is no relationship between or among any of the subsidiaries listed above other than the fact that they are wholly owned subsidiaries of the Company. All of the above listed subsidiaries are included in consolidated financial statements of the Company.

Item 5 — Legal Proceedings

None.

Item 6 — Increases and Decreases in Outstanding Securities and Indebtedness

The Company's outstanding common stock was increased from 1,609,309 shares to 2,413,964 shares, an increase of 804,655 shares, on July 29, 1977, the date of distribution of a 50% stock dividend declared on April 21, 1977. The Company's outstanding common stock was further increased from 2,413,964 shares to 3,218,619 shares, an increase of 804,655 shares, on April 28, 1978, the date of distribution of a 33⅓% stock dividend declared on March 14, 1978.

Item 7 — Changes in Securities and Changes in Security for Registered Securities

In February, 1976, the Company entered into a loan agreement with The Prudential Insurance Company of America and issued its note in the original amount of \$8,000,000 payable in annual installments and maturing in 1988. The loan agreement provides, among other things, limitations upon payment of cash dividends and redemption or reacquisition of the Company's stock. Such payments may only be made out of 60% of the Company's net earnings and only if such payments do not reduce the Company's working capital below \$9,000,000.

Item 8 — Defaults Upon Senior Securities

None.

Item 9 — Approximate Number of Equity Security Holders

As of April 10, 1978, there were 2,293 holders of record of the Company's common stock.

Item 10 — Submission of Matters to Vote of Security Holders

The election of directors and approval of selection of auditors was submitted to a vote of the Company's stockholders on June 21, 1977, at the annual meeting of stockholders. Proxies for the meeting were solicited pursuant to Regulation 14 under the Securities Exchange Act of 1934. There was no solicitation in opposition to management's nominees as listed in the proxy statement and all such nominees were elected.

Item 11 — Executive Officers of the Company

(a)

<u>Name</u>	<u>Age</u>	<u>Positions and Offices</u>
David J. Heerensperger	41	Chairman of the Board and Chief Executive Officer; Director
Jerry L. Marlow	42	President and Chief Operating Officer; Director
Harold F. Bacon	61	Executive Vice President; Director
Halvor Knudtson, Jr.	51	Secretary-Treasurer and Controller; Director
Victor W. Crosswhite	41	Vice President-Midwest Merchandising
Peter W. Gallina	42	Vice President-Real Estate and Store Development
Terri L. Lucero	35	Vice President-Personnel
Curtis L. Rhodes	56	Vice President-Purchasing; Director

There are no family relationships among the above officers except that Mr. Crosswhite's wife and Mr. Heerensperger are first cousins. 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. Knudtzon has served as Secretary-Treasurer since August, 1970. Each of the other officers has served in his or her respective office since December, 1977. There are no arrangements or understandings between any of the above officers and any other person pursuant to which he was selected as an officer.

(b) All of the above officers 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, and also, from November, 1975 to December, 1977, as President. Halvor Knudtzon, Jr. has served the Company as Controller and Secretary-Treasurer. Harold F. Bacon has served the Company as Executive Vice President since December, 1977 and prior thereto as Vice President-Merchandising from September, 1974, and as Advertising and Public Relations Director. Jerry L. Marlow, prior to his election as President and Chief Operating Officer in December, 1977, served the Company as Vice President-Operations and Chief Operating Officer from November, 1975, and prior thereto as a District Manager. Victor W. Crosswhite, prior to his election as Vice President-Midwest Merchandising in December, 1977, served the Company as a purchasing agent for electrical, lighting and heating supplies from November, 1975, and prior thereto as a store manager. Peter W. Gallina, prior to his election as Vice President-Real Estate and Store Development in December, 1977, served the Company as Director of Store Development, Construction and Real Estate. Terri L. Lucero, prior to her election as Vice President-Personnel in December, 1977, served the Company as Personnel Director. Curtis L. Rhodes, prior to his election as Vice President-Purchasing, served the Company as Purchasing Director.

