

ANNUAL REPORTS

PAY'n PAK Stores, Inc 1979

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PAY 'N PAK STORES, INC.
ANNUAL REPORT — FISCAL 1979

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Francisco, California*

PAY 'N PAK STORES, INC.

Ten Year Summary of Growth Highlights

Years ended February 28 or 29	1979	1978	1977	1976	1975	1974	1973	1972	1971	1970
OPERATIONS										
Revenues	\$117,688,090	\$98,051,888	\$80,642,749	\$73,279,952	\$61,470,839	\$51,893,886	\$42,396,952	\$30,927,898	\$21,806,396	\$18,096,789
*Income before federal and state taxes	10,199,489	7,882,339	5,463,526	4,604,566	4,070,713	3,437,538	2,808,639	2,080,131	1,465,100	1,108,838
*Net income	5,402,926	4,006,465(2)	2,871,128	2,429,974	2,113,438	1,763,378	1,394,451	1,085,032	647,865(3)	554,748
COMMON STOCK										
Average number of common shares	3,378,278	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	\$1.60	\$1.24(2)	\$.89	\$.73	\$.63	\$.53	\$.42	\$.33	\$.20(3)	\$.21
Stock dividends and stock splits	33 1/2%	50%	10%	10%						
Cash dividends	\$.60	\$.413	\$.27	\$.21	\$.145	\$.103	\$.065	\$.062	\$.062	\$.062
FINANCIAL POSITION[End of year]										
*Total assets	\$ 70,102,914	\$50,272,628	\$45,833,216	\$39,126,568	\$33,155,258	\$29,730,370	\$27,136,642	\$20,355,014	\$13,161,669	\$10,887,306
*Stockholders' equity	28,475,006	16,694,335	13,566,305	11,616,885	12,081,360	10,451,328	9,033,240	7,699,605	6,548,259	6,099,090
*Return on shareholders' equity	32.4%	29.5%	24.7%	20.1%	20.2%	19.5%	18.1%	16.6%	10.6%	29.9%
Shares of common stock outstanding	3,688,619	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	\$8.00(1)	\$5.52 (1)	\$4.56(1)	\$3.98 (1)	\$3.61	\$3.13	\$2.70	\$2.35	\$2.03	\$1.89
*Long term debt	\$ 23,848,328	\$18,467,381	\$19,124,915	\$17,721,561	\$12,518,834	\$12,070,882	\$ 6,555,256	\$ 4,523,274	\$ 2,977,868	\$ 1,524,203
STORES IN OPERATION										
Number of stores open (4)	70	65	60	55	50	44	40	37	33	28
Number of stores sold or closed	1	1	0	3	1	1	1	0	0	0
Stores replaced with new stores	1	1	2	2	0	3	5	0	0	0
Number of states in which we operated	14	13	13	11	11	11	11	8	6	6
Square footage of stores	1,496,787	1,365,182	1,260,769	1,144,847	1,030,808	890,527	783,588	584,380	465,180	358,680
Average square footage per store	21,383	21,003	21,013	20,815	20,616	20,239	19,590	15,794	14,096	12,810
Average annual inventory in stores	\$ 23,302,096	\$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)	\$ 31,253,285	\$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	\$ 1,657,579	\$ 1,508,490	\$ 1,344,046	\$ 1,332,363	\$ 1,229,417	\$ 1,179,407	\$ 1,059,924	\$ 835,889	\$ 660,800	\$ 646,314
Number of customers served	5,468,777	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	\$21.52	\$19.69	\$18.25	\$17.85	\$16.86	\$15.96	\$14.88	N/A	N/A	N/A
Sales per square foot	\$78.63	\$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)	\$ 113,489	\$ 115,084	\$ 108,536	\$ 103,502	\$ 88,320	\$ 91,523	\$ 83,294	\$ 74,345	N/A	N/A

*Retroactive effect has been given for leases capitalized March 1, 1978 in accordance with S.E.C. accounting series 225 and FASB 13. (N/A = not available)

(1) 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, 128,503 in 1979.

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

(3) Net income in 1971 includes a net reduction of \$98.692 (\$.03 per share) due to a loss from discontinued operations.

(4) Prior to fiscal 1979 the company treated as 5 separate stores the 5 physically separate sales outlets located in the Kent, Washington Mall. In this table and throughout this report the entire Kent mall is treated as only 1 store.

After giving retroactive effect to the 20% stock dividend paid to shareholders on April 27, 1979:

Average number of common shares	4,053,934	3,862,343	3,862,343	3,986,130	4,010,888	4,010,888	3,974,344	3,886,741	3,864,475	3,240,311
Net income per common share	\$1.33	\$1.04(2)	\$.74	\$.61	\$.53	\$.44	\$.35	\$.28	\$.17 (3)	\$.17
Cash dividend paid per common share	.50	.344	.225	.175	.121	.086	.054	.052	.052	.052
Shares of common stock outstanding (end of year)	4,426,343	3,862,343	3,862,343	3,862,343	4,010,888	4,010,888	4,010,888	3,930,301	3,864,960	3,863,798
Net asset value per share	\$6.67(5)	\$4.60(5)	\$3.80(5)	\$3.32(5)	\$3.01	\$2.61	\$2.25	\$1.96	\$1.69	\$1.58

(5) After giving effect to shares held by the ESOT which have not been allocated to employee accounts 358,506 shares in 1976, 296,162 in 1977, 230,089 in 1978 and 154,204 in 1979.



PAY 'N PAK STORES, INC.

Pay 'N Pak Stores, Inc. operates 70 stores in 56 cities located in 14 western and midwestern states.

The company concentrates on 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 also feature sporting goods, automotive parts and accessories.

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

THE COVER STORY

The flight of the one hundred million dollar commemorative coin into space symbolizes the company's pride in its growth record. From \$18 million in fiscal 1970 at the time the present company was formed by merger to \$117 million in just 10 years.



Report to Shareholders

Fiscal year 1979 was another year of increased sales and profits for Pay 'N Pak. Since fiscal 1970 your company has now recorded thirty-six consecutive quarter-for-quarter increases in both revenues and earnings on an annual basis.

Revenues for fiscal 1979 were \$117,688,090, an increase of 20% over the prior fiscal year. Net income after taxes was \$5,402,926, an increase of 35% over 1978.

Per share income was \$1.60 on 3,378,278 average number of common shares outstanding as compared to \$1.24 per share on 3,218,619 shares outstanding in the prior year. We are pleased to point out that your company earned 4.6% on gross sales on an after tax basis.

Another figure that is particularly gratifying is store-for-store sales in our established units (stores three years old or older) increased 14% over the previous year. While inflation is a factor this figure is still a positive measure of the company's operating efficiency.

One of the highlights of the year was the sale in October of 470,000 new shares to the public. This increased our capital by over \$8 million and, needless to say, the money is being put to good use. Whereas in the past year your company opened 6 new stores and replaced 2 outmoded units it is anticipated that we will open as many as 12 new stores in fiscal 1980.

During the past year new stores were opened in Cheyenne, Wyoming; Hutchinson, Kansas; Coeur d'Alene, Idaho; Spanaway, Washington; Rapid City, South

Dakota; and Grand Forks, North Dakota. A new store in Redding, California replaced our old, outmoded unit there and the company entirely rebuilt its Kennewick, Washington store, approximately doubling its size.

These new and replacement stores increased overall store square footage by 132,405 square feet, a net increase of 10%.

During fiscal 1980 your company plans additional stores in Eureka, California; Fort Collins, Colorado; North Platte, Nebraska; Orem, Sandy and Bountiful in Utah; Aberdeen, Federal Way, Vancouver and Bothell in Washington and Beaverton and Bend, Oregon.

Another important event last year was the opening of the company's new mid-western distribution center in Denver. It has greatly enhanced the operations of the 25 stores which it presently serves. Many of these stores had been receiving monthly merchandise shipments from the company's Kent, Washington warehouse but now receive shipments on a weekly basis. This, of course, assures better in-stock positions on all merchandise.

We found it interesting to note that the December 1978 issue of the Federal Home Loan Bank's publication, "Journal '78" stated that the median price of the single family dwelling will be \$125,000 by 1988 and that already in 1978 the median price was \$68,000. Such new home costs as these are leading many families to invest in home improvements in their existing dwellings rather than considering new home purchases. Additionally, the continuing upward spiral in skilled tradepeoples'

hourly rates will surely mean expanded growth in the ranks of the do-it-yourselfers. These continuing trends coupled with the very real economic boom in the Northwest, where your company's concentration is the greatest, cause your management to look forward to 1980 with great optimism.

On April 28, 1978 your company paid a 33½% stock dividend. This year the company paid a 20% stock dividend on April 27, 1979. On both dividends the company maintained the current annual cash dividend rate of \$.60 per share.

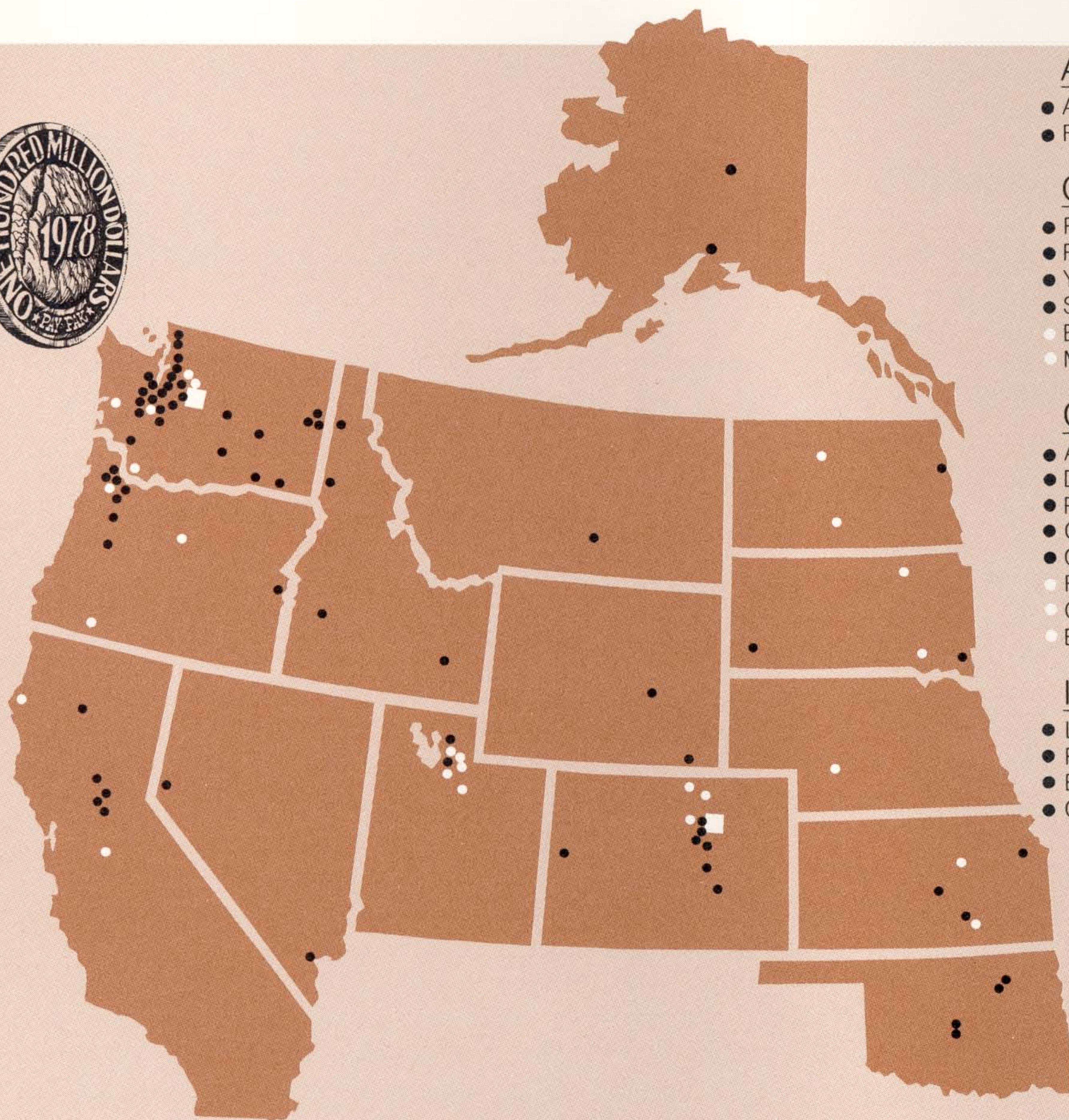
We trust that you were pleased with the performance of the company in fiscal 1979 as we passed the 100 million dollar sales mark and we look forward to the further acceleration of our expansion with the additional financing obtained by this year's special stock offering. We try to run an open and honest company and keep our shareholders interests in the forefront of all our decisions. We welcome any suggestions you may have to these ends.

