

1975
Annual
Report

Pacific
Western
Industries,
Inc.

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Financial Highlights

Income Data	1975	1974
Sales and other income	\$30,998,056	\$23,743,951
Costs and expenses	30,327,950	23,133,164
Income taxes	278,000	279,000
Income from continuing operations	392,106	331,787
Income from discontinued operations	42,804	(87,388)
Net income	\$ 434,910	\$ 244,399
Net income per share:		
From continuing operations	\$.57	\$.48
From discontinued operations	.06	(.13)
	\$.63	\$.35

Balance Sheet Data		
Net working capital	\$ 2,458,464	\$ 2,286,672
Property, plant and equipment, net	1,830,719	1,699,784
Total assets	10,476,096	10,494,750
Stockholders' equity	3,849,266	3,418,771

Analytical Data		
Profit margin on sales	1.4%	1.0%
Return on stockholders' equity	12.0%	7.4%
Current ratio	1.5-1	1.4-1
Book value per share	\$ 5.55	\$ 5.41
Cash flow from operations	\$ 852,673	\$ 524,455

Stock Data		
Weighted average shares outstanding	694,891	697,240
Number of shareholders (approximate)	1,500	1,500
Bid price range by quarter		
First	2½-1¾	3½-2¾
Second	3½-2¾	3 - 2
Third	3½-2¾	2½-1½
Fourth	2¾-1¾	2½-1¾

The stock is traded in the OTC Market, Symbol PWII, principally in the Northwest.

A total of 124,599 shares were traded in 1975.

All officers and directors as a group own 28.4% of the Company's outstanding stock.

In 1975 the Company paid a 10% stock dividend. No cash dividends have been paid.

Cover: The cover photograph presents the products and services of Pacific Western Industries, from plywood and lumber, to doors, cabinets and millwork, to lighting hardware and prefinished paneling, to modular and component housing.

To Our Shareholders:

As you read through the Annual Report of Pacific Western Industries, Inc. you will be able to see where the Company has been and where it is today. What we would like to do in this message is give you a "feel" for how we got here and where the Company is going.

Five years ago we established certain goals and objectives for Pacific Western Industries, some of which were directed to correcting specific problems and others to setting the course for the Company's future. Common to each objective was that their accomplishment would lead to improved profitability.

First, we recognized that our principal strengths were in wood and building products businesses—plywood and lumber, doors, cabinets and millwork—so we set out to grow in these and related areas. We withdrew from other operations that were not related to wood and building products. Accordingly, our growth has come primarily from the expansion of existing production and marketing capabilities, and from our recent entry into modular and component housing and prefinished paneling.

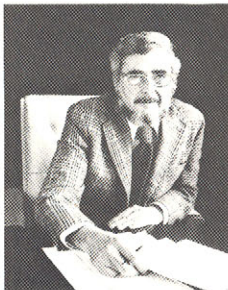
Second, we knew that our form of organization would have an impact on our profitability. We have maintained a decentralized form of organization which stresses the importance of profitable performance at each division. Considering the tremendous talents of our people and the diversity of our operations, we will continue to put our emphasis on improving and expanding our capabilities at each division, while at the same time, improving the support of those operations through a modest corporate staff.

Third, we realized that our company, as a whole, was subject to uncontrollable business cycles and, that within that framework, each of our operations were affected by specific market conditions that could either enhance or be detrimental to profitability. To minimize the impact of these external factors, we have expanded the marketing areas and service capabilities of our major operations, and we are working to accomplish the same thing with our newer, less mature businesses. Although still subject to the cycles of the wood and building products industry we have minimized the severe dips that can result in a loss of momentum and direction.

Fourth, we recognized that to accomplish our other goals we needed a financially sound company. Our profits over the past five years and our public stock offering in 1972 have generated a base of financial strength that has allowed the Company to expand existing operations and enter new businesses. As our financial ability continues to improve we will be able to seek out other opportunities and at the same time continue to strengthen our existing operations.

We are very pleased with what we have been able to accomplish relative to these goals and objectives. Each of them, however, are of a continuing nature and we are constantly striving to (1) build on our operating strengths and correct our weaknesses (2) maintain an effective organization (3) maximize profitability and minimize the affect of downward cycles, and (4) improve our financial strength.

The single disappointment we have had is that many shareholders have not seen an improvement in the market value of their investment, despite the progress the Company has made and the bright prospects for our future. We continue to believe that our responsibility is to do an effective job managing the Company, and that the results of our efforts and accomplishments will be translated into increased value for our shareholders. We will continue to improve the Company and its performance. At the same time, we will undertake to make more people aware of Pacific Western Industries. Ours is an excellent company, operating in the large and growing wood and building products industry. We have a good story to tell.



J. Allan MacDonald, President

J. Allan MacDonald

Western Cabinet & Millwork

Operating since 1953, this company was the predecessor to Pacific Western Industries.

Products

Prefinished kitchen and vanity cabinets, prehung doors, standard and custom millwork.

Services

Complete prefinished millwork package, manufactured to customer specifications and delivered, ready for installation.

