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GAMBLE-SKOGMO, INC.

1979 ANNUAL REPORT

Gamble-Skogmo, Inc...
a major diversified corporation
with substantial growth potential
in two of the most dynamic areas
of consumer activity: merchandising
and financial services.

FORM 10-K

A copy of the company's annual report to the Securities and Exchange Commission on Form 10-K for its most recent fiscal year may be obtained by stockholders without charge by writing to:

Charles H. Gauck, Vice President,
Secretary and General Counsel
Gamble-Skogmo, Inc.
5100 Gamble Drive
Minneapolis, Minnesota 55481

CORPORATE HEADQUARTERS

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201 Alhambra Circle
Coral Gables, Florida 33134
(305) 442-6700

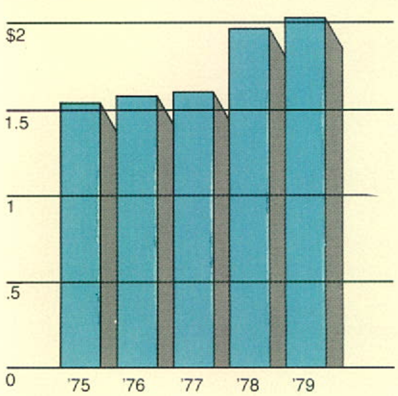
Highlights of The Year

All dollars in thousands except amounts per share

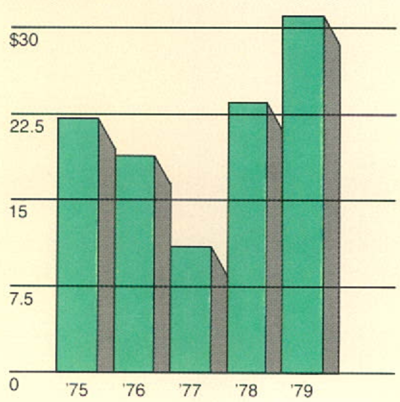
Performance	1979 (Fifty-Two Weeks Ended Jan. 26, 1980)	1978 (Fifty-Two Weeks Ended Jan. 27, 1979)	% Change
Sales	**$2,053,003**	$1,954,644	5.0
Net Earnings	**$ 31,184**	$ 23,224	34.3
Per Common Share:			
Primary Earnings	**$ 7.52**	$ 5.47	37.5
Fully Diluted Earnings	**$ 7.11**	$ 5.15	38.1
Dividends	**$ 1.50**	$ 1.40	7.1
Stockholders' Equity	**$ 59.42**	$ 54.05	9.9

Other Significant Highlights	1979	1978	% Change
Common Stock and Other Stockholders' Equity	**$ 247,398**	$ 218,129	13.4
Redeemable Preferred Stock	**$ 9,799**	$ 14,783	(33.7)
Subordinated Income Notes Outstanding	**$ 258,215**	$ 251,843	2.5
Number of Common Shares Outstanding	**4,163,215**	4,036,034	3.2
Number of Preferred Shares Outstanding	**260,662**	402,029	(35.2)
Number of Stockholders	**11,216**	11,471	(2.2)
Number of Subordinated Income Noteholders	**42,693**	39,414	8.3

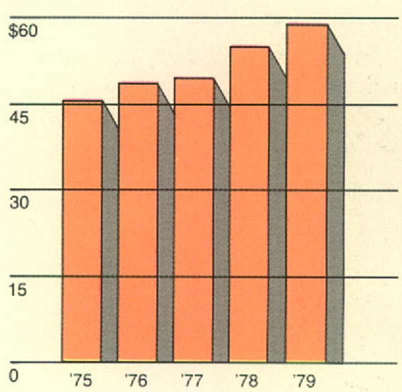
SALES
(Billions)



EARNINGS
(Millions)



STOCKHOLDERS' EQUITY–PER SHARE



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To Our Stockholders:

The year 1979 was probably the most significant in Gamble-Skogmo's 55-year history. Three matters are of particular importance to our stockholders:

- Records were set in sales, net earnings and earnings per share.
- Definitive financial policies, operating objectives and performance standards were established during the year to insure that Gambles' capital resources and management time are directed to achieve maximum future growth and profitability.
- A preliminary agreement in principle was reached between Gamble-Skogmo and The Wickes Corporation concerning the proposed acquisition of the company by Wickes.

Although the economy was unsettled by rampant inflation, rising energy costs and higher interest rates, Gambles' sales reached a record \$2.1 billion, up five percent over 1978. Net earnings were up sharply to \$31.2 million, or \$7.52 per share, a gain of 34 percent over last year. Reflecting Gambles' continued progress, the directors raised the cash dividend on common stock to \$1.50 per share in 1979.

The substantial earnings improvement was achieved on a relatively modest sales increase. This reflects improved operating efficiencies and the absence of the losses incurred in closing the Tempo-Buckeye division in 1978. Eliminating these losses resulted in a pre-tax improvement of nearly \$5.7 million in 1979 merchandising group profits. Merging the Leath and Maxwell furniture companies and the absorption of the Gambles House of Fabrics division by the J. M. McDonald division resulted in more efficient operations and lower overhead and administrative expenses.

There were several other major factors contributing to the company's improved earnings in 1979. Gambles' equity in the earnings of its unconsolidated financial services subsidiaries increased 86 percent to \$16.6 million from \$8.9 million in 1978. A major factor in this gain was that Aristar, Inc. and its insurance subsidiary were only 51 percent owned in 1978 but became wholly owned this year. Finally, a favorable shift in currency adjustments relative to the Canadian dollar contributed to earnings improvement.

During the year, management began a rigorous analysis of each profit center. We evaluated each unit's success during the last five years in achieving an improved rate of return on the operating capital employed in the business. We believe this to be the single most important measure of profitablity because it relates earnings to the amount of capital committed to each profit center.

At present, the overall rate of return being earned on Gambles' total capital investment is unsatisfactory. Through our analysis, we have identified those profit centers where the rate of

Walter H. Davies, Jr.

return justifies a priority for additional capital resources; those where the performance can be improved in a specified period with the infusion of additional capital and management time; and those where the rates of return in the future are sufficiently uncertain to suggest consideration of selling or liquidating the profit center.

A more complete discussion of our review process and the approach we are taking in our analysis is contained in a new section of the annual report called Financial Policy, which begins on Page 12. We believe you will find this section of interest.

In December 1979, Gambles' directors announced that an agreement in principle had been reached with the directors of The Wickes Corporation with respect to the proposed acquisition of Gamble-Skogmo by Wickes. At that time, the transaction was valued at $200 million in securities, or approximately $45 per common share of Gambles. On March 12, 1980, the companies announced a revised agreement in principle for Wickes to acquire all of the outstanding shares of Gambles for $33 per share in cash and ¾ share of common stock in a holding company to be formed in conjunction with the acquisition. If the transaction is consummated, the new holding company would act as the parent of Wickes and Gambles, both of which would continue as separate operating entities.

There are numerous subjective judgments yet to be made by both Wickes and Gambles, as well as the receipt of necessary regulatory approvals and the negotiation and execution of a binding agreement, before the proposal can be put to a vote by the stockholders of both companies.

While much time has been spent in recent months on review and analysis of financial performance, we have not lost sight of the fact that our single most valuable asset is our 29,000 employees. Their loyalty and hard work have built Gambles into a $2 billion organization. From the beginning, our employees have been encouraged to invest in their own and the company's future through ownership of Gambles' stock. Today, the shares owned by our Thrift/Sharing and Employee Stock Ownership Plan make it the company's largest stockholder. This year Gambles will contribute $3.9 million from 1979 earnings to the Plan, enabling participating employees to share in the profits they helped produce.