David J. Heerensperger

David J. Heerensperger
Chairman of the Board

Jerry L. Marlow

Jerry L. Marlow
President



- Present locations
- Planned future locations
- Distribution centers

ALASKA

- Anchorage
- Fairbanks

CALIFORNIA

- Redding
- Roseville
- Yuba City
- Sacramento (2)
- Eureka
- Modesto

COLORADO

- Aurora
- Denver (3)
- Pueblo
- Colorado Springs
- Grand Junction
- Fort Collins
- Greeley
- Boulder

IDAHO

- Lewiston
- Pocatello
- Boise
- Coeur d'Alene

KANSAS

- Wichita
- Topeka
- Hutchinson
- Salina
- Wichita

MONTANA

- Billings

NEBRASKA

- North Platte

NEVADA

- Las Vegas
- Reno

NORTH DAKOTA

- Grand Forks
- Bismarck
- Minot

OKLAHOMA

- Oklahoma City (2)
- Tulsa (2)

OREGON

- Albany
- Eugene
- Milwaukie
- Portland (3)
- Salem
- Ontario
- Beaverton
- Bend
- Medford

SOUTH DAKOTA

- Sioux Falls
- Rapid City
- Mitchell
- Aberdeen

UTAH

- Salt Lake City
- Ogden
- Orem
- Sandy
- Bountiful
- Provo
- Granger

WASHINGTON

- Bellevue
- Bellingham
- Bremerton
- Everett
- Kennewick
- Kent
- Longview
- Lynnwood
- Marysville
- Moses Lake
- Mt. Vernon
- Olympia
- Puyallup
- Renton
- Seattle (3)
- Spokane (3)
- Tacoma (2)
- Walla Walla
- Wenatchee
- White Center
- Yakima
- Spanaway
- Aberdeen
- Bothell
- Federal Way
- Kirkland
- Vancouver

WYOMING

- Casper
- Cheyenne

OFFICERS, STAFF AND ASSISTANTS:

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

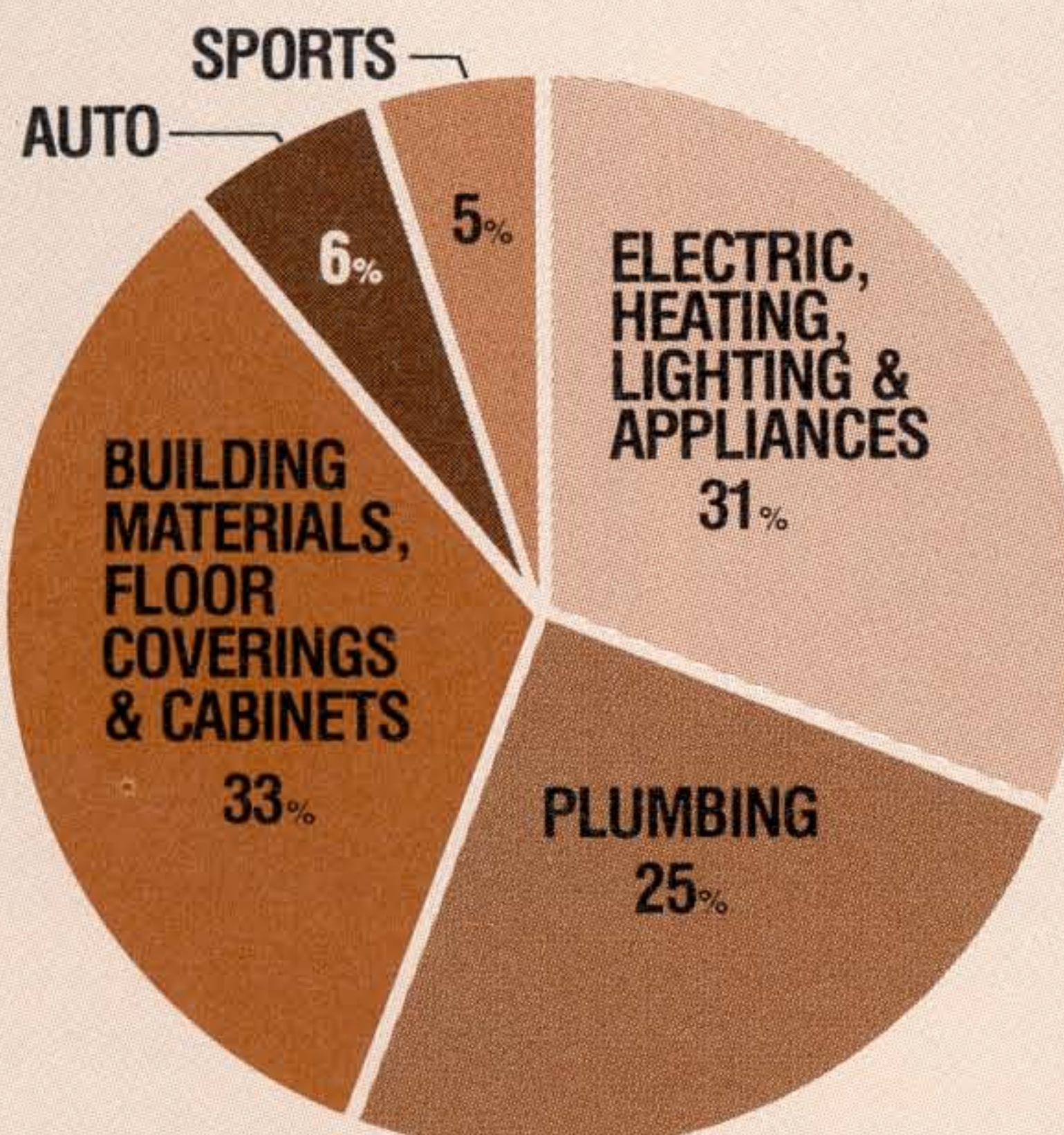
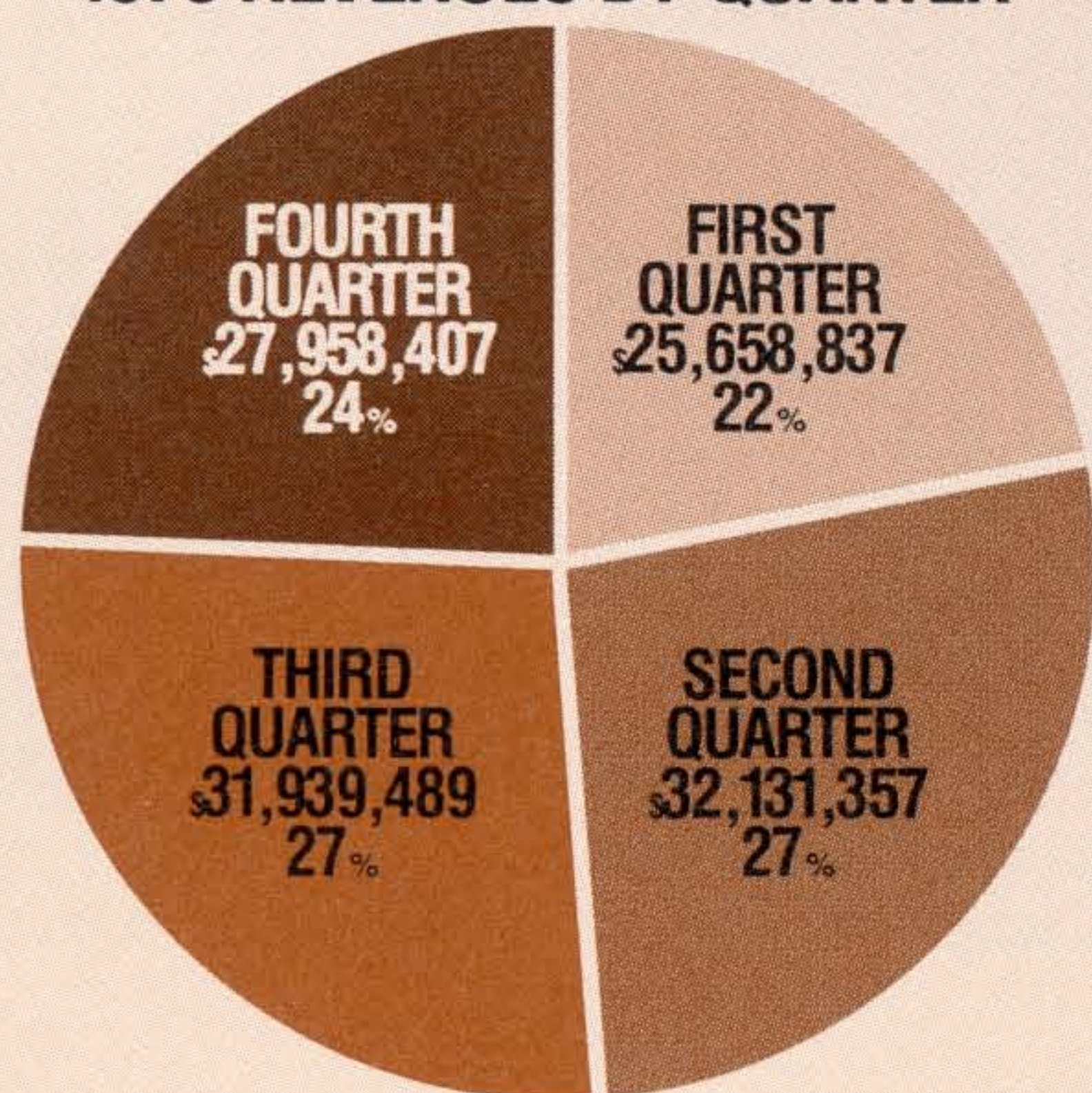
DISTRICT MANAGERS:

Bud Brown, *Midwest North*; John Coogan, *Mountain*; Warren Jones, *Southwestern Washington*; Gene Kasper, *Midwest South*; Mel Kelley, *Oregon-Alaska*; Mike Mandick, *Automotive/Sporting Goods*; Larry Marlow, *Eastern Washington and Northern Idaho*; John Schweitzer, *California-Nevada*; and Wally Tesch, *Western Washington*.