Item 12 — Indemnification of Directors and Officers

The general effect of Section VIII of the Company's Bylaws is that the officers and directors shall be indemnified by the Company against all costs, expenses, judgments and liabilities, including attorneys' fees, reasonably incurred by or imposed upon them in connection with or resulting from any action, suit or proceeding, civil or criminal, in which they may be made a party by reason of their position with the Company. Specifically excluded is liability for willful misconduct in the performance of duty as a director or officer.

The above indemnification provision is authorized by Section 23A.08.025 of the Revised Code of Washington which provides generally that a corporation has the power to indemnify any officer or director in connection with a civil or criminal proceeding, provided the officer or director has acted in good faith and in a manner he reasonably believed to be in or not opposed to the best interest of the corporation, and, with respect to any criminal action or proceeding, had no reasonable cause to believe that his conduct was unlawful. The statute also authorizes a corporation to purchase and maintain officers' and directors' liability insurance against any liability asserted against such person by reason of their position with the Company.

The Company is insured under a directors' and officers' liability and corporation reimbursement policy under which the insurer has agreed to pay on behalf of the Company any amount the Company shall be required or permitted by law to pay to an officer or director as indemnity for any claim made against an officer or director by reason of any breach of duty, neglect, error, misstatement, misleading statement, omission or other act, done or wrongfully attempted by the officer or director in his capacity as an officer or director; but only when he shall have been entitled to indemnification by the Company, provided that such loss shall not include fines or penalties imposed by law or other matters which may be deemed uninsurable under the law pursuant to which the policy shall be construed.

Item 13 — Financial Statements, Exhibits Filed and Reports on Form 8-K

(a) **Financial Statements.** The consolidated financial statements and supporting schedules as set forth in the index to financial statements on the following pages are filed as part of this Annual Report.

(b) **Exhibits.** Accountant's letter on change in method of accounting.

(c) **Reports on Form 8-K.** No reports on Form 8-K were filed during the last quarter of the Company's fiscal year ended February 28, 1978.

Part II

Items 14-18 are omitted as this information is furnished in the Company's definitive proxy statement being filed with the Securities and Exchange Commission.

SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the Company has duly caused this Annual Report to be signed on its behalf by the undersigned, thereunto duly authorized.

PAY 'N PAK STORES, INC. (Registrant)

By 
Halvor Knudtson, Jr.
Treasurer

Dated: May 24, 1978

PAY 'N PAK STORES, INC.
INDEX TO FINANCIAL STATEMENTS
COVERED BY REPORT OF CERTIFIED PUBLIC ACCOUNTANTS
(Item 13(a))

Consolidated balance sheet — February 28, 1978 and 1977

Consolidated statements of income, retained earnings and capital in excess of par value for the five years ended February 28, 1978 (Included in Item 2)

Consolidated statement of changes in financial position for the five years ended February 28, 1978

Notes to consolidated financial statements

Schedules for the years ended February 28, 1978 and 1977

II—Amount receivable from underwriters,
promoters, directors, officers,
employees and principal holders
(other than affiliates) of equity
securities of the Company and its affiliates

V—Property, plant and equipment

VI—Accumulated depreciation of property,
plant and equipment

XII—Reserves

XVI—Supplementary income statement
information

All other schedules have been omitted since the required information is not applicable 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, including the notes thereto.

Financial statements and schedules of Pay 'N Pak Stores, Inc. (not consolidated) are omitted since the Company is primarily an operating company, and all subsidiaries included in the consolidated financial statements are deemed to be totally-held.

PAY 'N PAK STORES, INC.

REPORT OF CERTIFIED PUBLIC ACCOUNTANTS

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

We have examined the consolidated financial statements of Pay 'N Pak Stores, Inc. listed in the accompanying index to financial statements. 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 accompanying index to financial statements present fairly the consolidated financial position of Pay 'N Pak Stores, Inc. at February 28, 1978 and 1977 and the consolidated results of its operations and the consolidated changes in financial position for the five years ended February 28, 1978, in conformity with generally accepted accounting principles applied on a consistent basis during the period.