Due to present economic uncertainties, 1980 will be a very challenging year. The productivity and loyalty of our employees, together with the cooperation and support of our other stockholders, suppliers and customers, further underscore our commitment to attain our 1980 objectives.

Walter H. Davies, Jr.
Chairman and
Chief Financial Officer

Wayne E. Matschullat
President and
Chief Executive Officer

The Year in Review
Merchandising Group

1979 Highlights

Sales $2.1 billion, 5 percent more than 1978

Comparative Sales (All dollars in thousands)

General Merchandising		
Retail	$352,291	+14.9%
Wholesale	213,207	+ 1.2
Mass Merchandising	244,774	− 7.1
Food and Drug	799,834	+ 9.5
Catalog	249,365	− 2.6
Canadian Merchandising	202,839	+ 1.5

Despite an unsettled domestic economy, Gambles' merchandising businesses had their best year ever in fiscal 1979. Revenues reached record levels. Profits, which were under pressure because of inflation and higher interest rates, improved consistently through the year and set a new record.

A combination of innovative promotions, careful inventory management, effective cost control programs and increased emphasis on productivity in all aspects of the merchandising operation helped produce these improved results. New markets were opened, several companies underwent substantial restructuring and most have been repositioned to take advantage of opportunities for growth and increased profitability as we enter the 1980s.

An Example of Successful Merchandising –

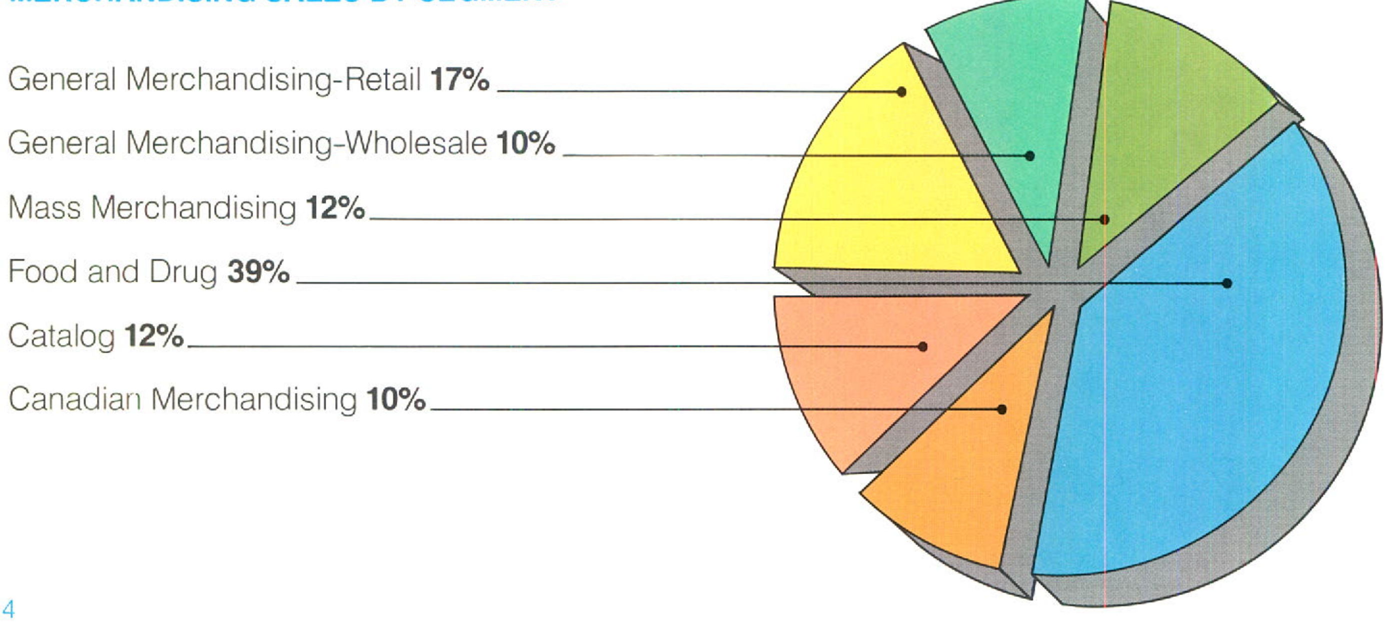
Woman's World Shops

Woman's World Shops reflects the type of growth and profitability objectives which Gambles' management is endeavoring to develop throughout the entire merchandising group. With 70 specialty stores featuring higher-priced, branded fashion apparel in large and half-sizes, Woman's World produced a 36 percent increase in sales in fiscal 1979. This was the seventh consecutive year of sales and profit increases since its acquisition by Gambles in 1972. This success is based on superior merchandising, keyed to a program of careful market analysis to pinpoint and project customer needs. By providing the right type of merchandise at the right time, in a highly creative retail environment, Woman's World has succeeded in the specialty store field where others have failed.

Consistent increases in profits have resulted from an effective expense control system which was improved in 1979 by the completion of the first two phases of an extensive merchandise reporting system. In 1980, installation of point-of-sale cash registers in every store will improve this program further by providing immediate merchandise and sales information and by refining internal accounting practices.

By recognizing the impact of inflation on consumer spending patterns, Woman's World changed its advertising theme from emphasis on fashion to a

MERCHANDISING SALES BY SEGMENT



hard-hitting promotional campaign, revised monthly. The result was the highest second half sales and profit increase in its history. In addition, the company has motivated its merchandising team with new bonus programs. Woman's World is well-positioned to benefit from the opening of 15 new stores planned for 1980.

An Example of Market Expansion –

Toy World, division of Rasco Stores

In recent years, one of the fastest growing segments of retailing has been specialty toy stores. Gamble-Skogmo's entry into this business is the 51-store Toy World chain with outlets in regional malls and shopping centers in California and Arizona.

Effective merchandising and the dramatic proliferation of hand-held and home entertainment electronic games accounted for a significant portion of sales growth in 1979 when 15 new stores were opened. In fact, sales exceeded $200 per sq. ft. of selling space.

Current economic trends underlie an expansive marketing plan for 1980 which includes the addition of 15 new stores and the first Toy World store in the Midwest.

An Example of Improved Productivity –

Leath-Maxwell Stores

Economic and demographic studies indicate that the growth potential for the Leath-Maxwell group of full-service furniture stores should be excellent through the 1980s. This past year was a period of preparing for that growth. Assimilating the 76-store Maxwell division into the Leath organization was completed in an environment adversely influenced by the general slowdown in the housing market and a depressed economy in many cities affected by the auto industry. In addition, an extensive management review prompted the closing of 11 unprofitable Maxwell stores.

The buying power and cost savings achieved by combining the organizations will provide excellent growth potential, as will upgrading the computer capability to improve inventory control and turnover. Gambles' streamlined furniture operations are now among the best positioned in the industry.