STAFF and ASSISTANTS:

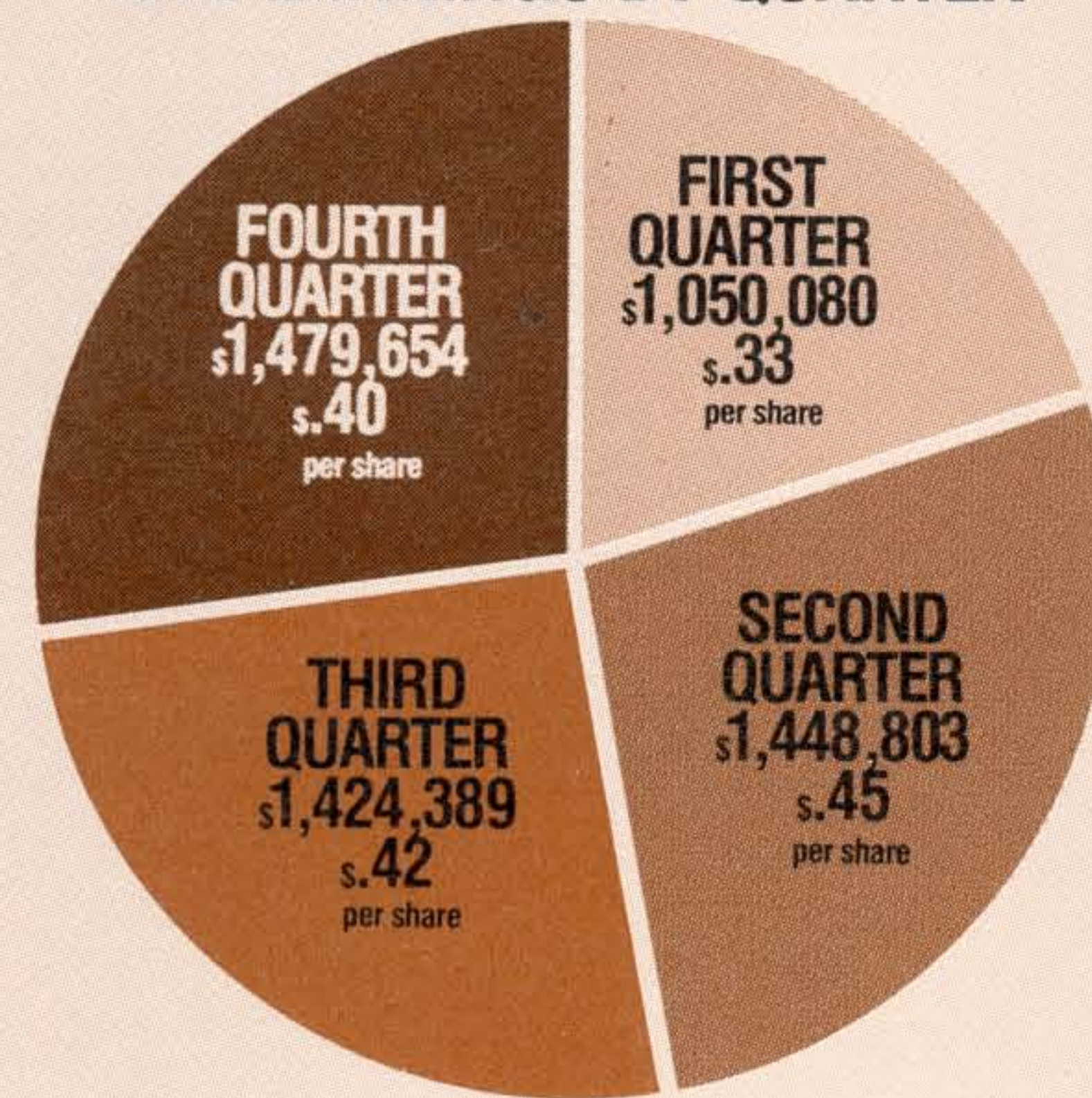
Ralph Beniasch, *Purchasing*; Rod Cosgriff, *Purchasing*; Larry Elliott, *Purchasing*; William Gottbreht, *Office Manager*; Bud Larsen, *Purchasing*; Monte Leen, *Purchasing*; Herbert McCleary, *Advertising Director*; Robert Scher, *Purchasing*; George Smith, *Training Director*; Steve Unash, *Merchandising Director*; Tom McCloskey, *Assistant Controller*; Paul Morris, *Design Assistant*; Marvin Iverson, *Building Production Assistant*.

1979 REVENUES BY QUARTER



1979 SALES BY CATEGORY

1979 EARNINGS BY QUARTER





Corporate Profile:

THE MARKET

The company's commitment to the do-it-yourself home improvement market should continue to pay big dividends. Home Center Magazine says, "1979 can be a great year for Home Centers: 'America's Fix-up Mood' has developed into a full scale do-it-yourself chorus, 'I can restore it.' Your customer of 10 to 15 years ago who might have undertaken fixing a faucet now installs his whole new bathroom. The weekend painter will panel a room."

"Your customer," Home Center magazine goes on to explain, "is a confident do-it-yourselfer. He handles 80% or more of his home improvement projects himself and thinks of himself as, at least, moderately proficient in do-it-yourself."

Home Center magazine discovered in a recent customer profile survey it conducted that the average customer spends \$1,051.31 a year on do-it-yourself home repair projects in his or her own home.

These are very impressive figures. It is no coincidence that the 18.7 billion dollar do-it-yourself home improvement market is a very healthy one. To take advantage of this burgeoning market your company has organized itself as follows.

OPERATIONS

The company's stores are divided into eight operating districts along geographic lines, each with a district manager. Additionally, one district manager supervises the eleven automotive and sporting goods operations. The district managers serve as the eyes and ears of top management. They must develop managers and assistant managers to keep pace with the company's growth goals and

each reports to and works closely with the president of the company who is the chief operating officer.

The company schedules regular managers' meetings each year where all the managers and headquarters staff are brought together. There are at least three managers' meetings per year at central locations within each district. These meetings are conducted by the president and by each district manager.

TRAINING

It is imperative to continue to develop better trained store personnel to be able to help the do-it-yourselfer and thus further develop his or her self confidence. The company's sophisticated training programs have been further modified and intensified this year.

Our Pay 'N Pak Mobile Training Coach logged 41,025 miles during this fiscal year while training Pay 'N Pak employees on basic product usage.

This Greyhound bus-like motor coach was especially constructed as a mobile training classroom. It is outfitted with complete training aids to teach electrical, plumbing and other subjects to our employees. Employees can actually work with products in a classroom environment. The electrical training aids are "hot" in that they are fully wired; the plumbing aids work as they would in a house and employee-students can learn by actually doing the work.

Additionally, there are several other specific training programs to assist all new employees, such as cashiers, freight persons and purchasing agents. There is a basic day-by-day training plan for the orientation of new sales personnel. Saturday morning meet-

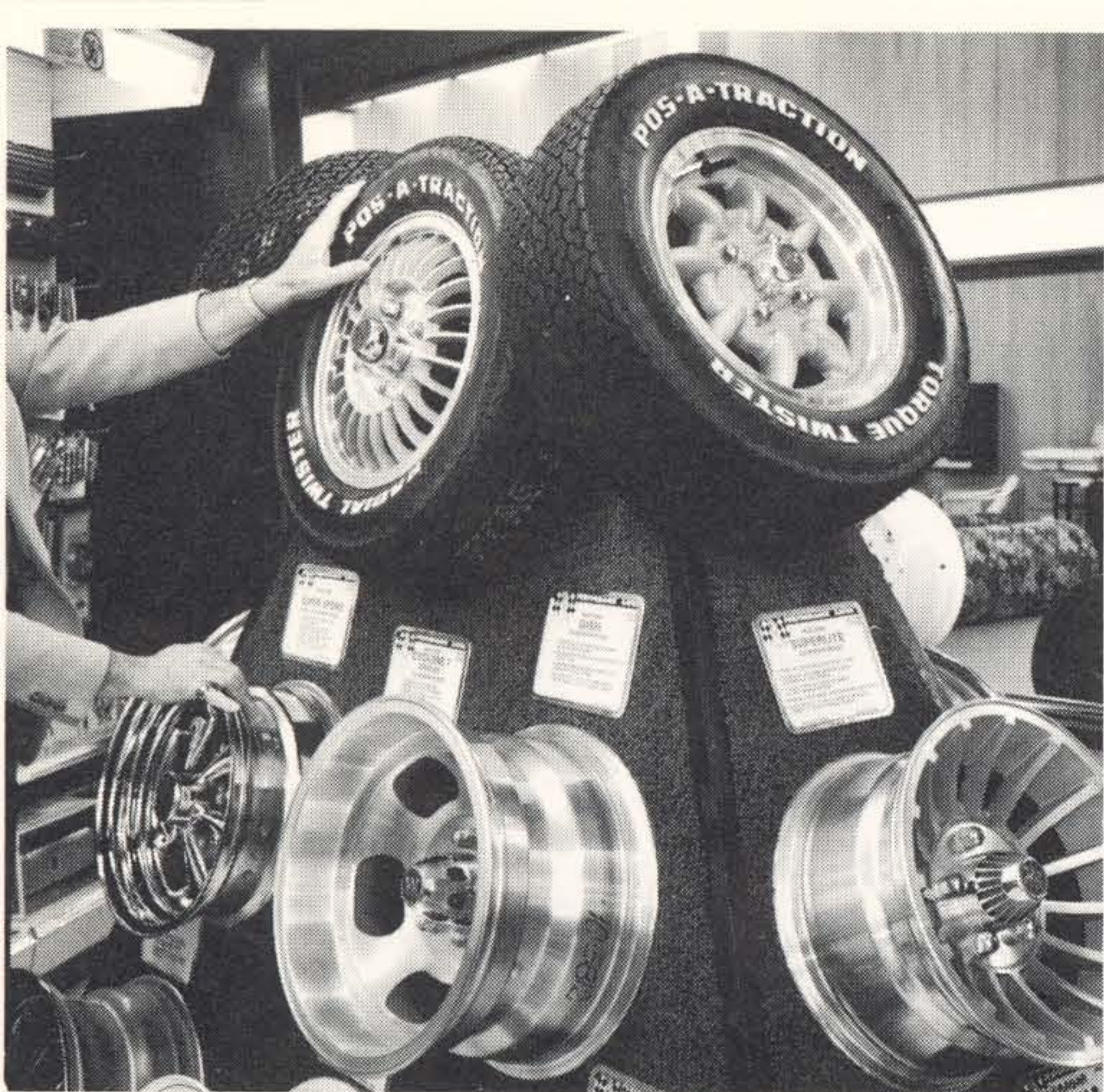
ings for the entire store staff covering both procedures and product knowledge are held weekly. A continuing assistant manager training program is aimed at developing store managers as quickly as possible. The assistant manager training program has been extended this year to include the assistant's assistant, or in our nomenclature, "the third persons."

Our training director and his staff of 7 administer the company's training program. The bus, the training theatre film program, the product training, and retail selling skills program are all designed to enable our employees to better advise the do-it-yourselfer so he or she in turn can approach home improvement projects with confidence.