Markets

Washington, Oregon and Idaho by truck, and Alaska, Hawaii and export by container.

Customers

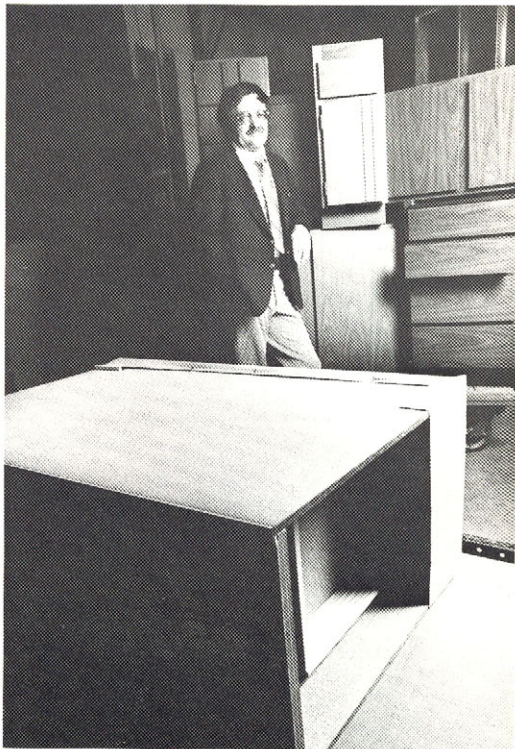
Residential builders of single family homes, apartment houses and condominiums.

Facilities

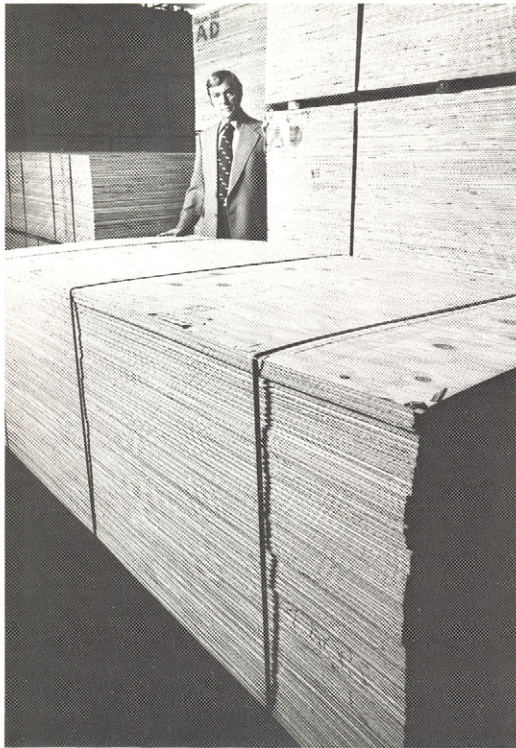
Kirkland, Washington—70,000 square feet. Boise Idaho—15,000 square feet.

Employs

120-150



Milton D. Skutle, President, of Western Cabinet & Millwork's Kirkland Plant.



Donald S. Hansen, President, at Timberland's Seattle warehouse.

Timberland Forest Products

Founded in 1963, the company joined Pacific Western Industries in 1969.

Products

Plywood and lumber products

Services

Wholesale distribution in common or mixed carloads. (The Company recently began a local distribution business to serve major building products retailers in the Greater Seattle area.)

Markets

Continental United States

Customers

Major wholesale distributors

Facilities

Seattle, Washington—65,000 square feet.
Spokane, Washington—40,000 square feet.

Employs

10

Cal-Wood Door

Operating since 1967, a successor to a previous business, the company joined Pacific Western Industries in 1968.

Products

Flush doors, hollow and solid core. Bifold, louver, lite and fire doors, jambs and casing.

Services

Product engineering and specifications, custom manufacturing, prefinishing, machining and delivery.

Markets

Eleven Western states by truck, Hawaii and export by container, and balance of continental United States by rail.

Customers

Major wholesale distributors and millwork suppliers.

Facilities

Santa Rosa, California—90,000 square feet.

Employs

110-150



Ian MacDonald, President, at Cal-Wood Door's Santa Rosa facilities.



Alfred W. Finch, President, at Brennan Supply's Seattle store.

Brennan Supply

Operating since 1958, the company was acquired by Pacific Western Industries in 1969.

Products

Lighting fixtures, hardware, kitchen and vanity cabinets, and related building supplies.

Services

Full line supplier with over 5,000 items for residential and commercial use, design, specifications and delivery.

Markets

Greater Seattle and Western Washington.

Customers

Residential builders, commercial contractors and consumers.

Facilities

Seattle, Washington—14,000 square feet. Bellevue, Washington—4,000 square feet. (The company will be opening a new 12,000 square foot warehouse and showroom in Bellevue this fall.)

Employs

25

Western Modular

Founded by Pacific Western Industries in 1974.

Products

Modular and component housing in single and multiple units, and light commercial buildings.

Services

Complete design, engineering and construction, with services available for delivery and installation.

Markets

Washington, Oregon, Alaska, Hawaii and export.