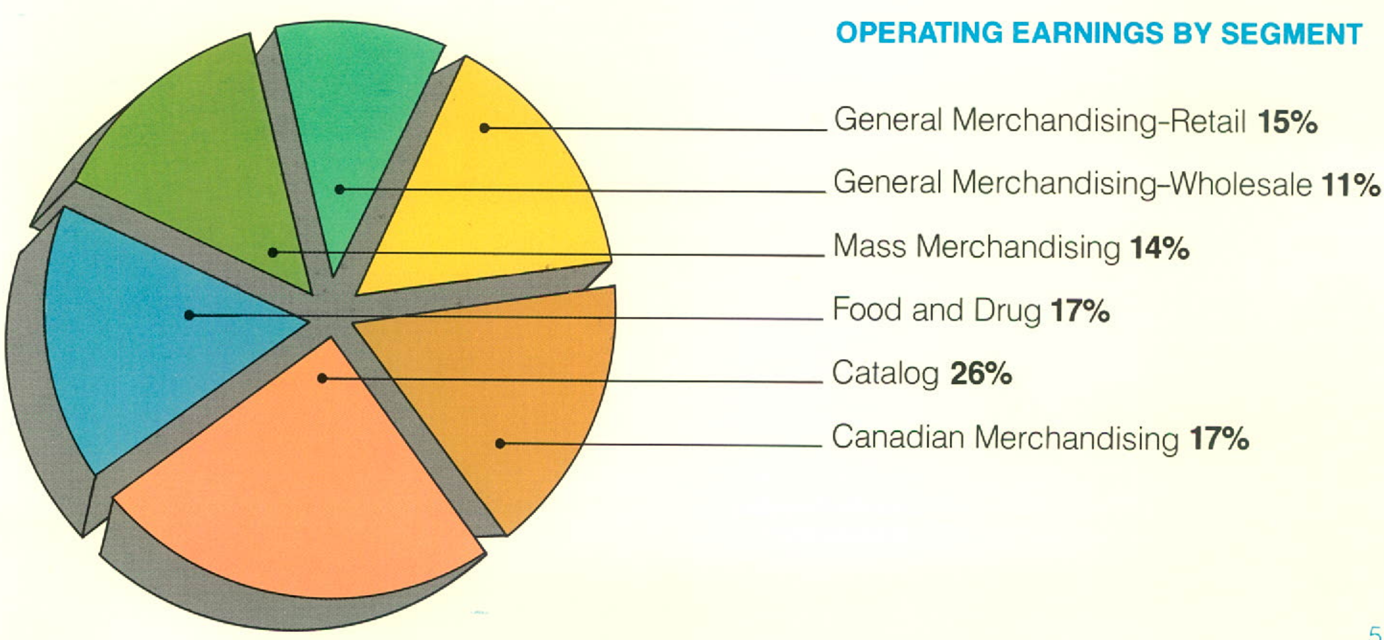
An Example of Attention to Fundamentals –

Howard Bros.

Howard Bros., the mass merchandising store group located in 10 Sunbelt states, continued its 20-year pattern of sales and profit gains.

Howard's attitude toward the customer is a classic example of attention to merchandising fundamentals: maintain basic merchandise in stock, display and promote it properly and merchandise to the needs of the customer.

The company is well-known for its nationally branded



lines of merchandise, while many other discount store chains emphasize just low price. Howard's reputation for excellent value at a low price is increasingly important in the current inflationary environment where consumers want more value for their money.

Sales and profit growth was limited last year by the necessary conversion to a different form of merchandise distribution among the Howard store group. A system developed two years ago was determined to be inappropriate and management made the decision to make the entire change during 1979. The new system is currently in place and working effectively so that Howard's growth pattern should be maintained in 1980.

A Case of Maintaining Market Share –
Red Owl and Snyder Stores

The food and drug store group at Gambles is comprised of 84 company-owned Red Owl retail food outlets and 277 dealer-owned stores located in the Midwest, principally Minnesota and Wisconsin. In addition, there are 132 Snyder drug stores in the same geographic area.

Accelerating inflation, rapidly increasing real estate costs and the record high cost of financing made it more difficult for Red Owl and Snyder stores to maintain the pace of profit growth in recent years. Nevertheless, aggressive promotional activity in the conventional supermarkets, including game promotions and a "Cash Dividend" program, were successful in holding market share. To better serve customers, Red Owl expanded warehouses and acquired additional frozen food warehouse capacity.

Rising food costs, more working women, as well as financially pressed, newly established households, and the increase in working single people–all are factors supporting more aggressive growth of our Country Store warehouse-style food market concept. The Country Store slogan, "Work A Little–Save A Lot," is very timely.

The 1980 program for expansion includes the opening of the first Snyder/Red Owl "Combo" store–a complete drug operation and full-line supermarket under one roof. This merchandising concept appears on target to satisfy changing customer needs.

A Case of Tight Cost Controls –
Macleods and Stedmans Stores

Our Canadian merchandising companies, Stedmans and Macleods, performed well in 1979, despite a Canadian economy which paralleled the U.S. in many ways. Innovative promotion, tight cost control and a "back-to-basics" merchandising philosophy underscored the approach taken by both Macleods and Stedmans. Macleods, operating hardware stores in smaller rural towns in Canada's western provinces, benefited from a strong fourth quarter and relatively bouyant provincial economies in the Canadian West. Imaginative and stimulating advertising and merchandising campaigns, initiated in 1978, began to yield positive sales results.

Similarly, Stedmans produced a consistent pattern of sales gains through the year, culminating in a record fourth quarter which helped full-year profits increase 50 percent. The Stedmans group of 263 soft line and variety stores, located in all Canadian provinces, benefited from a consistent increase in the number of dual-income families and the resultant high level of consumer spending.

TOP PHOTO: While shopping for groceries, a young customer pauses to place a drug prescription at a new Snyder-Red Owl COMBO store.

BOTTOM PHOTO: A complete selection of national brand merchandise is displayed in this typical Leath's Home Furnishings store.


CĒPASTAT


MODEL 1974

1979 Highlights

Revenues $203.9 million, 53 percent more than 1978

Comparative Revenues (All dollars in thousands)

Consumer Finance	$ 85,870 + 24.1%
Insurance	97,540 + 78.0
Leasing	31,738 + 80.5

Gambles' financial services activities were greatly expanded and strengthened by the acquisition of Aristar, Inc. at the end of 1978. In 1979, the separate insurance operations of Gambles and Aristar were merged into John Alden Life Insurance Company which, with over $2 billion of insurance in force, is among the top 10 percent of all life insurance companies in the United States.

Aristar's Blazer Financial Services, a consumer finance company, and Gambles C & M Leasing Company, a vehicle leasing and management company, are the two other major entities in the Financial Services group. All three are subsidiaries of Aristar Holdings, Inc., a wholly owned subsidiary of Gamble-Skogmo.

1979 was a successful year for the Financial Services Group. Pretax earnings increased 11 percent, reflecting a 40 percent increase in insurance company earnings and more modest gains in consumer finance and leasing.

TOP PHOTO: An operator at one of Mode O'Day's manufacturing facilities makes a visual quality inspection of a new garment.

BOTTOM PHOTO: A sportswear buyer for Woman's World Shops reviews new fall fashions with a major supplier.