MERCHANDISE MIX

The company's stores, which average 21,383 square feet, offer a full selection of electrical, lighting, heating and plumbing supplies and most of the essential things in building materials for the typical do-it-yourself project. The company is not a lumber yard type company. We are really a specialty retailer with well over 50% of our sales in electrical and plumbing supplies and we do 98%







of our business with the do-it-yourselfer. This means our company is in an every day business and not nearly as tied to cyclical trends as the typical lumber yard type company whose customer is largely the professional builder or contractor.

As any retail company grows the basic communication between the stores and administration often tends to suffer. To insure this doesn't happen your company has established an "IN-THE-FIELD" merchandising committee made up of store managers and purchasing agents from various areas who meet with the staff on a twice-a-year basis for an in-depth study of the merchandise mix, depth of inventory, advertising results and other details that can only be measured by alert people at the store level.

The persons "in-the-field" who serve on this committee are managers Kirk Knapp of Tacoma, Jack Regan of Everett, Bob Hall of Spokane Auto and Sports, Marc Roberts of Portland, Rick Noegel of Anchorage, Bill Smith of Sacramento, Bill Strohm of Wichita, Ken Kowalczyk of Casper, Wyoming, Ben Fleming of Denver; and purchasing agents Harry Hixson of Spokane and Art Mafle of Seattle.

The group acquires input from other stores in their areas prior to the meeting with the Kent headquarters management.

One competitive edge we enjoy is the fact that we buy over 80% of our merchandise direct from the manufacturer while many of our competitors buy through wholesalers. This enables us to sell at lower prices while still maintaining high gross margins. Our selection is much more in depth in electric and plumbing than most of our competitors. Each of our stores has over 450 different



styles of light fixtures in stock and each store stocks 6,000 different electrical and plumbing items.

We have many exclusive products manufactured just for us. A good example of this is our kitchen cabinet line, a field in which we are particularly strong.

Your company is also a large importer and our buyers are regularly overseas for procurement of outstanding products to sell.

ADVERTISING and PROMOTION

We believe in strong, large space impact advertising. We allocate better than 95% of our mass media dollars to newspaper advertising on a weekly basis in all markets in which we operate. We have developed a strong price image with our weekly ads, mostly full pages, and we reinforce that image four times a year with pre-printed tabloids. These special promotions are in multi-color (over 5 million copies) and distributed in 72 newspapers covering all our markets.

CONTROLS

The central accounting de-

partment, directly under the control and supervision of the secretary-treasurer, has its own "in-house" computer which assures the controls and read outs necessary in the retail business.

STORE DEVELOPMENT

Our continuing expansion requires that your company have knowledgeable career people in its real estate and store development department. This vital function is under the direction of a vice presi-



business / outlook '79

Boom is changing the state's landscape

Associated Press

The Cascade Mountains may look the same, but all around Washington, the landscape is changing, altered by an unprecedented economic boom and population surge.

"The symbol of Lynnwood should be changed to the bulldozer," remarked Larry Burke, president of the Lynnwood Community Environmental Association in Snohomish County, where 16,000 new housing units are planned within three years.

"In the last 8 to 10 years, we've gone from a rural county to an urban one, just like that," said Bruce Frickelton, commissioner in Clark County, one of the fastest growing corners of the state.

"Washington State is the third-fastest growing state in the nation," said Gov. Dixy Lee Ray in September when she established a "Working Group on Growth Management" to provide a way for the state to respond to growth problems.

Planners expect 800,000 new citizens by 1985 and 1.5 million by the year 2000, she said.

Despite a few black spots in 1978 — a rain-damaged wheat crop and spreading paper workers' strikes — the state's economy has been signalling a bright green light for growth.

"I can put it in one word, explosive," said Al Barran, president of the General Telephone Co., speaking earlier this year during an economic symposium. "I don't think there's any time in history when even when you're in a boom, you're not in a boom."

been clocked at 10.5 per cent in the southeast, in the northwest and East Coast," the Macmillan Bloedel spokesman said. At the time he was interviewed, Canada's dollar would only trade at 85 United States cents.

"We do most of our business in the northwest and East Coast," the Macmillan Bloedel spokesman said. At the time he was interviewed, Canada's dollar would only trade at 85 United States cents.

"It's obvious to me that there's a spillover area for Oregon," said a publican. "People have been coming here. Put that in the areas, good neighborhoods and you've got a boom."

The federal government, under construction, spelled boom for King County, where jobs were created at 4.6 per cent.

Growth is attracting attention to the urban areas, but few have yet to see another Seattle's skyline.

That will begin in 1979, in 1980 and beyond. The known action in the next couple of years should be unlike any in the central city for nearly a decade, with even more anticipated.

Most obvious is the 24-story building, the structure is being built on the site of the old building. The building is being built on the site of the old building.

year, second to Alberta's 10 per cent, compared to an overall 4 per cent for the entire nation.

A further indication is that during one trading week, the Toronto Stock Exchange, the country's



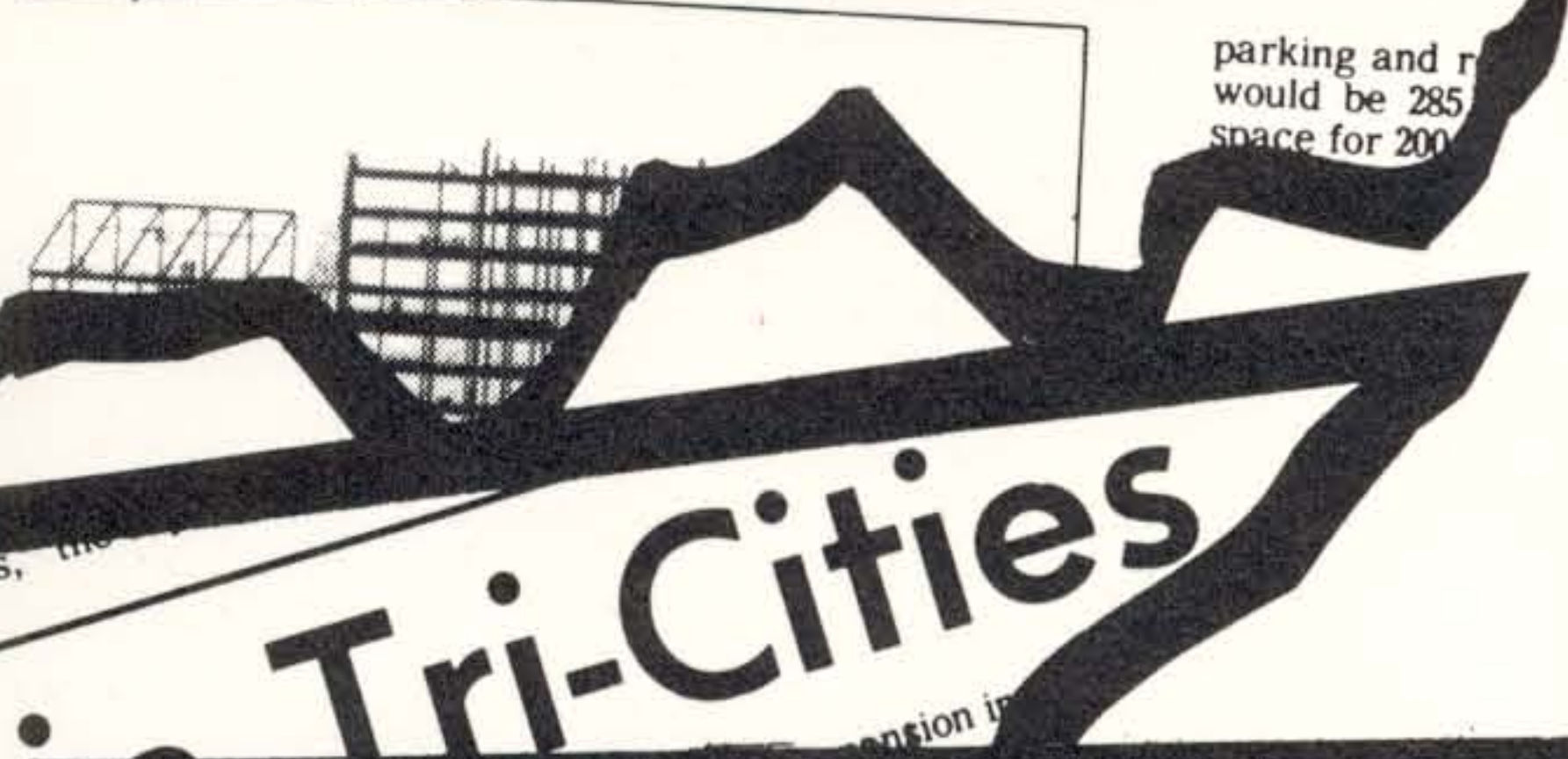
1978 was Seattle's year



Sally Gene Mahoney
Times staff reporter

start planned early this year. Several blocks away, The Seattle Times' \$5.3 million remodeling and expansion is just beginning. The addition, 19,000 square feet on the present press building on the northeast corner of Boren Avenue North and John Street will add office space, a 100-seat auditorium, a museum and a new building entry.

Remodeling is to include extensive renovation of the newsroom, a glass and steel structure, and labor disputes, the



Salt Lake Tribune Business

Fiscal Analysts Hopeful At Prudential Seminar

By Paul Rolly
Tribune Staff Writer

There will be no recession in 1979, especially not in Utah, according to an economic report delivered Tuesday night to hundreds of realtors and home builders at the 20th Annual Prudential Federal Savings Housing Seminar.

Prudential President George W. Brown was the most optimistic of the seminar's panelists, who predicted a strong economic recovery in 1979.

expansion scene



Boyd Burchard
Times business columnist

economic picture in the new year, despite a recession in the national economy, predicted by the Department of Commerce and the Department of Economic Development.

The state's booming aerospace industry should lead the economy, with an expected employment increase of 10,000.



Official Reports Drilling Activity

Oil and gas drilling in Utah is considerably ahead of last year's activity, according to Carlton Stowe, a specialist for the Utah Department of Natural Resources.

Mr. Stowe noted that 54 wells have been completed so far this year, compared with 29 at the same time last year. Of the 54 wells, nine are oil wells and 45 are gas wells.

Idaho Boise, entire state are growing and growing fast



Stephen Dunne

State Business People Op

By Gail Pitts
Denver Post Business News Director

If it is true that by the time an economic condition becomes generally accepted, it is outdated, then—

There will be no national recession and Colorado will exceed 1978 growth records. Inflation will abate; unemployment will decline and government will increase its hold on the citizens, both individual and corporate.

For Colorado, some of these predictions appear more likely than for the rest of the country. Economists, Denver Post staff experts, say the cross-section of the state's economy is healthy and growing.



City businessmen expect good 1979

By DANIEL GEARINO
Of The Gazette Staff

Not that it comes as a surprise, but the University of Montana's Bureau of Business and Economic Research has concluded that Billings businessmen: Expect 1979 to be a profitable year.

* Businessmen all over the state resent the growing rate of government spending.

Grand Junction Growth Outpace State, Editor Says

Wayne Walker, president Colorado Sign Co., I don't believe a national recession will have any effect in 1979 on the region's economy. Commercial building and continued population growth close to the 1978 level will keep our economy on a very positive note for 1979. Current movement of projects and the anticipated movement of national firms to this area should be untouched by a national recession. A slowdown should occur.



SACRAMENTO RAPID POP

Sacramento apparently is embarking on the kind of population growth usually associated with Southern California. For the second consecutive year the metro area's population is expected to grow faster than the state's rate and three times as fast as the nation's rate.