Customers

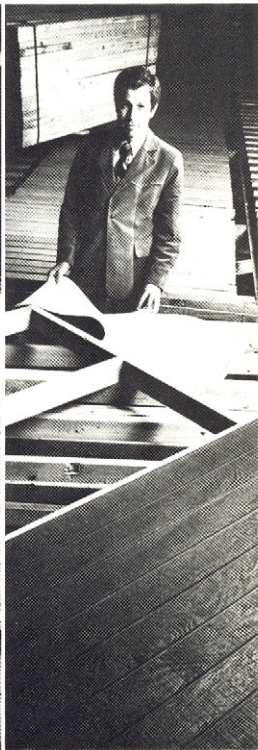
Retail dealers, developers, residential and commercial contractors.

Facilities

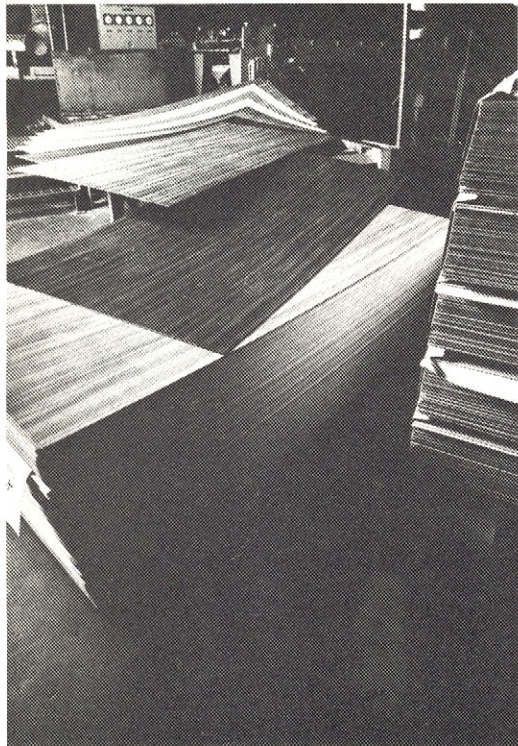
Kent, Washington—12,000 square feet on 10 acres.

Employs

30-60



Ronald D. André, President and George P. Sullivan, Vice President, at Western Modular's Kent facility.



A display of Welsh's prefinished panels at the Longview, Washington manufacturing facility.

Welsh Panel

Started by Pacific Western Industries in mid-1975, this company succeeded a previous business that had operated since 1958.

Products

Prefinished paneling in a variety of wood-grain patterns and styles.

Services

Product design, painting, printing, embossing and finishing, packaging and delivery.

Markets

Continental United States, Alaska and Hawaii

Customers

Major wholesale distributors, mobile home, furniture and door manufacturers.

Facilities

Longview, Washington—80,000 square feet.

Employs

30-40

Summary of Operations	Years ended December 31,				
	1975	1974	1973	1972	1971
Net sales	\$30,880,897	\$23,711,868	\$24,092,913	\$23,303,167	\$23,395,844
Other income	85,659	32,083	114,814	294,957	154,490
	<u>30,966,556</u>	<u>23,743,951</u>	<u>24,207,727</u>	<u>23,598,124</u>	<u>23,550,334</u>
Cost and expenses:					
Cost of sales	26,870,333	20,494,111	19,905,574	20,558,266	21,334,051
Selling and administrative expenses	3,069,199	2,244,937	2,405,120	1,903,551	1,473,363
Interest expense	356,918	394,116	185,045	176,141	213,617
	<u>30,296,450</u>	<u>23,133,164</u>	<u>22,495,739</u>	<u>22,637,958</u>	<u>23,021,031</u>
Income before provision for income taxes	670,106	610,787	1,711,988	960,166	529,303
Provision for income taxes:					
Federal	268,000	278,000	819,000	450,867	237,747
State	10,000	1,000	8,000	8,133	12,653
	<u>278,000</u>	<u>279,000</u>	<u>827,000</u>	<u>459,000</u>	<u>250,400</u>
Income from continuing operations	392,106	331,787	884,988	501,166	278,903
Income (loss) from former subsidiaries and discontinued operations	42,804	(87,388)	(10,365)	(25,420)	56,724
Income before extraordinary items	434,910	244,399	874,623	475,746	335,627
Extraordinary items:					
Reduction of cost of investment in subsidiary					(100,000)
Credit arising from utilization of net operating loss carry-forward					125,646
Net income	<u>\$ 434,910</u>	<u>\$ 244,399</u>	<u>\$ 874,623</u>	<u>\$ 475,746</u>	<u>\$ 361,273</u>
Net income (loss) per share:					
From continuing operations	\$.57	\$.48	\$ 1.23	\$.74	\$.45
From discontinued operations06	(.13)	(.01)	(.04)	.09
From extraordinary items04
Net income per share	<u>\$.63</u>	<u>\$.35</u>	<u>\$ 1.22</u>	<u>\$.70</u>	<u>\$.58</u>

(not covered by accompanying accountants' opinion)

Analysis of Sales and Income by Product Line	1975	1974	1973	1972	1971
Sales					
Cabinets and Millwork	31%	29%	28%	22%	17%
Plywood and Lumber	38	35	38	47	58
Doors	20	34	34	31	25
Modular and Component Housing	10	2			
Prefinished Paneling	1				
	<u>100%</u>	<u>100%</u>	<u>100%</u>	<u>100%</u>	<u>100%</u>
Income					
Cabinets and Millwork	94%	54%	19%	13%	10%
Plywood and Lumber	32	56	75	59	40
Doors	7	22	6	28	50
Modular and Component Housing	(12)	(6)			
Prefinished Paneling	(27)				
	<u>100%</u>	<u>100%</u>	<u>100%</u>	<u>100%</u>	<u>100%</u>

Note: These tables are based on sales and income of continuing operations.