An Example of Creative Marketing of Insurance to Consumers –

John Alden Life Insurance Company

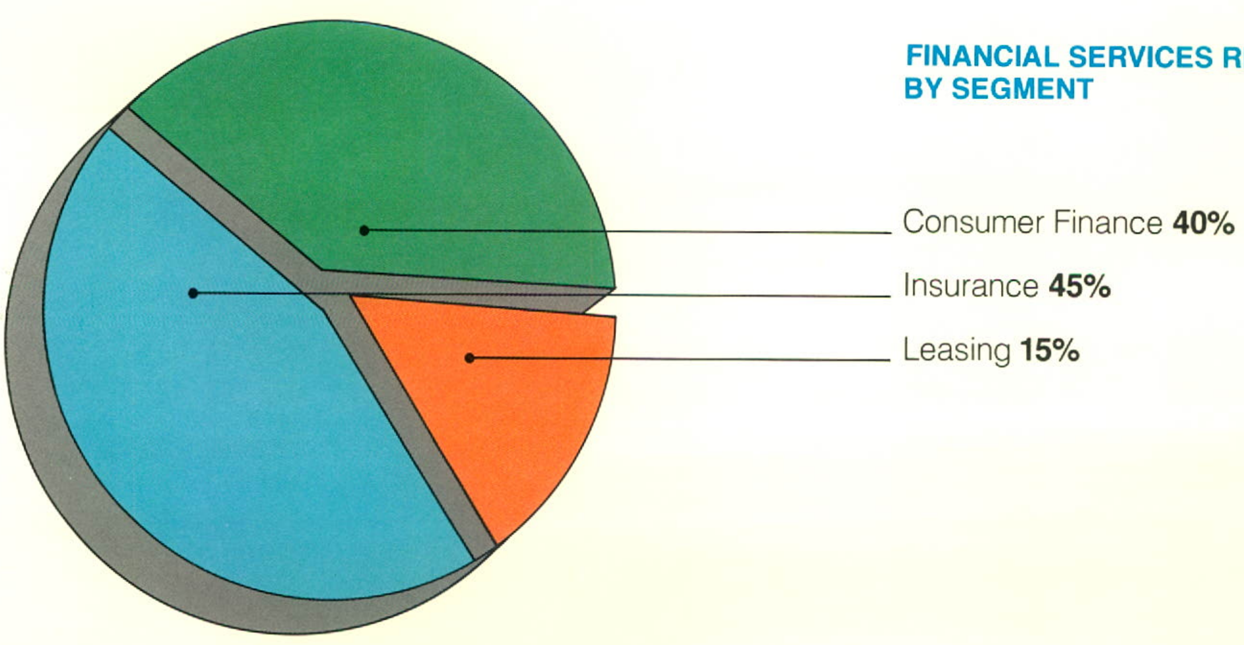
The insurance companies at both Gambles and Aristar had their origins providing life and property insurance to protect consumer credit transactions. Today's John Alden Life Insurance Company, however, offers a wide range of insurance products, three of which exhibited unusual growth in 1979.

For several years, John Alden Insurance has been one of the largest underwriters of specialized plans for small businesses, combining life, health, property and liability insurance protection in a single comprehensive policy. The company continued its leadership in this market in 1979 and opened 14 additional offices to sell and service these policies, bringing the total number of such offices to 27.

The company is also a major factor in direct mail mass marketing of insurance products, offering supplemental life, accident and health insurance policies. In 1979, over 8 million brochures describing John Alden's policies were mailed to customers of banks, oil companies, retailers and others who endorse the John Alden products.

The insurance company's most exciting new product is a Single Premium Deferred Annuity contract marketed through insurance agents and securities

FINANCIAL SERVICES REVENUES BY SEGMENT




The John Alden Life
Single Premium
Tax-Deferred Annuity
Let Merrill Lynch

brokers. These policies allow the tax-deferred accumulation of interest for retirement security. Among the prominent brokerage firms marketing the John Alden contracts are Merrill Lynch Life Agency, Inc., Bateman Eichler, Hill Richards, Inc., S.B.H.U. Life Agency, Inc. (Smith Barney, Harris Upham & Co., Inc.) and Dain Bosworth, Inc.

An Example of Rapid Growth in Consumer Finance –

Blazer Financial Services

Blazer Financial Services has been a consumer finance industry leader in the recent trend toward making larger loans secured by the borrower's equity in his home. A significant percentage of the new loans Blazer made last year were secured with real estate, and the average loan written was $1,897, compared with $1,582 in 1978.

Blazer's marketing leadership is evidenced by its growth in 1979–17 new offices, 27,000 new accounts and $88 million more loans outstanding at year-end. In addition, the company further improved its reputation in the industry for portfolio quality. Loan losses were reduced to 1.9 percent in 1979, from 2.3 in 1978.

TOP PHOTO: The innovative features of John Alden Life's new SINGLE PREMIUM DEFERRED ANNUITY is explained to a prospect by a Merrill Lynch Life Agency account executive.

BOTTOM PHOTO: Money from a Blazer home equity loan will assist this couple with the construction of a new room addition.

In 1980, Blazer will introduce a new "first" – residential first mortgages written at rates competitive with banks and savings and loan associations. These loans will enable Blazer to attract new customers, including those who have never borrowed money from a consumer finance company before.

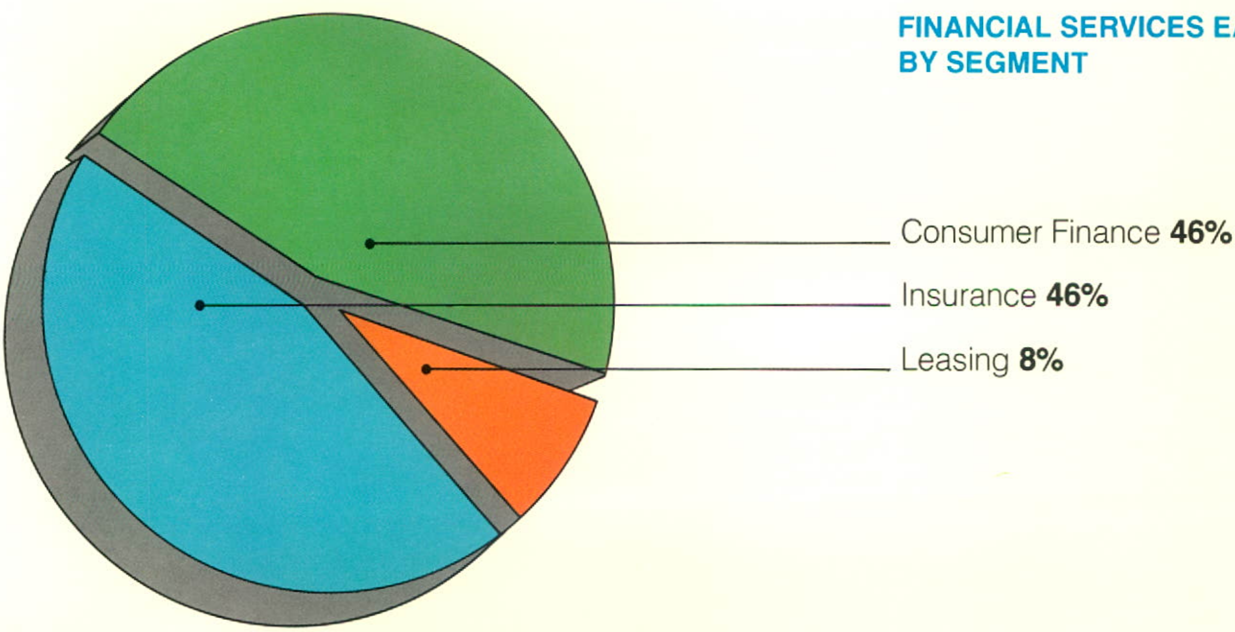
An Example of Superior Growth Based on Customer Service –

Gambles C & M Leasing

In 10 years, Gambles C & M Leasing Company, which provides fleet vehicle leasing and management services, has grown from number 151 in the industry to number 7. This dramatic record was accomplished by providing superior service to its customers which number over 200 of the FORTUNE 1000 companies.

To serve its customers better in 1979, the company opened five new regional sales and client service offices, bringing the total to nine. In the past, C & M's regional offices have concentrated primarily on developing new accounts. This year, to improve customer service further, the company began to decentralize its client service activities into these offices as well.

In 1980, C & M plans to begin using an on-line computer system to order vehicles direct from manufacturers. This system will eventually also be made available to C & M clients who wish to place orders directly from their own office.



Financial Policy

During 1979, Gambles initiated a program of financial planning and policy formulation. With the assistance of outside financial counsel, we undertook an examination of the performance of the individual segments and of the company as a whole. The focus of this examination was on the valuation of our individual businesses, to determine if sufficient value is being created for the amount of capital being employed in each of the businesses. We wished to identify those operating units which have not been generating adequate results and to plan for their improvement. At the same time, we wished to identify those units whose performance has been well above average so that the majority of available capital resources can be committed to foster their future growth.