The boom comes partly from a resurgence of in-migrants looking for jobs.

Oregon What would have been a mortal blow

PORTLAND — A month ago, the local economic community got the bad news: The nation's largest forest-products firm was pulling out of the area.

Reprinted from the Denver Post

Salt Lake City Tribune
Billings Gazette
Seattle Times
Sacramento Bee



dent. New locations and potential locations are constantly under analysis by this team. A glance at the map in this report makes it obvious that the company concentrates on intermediate size cities for its expansion. Past experience shows that the company does exceptionally well in these medium size (50,000 to 75,000 population) towns. The company is able to become a strong marketing factor in this size community and can influence the market faster. Advertising rates are lower and advertising coverage normally is more complete — all factors enabling a new store to become profitable faster. In larger cities we open clusters of stores to reduce advertising and distribution costs.

In addition to new store development, merchandising teams in the field are continually re-merchandising and updating the appearance and display quality of each store.

PEOPLE

No company can grow without strong dedicated employees. We are proud to note that all our managers and district managers have been promoted from within. Our top priority is dedicated to developing people to meet the challenges of growth. Your company wants people growing in their jobs so they are ready to move ahead. Each person is trained to have his or her replacement ready to move up. It works!

Any company must have more than just sales and earnings and a growth record to motivate personnel. The company's Employee Stock Ownership Plan (ESOP) provides employees with an individual sense of ownership responsibility and participation. We now have over 275 people in the ESOP. Every full time employee who

remains with the company for 3 years is on the plan and 10% of his or her total wages (maximum contribution \$2,000) per year is paid into the employee account by the company. It is exactly like saving 10% of an employee's gross earnings with no deductions taken out. This money then buys company stock in the employee's name from shares previously purchased at well below the current market price and held by the ESOP. We sell the advantages of the ESOP very hard to attract and retain our people. This program, plus a strong medical and dental plan, higher-than-industry-average wages, as well as 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 his or her 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 growth reflects this concern.



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.

NASDAQ Symbol PAYP

Quarterly High and Low Bid Prices

(Asked prices are 1/2 point more)

Years ended February 28th	Last Two Fiscal Years	
	1979	1978
1st quarter	13 - 8	10 ³ / ₈ - 5 ³ / ₈
2nd quarter	13 ¹ / ₈ - 9 ³ / ₈	8 ¹ / ₈ - 6 ¹ / ₂
3rd quarter	18 - 11 ³ / ₈	9 - 7 ¹ / ₈
4th quarter	15 ¹ / ₂ - 14	9 ¹ / ₈ - 7 ¹ / ₂

Quarterly Dividends

Years ended February 28th	Last Two Fiscal Years	
	1979	1978
1st quarter	.125	.062
2nd quarter	.125	.094
3rd quarter	.125	.094
4th quarter	.125	.094

The range of high and low representative bid prices and the quarterly dividends have been adjusted for the stock dividends of a 50% dividend paid July 29, 1977, 33¹/₃% dividend paid April 28, 1978 and a 20% dividend paid April 27, 1979.

Transfer Agents and Registrars

Peoples National Bank of Washington
Seattle, Washington

Citibank, N.A.
New York, New York

Banks

Peoples National Bank of Washington
Seattle, Washington

Old National Bank of Washington
Spokane, Washington

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, 1979

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, 1979 — 3,688,619 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:

Items 13 thru 15 are omitted, except information regarding executive officers, as the required information will be furnished in the Company's proxy statement.

Part I

Item 1 — Business

(a) *General development of business.* Pay 'N Pak Stores, Inc. (the "Company") was incorporated in 1961 under the laws of the State of Washington, as the successor to a partnership formed in 1953 to engage in the retail sale of home improvement products, principally electric and plumbing supplies. The Company in its present form evolved from a merger in 1969 of three groups of similar stores in adjacent geographic areas. Immediately after the merger, the Company had 22 stores in 3 western states, Washington, California and Colorado. Since the merger, the Company has undertaken a store expansion program and has added auto parts and supplies and sporting goods to its lines of merchandise. During the past five years, the Company has opened between six to nine new stores in each fiscal year and currently operates 70 stores in 14 states, all west of the Mississippi River, although about half of the stores are located in the Pacific Northwest, with 27 stores in Washington and 8 stores in Oregon.

Item 1 — Business, continued

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

(c) (1) (i) *Description of business.* The Company caters to the do-it-yourself home improvement market. Home improvement products include electrical products, plumbing supplies, building materials, and cabinets and built-in appliances. Eleven stores also carry sporting goods and automotive parts and accessories. All but three stores are operated under the name "Pay 'N Pak." Three stores located in Idaho and Oregon are operated under the name "Eagle Electric & Plumbing Supply." The Company's sole method of distribution of merchandise to customers is through sales at its retail stores, all of which are operated by the Company.

The Company's marketing efforts are primarily directed toward homeowners and other do-it-yourself customers. The Company estimates that over 98% of sales of home improvement products and auto supplies were made to do-it-yourself customers in fiscal 1979, with professional builders and others accounting for less than 2%.

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

	<u>1975</u>	<u>1976</u>	<u>1977</u>	<u>1978</u>	<u>1979</u>
Electrical	28%	29%	33%	32%	31%
Plumbing	26	27	26	26	25
Building Materials	31	30	29	30	33
Automotive	7	7	7	6	6
Sporting Goods	8	7	5	6	5
Total	<u>100%</u>	<u>100%</u>	<u>100%</u>	<u>100%</u>	<u>100%</u>

The Company uses modern merchandising and marketing techniques in the operation of its retail stores. Store lay-out, merchandise organization and merchandise signs are designed by the Company's corporate staff and are essentially consistent throughout its stores. Merchandise is conveniently arranged and displayed in well-lighted stores, with emphasis placed on displays which illustrate how the product will look in the customer's own home. Many brand name products are carried by the stores, particularly where the Company believes such brand names are recognized by the customer as indicative of quality and reliability. The Company also carries private label merchandise, some of which is the manufacturers' standard merchandise and some of which is designed and manufactured to the Company's specifications. The Company attempts to charge competitive prices with respect to the merchandise sold through its stores, particularly on high volume, commodity products. Such pricing is facilitated by the Company's ability to purchase certain products in volume directly from manufacturers. Sales are predominantly on a cash and carry basis, which includes sales made through the use of bank credit cards by customers. To a limited extent, goods are also sold under installment sales contracts which are in turn sold to finance companies on a nonrecourse basis. The Company estimates that during fiscal 1979, sales on which it directly extended credit accounted for less than 5% of sales. The Company maintains a liberal merchandise return policy, with full refunds given under most circumstances to customers who return products.

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

Since March 1, 1978, the Company has opened new stores in Cheyenne, Wyoming, Hutchinson, Kansas, Spanaway, Washington, Coeur d'Alene, Idaho, Rapid City, South Dakota and Grand Forks, North Dakota (its first entry into North Dakota). The Company has also replaced its Redding, California store with a newer, larger store and has entirely rebuilt its Kennewick, Washington store, approximately doubling its size.

Item 1 — Business, continued

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

	Year Ended February 28 or 29				
	1975	1976	1977	1978	1979
Stores in operation at beginning of year (1)	44	50	55	60	65
New stores opened	7	9	7	6	7
Stores replaced by new stores		(2)	(2)	(1)	(1)
Stores sold or closed (2)	(1)	(2)			(1)
Stores in operation at end of year	50	55	60	65	70

(1) Prior to fiscal 1979 the Company treated as five separate stores the five physically separate sales outlets in the Kent, Washington mall. In this table, the Kent mall is treated as one store.

(2) In January, 1979, when the Company's lease expired it closed an outmoded store in Redmond, Washington.

The Company has undertaken a store expansion program to increase the annual number of new store openings to eight or ten. The exact number of stores opened in any period will depend on many factors, including the availability of suitable locations and general business conditions.

The Company is continually investigating locations for the establishment of new stores. Each location is investigated with respect to population and population trends, competition in the trading area and other pertinent factors in order to analyze its sales potential. The Company attempts to locate its stores in areas which are convenient to the do-it-yourself customer, principally in smaller cities and in suburban areas of larger cities. In selecting locations for future stores, the Company plans to concentrate on trading areas in the western and mid-western half of the United States that have a minimum trading area population of 50,000 persons.

The Company has purchased undeveloped real property in Fort Collins, Colorado, North Platte, Nebraska and Aberdeen, Federal Way and Bothell, Washington, upon which it plans to construct and open new stores during fiscal year 1980. The Company has also entered into leases and plans to open new stores later in fiscal 1980 in Eureka, California, Bountiful, Orem and Sandy, Utah, and Beaverton and Bend, Oregon. The Company is also presently negotiating a lease for a new store in Vancouver, Washington and the purchase of undeveloped real property in Kirkland, Washington, upon which it plans to construct a new store. In addition, the Company is constructing a new store adjacent to its main offices and shopping mall in Kent, Washington to replace its present retail store, which will be remodeled in part for expansion of the Company's main offices.

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

(iii) *Raw materials.* The Company buys its merchandise from several hundred independent suppliers, including manufacturers and importers, none of which accounts for more than 8.5% of the Company's purchases.

Approximately half the merchandise is shipped by suppliers directly to the Company's stores. The Company also stores merchandise and supplies its stores through two central warehouses, one a 121,500 square foot facility in Kent, Washington, and the other, opened in January 1978, a 78,900 square foot facility located in Denver, Colorado. The Company has also leased additional temporary warehouse space from time to time. The warehouse in Denver, Colorado service the Company's 25 stores located in Colorado, Kansas, Montana, Oklahoma, South Dakota, North Dakota, Utah, Idaho and Wyoming and the Kent, Washington warehouse services the remainder.

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

(v) *Seasonal business.* No material portion of the Company's business is seasonal, except to the extent that sales of home improvement products tend to be slightly lower during the winter season, and sales of sporting goods, particularly skis and ski equipment, tend to be higher during the winter season.

Item 1 — Business, continued

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

The Company sells most of its goods on a cash basis and other than selling a limited amount of goods under installment sales contracts that are sold to finance companies on a non-recourse basis, the Company does not provide extended payment terms to customers.

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

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

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

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

(2) (i) Research and development activities. The Company has engaged in research and development activities relating to the improvement of services to its customers, through the development of product knowledge training 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 \$221,514 and \$290,818 in 1978 and 1979, respectively.

(ii) Major customers. The Company does not have any customer to which sales are made in an amount which equals $\frac{1}{2}$ of 1% or more of the Company's consolidated revenue.

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

(iv) Number of employees. The Company currently employs approximately 960 full-time persons and 155 part-time persons.

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

Item 2 — Summary of operations

The following consolidated statements of income, retained earnings and capital in excess of par value of Pay 'N Pak Stores, Inc. for each of the five years in the period ended February 28, 1979, has been examined by Arthur Young & Company, certified public accountants, whose report with respect thereto appears elsewhere in this Form 10-K. The report calls attention to a change, with which they concur, in the method of accounting for leases as described in Note (e) of Notes to Consolidated Statement of Income. The statements should be read in conjunction with the other financial statements appearing elsewhere herein.