Review of Operations

1975-1974

During 1975 sales increased 30%, reflecting the general improvement in demand for wood and building products. The principal contributors to the \$7.2 million increase were Western Modular Corp., which recorded sales of \$3.2 million in its first full year of operation, and Timberland Forest Products, with an increase of \$3.2 million based on increased activity in plywood and lumber markets. Sales also increased at Western Cabinet & Millwork and Brennan Supply Co., Inc. by a total of \$2.4 million, while Cal-Wood Door recorded a \$1.4 million decrease as a result of generally weak market conditions for the sale of doors. The newly formed prefinished paneling division, Welsh Panel Co., recorded sales of \$350,000 during its first five months of operations.

The overall gross profit margin decreased slightly to 13% in 1975, compared to 13.6% in 1974. The lower margins are attributable to the start-up of Welsh Panel Co. and to increased volume at slightly lower margins at Timberland Forest Products. Selling and administrative expense increased by \$824,000, reflecting the start up of Welsh Panel Co., the first full year of operations at Western Modular Corp. and a general increase in costs directed at expanding marketing and product capabilities.

Net income from continuing operations increased 18%, from \$332,000 in 1974 to \$392,000 in 1975. As in 1974, each of the door manufacturing, cabinet/millwork and plywood wholesaling divisions realized good operating results considering the external market opportunities and constraints, with Western Cabinet & Millwork providing the largest portion of the 1975 net income. The manufactured housing division incurred a small loss in its first full year of operation. The prefinished paneling division recorded an expected loss for its first five months of operation.

Sales decreased by 2% from 1973 to \$24 million. Newly started operations, Western Cabinet & Millwork, Inc. (Boise) and Western Modular Corp., contributed \$1.4 million to consolidated sales in 1974. The combined sales of the door, cabinet/millwork and plywood wholesaling divisions decreased by \$1.8 million from 1973, due to decreased demand for building products. Overall gross profit margins decreased from 17.4% to 13.6%, generally reflecting increased costs due to inflation, and pressure on prices for building products. During 1974 the Company decreased selling and administrative costs by 6.7%. At the same time, however, interest costs increased by \$209,000 or 113% reflecting both the unprecedented high interest rates and the higher overall level of borrowing required to finance inflation caused increases in receivables and inventories.

Net income from continuing operation for 1974 was \$332,000, down 62% from the record net income of \$885,000 achieved in 1973. Each of the door, cabinet/millwork, and plywood wholesaling divisions realized excellent profit levels in spite of the severely depressed market conditions. Western Cabinet & Millwork, the Boise, Idaho cabinet/-millwork division, recorded a profit during its first nine months of operations. The new manufactured housing division, Western Modular Corp., made good progress, though start-up and market development costs contributed to the earnings decline.

1974-1973

In 1972 the Company had principally completed the restructuring that was started in mid-1970 when a change in management was implemented. In 1972 sales were at the same level as 1971, but net income from continuing operations increased by 80% from \$279,000 to \$501,000, reflecting the increased demand for wood and building products that began in 1971. A principal contributor to the increased net income was a broadening of the market areas served by the Company.

Also during 1972, the Company improved its financial condition with a public offering of 232,159 shares of common stock at \$6.00 per share. Funds from the public offering were used to acquire a large block of the Company's common stock, to repay a large portion of short-term bank debt, and to improve the Company's working capital position.

In 1973 sales increased 3% over 1972. The overall gross profit margin increased from 11.8% in 1972 to 17.4% in 1973, principally due to the increased profits of the plywood wholesaling division. Selling and administration expenses increased 26.3% as the Company continued to implement its geographic diversification, and invested in operating systems and efficiencies to benefit future years. Net income from continuing operation in 1973 was \$885,000, a 76.6% increase over 1972. The vastly improved results reflected the high activity in the housing and construction industry.