While performance evaluation has, of course, gone on continuously in the past, the current program involves a more formalized procedure employing more sophisticated evaluation techniques. For example, we have adopted an approach which relies on economic, rather than accounting, measures of performance in the belief that this approach provides a better measure of management capability.

In the past, we have not explicitly stated our financial goals and policies in the Annual Report. The following discussion is designed to provide our stockholders with this information.

Asset Management

We believe that the best measure of your management's performance is the rate of return on operating capital employed. Operating capital is defined as the sum of average interest-bearing debt, capitalized and non-capitalized leases, deferred income taxes, preferred stock and common stockholders' equity. Return is defined as the sum of net earnings before corporate expenses plus aftertax interest. In addition, certain expense categories which have no effect on cash, such as amortization of goodwill and changes in the amount of deferred income taxes, are included in the return. The calculations for merchandising also include the capital and earnings of the unconsolidated captive merchandising finance subsidiaries. However, they do not include the assets employed in and the earnings derived from investments in other unconsolidated subsidiaries and investee companies and from investments of temporary excess cash. We believe that this approach offers the advantage of measuring performance on a consistent basis while focusing on how well we manage our operating assets.

Because our merchandising and financial services operations are so dissimilar, we have chosen to examine these two groups of Gambles' business separately. Rates of return for the financial services group are shown for

Return on Average Operating Capital (Dollars in millions)

Merchandising Group

	1975	1976	1977	1978	1979
Average Operating Capital	$772.7	$800.1	$833.4	$928.3	**$1036.4**
Return	47.4	48.8	35.9	58.7	**65.3**
Rate of Return	6.1%	6.1%	4.3%	6.3%	**6.3%**

Financial Services Group

	1978	1979
Average Operating Capital	$387.8	**$442.7**
Return	28.1	**36.9**
Rate of Return	7.2%	**8.3%**

only two years because consolidated financial information for the restructured financial services group is not available for years prior to 1978.

Within each of the above groups, there are profit centers whose rate of return is significantly above the average, while others are below. We are committed to correcting weaknesses in the underachieving companies, either by improved productivity or by more efficient use of their operating assets. At the same time, we are also determined to maintain the returns on our most productive units and will continue to monitor their performance to ensure that result.

It is management's objective to increase the rate of return on operating capital for the company as a whole to 11 percent. While we are not currently achieving this objective, future capital resource commitments will be expected to generate at least this level of return.

Capital Expenditures

Gambles plans to undertake new capital expenditures, excluding capitalized leases, of $31 million in 1980. Approximately $10 million of these funds will be expended for new retail locations with the remaining $21 million being expended for improvements in existing locations.

Gambles' policy with respect to capital resource allocation is to employ funds in areas which appear most likely to produce superior rates of return consistent with prudent assumption of risk.

In addition, projects funded must be capable of returning at least the target 11 percent to justify the investment in them. These policies apply equally to expenditures for internal expansion and for outside acquisitions.

Capital Structure

Capital structure is best discussed in terms of the ratio of debt to total capital, with capital as defined earlier. In general, debt is a less expensive source of financing, since the associated interest expense is tax deductible. Too much debt, however, can jeopardize a company's financing flexibility, particularly in times of "tight credit". Gambles' policy is to maintain an acceptable balance between these two considerations. We expect Gambles' reliance on debt financing to decrease over time, as we utilize internally generated funds to an increasing degree.

The historical capital structure for the company is presented below:

Dividend Policy

The dividend on Gambles' common stock was increased to $1.50 per share in 1979. We plan to maintain this payment for the present. We will review this policy periodically and alter it as necessary to reflect changes in our profitability and/or the attractiveness of investment opportunities available to us.

Debt-to-Total Capital – Total Company* (Dollars in thousands)

	1977	1978	**1979**
Subordinated Income Notes	$ 254,079	$ 251,843	**$ 258,215**
Other Interest-Bearing Debt	455,244	670,905	**726,595**
Total Debt	$ 709,323	$ 922,748	**$ 984,810**
Total Capital	$1,000,508	$1,224,348	**$1,310,222**
Debt-to-Total Capital	70.9%	75.4%	**75.2%**
Debt- (excluding subordinated income notes) to-Total Capital	45.5%	54.8%	**55.5%**

*Total company includes Gamble-Skogmo Inc. and consolidated subsidiaries and merchandising-related finance companies.

5-Year Summary of Operations

(All dollars in thousands except amounts per share)

The following summary of operations presents in condensed form the consolidated results of operations of the company for the five years ended January 26, 1980 and should be read in conjunction with the financial statements and notes thereto appearing elsewhere in this annual report.

	1979	1978	1977	1976	1975
Net sales	**$2,053,003**	$1,954,644	$1,634,122	$1,590,372	$1,559,043
Costs and expenses:					
Cost of sales	**1,529,600**	1,480,415	1,257,708	1,224,082	1,202,937
Operating and administrative	**407,911**	375,216	306,115	284,078	269,725
Interest:					
Long-term debt	**61,922**	52,126	42,488	33,787	24,379
Other	**18,001**	14,419	6,838	11,581	13,810
Income	**(5,640)**	(6,337)	(6,830)	(5,522)	(2,269)
Other costs and expenses	**19,129**	16,919	15,110	14,350	13,916
Earnings before income taxes and equity in net earnings of unconsolidated subsidiaries and investee company	**22,080**	21,886	12,693	28,016	36,545
Income taxes	**(9,681)**	(9,296)	(6,875)	(13,417)	(18,445)
Equity in net earnings of unconsolidated subsidiaries and investee company	**18,785**	10,634	3,946	3,611	4,274
Net earnings	**31,184**	23,224	9,764	18,210	22,374
Dividend requirements on preferred stock	**(593)**	(726)	(779)	(1,079)	(1,376)
Net earnings applicable to common stock	**$ 30,591**	$ 22,498	$ 8,985	$ 17,131	$ 20,998

	1979	1978	1977	1976	1975
Average number of common and common equivalent shares outstanding:					
Primary	**4,065,000**	4,114,000	4,403,000	4,439,000	4,404,000
Fully diluted	**4,385,000**	4,511,000	4,833,000	5,083,000	5,162,000
Earnings per common share:					
Primary	**$ 7.52**	$ 5.47	$ 2.04	$ 3.86	$ 4.77
Fully diluted	**$ 7.11**	$ 5.15	$ 2.02	$ 3.58	$ 4.33
Cash dividends paid per share of common stock	**$ 1.50**	$ 1.40	$ 1.40	$ 1.40	$ 1.40

Analysis of Summary of Operations

1979 Compared with 1978

Net sales increased $98.4 million (5.0%) to just over $2 billion in 1979. Companies acquired in early and mid-1978 accounted for most of the increase.

Cost of sales as a percentage of sales decreased from 75.7% in 1978 to 74.5% in 1979. This decrease resulted primarily through better promotional efforts.

Operating and administrative expenses increased from 19.2% of sales in 1978 to 19.9% in 1979. The increase in operating and administrative expenses is primarily a result of inflation. Additionally, for the fifty-two weeks ended January 26, 1980, $1.9 million of goodwill, related to an unprofitable division, was written off.

Net interest expense increased approximately $14.1 million in 1979 to $74.3 million. Long-term interest increased due to the issuance of long-term debt, including additional long-term debt used to acquire companies in 1978 and long-term debt of newly acquired companies. Short-term interest increased due to higher short-term borrowings coupled with increased interest rates. The decline in interest income is due to a reduction in average short-term investments.

Income taxes as a percentage of earnings (before income taxes and equity in net earnings of unconsolidated subsidiaries and investee company) increased from 42.5% in 1978 to 43.8% in 1979, despite increased investment tax credits and a decrease in the Federal tax rate from 48% to 46%. The increase is due to increased goodwill write-off, accrual of a Canadian dividend tax and other smaller permanent differences.