Item 2 — Summary of operations, continued

CONSOLIDATED STATEMENT OF INCOME

	Year ended February 28 or 29,				
	1975	1976	1977	1978	1979
Revenues:					
Net sales	\$61,379,628	\$73,221,950	\$80,592,395	\$98,000,321	\$117,341,577
Interest	61,633	25,394	32,080	42,201	336,047
Rentals and other	29,578	32,608	18,274	9,366	10,466
	<u>61,470,839</u>	<u>73,279,952</u>	<u>80,642,749</u>	<u>98,051,888</u>	<u>117,688,090</u>
Costs and expenses:					
Cost of sales (a)	40,190,618	48,783,406	51,859,031	62,958,711	75,255,440
Selling and administrative	14,050,938	16,069,234	18,771,334	22,121,472	26,005,335
Rent	689,298	813,865	839,042	1,052,671	1,424,436
Depreciation	1,128,629	1,379,970	1,641,183	1,866,524	2,203,011
Interest on long-term debt	1,324,010	1,530,768	2,014,658	2,156,079	2,522,478
Other interest	16,633	98,143	53,975	14,092	77,901
	<u>57,400,126</u>	<u>68,675,386</u>	<u>75,179,223</u>	<u>90,169,549</u>	<u>107,488,601</u>
Income before income taxes	4,070,713	4,604,566	5,463,526	7,882,339	10,199,489
Provision for income taxes (b) ...	1,935,185	2,174,592	2,592,398	3,684,537	4,796,563
	<u>2,135,528</u>	<u>2,429,974</u>	<u>2,871,128</u>	<u>4,197,802</u>	<u>5,402,926</u>
Minority interest	22,090				
Income before cumulative effect of change in accounting principle	2,113,438	2,429,974	2,871,128	4,197,802	5,402,926
Cumulative effect on prior years (to February 28, 1977) of change in accounting principle (e)				(191,337)	
Net income (e)	<u>\$ 2,113,438</u>	<u>\$ 2,429,974</u>	<u>\$ 2,871,128</u>	<u>\$ 4,006,465</u>	<u>\$ 5,402,926</u>
BEFORE 1980 STOCK SPLIT (c):					
Average number of common shares	<u>3,342,407</u>	<u>3,321,775</u>	<u>3,218,619</u>	<u>3,218,619</u>	<u>3,378,278</u>
Per common share:					
Income before cumulative effect of change in accounting principle	\$.63	\$.73	\$.89	\$1.30	\$1.60
Cumulative effect of change in accounting principle				(.06)	
Net income	<u>\$.63</u>	<u>\$.73</u>	<u>\$.89</u>	<u>\$1.24</u>	<u>\$1.60</u>
Dividends per common share (d):					
Cash paid	<u>\$.145</u>	<u>\$.21</u>	<u>\$.27</u>	<u>\$.413</u>	<u>\$.60</u>
Stock		<u>10%</u>	<u>10%</u>		
AFTER 1980 STOCK SPLIT (c):					
Average number of common shares	<u>4,010,888</u>	<u>3,986,130</u>	<u>3,862,343</u>	<u>3,862,343</u>	<u>4,053,934</u>
Per common share:					
Income before cumulative effect of change in accounting principle	\$.53	\$.61	\$.74	\$1.09	\$1.33
Cumulative effect of change in accounting principle				(.05)	
Net income	<u>\$.53</u>	<u>\$.61</u>	<u>\$.74</u>	<u>\$1.04</u>	<u>\$1.33</u>
Dividends per common share (d):					
Cash paid	<u>\$.121</u>	<u>\$.175</u>	<u>\$.225</u>	<u>\$.344</u>	<u>\$.50</u>
Stock		<u>10%</u>	<u>10%</u>		

(See Notes to consolidated statement of income beginning 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, 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; February 28, 1979—\$34,493,352.

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

	Year ended February 28 or 29,				
	1975	1976	1977	1978	1979
Current federal income tax	\$1,956,954	\$2,108,967	\$2,510,725	\$3,762,303	\$4,712,255
Investment tax credit	(75,167)	(101,905)	(120,125)	(157,502)	(168,325)
Tax effect of jobs credit . . .				(52,000)	(52,000)
Deferred income tax	(70,938)	34,340	43,579	(90,292)	(6,400)
State income taxes	124,336	133,190	158,219	222,028	311,033
	<u>\$1,935,185</u>	<u>\$2,174,592</u>	<u>\$2,592,398</u>	<u>\$3,684,537</u>	<u>\$4,796,563</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:

	Year ended February 28 or 29,				
	1975	1976	1977	1978	1979
Gain on sale of properties sold and leased back	\$ 1,749	\$ 1,749	\$ 1,749	\$ 1,749	\$ 1,749
Depreciation deducted for tax purposes in excess of the amount deducted for accounting purposes	58,179	132,916	179,825	193,961	120,135
Amortization of leasehold rights and related interest expense in excess of the rental expense deducted for income tax purposes	(101,883)	(129,308)	(143,908)	(140,213)	(151,780)
Pre-opening expenses deducted for book purposes (in excess) less than the amount deducted for tax purposes			5,913	(148,515)	23,796
Deferred state taxes				2,726	(300)
Airplane repair costs	(28,983)	28,983			
	<u>\$ (70,938)</u>	<u>\$ 34,340</u>	<u>\$ 43,579</u>	<u>\$ (90,292)</u>	<u>\$ (6,400)</u>

- (c) Before 1980 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, the 3 for 2 stock split declared in fiscal year 1978 and the 4 for 3 stock split declared in fiscal year 1979. After 1980 stock split per common share amounts give retroactive effect to the 6 for 5 stock split declared March 14, 1979, which is issuable in the form of a 20% stock dividend on April 27, 1979 to stockholders of record April 13, 1979.
- (d) Cash dividends paid per common share are stated at amounts after giving retroactive effect to stock dividends and splits described in Note (c). 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)

	Quarter Ended			
	May 31	Aug. 31	Nov. 30	Feb. 28
(000's omitted, except per share amounts)				
1978				
Revenues	\$22,212	\$27,901	\$26,336	\$21,603
Gross profit on sales	\$ 8,112	\$ 9,722	\$ 9,444	\$ 7,763
Income before cumulative effect of change in accounting principle	\$ 863	\$ 1,112	\$ 1,127	\$ 1,096
Cumulative effect on prior year of change in accounting principle	(191)			
Net income	\$ 672	\$ 1,112	\$ 1,127	\$ 1,096
Per share amounts (Note (c)):				
Before 1980 stock split:				
Income before cumulative effect of change in accounting principle	\$.27	\$.34	\$.35	\$.34
Cumulative effect of change in accounting principle	(.06)			
Net income	\$.21	\$.34	\$.35	\$.34
After 1980 stock split:				
Income before cumulative effect of change in accounting principle	\$.23	\$.29	\$.29	\$.28
Cumulative effect of change in accounting principle	(.05)			
Net income	\$.18	\$.29	\$.29	\$.28
1979				
Revenues	\$25,659	\$32,131	\$31,940	\$27,958
Gross profit on sales	\$ 9,456	\$11,288	\$11,516	\$ 9,826
Net income	\$ 1,050	\$ 1,449	\$ 1,424	\$ 1,480
Net income per share (Note (c)):				
Before 1980 stock split	\$.33	\$.45	\$.42	\$.40
After 1980 stock split	\$.27	\$.38	\$.35	\$.33

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 1978 to one of charging such costs to expense as incurred. Previously, the Company's pre-opening costs were capitalized and amortized on the straight-line method 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 during the first quarter of 1978.

Effective March 1, 1978, the Company retroactively capitalized the majority of its leases in accordance with the Securities and Exchange Commission Accounting Series Release No. 225 and Statement of Financial Accounting Standards No. 13. As a result, income before cumulative effect of change in accounting principle and net income were reduced retroactively by the following amounts for the year ended February 28 or 29: 1975—\$112,607 (\$.04 per share); 1976—\$144,650 (\$.05 per share); 1977—\$159,695 (\$.05 per share); and 1978—\$160,030 (\$.05 per share). Also, income before cumulative effect of change in accounting principle and net income were reduced retroactively by the following amounts for the quarters ended: May 31, 1977—\$42,408 (\$.01 per share); August 31, 1977—\$40,807 (\$.02 per share); November 30, 1977—\$39,207 (\$.01 per share); and February 28, 1978—\$37,607 (\$.01 per share).

Item 2 — Summary of operations, continued

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

During the past five years the Company's revenues have increased from \$61,470,839 in fiscal 1975 to \$117,688,090 in fiscal 1979 (an increase of 91%). Net income has increased during this period from \$2,113,438 in fiscal 1975 to \$5,402,926 in fiscal 1979 (an increase of 156%).

The year to year increase in revenues was 19% from fiscal 1975 to 1976, 10% from fiscal 1976 to 1977, 22% from fiscal 1977 to 1978 and 20% from fiscal 1978 to 1979. These increases are generally attributable to new stores opened during the periods, increased volume in existing stores and, to a lesser extent, price increases. For information regarding numbers of new stores opened in each of the last five fiscal years, see "Business". The percentage increase in revenues from 1976 to 1977 was less than the increases for other years, primarily because of the elimination of plywood and sheet rock from the Company's product line and the sale of two stores in December 1975. In addition, management changes occurring in connection with the resignation of the Company's President and Vice President—Operations in November 1975 caused some disruption in the Company's sales efforts in the first two quarters of fiscal 1977. Interest income increased \$29,846 in 1979 over 1978 as a result of investments of excess funds in short-term securities.

Increases in store revenues during the five-year period were attributable to the following:

	Increase (Decrease) in 1976 over 1975	Increase (Decrease) in 1977 over 1976	Increase (Decrease) in 1978 over 1977	Increase (Decrease) in 1979 over 1978
	(In thousands)			
Net sales of stores opened during fiscal year*	\$ 3,017	\$ 2,983	\$ 2,721	\$ 2,763
Increase in net sales over the preceding year of stores in their first full fiscal year of operation	6,241	3,666	4,323	3,279
Increase in net sales over the preceding year of stores opened for over two fiscal years ...	3,420	2,500	10,364	13,299
Change in net sales for stores closed or sold ..	(836)	(1,779)	—	—
	<u>\$11,842</u>	<u>\$7,370</u>	<u>\$17,408</u>	<u>\$19,341</u>

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

During the five-year period, cost of sales and selling and administrative expense have generally increased in proportion to the increase in revenues, except from 1976 to 1977. The elimination of plywood and sheet rock, both low margin items, from the Company's product line and the results of a management reorganization following the resignations discussed above contributed to a decrease in cost of sales, as a percentage of revenues, from 66.6% in fiscal 1976 to 64.3% in fiscal 1977. Rent and depreciation have increased throughout the period, primarily as a result of new store openings. Interest on long-term debt has increased primarily as a result of a \$3,550,000 borrowing in February 1976 and an additional increase in borrowing of \$5,000,000 in June 1978. Interest income increased \$293,846 or 696% in fiscal 1979 over 1978 as a result of investing the proceeds of a stock offering received in October 1978 in time certificates of deposit.

The Company's effective income tax rates for the five fiscal years were as follows: 1975—47.5%, 1976—47.2%, 1977—47.4%, 1978—46.7%, 1979—47.0%. The fluctuations were primarily due to variations in the amount of investment tax credit available in the respective periods.

Primarily as a result of the factors discussed above, net income increased by 15% from 1975 to 1976, by 18.2% from 1976 to 1977, by 39.5% from 1977 to 1978 and by 34.9% from 1978 to 1979.