ARTHUR YOUNG & COMPANY

Seattle, Washington
March 24, 1978

PAY 'N PAK STORES, INC.
CONSOLIDATED BALANCE SHEET
February 28, 1978 and 1977

<u>ASSETS</u>		
	<u>1978</u>	<u>1977</u>
Current assets:		
Cash	\$ 600,592	\$ 738,897
Trade accounts receivable, less allowance of \$50,000 (\$40,000 in 1977) for doubtful accounts (Schedule XII)	361,275	288,869
Merchandise inventories, at the lower of cost (first-in, first-out) or market	27,457,883	24,042,732
Prepaid expenses	<u>576,280</u>	<u>665,739</u>
Total current assets	28,996,030	25,736,237
Other assets:		
Cost of acquired stores in excess of amounts assigned to net assets at dates of acquisition (Note 1(c))	239,189	255,209
Pre-opening costs and other (Note 1(d))	<u>105,979</u>	<u>321,967</u>
Total other assets	345,168	577,176
Property, plant and equipment, at cost (Notes 1(b), 1(f), 2 and 6) (Schedule V):		
Land	520,058	520,058
Buildings	2,005,018	1,849,521
Leasehold rights and improvements	5,300,990	4,071,354
Store equipment	7,281,477	6,217,794
Transportation equipment	1,053,198	538,118
Construction in progress	<u>84,999</u>	<u>164,502</u>
	16,245,740	13,361,347
Less accumulated depreciation and amortization (Schedule VI)	<u>4,672,310</u>	<u>3,601,594</u>
	11,573,430	9,759,753
Properties held for development and/or investment	<u>612,485</u>	<u>611,485</u>
Net property, plant and equipment	<u>12,185,915</u>	<u>10,371,238</u>
	<u>\$41,527,113</u>	<u>\$36,684,651</u>

See accompanying notes.

PAY 'N PAK STORES, INC.
CONSOLIDATED BALANCE SHEET
February 28, 1978 and 1977

<u>LIABILITIES AND STOCKHOLDERS' EQUITY</u>		
	<u>1978</u>	<u>1977</u>
Current liabilities:		
Notes payable to bank (Note 2)	\$ 1,850,000	\$ 700,000
Accounts payable	7,763,255	7,680,704
Federal and state income taxes	1,255,644	595,521
Accrued liabilities:		
Payroll and profit sharing	870,613	691,621
Taxes, other than income	925,986	812,151
Interest and other	100,822	85,729
	<u>1,897,421</u>	<u>1,589,501</u>
Dividends payable (Note 3)		241,396
Long-term debt due within one year	<u>755,903</u>	<u>748,162</u>
Total current liabilities	<u>13,522,223</u>	<u>11,555,284</u>
Long-term debt (Note 2)	8,772,804	9,020,548
Employee benefit plan (Note 4)	1,253,435	1,461,285
Deferred income (Note 1(b))	118,563	125,427
Deferred income taxes (Note 1(e))	342,770	292,849
Commitments (Note 5)		
Stockholders' equity:		
Preferred stock, without par value, 1,000,000 shares authorized, none issued		
Common stock, \$.10 par value, 5,000,000 shares authorized, 2,413,964 shares issued (1,609,309 in 1977)	241,396	160,931
Capital in excess of par value	7,136,168	7,216,633
Retained earnings (Note 2)	<u>11,393,189</u>	<u>8,312,979</u>
	<u>18,770,753</u>	<u>15,690,543</u>
Deferred employee benefits (Note 4)	<u>(1,253,435)</u>	<u>(1,461,285)</u>
Total stockholders' equity	<u>17,517,318</u>	<u>14,229,258</u>
	<u>\$41,527,113</u>	<u>\$36,684,651</u>

See accompanying notes.