1973-1972-1971

**Pacific Western
Industries, Inc.**
**Consolidated
Balance Sheet**

Assets

December 31

1975 **1974**

Current Assets

Cash	\$ 143,480	\$ 303,872
Accounts and notes receivable, less allowances for doubtful accounts and notes of \$142,271 in 1975 and \$184,999 in 1974 (Note 4)	3,053,038	3,306,627
Inventories (Notes 1b and 4)	4,458,586	4,271,127
Account balances with brokers (Note 9)	173,732	162,534
Prepaid expenses	98,759	91,491
Total current assets	<u>7,927,595</u>	<u>8,135,651</u>

Property, plant and equipment — at cost
(Notes 1c and 5)

Land	76,338	81,738
Buildings	824,703	894,509
Machinery	1,200,606	838,465
Automobiles and trucks	383,959	428,008
Furniture and fixtures	190,757	244,202
Leasehold improvements	152,688	239,990
	<u>2,829,051</u>	<u>2,726,912</u>

Less accumulated depreciation and amortization	<u>(998,332)</u>	<u>(1,027,128)</u>
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	<u>1,830,719</u>	<u>1,699,784</u>
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Excess of cost of investment in subsidiary over the
net asset value at date of acquisition (Note 1d)

Notes receivable	539,529	560,280
Other assets	172,835	15,112
	<u>5,418</u>	<u>83,923</u>
	<u>\$10,476,096</u>	<u>\$10,494,750</u>

	December 31,	
Liabilities and stockholders' equity	1975	1974

Current Liabilities

Notes payable:

Banks (Note 4)	\$ 2,802,788	\$ 3,232,193
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Other	325,788	180,800
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Accounts payable, trade	1,298,551	1,755,550
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Customer deposits and other deferred income ..	81,238	23,714
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Accrued liabilities:

Salaries and wages	45,117	63,420
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Interest	5,315	789
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Taxes, other than on income	170,427	189,437
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Other	165,071	180,293
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Current portion of long-term debt	492,653	254,872
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Accrued Federal and State income taxes	82,183	(32,089)
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Total current liabilities	<u>5,469,131</u>	<u>5,848,979</u>
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Long-term debt, less current portion shown above

(Note 5)	<u>919,426</u>	<u>1,189,917</u>
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Deferred income taxes (Note 1)	<u>187,360</u>	<u>37,083</u>
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Deferred income (Note 3)	<u>50,913</u>	
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Commitments and contingencies (Notes 3 and 9) ...

Stockholders' equity (Notes 2, 5 and 6)

Common stock, authorized 1,250,000 shares of \$.16 par value; issued and outstanding, 693,575 shares in 1975 and 631,785 shares in 1974	110,972	101,085
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Additional paid-in capital	1,598,115	1,414,983
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Retained earnings	<u>2,140,179</u>	<u>1,902,703</u>
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	<u>3,849,266</u>	<u>3,418,771</u>
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	<u>\$10,476,096</u>	<u>\$10,494,750</u>
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**Pacific Western
Industries, Inc.**
**Consolidated
Statement of Income**

Years Ended December 31, 1975 and 1974	1975	1974
Net sales	\$30,880,897	\$23,711,868
Other income		
Interest income	19,434	15,448
Gain on sale of assets	43,885	
Miscellaneous income	53,840	16,635
	<u>30,988,056</u>	<u>23,743,951</u>
Costs and expenses		
Cost of sales	26,635,406	20,286,380
Selling and administrative expenses	3,335,626	2,452,668
Interest expense	356,918	394,116
	<u>30,327,950</u>	<u>23,133,164</u>
Income from continuing operations		
before income taxes	670,106	610,787
Provision for income taxes (Note 7)	278,000	279,000
Income from continuing operations	<u>392,106</u>	<u>331,787</u>
Discontinued operations (Note 3)		
Income (loss) from operations of discontinued subsidiary (net of applicable income taxes of \$39,104 in 1975 and income tax benefits of \$87,500 in 1974)	42,804	(87,388)
Net income	<u>\$ 434,910</u>	<u>\$ 244,399</u>
Net income per share (Note 8)		
From continuing operations	\$.57	\$.48
From discontinued operations	.06	(.13)
Net income per share	<u>\$.63</u>	<u>\$.35</u>

**Consolidated
Statement of
Stockholders' Equity**

	Years ended December 31, 1975 and 1974			
	Number of Shares Outstanding	Par Value of Common Stock	Additional Paid-In Capital	Retained Earnings
Balance at				
December 31, 1973	646,889	\$103,502	\$1,457,878	\$1,858,304
Retirement of stock purchased from a former officer at February 27, 1974	(17,604)	(2,817)	(49,995)	
Issuance of stock in connection with the acquisition of a subsidiary company (Note 2)	2,500	400	7,100	
Net income 1974				244,399
Balance at				
December 31, 1974	631,785	\$101,085	\$1,414,983	\$1,902,703
10% stock dividend distributed September 15, 1975 at fair market value (fractional shares paid in cash)	63,110	10,098	187,121	(197,434)
Retirement of stock purchased from former company employees at December 31, 1975	(1,320)	(211)	(3,989)	
Net income 1975				434,910
Balance at				
December 31, 1975	693,575	\$110,972	\$1,598,115	\$2,140,279

The accompanying notes are an integral part of these financial statements.