Item 2 — Summary of operations, continued**CONSOLIDATED STATEMENT OF RETAINED EARNINGS**

	Year ended February 28 or 29,				
	1975	1976	1977	1978	1979
Balance at beginning of year:					
As previously reported	\$ 6,770,496	\$ 8,513,135	\$ 8,203,053	\$ 8,312,979	\$11,393,189
Adjustment (Note 1 (f))	(246,001)	(358,608)	(503,258)	(662,953)	(822,983)
As adjusted	6,524,495	8,154,527	7,699,795	7,650,026	10,570,206
Add (deduct):					
Net income	2,113,438	2,429,974	2,871,128	4,006,465	5,402,926
Dividends:					
Cash	(483,406)	(692,114)	(1,110,423)	(1,086,285)	(2,001,669)
10% stock at fair market value at date of issuance		(2,192,592)	(1,810,474)		
Balance at February 28 or 29	<u>\$ 8,154,527</u>	<u>\$ 7,699,795</u>	<u>\$ 7,650,026</u>	<u>\$10,570,206</u>	<u>\$13,971,463</u>

See Notes to Consolidated Financial Statements: Note 2 concerning restrictions on the payment of cash dividends and Note 1 (f) concerning retroactive capitalization of leases.

CONSOLIDATED STATEMENT OF CAPITAL IN EXCESS OF PAR VALUE

	Year ended February 28 or 29,				
	1975	1976	1977	1978	1979
Balance at beginning of year	\$ 3,788,717	\$ 3,788,717	\$ 5,967,497	\$ 7,216,633	\$ 7,136,168
Add (deduct):					
Excess of fair market value over par value of 10% stock dividends (138,116 shares in 1976, 146,301 shares in 1977)		2,178,780	1,795,844		
Retirement of treasury stock (56,267 shares)			(546,708)		
50% stock split at par value (804,655 shares)				(80,465)	
33⅓% of stock split at par value (804,655 shares)					(80,466)
Net proceeds from sale of 470,000 shares of common stock - excess over par value					8,082,848
Balance at February 28 or 29	<u>\$ 3,788,717</u>	<u>\$ 5,967,497</u>	<u>\$ 7,216,633</u>	<u>\$ 7,136,168</u>	<u>\$15,138,550</u>

Item 3 — Properties

Of the Company's 70 stores, 27 are located in the State of Washington, 8 in Oregon, 5 in California, 2 in Nevada, 4 in Idaho, 1 in Montana, 2 in Utah, 7 in Colorado, 3 in Kansas, 4 in Oklahoma, 2 in Alaska, 2 in Wyoming, 2 in South Dakota and 1 in North Dakota. All of the Company's stores except three are leased under leases expiring at various times between June 4, 1979 and June 1, 2003. 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 parcels in Fort Collins, Colorado, North Platte, Nebraska and Aberdeen and Federal Way, Washington. All but the Spokane property is being developed for new stores.

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.

Item 3 — Properties, continued

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. Since 1969, the Company has replaced 13 older, smaller stores with larger, new stores. The buildings contain all of the fixtures and improvements which the Company believes are necessary in its business. Many of the Company's present stores were formerly supermarkets, as their size, structure and location made them easy and appropriate to convert to Pay 'N Pak stores. Adequate off-street parking is provided adjacent to all stores.

Item 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, 1979:

- | | |
|---------------|---|
| 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 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 33 $\frac{1}{3}$ % stock split issued as a stock dividend declared on March 14, 1978. The Company's outstanding common stock was further increased from 3,218,619 shares to 3,688,619 shares on October 26, 1978, the date of issuance of 470,000 shares in connection with a registered public offering of such shares. The Company's outstanding common stock was further increased from 3,688,619 shares to 4,426,342 shares, an increase of 737,723 shares, on April 27, 1979, the date of distribution of a 20% stock split issued as a stock dividend declared on March 14, 1979.

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

In June, 1978, the Company entered into a loan agreement with The Prudential Insurance Company of America and issued its note in the original amount of \$11,700,000 payable in annual installments and maturing in 1993. 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 \$13,000,000.

Item 8 — Defaults Upon Senior Securities

None.

Item 9 — Approximate Number of Equity Security Holders

As of April 13, 1979, there were 2,446 holders of record of the Company's common stock.

Item 10 — Submission of Matters to a 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 20, 1978, 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.

Executive Officers of the Company

<u>Name</u>	<u>Age</u>	<u>Positions and Offices</u>
David J. Heerensperger	42	Chairman of the Board and Chief Executive Officer; Director
Jerry L. Marlow	43	President and Chief Operating Officer; Director
Harold F. Bacon	62	Executive Vice President; Director
Halvor Knudtzon, Jr.	52	Secretary-Treasurer and Controller; Director
Victor W. Crosswhite	42	Vice President-Midwest Merchandising
Peter W. Gallina	43	Vice President-Real Estate and Store Development
Terri L. Lucero	36	Vice President-Personnel
Curtis L. Rhodes	57	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.

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 11 — 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.

Item 11 — Indemnification of Directors and Officers, continued

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

(a) 1. 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.

2. Exhibits. None.

(b) 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, 1979.

Part II

Items 13-15 are omitted, except information regarding executive officers, 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 Knudtzon, Jr.
Treasurer

Dated: May 24, 1979

PAY 'N PAK STORES, INC.
INDEX TO FINANCIAL STATEMENTS
COVERED BY REPORT OF CERTIFIED PUBLIC ACCOUNTANTS
(Item 12(a))

Consolidated balance sheet—February 28, 1979 and 1978

Consolidated statements of income, retained earnings and capital in excess of par value for the five years ended February 28, 1979 (Included in Item 2)

Consolidated statement of changes in financial position for the five years ended February 28, 1979

Notes to consolidated financial statements

Schedules for the years ended February 28, 1979 and 1978

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, 1979 and 1978 and the consolidated results of its operations and the consolidated changes in financial position for each of the five years in the period ended February 28, 1979, in conformity with generally accepted accounting principles applied on a consistent basis during the period after restatement of the consolidated financial statements for all years ended February 28, 1978 to give retroactive effect to the change, with which we concur, in the method of accounting for leases as described in Note 1 (f) of Notes to Consolidated Financial Statements.

Arthur Young & Company

Seattle, Washington
March 26, 1979

PAY 'N PAK STORES, INC.
CONSOLIDATED BALANCE SHEET

February 28, 1979 and 1978

<u>ASSETS</u>		
	<u>1979</u>	<u>1978</u>
Current assets:		
Cash	\$ 804,100	\$ 600,592
Time certificates of deposit (Note 2)	4,600,000	
Trade accounts receivable, less allowance of \$50,000 for doubtful accounts (Schedule XII)	865,790	361,275
Merchandise inventories, at the lower of cost (first-in, first-out) or market	34,493,352	27,457,883
Prepaid expenses	882,651	576,280
Total current assets	41,645,893	28,996,030
Property, plant and equipment, at cost (Notes 1 (b), 1 (f) and 2) (Schedule V):		
Land	707,715	520,058
Buildings	1,905,719	2,005,018
Leasehold rights and improvements	18,498,568	16,097,581
Store equipment	8,798,214	7,281,477
Transportation equipment	1,241,538	1,053,198
Construction in progress	1,188,091	84,999
	32,339,845	27,042,331
Less accumulated depreciation and amortization (Schedule VI)	9,006,583	7,135,146
	23,333,262	19,907,185
Properties held for development and/or investment	1,012,320	612,485
Net property, plant and equipment	24,345,582	20,519,670
Time certificates of deposit (Note 2)	3,400,000	
Deferred income taxes (Note 1 (d))	417,860	411,760
Cost of acquired stores in excess of amounts assigned to net assets at dates of acquisition (Note 1 (c))	223,169	239,189
Other assets, at cost	70,410	105,979
	<u>\$70,102,914</u>	<u>\$50,272,628</u>

See accompanying notes

PAY 'N PAK STORES, INC.
CONSOLIDATED BALANCE SHEET
February 28, 1979 and 1978

LIABILITIES AND STOCKHOLDERS' EQUITY		
	<u>1979</u>	<u>1978</u>
Current liabilities:		
Notes payable to bank (Note 2)	\$ 2,400,000	\$ 1,850,000
Accounts payable	9,452,304	7,763,255
Federal and state income taxes	1,045,153	1,255,644
Accrued liabilities:		
Payroll and profit sharing	1,191,698	870,613
Taxes, other than income	1,093,113	925,986
Interest and other	328,830	100,822
	<u>2,613,641</u>	<u>1,897,421</u>
Long-term debt due within one year (Note 2)	1,152,914	972,594
Total current liabilities	16,664,012	13,738,914
Long-term debt (Note 2)	23,848,328	18,467,381
Employee benefit plan (Note 3)	1,003,869	1,253,435
Deferred income (Note 1 (d))	111,699	118,563
Commitments (Note 4)		
Stockholders' equity:		
Preferred stock, without par value, 1,000,000 shares authorized, none issued		
Common stock, \$.10 par value, 5,000,000 shares authorized, 3,688,619 shares issued (2,413,964 at February 28, 1978)	368,862	241,396
Capital in excess of par value	15,138,550	7,136,168
Retained earnings (Note 2)	13,971,463	10,570,206
	<u>29,478,875</u>	<u>17,947,770</u>
Deferred employee benefits (Note 3)	(1,003,869)	(1,253,435)
Total stockholders' equity	<u>28,475,006</u>	<u>16,694,335</u>
	<u>\$70,102,914</u>	<u>\$50,272,628</u>

See accompanying notes.

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

	Year ended February 28 or 29,				
	1975	1976	1977	1978	1979
Source of funds:					
Net income	\$ 2,113,438	\$ 2,429,974	\$ 2,871,128	\$ 4,006,465	\$ 5,402,926
Charges (credits) against income not involving working capital:					
Depreciation and amortization	1,534,035	1,680,425	1,971,564	2,202,053	2,252,019
Deferred income taxes	(70,938)	34,340	43,579	(90,292)	(6,400)
Minority interest	22,090				
Net asset amount of land and equipment retired and (gain) loss on sale of assets	60,877	(46,155)	54,021	3,524	24,163
Working capital provided from operations	3,659,502	4,098,584	4,940,292	6,121,750	7,672,708
Increase in long-term debt	974,322	6,292,311	2,800,277	507,245	5,966,065
Proceeds from sale of assets, or sale and leaseback of properties	145,661	944,997	351,468		353,740
Proceeds from sale of common stock					8,129,848
	<u>4,779,485</u>	<u>11,335,892</u>	<u>8,092,037</u>	<u>6,628,995</u>	<u>22,122,361</u>
Application of funds:					
Additions to property, plant and equipment	4,455,634	5,127,869	2,937,493	3,191,383	6,406,526
Cash dividends paid and payable	483,406	692,114	1,110,423	1,086,285	2,001,669
Reduction of long-term debt	550,643	1,128,777	1,418,446	971,680	585,118
Non-competition agreements		135,000			
Pre-opening costs and other assets	389,804	348,533	278,275	110,384	4,283
Increase in long-term time certificates of deposit					3,400,000
Increase (decrease) in notes receivable	245,201	(245,201)			
Purchase of minority interest in subsidiary	63,311				
Purchase of treasury stock		552,335			
	<u>6,187,999</u>	<u>7,739,427</u>	<u>5,744,637</u>	<u>5,359,732</u>	<u>12,397,596</u>
Increase (decrease) in working capital	<u>\$(1,408,514)</u>	<u>\$ 3,596,465</u>	<u>\$ 2,347,400</u>	<u>\$ 1,269,263</u>	<u>\$ 9,724,765</u>
The net increases (decreases) in the elements of working capital are as follows:					
Cash, treasury bills and time certificates ...	\$ (437,485)	\$ 681,827	\$ (76,825)	\$ (138,305)	\$ 4,803,508
Receivables	140,988	28,876	(158,450)	72,406	504,515
Merchandise inventories	186,879	2,231,458	6,351,044	3,415,151	7,035,469
Prepaid expenses	125,366	283,419	(197,393)	(89,459)	306,371
Notes payable	115,000	550,000	(700,000)	(1,150,000)	(550,000)
Accounts payable	(1,265,777)	249,498	(2,083,841)	(82,551)	(1,689,049)
Federal and state income taxes	(30,130)	33,765	(144,578)	(660,123)	210,491
Accrued liabilities	(195,873)	10,024	(481,711)	(307,920)	(716,220)
Dividends payable			(241,396)	241,396	
Long-term debt due within one year	(47,482)	(472,402)	80,550	(31,332)	(180,320)
Increase (decrease) in working capital	<u>\$(1,408,514)</u>	<u>\$ 3,596,465</u>	<u>\$ 2,347,400</u>	<u>\$ 1,269,263</u>	<u>\$ 9,724,765</u>

See accompanying notes.