PAY 'N PAK STORES, INC.
CONSOLIDATED STATEMENT OF CHANGES IN FINANCIAL POSITION

	Year ended February 28 or 29				
	1974	1975	1976	1977	1978
Source of funds:					
Net income	\$1,857,300	\$ 2,226,045	\$2,574,624	\$3,030,823	\$4,166,495
Charges (credit) against income not involving working capital:					
Depreciation and amortization	1,065,709	1,211,434	1,274,083	1,496,384	1,708,710
Deferred federal income tax	1,749	30,945	163,648	187,487	49,921
Minority interest	13,468	22,090			
Net asset amount of land and equipment retired and (gain) loss on sale of assets	51,956	60,877	(46,155)	54,021	3,524
Working capital provided from operations	2,990,182	3,551,391	3,966,200	4,768,715	5,928,650
Increase in long-term debt	5,166,000	54,000	4,174,770	2,020,000	507,245
Proceeds from sale of assets, or sale and leaseback of properties	356,780	145,661	944,997	351,468	
	<u>8,512,962</u>	<u>3,751,052</u>	<u>9,085,967</u>	<u>7,140,183</u>	<u>6,435,895</u>
Application of funds:					
Additions to property, plant and equipment	2,157,172	3,535,312	3,010,328	2,157,216	3,191,383
Cash dividends paid and payable	345,290	483,406	692,114	1,110,423	1,086,285
Reduction of long-term debt	395,392	418,259	957,200	1,225,346	754,989
Non-competition agreements			135,000		
Pre-opening costs and other assets	173,490	389,804	348,533	278,275	110,384
Increase (decrease) in notes receivable		245,201	(245,201)		
Purchase of minority interest in subsidiary		63,311			
Purchase of treasury stock			552,335		
	<u>3,071,344</u>	<u>5,135,293</u>	<u>5,450,309</u>	<u>4,771,260</u>	<u>5,143,041</u>
Increase (decrease) in working capital	<u>\$5,441,618</u>	<u>\$(1,384,241)</u>	<u>\$3,635,658</u>	<u>\$2,368,923</u>	<u>\$1,292,854</u>
The net increases (decreases) in the elements of working capital are as follows:					
Cash and treasury bills	\$ (24,441)	\$ (437,485)	\$ 681,827	\$ (76,825)	\$ (138,305)
Receivables	(172,537)	140,988	28,876	(158,450)	72,406
Merchandise inventories	1,347,963	186,879	2,231,458	6,351,044	3,415,151
Prepaid expenses	(52,273)	125,366	283,419	(197,393)	(89,459)
Notes payable	4,985,000	115,000	550,000	(700,000)	(1,150,000)
Accounts payable	(86,029)	(1,265,777)	249,498	(2,083,841)	(82,551)
Federal and state income taxes	(46,723)	(30,130)	33,765	(144,578)	(660,123)
Accrued liabilities	(185,390)	(195,873)	10,024	(481,711)	(307,920)
Dividends payable				(241,396)	241,396
Long-term debt due within one year	(323,952)	(23,209)	(433,209)	102,073	(7,741)
Increase (decrease) in working capital	<u>\$5,441,618</u>	<u>\$(1,384,241)</u>	<u>\$3,635,658</u>	<u>\$2,368,923</u>	<u>\$1,292,854</u>

See accompanying notes.

PAY 'N PAK STORES, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
February 28, 1978 and 1977

1. Description of the Company, basis of presentation and significant accounting policies

The Company is engaged in retail selling of home improvement products, including electrical and plumbing supplies, heating and lighting fixtures, building materials, cabinets and built-in appliances, floor covering, automotive parts and accessories and sporting goods.

(a) **Consolidation** — The financial statements consolidate the accounts of the parent company and its subsidiaries.

(b) **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 — 10 years or life (principally 15 to 25 years) of the lease; equipment — 3 to 10 years.

Additions, replacements and betterments are capitalized; maintenance and repairs are charged to operations as incurred. When assets are sold or retired, the cost of the assets and the related accumulated depreciation are removed from the balance sheet accounts, and the resulting gain or loss is included in the consolidated statement of income unless the assets are leased back in which event the gain or loss is deferred and amortized to income over the period of the lease.

(c) **Investment in acquired stores** — Costs of acquired stores in excess of amounts assigned to net assets at dates of acquisition are amortized on the straight-line method using a twenty-five year life.

(d) **Pre-opening costs** — In order to conform with the predominant method used in the retail industry to account for pre-opening costs, the Company changed its method in the fourth quarter of fiscal 1978 to charge such costs to expense as incurred. Previously the Company's pre-opening costs were capitalized and amortized on a straight-line basis over three years commencing with the opening of the store. The cumulative effect of the change as of the beginning of the year is presented as a separate charge in fiscal 1978 on the Consolidated Statement of Income (see Note (e)). The effect of the change on income before and after such charge is not material.