Equity in earnings of unconsolidated subsidiaries and investee company increased to $18.8 million in 1979 compared with $10.6 million in 1978. The increase represents earnings of companies acquired in late 1978.

1978 net earnings were adversely affected by approximately $7 million due to the dissolution of the Tempo-Buckeye Stores division, and the translation of the results of Canadian operations into U.S. dollars. The Tempo-Buckeye dissolution had no impact on 1979 net earnings and the stabilizing of the Canadian dollar resulted in a slight gain in net earnings for 1979.

1978 Compared with 1977

Net sales increased $320.5 million (19.6%) to almost two billion dollars in 1978. The increase reflected improved sales of both continuing and newly acquired businesses. Businesses acquired during 1978 contributed $196.6 million of net sales, while net sales of continuing operations increased by $123.9 million.

Cost of sales as a percentage of sales decreased from 77.0% in 1977 to 75.7% in 1978. This decrease was due in part to the acquisition of Leath and Company and the inclusion of Aristar Home Furnishings for an entire year. These furniture retailers earn a higher gross profit than most other retailers included in the company's consolidated financial statements. In addition, the strengthening of our economy in our operating areas allowed the company to obtain better markups than the prior year, further lowering the cost of sales as a percentage of sales.

Operating and administrative expenses increased from 18.7% in 1977 to 19.2% in 1978. Inflationary pressures and the addition of the furniture businesses increased operating expenses. Both years had higher than normal closing costs; approximately $5.7 million pretax for Tempo-Buckeye stores in 1978 and approximately $4.6 million for various stores closed in 1977.

Interest expense increased significantly during 1978 for various reasons. Short-term rates averaged 277 basis points higher than a year ago and, in recent months, were more than 300 basis points higher. Long-term interest was up due to the placement of higher cost long-term debt and the assumption of long-term debt of acquired companies. Notes were issued for a portion of the shares purchased in the Howard Bros. and Garfinckel acquisitions. The remainder of these shares were purchased for cash. This, plus the purchase of Leath and the purchase of common stock for the Treasury, contributed to the increase in short-term interest. The financing of higher receivable balances, due primarily to our catalog business, also contributed to the higher interest expense. Interest income is down because of a decrease in average short-term investments.

Tax expense as a percentage of earnings before income taxes and equity in net earnings of unconsolidated subsidiaries was 42.5% in 1978 compared to 54.2% in 1977. Tax benefits from capital gains transactions, a lesser tax impact from the translation of the company's Canadian operation into U.S. dollars and investment tax credits were the principal causes of this lower tax rate.

The company combined and streamlined existing warehouse facilities utilized by the Gamble Stores Division which enabled the company to sell a warehouse for a pretax gain of approximately $2.5 million. The liquidation and the redeployment of the Tempo-Buckeye assets, together with the foreign exchange loss from the translation of our Canadian operations into U.S. dollars, reduced net earnings by approximately $7.0 million or $1.70 per share.

Significant Comparisons

GAMBLE-SKOGMO INC., AND CONSOLIDATED SUBSIDIARIES

(All dollars in thousands except amounts per share)

	1979	1978	1977
RESULTS FOR THE YEAR			
Net sales and operating revenues	**$2,053,003**	$1,954,644	$1,634,122
Net earnings	**31,184**	23,224	9,764
Cash dividends (including preferred dividends)	**6,715**	6,432	6,903
PER SHARE OF COMMON STOCK			
Earnings per share including common equivalents	**7.52**	5.47	2.04
Cash dividends	**1.50**	1.40	1.40
Book value	**59.42**	54.05	50.30
Book value assuming conversion of preferred stock	**58.79**	53.09	49.46
YEAR-END POSITION			
Inventories	**361,890**	352,611	286,534
Net working capital	**204,873**	201,900	240,175
Current ratio	**1.6 to 1**	1.6 to 1	1.9 to 1
Subordinated income notes	**258,215**	251,843	254,079
Common stock and other stockholders' equity	**247,398**	218,129	216,231
Redeemable preferred stock	**9,799**	14,783	17,074
NUMBER OF:			
Full-time employees	**21,900**	21,100	20,700
Square feet of retail selling space	**13,387,000**	13,489,000	8,514,000
Company-owned stores	**907**	861	668
Dealer-owned stores	**2,354**	2,402	2,476
Common shares outstanding at year-end**	**4,163,215**	4,036,034	4,298,628
Shareholders	**11,216**	11,471	12,076
Subordinated income note holders	**42,693**	39,414	39,110

**Excludes extraordinary item of $5,616 ($1.15 per share)*
***Excludes shares of treasury stock in 1973-1979*
****Not restated for the effects of FASB #13 (Leases)*

1976	1975	1974	1973***	1972***	1971***	1970***
$1,590,372	$1,559,043	$1,487,455	$1,394,883	$1,348,826	$1,315,092	$1,296,704
18,210	22,374	24,756	24,929	22,371*	19,127	15,066
7,296	7,547	7,681	7,871	8,382	8,462	8,165
3.86	4.77	5.46	5.32	4.09*	3.56	3.08
1.40	1.40	1.40	1.35	1.30	1.30	1.30
49.01	46.23	43.19	39.83	39.21	34.81	31.87
48.28	45.46	42.86	39.25	38.51	35.21	33.39
255,158	255,479	253,550	230,396	212,870	202,720	214,173
246,554	235,846	197,226	177,465	144,540	153,346	174,236
2.0 to 1	2.0 to 1	1.9 to 1	1.9 to 1	1.8 to 1	1.9 to 1	2.0 to 1
237,385	188,379	163,095	139,146	114,603	100,099	88,021
217,931	204,197	189,423	169,293	160,694	166,477	127,478
18,068	30,559	31,167	46,357	50,642	54,535	66,194
18,100	19,000	18,800	19,500	21,500	22,200	24,300
8,189,000	8,739,000	8,741,000	8,860,000	8,990,000	8,839,000	8,931,000
676	680	678	673	674	711	799
2,647	2,752	2,843	2,850	2,872	3,158	3,205
4,446,315	4,416,580	4,385,468	4,250,896	4,097,758	4,783,110	3,999,620
12,661	14,525	14,540	14,976	15,244	16,108	17,345
37,396	27,762	23,285	17,529	12,540	10,017	7,566

Stock Information

The company's common stock, $5 par value preferred stock, and $40 par value preferred stock are listed on the New York Stock Exchange. The common stock is also listed on the Midwest Stock Exchange. The symbol on both exchanges for the company's common stock is GSK.

Quarterly dividend payments per share and market prices per share for the various classes of stock over the past two fiscal years are shown below:

		1979			1978		
	Quarter	New York Stock Exchange Market Price High	New York Stock Exchange Market Price Low	Dividends Paid	New York Stock Exchange Market Price High	New York Stock Exchange Market Price Low	Dividends Paid
COMMON STOCK	1st	29¼	24⅞	$0.37½	30⅛	26¼	$0.35
	2nd	33⅛	26⅜	0.37½	28⅞	24⅛	0.35
	3rd	31¼	24⅛	0.37½	38⅛	27	0.35
	4th	36⅞	22¼	0.37½	28⅞	23⅜	0.35
				$1.50			$1.40
$5 PAR VALUE PREFERRED STOCK	1st	25½	22	$0.40	25	23	$0.40
	2nd	28	23¼	0.40	25	22	0.40
	3rd	27⅛	21½	0.40	32½	24¾	0.40
	4th	27½	19¼	0.40	24½	21¾	0.40
				$1.60			$1.60
$40 PAR VALUE PREFERRED STOCK	1st	23½	23	$0.43¾	26¼	24	$0.43¾
	2nd	25¼	22⅝	0.43¾	24⅝	22⅛	0.43¾
	3rd	25	22½	0.43¾	34	24¼	0.43¾
	4th	30	20	0.43¾	23½	22¼	0.43¾
				$1.75			$1.75

Gamble-Skogmo, Inc. and consolidated subsidiaries ended the year in a strong financial position. Cash and temporary investments exceeded $104,000,000, which was $47,000,000 more than short-term debt. Capital funds at year-end totaled $515,000,000, comprised of $258,000,000 in subordinated income notes, $10,000,000 in redeemable preferred stock and $247,000,000 of common stockholders' equity. Preferred stock is reported separately from common stockholders' equity this year, in conformance with the amendments to Regulation S-X of the Securities and Exchange Commission governing the presentation in financial statements of redeemable preferred stocks.