PAY 'N PAK STORES, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
February 28, 1979 and 1978

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 products, plumbing supplies, building materials, and cabinets and built-in appliances. The Company also sells sporting goods and automotive parts and accessories.

(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) **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. See Note (b) of Notes to Consolidated Statement of Income.

Investment tax credits are recorded on the flow-through method at the time assets are placed in service.

(e) **Pre-opening costs** — Effective March 1, 1977, the Company charges pre-opening costs to expense as incurred.

(f) **Leases** — The Company has capitalized leased retail stores for capital leases entered into after January 1, 1977 and, effective March 1, 1978, retroactively capitalized the remainder of its capital leases for retail stores in accordance with Securities and Exchange Commission Accounting Series Release No. 225 and Statement of Financial Accounting Standards No. 13. As a result of the above restatement, the following accounts included in the consolidated balance sheet at February 28, 1978 have been adjusted from those previously reported: Increase of \$10,796,591 in leasehold rights and improvements for retail stores and one warehouse; increase of \$2,462,836 in accumulated depreciation and amortization; increase of \$754,530 in a charge to deferred income taxes; increase of \$216,691 in long-term debt due within one year; increase of \$9,694,577 in long-term debt; and a decrease of \$822,983 in retained earnings of which \$246,001 is applicable to periods prior to March 1, 1974. Included in leasehold rights and improvements is \$12,128,588 (\$11,310,023 at February 28, 1978) for capitalized lease obligations for retail stores and one warehouse, and accumulated depreciation and amortization includes \$3,018,776 (\$2,476,116 at February 28, 1978) applicable thereto.

PAY 'N PAK STORES, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
February 28, 1979 and 1978

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

(g) **Per share information** — Common share amounts were determined on the weighted average number of such shares outstanding during each year and give effect to the 10% stock dividends declared in fiscal years 1976 and 1977 and the 3 for 2 and 4 for 3 stock splits declared in fiscal years 1978 and 1979, which splits were effected in the form of 50% and 33⅓% stock dividends, respectively. A 6 for 5 stock split was declared March 14, 1979, which is issuable in the form of a 20% stock dividend on April 27, 1979 to stockholders of record April 13, 1979.

2. Short-term and long-term debt

At February 28, 1979, the Company has available unused lines-of-credit of \$4,905,033 under informal agreements with banks, which expire in June 1979 and February 1980. The interest rate is at ½% above prime. The maximum amount of month-end short-term bank borrowings during the fiscal year ended February 28, 1979 was \$4,950,000 (\$1,850,000 in 1978), the approximate average daily amount of such borrowings was \$382,000 (\$157,000 in 1978) and the weighted daily average interest rate was 9.0% (7.3% in 1978).

Long-term debt outstanding at February 28, 1979 and 1978 is shown in the following summary:

	<u>1979</u>	<u>1978</u>
9½% note payable to insurance company, due \$780,000 annually beginning December 1979 to 1994, plus interest	\$11,700,000	\$ 6,700,000
9⅝% to 9⅞% mortgage notes payable, due \$216,240 annually including interest to 2002, subject to call by holders in 1992 .	1,977,941	1,999,932
6½% to 9¾% (average 8.4%) contracts and notes payable, due \$73,063 annually including interest to 1980, \$43,488 in 1981 and reduced amounts to 1989	318,325	321,530
Capitalized lease obligations (\$27,007,322), less imputed interest (\$16,002,346) payable \$1,125,300 per year including imputed interest, 7.7% to 24.3% (average 12.2%), final payment in 2003	11,004,976	10,418,513
	25,001,242	19,439,975
Less amounts due within one year	1,152,914	972,594
	<u>\$23,848,328</u>	<u>\$18,467,381</u>

Payments on the principal of long-term debt and capitalized lease obligations for the four years ending August 31, 1984 are required as follows: 1981 — \$1,146,000; 1982 — \$1,163,000; 1983 — \$1,202,000; 1984 — \$1,227,000.

Properties held for development and/or investment at a cost of \$289,681 and operating plant and equipment having a net book amount of \$11,093,884 are pledged as collateral for the above debt, except capitalized leases and the note payable to insurance company.

The loan agreement covering the 9½% 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, 1979, retained earnings of \$1,740,085 was not restricted. The Company has also agreed to invest \$5,000,000 in new retail stores by July 1, 1980 of which \$3,400,000 remains to be invested at February 28, 1979.

PAY 'N PAK STORES, INC

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

February 28, 1979 and 1978

2. Short-term and long-term debt, continued

Of the \$8,129,848 of net proceeds received from the October 1978 sale of 470,000 shares of common stock, \$8,000,000 has been invested in time certificates of deposit. The \$3,400,000 of time certificates of deposit classified as a long-term asset represents the estimated remaining amount of the net proceeds to be invested in new retail stores. The investment covenant mentioned in the preceding paragraph would then be satisfied.

3. 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 331,346 shares of the Company's common stock. The unpaid balance is payable at \$62,500 per quarter to 1982 including interest at 2¼% above prime. The obligation of the ESOT is guaranteed by the Company and is expected to be serviced through future Company contributions (\$397,158 in 1979 and \$311,981 in 1978) 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 deduction from stockholders' equity. Deferred employee benefit amortization was \$249,566 and \$207,850 in 1979 and 1978, respectively.

4. Commitments

The Company leases substantially all retail store facilities and 2 warehouses. Certain of these leases have been capitalized. See Notes 1 (f) and 2. 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 have been less than 3.0% of total annual rental expense during each of the five years in the period ended February 28, 1979. The Company has options to renew most leases for three to five-year periods at agreed amounts. In some cases, rent is subject to renegotiation in the event the Company exercises its option to renew. There are no existing options to purchase leased property.

Rental expense for operating leases, except those with terms of a month or less that were not renewed, was \$1,533,967 and \$1,163,487 for the years ended February 28, 1979 and 1978, respectively.

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

<u>Year ending</u> <u>February 28 or 29,</u>	<u>000's omitted</u>
1980	\$ 1,114
1981	1,084
1982	1,063
1983	1,059
1984	1,070
Later years	12,717
	<u>\$18,107</u>

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, 1979 and 1978

<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</u>
David J. Heerensperger				
1978	\$ 3,117	\$47,632	\$ 50,749	\$ —
1979	\$ —	\$ 3,705	\$ 3,705	\$ —

PAY 'N PAK STORES, INC.

SCHEDULE V — PROPERTY, PLANT AND EQUIPMENT

Years ended February 28, 1979 and 1978

<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>
1978:				
Land	\$ 520,058	\$	\$	\$ 520,058
Buildings	1,849,521	155,497		2,005,018
Leasehold rights and improvements .	14,867,945	1,331,407	101,771	16,097,581
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
	24,157,938	3,190,383	305,990	27,042,331
Properties held for development and/or investment	611,485	1,000		612,485
	<u>\$24,769,423</u>	<u>\$3,191,383</u>	<u>\$ 305,990</u>	<u>\$27,654,816</u>
1979:				
Land	\$ 520,058	\$ 386,015	\$ 198,358	\$ 707,715
Buildings	2,005,018		99,299	1,905,719
Leasehold rights and improvements .	16,097,581	2,486,198	85,211	18,498,568
Store equipment	7,281,477	1,726,008	209,271	8,798,214
Transportation equipment	1,053,198	237,976	49,636	1,241,538
Construction in progress	84,999	3,164,565	2,061,473	1,188,091
	27,042,331	8,000,762	2,703,248	32,339,845
Properties held for development and/or investment	612,485	467,235	67,400	1,012,320
	<u>\$27,654,816</u>	<u>\$8,467,997</u>	<u>\$2,770,648</u>	<u>\$33,352,165</u>

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

Years ended February 28, 1979 and 1978

Description	Balance at beginning of period	Additions charged to income	Retirements or sales	Balance at close of period
1978:				
Buildings	\$ 96,715	\$ 50,073	\$	\$ 146,788
Leasehold rights and improvements .	3,126,669	852,081	101,771	3,876,979
Store equipment	2,254,188	885,954	198,000	2,942,142
Transportation equipment	93,517	78,417	2,697	169,237
	<u>\$5,571,089</u>	<u>\$1,866,525</u>	<u>\$ 302,468</u>	<u>\$7,135,146</u>
1979:				
Buildings	\$ 146,788	\$ 52,287	\$ 11,614	\$ 187,461
Leasehold rights and improvements .	3,876,979	953,668	85,211	4,745,436
Store equipment	2,942,142	1,059,582	209,272	3,792,452
Transportation equipment	169,237	137,474	25,477	281,234
	<u>\$7,135,146</u>	<u>\$2,203,011</u>	<u>\$ 331,574</u>	<u>\$9,006,583</u>

PAY 'N PAK STORES, INC.

SCHEDULE XII — RESERVES

Years ended February 28, 1979 and 1978

	Balance at beginning of period	Additions charged to income	Deductions accounts written-off	Balance at close of period
Allowance for doubtful accounts deduc- ted from the asset to which it applies:				
1978	<u>\$40,000</u>	<u>\$66,092</u>	<u>\$56,092</u>	<u>\$50,000</u>
1979	<u>\$50,000</u>	<u>\$75,505</u>	<u>\$75,505</u>	<u>\$50,000</u>

PAY 'N PAK STORES, INC.

SCHEDULE XVI — SUPPLEMENTARY INCOME STATEMENT INFORMATION

Years ended February 28, 1979 and 1978

	Charged to costs and expenses	
	1978	1979
Taxes, other than taxes on income	\$1,884,158	\$2,215,414
Depreciation (Schedule VI)	\$1,866,525	\$2,203,011
Rent — charged to:		
Rent	\$1,052,671	\$1,424,436
Selling and administrative	110,816	109,531
Total rent expense	\$1,163,487	\$1,533,967
Advertising	\$3,320,121	\$3,302,069

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:

	1978	1979
Depreciation (Schedule VI)	\$1,866,525	\$2,203,011
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	33,624
Amortization of pre-opening costs	262,715	
Amortization of loan fees	8,253	6,228
	\$2,202,053	\$2,252,019