Years ended December 31	1975	1974
Financial resources provided by		
Income for the year from:		
Continuing operations	\$ 392,106	\$ 331,787
Discontinued operations	42,804	(87,388)
	<u>434,910</u>	<u>244,399</u>
Add income charges not requiring use of working capital:		
Depreciation and amortization of plant and equipment	234,928	248,385
Amortization of excess cost of investment in subsidiary	20,751	20,751
Deferred income taxes (Note 7)	162,084	10,920
Total from operations	<u>852,673</u>	<u>524,455</u>
Additional long-term borrowings and refinancing of notes payable to banks	360,472	289,098
Issuance of stock in connection with the purchase of a subsidiary company		7,500
Deferred income from the sale of a subsidiary	50,913	
Sale of property, plant and equipment and Chicago Board of Trade membership	444,882	
	<u>1,708,940</u>	<u>821,053</u>
Financial resources applied to		
Payments of long-term debt (including reclassification of such debt due within one year)	630,963	311,120
Long-term portion of note receivable from sale of a subsidiary	172,835	
Expended for property, plant and equipment	732,222	307,294
Acquisition of treasury stock (retired)	4,200	52,812
Purchase of Chicago Board of Trade membership (sold in 1975)		77,050
Other changes, net	(3,072)	14,503
	<u>1,537,148</u>	<u>762,779</u>
Increase in working capital	\$ 171,792	\$ 58,274
Changes in components of working capital		
Increases (decreases) in current assets:		
Cash	\$ (160,392)	\$ (447,804)
Accounts and notes receivable	(253,589)	354,237
Inventories	187,459	1,614,636
Balances with brokers and prepaid expenses	18,466	85,507
	<u>(208,056)</u>	<u>1,606,576</u>
Less increases (decreases) in current liabilities:		
Notes payable	(284,417)	1,814,806
Accounts payable and deposits	(399,475)	129,831
Accrued liabilities	(48,009)	(78,683)
Current portion of long-term debt	237,781	43,401
Federal and State income taxes	114,272	(361,053)
	<u>(379,848)</u>	<u>1,548,302</u>
Increase in working capital	\$ 171,792	\$ 58,274

**Pacific Western
Industries, Inc.**
**Consolidated
Statement of Changes
in Financial Position**

Notes to Financial Statements December 31, 1975 and 1974

Note 1—Summary of Accounting Policies

(a) *Principles of Consolidation.* The consolidated financial statements include the accounts of the Company and its subsidiaries, all of which are wholly owned. All significant intercompany balances and transactions have been eliminated.

(b) *Inventories.* Inventories are valued at the lower of cost (principally average cost and first-in, first-out basis) or market.

(c) *Depreciation Policy, etc.* The cost of property, plant and equipment is depreciated and amortized on the straight-line method over the estimated useful lives of the assets. Leasehold improvements are being amortized over the lesser of the life of the lease or the life of the improvement.

The estimated useful lives for computing depreciation generally are as follows:

	Years
Buildings	25
Machinery and equipment	8
Office equipment and furniture	8
Automobiles and trucks	4

Maintenance and repair expenditures are charged to operations; renewal and betterment expenditures are charged to property accounts. When assets are sold or retired the cost and related accumulated depreciation are removed from the accounts, and any resulting gain or loss is reflected in income.

(d) *Amortization of Intangible.* The excess of cost of investment in subsidiary over net assets acquired arose in connection with the acquisition of the operations and net assets of Brennan Supply Co., Inc. in 1969. As of January 1, 1972, the Company adopted a plan of amortization whereby the remaining excess cost of \$622,533 be amortized over 30 years. Accordingly, \$20,751 has been charged to operations in 1975 and 1974.

(e) *Income Taxes.* Income tax expense is computed on the basis of transactions entering into the pre-tax operating results and is reduced by investment tax credits (\$42,400 in 1975 and \$11,900 in 1974) accounted for by the flow-through method. Deferred Federal income taxes have been provided in recognition of timing differences between reporting depreciation expense and certain other income and expense items for income tax purposes and financial reporting.

(f) *Incentive Bonus Plan.* The Company's Board of Directors approved an executive bonus plan in 1973 which provides incentive compensation for selected division managers and corporate officers. Payments under the plan are accrued only if the Company has met pre-established performance goals involving capital return and profitability. In 1975 and 1974, four division management personnel participated in the plan. Incentive bonuses charged to operations in 1975 and 1974 totaled \$49,380 and \$35,100, respectively.

(g) *Reclassifications.* Certain 1974 amounts have been reclassified to conform with the 1975 presentation.

Note 2 — Acquisitions

In March 1974, the Company acquired the operations, certain specific assets and assumed certain specified liabilities of Anderson Component Co., Inc., a manufacturer and distributor of millwork items, through a newly-formed subsidiary, Western Cabinet and Millwork, Inc. for 2,500 shares of the Company's common stock and \$2,500. The acquisition was accounted for as a purchase.

In June 1974, the Company formed Western Modular Corporation, a manufacturer of modular and component housing.

The results of operations for 1974 contain the operations of these subsidiary companies from the respective dates of acquisition and formation. The results of operations for 1974 would not have been materially different had the Company acquired the operations of Anderson Component Co., Inc. at the beginning of the period.