Subordinated income notes are a unique financing instrument that Gambles has successfully sold to the public for more than a decade. Income bonds differ from conventional debt in that interest on them is payable only if earned. As a result, income bonds serve as near-equity capital, similar to preferred stock in the capital structure of a company. During the year, Gambles exchanged $5,600,000 worth of new Subordinated Income Capital Notes due in 2009 for similar bonds maturing in 1980 and sold an additional $25,300,000 of the bonds to other investors. At year-end, there was a total of $258,000,000 in income bonds outstanding, $219,000,000 of which mature in the next century through the year 2009 and which require no sinking fund.

Common stockholders' equity increased in 1979 by $29,000,000, the reconciliation of which increase can be found elsewhere in this report in the Consolidated Statements of Common Stock and Other Stockholders' Equity.

Total borrowings of Gamble-Skogmo and consolidated subsidiaries at year-end were $521,000,000, compared to $488,000,000 at year-end 1978. Of this total debt, 89% is long-term, of which 66% is subordinated. The predominantly long-term nature of the company's debt effectively isolates it from swings in short-term interest rates. For example, in 1979 Gambles' average borrowing rate increased only 0.74%, while short-term money market rates increased approximately 3.50%.

Gambles' need for borrowed funds arises primarily from the financing of inventories and consumer receivables. Accordingly, it is essential that these assets be tightly controlled, especially in periods of high interest rates. Inventories at year-end totaled $362,000,000, up only 2.6% from last year. Consumer receivables were $434,000,000, up 6.9% from the previous year. There were 1,895,000 open consumer accounts with an average balance of $232 compared to 1,962,000 accounts and $226 average balance in 1978. Charge-offs, as a percent of liquidations, were reduced to 3.4% from 3.6% last year, reflecting improved controls instituted in late 1978.

Capital expenditures, excluding capitalized leases, for 1979 amounted to $37,000,000, compared to $24,000,000 in 1978. The budget for 1980 is approximately $31,000,000, with the majority of funds committed to furthering the growth of those operating units which provide the highest return on operating capital employed.

Aristar, Inc., which became a wholly owned subsidiary of the company at the end of fiscal 1978, sold $25,000,000 of Subordinated Capital Notes due in 1991, reducing its need for short-term borrowing and strengthening its capital base. Aristar also re-entered the commercial paper market during the year and, at year-end, had approximately $53,000,000 of commercial paper outstanding. Since short-term bank borrowing is generally more expensive than commercial paper, Aristar benefited from lower average borrowing costs during the year.

In January, Aristar began selling up to $35,000,000 of Junior Subordinated Notes due in 1999. The proceeds of this offering will be used to reduce short-term debt outstanding.

Gamble-Skogmo increased its investment in the common stock of Credithrift Financial, Inc. during 1979 and held approximately 9.8% of Credithrift's outstanding common shares at year-end. Credithrift earned $15,000,000 on revenues of $202,000,000 in the year ending December 31, 1979. Gambles continues to hold its approximately 20% investment in the shares of Garfinckel, Brooks Brothers, Miller & Rhoads, Inc. Garfinckel earned $15,300,000 on sales of $392,000,000 in its fiscal year ending February 2, 1980, and Gambles recorded its equity in these earnings as explained in Note 3 to the Consolidated Financial Statements.

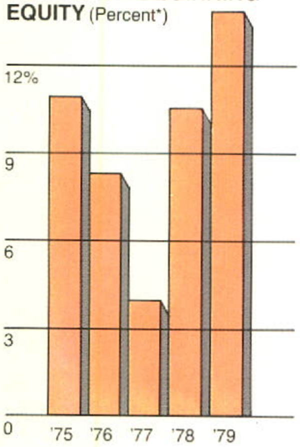
Consolidated Statements of Earnings

GAMBLE-SKOGMO, INC. AND CONSOLIDATED SUBSIDIARIES

(All dollars in thousands except earnings per share)

	1979 Fifty-Two weeks ended January 26, 1980	1978 Fifty-Two weeks ended January 27, 1979
Net sales	$2,053,003	$1,954,644
Costs and expenses:		
Cost of sales, including certain occupancy and buying costs	1,529,600	1,480,415
Operating and administrative (Notes 10 and 14)	407,911	375,216
Depreciation and amortization	21,298	19,800
Interest (Notes 15 and 16)	74,283	60,208
Total costs and expenses	2,033,092	1,935,639
Other income–net	2,169	2,881
Earnings before income taxes and equity in net earnings of unconsolidated subsidiaries and investee company	22,080	21,886
Income taxes (Note 17)	(9,681)	(9,296)
Equity in net earnings of Aristar Holdings, Inc. and subsidiaries (Note 3)	16,601	8,924
Equity in net earnings of other unconsolidated subsidiaries and investee company (Notes 3 and 6)	2,184	1,710
Net earnings	31,184	23,224
Dividend requirements on preferred stock	(593)	(726)
Net earnings applicable to common stock	$ 30,591	$ 22,498
Earnings per common share:		
Primary	$ 7.52	$ 5.47
Fully diluted	$ 7.11	$ 5.15
Average number of common and common equivalent shares outstanding:		
Primary	4,065,000	4,114,000
Fully diluted	4,385,000	4,511,000

RETURN ON BEGINNING EQUITY (Percent*)



*Net earnings applicable to common stock divided by beginning common stockholders' equity.

Consolidated Statements of Retained Earnings

GAMBLE-SKOGMO, INC. AND CONSOLIDATED SUBSIDIARIES

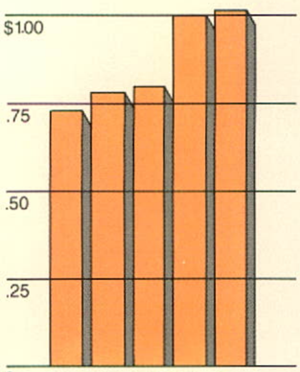
(All dollars in thousands)

	1979	1978
Beginning balance	$ 224,292	$ 207,500
Net earnings	31,184	23,224
Cash dividends:		
Preferred stock	(593)	(726)
Common stock	(6,122)	(5,706)
Ending balance (Note 13)	$ 248,761	224,292

See accompanying notes to consolidated financial statements.