(e) **Income taxes** — Deferred federal and state 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.

Investment tax credits realized at the time of property acquisitions are accounted for on the flow-through method.

(f) **Leases** — The Company has capitalized leased retail stores for capital leases entered into after January 1, 1977; see Notes 2 and 5.

(g) **Per share information** — Common share amounts were determined on the weighted average number of such shares outstanding during each period and gives effect to the 10% stock dividends declared in fiscal years 1977 and 1976 and retroactive effect to the 3 for 2 stock split declared in fiscal year 1978 and the 4 for 3 stock split declared March 14, 1978, which is issuable in the form of a 33⅓% stock dividend on April 28, 1978 to stockholders of record April 10, 1978.

PAY 'N PAK STORES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

February 28, 1978 and 1977

2. Short-term and long-term debt

At February 28, 1978, the Company has available unused lines-of-credit of \$430,000 under informal agreements with banks, which expire in June 1978. The interest rate is at $\frac{1}{2}\%$ above prime. The maximum amount of month-end short-term bank borrowings during the fiscal year ended February 28, 1978 was \$1,850,000 (\$2,500,000 in 1977), the approximate average daily amount of such borrowings was \$157,000 (\$558,000 in 1977) and the weighted daily average interest rate was 7.3% (7.6% in 1977).

Long-term debt outstanding at February 28, 1978 and 1977 is shown in the following summary:

	<u>1978</u>	<u>1977</u>
9 $\frac{1}{2}\%$ note payable to insurance company, due \$650,000 annually to 1987 and \$200,000 in 1988, plus interest	\$6,700,000	\$7,350,000
9 $\frac{5}{8}\%$ to 9 $\frac{7}{8}\%$ mortgage notes payable, due \$216,240 annually including interest to 2002, subject to call by holders in 1992 ...	1,999,932	2,019,152
6 $\frac{1}{2}\%$ to 9 $\frac{3}{4}\%$ (average 8.3%) contracts and notes payable, due \$103,842 annually including interest to 1980, \$50,607 in 1981 and reduced amounts to 1989	321,530	399,558
Capitalized lease obligations (\$1,307,475), less imputed interest (\$800,230) payable \$48,072 per year including imputed interest, 8.25% to 9.25% (average 8.75%), final payment in 2002	507,245	
	<u>9,528,707</u>	<u>9,768,710</u>
Less amounts due within one year	755,903	748,162
	<u>\$8,772,804</u>	<u>\$9,020,548</u>

Payments on the principal of long-term debt and capitalized lease obligations for the four years ending February 28, 1983 are required as follows: 1980 — \$767,000; 1981 — \$732,000; 1982 — \$713,000; 1983 — \$706,000.

Properties held for development and/or investment at a cost of \$189,681 and operating plant and equipment having a net book amount of \$2,282,848 are pledged as collateral for the above debt. Included in leasehold rights and improvements is \$513,432 for capitalized lease obligations and accumulated depreciation and amortization includes \$13,280 applicable thereto.

The loan agreement covering the 9 $\frac{1}{2}\%$ note payable provides, among other matters, restrictions on the payment of cash dividends, redemption or reacquisition of the Company's stock and payment of certain stockholder-employee compensation. At February 28, 1978, retained earnings of \$2,415,572 was not restricted.

3. Dividends

On January 14, 1977 a \$.10 per share cash dividend (before the 1979 stock split) for the first quarter of fiscal year 1978 was declared and was paid April 29, 1977.

4. Employee benefit plan

All employees participate in the Company's Employee Stock Ownership Plan after three years of employment.