In August 1975, a newly formed subsidiary of the Company, Welsh Panel Co., purchased certain assets of the Welsh Corporation, a manufacturer of prefabricated paneling, which had filed a petition in voluntary bankruptcy on February 28, 1975. Welsh Panel Co. also leased the facilities of the bankrupt corporation in Longview, Washington. The results of operations for 1975 include Welsh Panel Co. from the date of its formation. Operations of the bankrupt company prior to the date of Welsh Panel Co. acquiring its assets are not available.

Note 3—Discontinued Operations

On October 31, 1975, effective October 1, 1975, the Company completed a transaction wherein all of the outstanding capital stock of a subsidiary, MacDonald-Miller Co., engaged in air conditioning contracting, was sold to two principal employees of that subsidiary for \$200,000 in the form of a 9%, 7-year promissory note. The promissory note, providing for equal monthly installments, is collateralized by the stock of MacDonald-Miller Co. and the underlying assets. Additionally, the agreement provided for a capital contribution of \$100,000 by the purchasers. Pacific Western Industries will remain as guarantor through December 31, 1976 of up to \$250,000 of bank working capital loans, such guarantee collateralized by accounts receivable. The gain to the Company of \$58,900 resulting from this transaction is accounted for on the installment basis, and accordingly, \$1,520 has been included in the results of operations for 1975.

The results of operations of MacDonald-Miller Co. for periods prior to October 1, 1975, are included in the consolidated statement of income under the caption "Income from discontinued operations." The following is a summary of the operations for the periods prior to October 1, 1975:

	1975	1974
Net sales and other income	\$3,620,239	\$5,863,816
Costs and expenses	\$3,538,331	\$6,038,704
Net income (loss)	\$ 82,908	\$ (87,388)

Note 4 — Notes Payable to Banks

The Company has short-term lines of credit with various banks aggregating \$3,850,000 of which

\$2,802,788 was outstanding at December 31, 1975, collateralized by accounts and notes receivable of \$2,862,000 and inventories of \$4,100,000. Interest rates at December 31, 1975 range from 8.75% to 9.50% and the weighted average for the year 1975 was 9.85%.

Note 5—Long-Term Debt

Long-term debt consists of the following at December 31:

	1975	1974
Mortgage notes and a real estate contract collateralized by certain land and buildings, bearing interest rates from 7% to 9%, payable in monthly installments, including interest, with final payments due variously from 1979 to 1992	\$ 599,920	\$ 739,993
Equipment contracts payable collateralized by the related equipment, bearing interest rates from 5% to 12% payable in monthly installments, including interest	279,775	237,344
Notes payable to certain individuals, bearing interest rates from 6% to 8%, requiring quarterly and semiannual payments with final payments due from 1977 to 1980	61,543	86,611
Term note payable to bank, bearing interest at 2½% over the prime rate, with a minimum of 7¼% and a maximum of 9%, requiring quarterly payments of \$25,000 plus interest, and a lump sum of \$205,841 plus interest on January 1, 1977	280,841	380,841
Term note payable to bank, bearing interest at 2½% over the prime rate requiring quarterly payments of \$10,000 plus interest, maturing in 1980	190,000	
	1,412,079	1,444,789
Less current portion	492,653	254,872
	\$ 919,426	\$ 1,189,917

The two term notes payable to banks include certain provisions which require bank approval including: (1) officer's compensation levels; (2) acquisition of or engagement in any other business entity; (3) investment in fixed assets in excess of certain limits; (4) payment of dividends; and (5) maintenance of certain levels of working capital and net worth.

Annual payments on long-term debt outstanding at December 31, 1975, maturing during the following five years, are as follows: 1976—\$492,653; 1977—\$179,640; 1978—\$147,802; 1979—\$87,187; 1980—\$72,597.

Note 6—Stock Options

In 1969, the Company adopted a qualified stock option plan under which common shares were reserved for the granting of options to key employees of the Company and its subsidiaries to purchase common shares at not less than 100% of the market value at the date of grant. Options may be granted covering up to 30,000 shares of the Company's authorized but unissued common stock and are exercisable at the date of grant and expire at various dates to January 24, 1980.

Option activity (in shares) under the plan was:

	1975	1974
Outstanding, January 1	21,000	22,500
Granted	1,000	
Exercised		
Cancelled	(20,500)	(1,500)
Adjusted for stock dividend	150	
Outstanding and exercisable at December 31	1,650	21,000

No options have been exercised since the inception of the plan. At December 31, 1975, 1974, 28,350 and 9,000 shares remained available for future options, respectively.

During 1974, the Company granted nonqualified options to purchase an aggregate of 55,000 shares (adjusted for the 10% stock dividend), 27,500 shares each to two individuals, in connection with the formation of a subsidiary, at \$2.727 per share. On January 31, 1975, 11,000 shares became exercisable and 11,000 shares became exercisable on January 31, 1976 and each succeeding January 31st through 1979. Such options shall be exercisable for five years following the date on which they first become exercisable. In the event of termination of employment, options then exercisable shall be exercisable only for twelve months following such termination of employment.

During 1975, the Company granted nonqualified stock options to purchase 12,650 shares (adjusted for the 10% stock dividend) to eight members of its Board of Directors at \$2.386 per share which are exercisable until 1980. Nonqualified stock options outstanding for 6,000 shares at December 31, 1974 to seven board members were cancelled during 1975.