In December 1975, the Employee Stock Ownership Trust (ESOT) borrowed \$1,656,732 from a bank to acquire 273,360 shares of the Company's common stock. The unpaid balance is payable at \$62,500 per quarter to 1982 including interest at 2 $\frac{1}{4}\%$ above prime. The obligation of the ESOT is guaranteed by the Company and is expected to be serviced through future Company contributions (\$311,981 in 1978 and \$279,166 in 1977) and dividends paid on the common stock. Therefore, the unpaid balance of the loan has been reflected in the accompanying consolidated balance sheet as a liability and an equal amount, representing deferred employee benefits, is recorded as a reduction from stockholders' equity.

PAY 'N PAK STORES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

February 28, 1978 and 1977

5. Commitments

The Company leases substantially all retail store facilities and 2 warehouses. Rental expense for all operating leases, except those with terms of a month or less that were not renewed, was \$3,062,451 and \$2,726,329 for the years ended February 28, 1978 and 1977, respectively.

Most lease agreements provide for minimum rental payments on the basis of lapse of time, with certain leases providing for additional percentage rentals at such time that an individual store's annual sales exceed a specified amount. Percentage rentals of \$34,325 and \$24,909 were paid during the years ended February 28, 1978 and 1977, respectively. The Company has options to renew most leases for three to five-year periods at agreed amounts. There are no existing options to purchase lease property.

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

Year ending February 28 or 29	000's omitted
1979	\$ 2,417
1980	2,376
1981	2,344
1982	2,327
1983	2,310
Later years	26,646
	<u>\$38,420</u>

If all leases that would qualify for capitalization under the provisions of Financial Accounting Standards No. 13 — Accounting for Leases were capitalized and the related leasehold rights were amortized on a straight-line basis over the lives of the leases (15 to 25 years) and interest cost was accrued on the basis of the outstanding lease liability, the impact on the financial statements would be as follows:

	February 28,	
	1978	1977
	(000's omitted)	
Changes, debit (credit), in balance sheet accounts:		
Leasehold rights and improvements	\$10,938	\$10,938
Accumulated depreciation and amortization	(2,492)	(1,993)
Net property, plant and equipment	8,446	8,945
Prepaid federal income tax	765	623
Current portion of long-term debt	(222)	(194)
Long-term debt	(9,823)	(10,046)
Decrease in retained earnings, end of year	\$ 834	\$ 672
Decrease in net income	\$ 162	\$ 162

PAY 'N PAK STORES, INC.

SCHEDULE II — AMOUNT RECEIVABLE FROM UNDERWRITERS, PROMOTERS, DIRECTORS, OFFICERS, EMPLOYEES AND PRINCIPAL HOLDERS (OTHER THAN AFFILIATES) OF EQUITY SECURITIES OF THE COMPANY AND ITS AFFILIATES

Years ended February 28, 1978 and 1977

<u>Name of debtor</u>	<u>Balance at beginning of period</u>	<u>Additions</u>	<u>Amounts collected</u>	<u>Balance at end of period (current)</u>
David J. Heerensperger:				
1977	\$3,117	\$ —	\$ —	\$3,117
1978	\$3,117	\$47,632	\$50,749	\$ —

PAY 'N PAK STORES, INC.

SCHEDULE V — PROPERTY, PLANT AND EQUIPMENT

Years ended February 28, 1978 and 1977

<u>Description</u>	<u>Balance at beginning of period</u>	<u>Additions at cost</u>	<u>Retirements or sales</u>	<u>Balance at close of period</u>
1977:				
Land	\$ 441,700	\$ 98,358	\$ 20,000*	\$ 520,058
Buildings	1,455,958	416,688	23,125*	1,849,521
Leasehold improvements	3,529,906	638,956	97,508	4,071,354
Store equipment	5,344,436	1,246,044	372,686	6,217,794
Transportation equipment	504,852	46,042	12,776	538,118
Construction in progress	369,107	(204,605)		164,502
	11,645,959	2,241,483	526,095	13,361,347
Properties held for development and/or investment	1,060,980	(84,267)	365,228	611,485
	\$12,706,939	\$2,157,216	\$891,323	\$13,972,832
1978:				
Land	\$ 520,058	\$ —	\$ —	\$ 520,058
Buildings	1,849,521	155,497		2,005,018
Leasehold rights and improvements	4,071,354	1,331,407	101,771	5,300,990
Store equipment	6,217,794	1,261,682	197,999	7,281,477
Transportation equipment	538,118	521,300	6,220	1,053,198
Construction in progress	164,502	(79,503)		84,999
	13,361,347	3,190,383	305,990	16,245,740
Properties held for development and or investment	611,485	1,000		612,485
	\$13,972,832	\$3,191,383	\$305,990	\$16,858,225

*Properties sold and leased back.

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

Years ended February 28, 1978 and 1977

<u>Description</u>	<u>Balance at beginning of period</u>	<u>Additions charged to income</u>	<u>Retirements or sales</u>	<u>Balance at close of period</u>
1977:				
Buildings	\$ 62,262	\$ 44,782	\$ 10,329*	\$ 96,715
Leasehold improvements	931,486	323,196	97,508	1,157,174
Store equipment	1,888,633	736,493	370,938	2,254,188
Transportation equipment	39,044	61,532	7,059	93,517
	<u>\$2,921,425</u>	<u>\$1,166,003</u>	<u>\$485,834</u>	<u>\$3,601,594</u>
1978:				
Buildings	\$ 96,715	\$ 50,073	\$	\$ 146,788
Leasehold rights and improvements	1,157,174	358,738	101,770	1,414,142
Store equipment	2,254,188	885,954	198,000	2,942,142
Transportation equipment	93,517	78,417	2,697	169,237
	<u>\$3,601,594</u>	<u>\$1,373,182</u>	<u>\$302,467</u>	<u>\$4,672,309</u>

*Properties sold and leased back.

PAY 'N PAK STORES, INC.
SCHEDULE XII — RESERVES

Years ended February 28, 1978 and 1977

	<u>Balance at beginning of period</u>	<u>Additions charged to income</u>	<u>Deductions accounts written-off</u>	<u>Balance at close of period</u>
Allowance for doubtful accounts deducted from the asset to which it applies:				
1977	<u>\$34,622</u>	<u>\$123,656</u>	<u>\$118,278</u>	<u>\$40,000</u>
1978	<u>\$40,000</u>	<u>\$ 66,092</u>	<u>\$ 56,092</u>	<u>\$50,000</u>

PAY 'N PAK STORES, INC.

SCHEDULE XVI — SUPPLEMENTARY INCOME STATEMENT INFORMATION

Years ended February 28, 1978 and 1977

	Charged to costs and expenses for years ended February 28	
	1978	1977
Taxes other than taxes on income	\$1,680,701	\$1,413,049
Depreciation (Schedule VI)	\$1,373,182	\$1,166,003
Rent — charged to:		
Rent	\$2,694,108	\$2,389,895
Selling and administrative	110,816	128,351
Total rent expense	\$2,804,924	\$2,518,246
Advertising	\$3,320,121	\$2,717,324

There were no royalties paid during the period. Maintenance and repairs and amortization of intangible assets did not exceed one percent of net sales.

Depreciation and amortization as shown on Consolidated Statement of Changes in Financial Position:

Depreciation — Schedule VI	\$1,373,182	\$1,166,003
Amortization of cost of acquired stores in excess of amounts assigned to net assets at dates of acquisition	16,020	16,020
Amortization of deferred gain on sale and leaseback of properties — credited to rent expense	(6,864)	(6,864)
Amortization of non-competition agreements	55,404	55,404
Amortization of pre-opening costs	262,715	263,669
Amortization of loan fees	8,253	2,152
	<u>\$1,708,710</u>	<u>\$1,496,384</u>

Properties held for development and or investment	671,485	1,000	613,496
Construction in progress	13,361,347	3,190,383	806,990
Transportation equipment	538,113	521,300	8,227
Store equipment	5,217,794	1,361,682	197,963
Improvements	4,071,354	1,381,407	101,771
Leasehold rights and improvements	13,361,347	3,190,383	806,990
Properties held for development and or investment	671,485	1,000	613,496
	<u>\$13,972,832</u>	<u>\$4,191,383</u>	<u>\$305,990</u>
	<u>\$13,972,832</u>	<u>\$4,191,383</u>	<u>\$305,990</u>

*Properties sold and leased back.