Activity in nonqualified stock options is as follows:

	1975	1974
Outstanding, January 1	61,000	7,000
Granted	12,650	55,000
Cancelled	(6,000)	(1,000)
Outstanding, December 31	67,650	61,000

Under the terms of the public offering in 1972, the principal underwriter was issued an option to purchase 11,000 (adjusted for 10% stock dividend) shares of the Company's stock for a total consideration of \$100. The option provided for the purchase of stock at a price of \$5.94 per share until June 1, 1973, and the price increases each year thereafter by \$.594. The option expires on June 1, 1977. The option has not been exercised at December 31, 1975.

Proceeds from the exercise of the options will be credited to the common stock account to the extent of the par value thereof, and the excess credited to additional paid-in capital.

Note 7 — Income Taxes

The provision for taxes on income consists of the following:

	1975	1974
Amounts currently payable	\$158,316	\$279,980
Current additions to deferred income taxes	162,084	10,920
Reduction in Federal income tax payable as a result of the investment tax credit	(42,400)	(11,900)
	<u>\$278,000</u>	<u>\$279,000</u>

The increase in deferred income taxes results from timing differences in the recognition of revenue and expenses for tax and financial statement purposes. The sources of these differences and the tax effect of each were as follows:

	1975	1974
Accelerated depreciation	\$ 16,944	\$ 10,920
Increased basis in assets resulting from the partial liquidation of a subsidiary	144,564	
Other	576	
	<u>\$162,084</u>	<u>\$ 10,920</u>

During 1975, a subsidiary company in a partial liquidation transferred certain of its assets and liabilities to Pacific Western Industries, Inc. The transfer resulted in an

Auditors' Report

To the Board of Directors and Stockholders
Pacific Western Industries, Inc.

We have examined the consolidated balance sheet of Pacific Western Industries, Inc. and subsidiaries as of December 31, 1975 and 1974, and the related consolidated statements of income, stockholders' equity and changes in financial position for the years then ended. Our examinations were made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

increased tax basis of assets held by Pacific Western. The Company has provided for deferred taxes on the effect of this transaction.

The effective tax rate in 1974 was 45.7%. The effective tax rate of 41.5% in 1975 which differs from the statutory corporate tax rate of 48% is due principally to the utilization of investment tax credits (6%) and reduced tax rates on capital gains income.

Note 8 — Net Income Per Share

Net income per share is based on the weighted average of shares outstanding during the periods after retroactive adjustment for the 10% stock dividend. There is no material dilution of net income per share resulting from the assumed exercise of stock options.

Note 9 — Commitments and Contingencies

The Company and its subsidiaries lease certain premises used in their operations under leases which have terms extending to various dates through 1990. Rental expense charged to operations totaled \$282,000 and \$225,000 for 1975 and 1974, respectively. Aggregate annual rentals under such leases for each of the succeeding five years are as follows: 1976 — \$218,500; 1977 — \$187,000; 1978 — \$193,000; 1979 — \$117,000; and 1980 — \$59,000. Aggregate rentals for five-year periods beginning after 1980 are as follows: five years ending 1985 — \$243,000; five years ending 1990 — \$222,750.

A subsidiary of the Company trades in the futures market for its own account in both speculative and hedging transactions through the Chicago Board of Trade. Account balances with brokers in the amount of \$173,732 represents principally margin deposits at December 31, 1975.

In our opinion, the aforementioned statements present fairly the consolidated financial position of Pacific Western Industries, Inc. and subsidiaries at December 31, 1975 and 1974, and the results of their operations and changes in their financial position for the years then ended, in conformity with generally accepted accounting principles applied on a consistent basis.

Moss, Adams & Co.

Seattle, Washington
February 16, 1976

Board of Directors

J. Allan MacDonald

President, Pacific Western Industries, Inc.

Donald S. Hansen

President, Timberland Forest Products, Inc.

Ian MacDonald

President, Cal-Wood Door

Delos W. McNutt

Executive Vice-President and Treasurer
TAPCO, Inc. (Audio Electronics)

Robert J. DeArmond

President-Chief Executive
The Pak-River Company (Lumber Products)

Jack H. Canvin

Investor Relations Officer
Bank of America (Banking)

Thomas L. Bentley

General Manager
Puget Sound Plywood, Inc. (Plywood)

Curtis P. Lindley

Senior Vice-President
Univar Corporation (Industrial and
Agricultural Chemicals and Products)

Officers

J. Allan MacDonald

President

Donald S. Hansen

Vice-President

Ian MacDonald

Vice-President

James A. MacDonald, Jr.

Treasurer

Michael E. Stansbury

Secretary (Partner; Foster,
Pepper & Riviera, Attorneys)

Stockholders who wish copies of the
company's annual report on Form
10-K filed with the Securities and
Exchange Commission may receive
copies upon written request.

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Seattle, Washington

Attorneys

Foster, Pepper & Riviera
Seattle, Washington

Registrar and Transfer Agent

Seattle-First National Bank
Seattle, Washington

Pacific
Western
Industries,
Inc.