Consolidated Balance Sheets

GAMBLE-SKOGMO, INC. AND CONSOLIDATED SUBSIDIARIES



(All dollars in thousands

	1979 January 26, 1980	1978 January 27, 1979
Assets		
Current assets:		
Cash including temporary cash investments of $89,575 and $73,591	**$ 104,729**	$ 84,066
Receivables–net (Note 4)	**51,588**	59,271
Inventories	**361,890**	352,611
Prepaid expenses	**18,830**	18,799
Total current assets	**537,037**	514,747
Investments, principally unconsolidated subsidiaries and investee company (Notes 3, 6, 7 and 15)	**274,380**	250,021
Property and equipment–net (Notes 5, 7 and 8)	**193,734**	168,868
Excess of purchase price over equity of companies acquired	**39,754**	42,866
Deferred charges and other assets (Note 10)	**31,614**	27,514
TOTAL ASSETS	**$1,076,519**	$1,004,016
Liabilities and Stockholders' Equity		
Current liabilities:		
Commercial paper and notes payable	**$ 21,704**	$ 31,498
Current installments of long-term debt and lease obligations	**36,414**	21,359
Accounts payable and accrued liabilities	**203,388**	190,232
Current income taxes	**10,490**	6,961
Deferred income taxes applicable to installment sales (Note 17)	**60,168**	62,797
Total current liabilities	**332,164**	312,847
Deferred credits, including deferred income taxes (Note 17)	**7,398**	5,815
Excess of equity over purchase price of company acquired (Note 3)	**16,926**	17,362
Long-term debt (Notes 3, 8 and 10) and lease obligations (Note 7) excluding subordinated income notes shown below as capital accounts	**204,619**	183,237
Capital accounts:		
Subordinated income notes (Note 9)	**258,215**	251,843
Redeemable preferred stock (Note 11):		
$40 par value	**10,124**	10,418
$5 par value, including allocated paid-in capital	**5,433**	10,123
Par value of preferred stock reacquired and held in treasury	**(5,758)**	(5,758)
Total redeemable preferred stock	**9,799**	14,783
Common stock and other stockholders' equity (Notes 12 and 13):		
Common stock, $5 par value, including additional paid-in capital; authorized 10,000,000 shares; issued 5,821,123 and 5,694,839	**59,018**	54,033
Retained earnings	**248,761**	224,292
Receivable for stock sold under restricted stock plan	**(3,928)**	(5,029)
Net unrealized loss on marketable equity securities of unconsolidated subsidiaries	**(2,142)**	(823)
Cost of common stock reacquired and held in treasury	**(54,311)**	(54,344)
Total common stock and other stockholders' equity	**247,398**	218,129
Contingent liabilities and commitments (Notes 7 and 18)		
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	**$1,076,519**	$1,004,016

See accompanying notes to consolidated financial statements

Consolidated Statements Of Common Stock and Other Stockholders' Equity

GAMBLE-SKOGMO, INC. AND CONSOLIDATED SUBSIDIARIES

(All dollars in thousands)

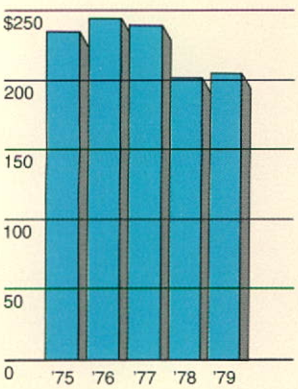
	1979 Fifty-two weeks ended January 26, 1980		1978 Fifty-two weeks ended January 27, 1979	
	SHARES	**AMOUNT**	**SHARES**	**AMOUNT**
Common stock, $5 par value, including additional paid-in capital:				
Beginning of year (Note 11)	**5,694,839**	**$ 54,033**	5,626,297	$ 53,122
Allocation of paid-in capital due to conversion of $5 par value preferred stock to common stock	**—**	**4,021**	—	400
Conversion of preferred stock	**126,284**	**963**	52,742	1,844
Exercise of stock options	**—**	**—**	15,800	352
Gain (loss) on restricted stock transactions (Note 12)	**—**	**1**	—	(1,685)
End of year	**5,821,123**	**59,018**	5,694,839	54,033
Retained earnings at end of year		**248,761**		224,292
Receivable for stock sold under restricted stock plan:				
Beginning of year	**(225,020)**	**(5,029)**	—	—
Shares sold	**(12,265)**	**(324)**	(226,120)	(5,715)
Shares terminated	**10,675**	**270**	1,100	28
Shares purchased by retiring employees	**3,750**	**71**	—	—
Amount charged against earnings as compensation	**—**	**1,084**	—	658
End of year	**(222,860)**	**(3,928)**	(225,020)	(5,029)
Net unrealized loss on marketable equity securities of unconsolidated subsidiaries:				
Beginning of year		**(823)**		(67)
Net unrealized loss during year		**(1,319)**		(756)
End of year		**(2,142)**		(823)
Treasury stock at cost:				
Common stock, $5 par value:				
Beginning of year	**(1,658,805)**	**(54,344)**	(1,327,669)	(44,277)
Purchased, at cost	**(693)**	**(20)**	(556,156)	(17,439)
Net shares sold to (purchased from) the restricted stock plan	**1,590**	**53**	225,020	7,372
End of year	**(1,657,908)**	**(54,311)**	(1,658,805)	(54,344)
Total Common Stock and Other Stockholders' Equity		**$247,398**		$218,129

See accompanying notes to consolidated financial statements.

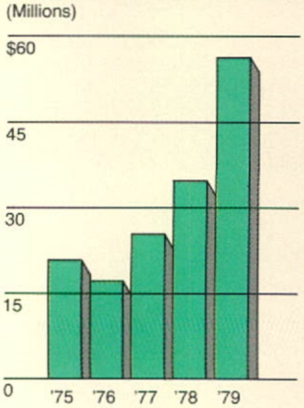
Consolidated Statements of Changes in Financial Position

GAMBLE-SKOGMO, INC. AND CONSOLIDATED SUBSIDIARIES

WORKING CAPITAL
(Millions)



CAPITAL EXPENDITURES–INCLUDING CAPITAL LEASES
(Millions)



(All dollars in thousands)

	1979 Fifty-two weeks ended January 26, 1980	1978 Fifty-two weeks ended January 27, 1979
SOURCE OF FUNDS		
Net earnings	**$ 31,184**	$ 23,224
Add (deduct) items not requiring working capital:		
Net earnings of unconsolidated subsidiaries and investee company included above	**(27,510)**	(17,530)
Depreciation and amortization	**21,298**	19,800
Cash dividends from unconsolidated subsidiaries and investee company	**1,569**	660
Non-current deferred income taxes	**2,455**	1,514
Other–net	**4,281**	958
Funds derived from operations	**33,277**	28,626
Issuance of subordinated income notes	**30,867**	—
Issuance of long-term debt and lease obligations	**50,598**	93,522
Carrying value of property, equipment and investments disposed of	**10,679**	14,702
Issuance of common stock	**—**	352
Decrease in working capital	**—**	38,275
	$125,421	$175,477
USE OF FUNDS		
Cash dividends	**$ 6,715**	$ 6,432
Reduction of subordinated income notes	**24,495**	2,236
Reduction of long-term debt and lease obligations	**29,216**	17,183
Additions to property and equipment, including capital leases	**56,343**	34,059
Investment in Aristar	**—**	53,727
Investment in Garfinckel	**—**	25,855
Acquisition of treasury stock	**20**	17,439
Increase in other investments	**1,563**	628
Acquisition of Leath and Howard Bros. less working capital of $48,464 (Note 3)		
Property and equipment	**—**	35,579
Intangibles	**—**	11,428
Long-term debt	**—**	(32,728)
Other–net	**—**	(367)
Other	**4,096**	4,006
Increase in working capital	**2,973**	—
	$125,421	$175,477
CHANGE IN WORKING CAPITAL BY COMPONENT		
Cash including temporary cash investments	**$ 20,663**	$ (33,330)
Receivables	**(7,683)**	(21,192)
Inventories	**9,279**	66,077
Prepaid expenses	**31**	143
Commercial paper, notes payable and current instalments of long-term debt and lease obligations	**(5,261)**	(20,733)
Accounts payable and accrued liabilities	**(13,156)**	(15,122)
Current and deferred income taxes	**(900)**	(14,118)
Increase (decrease) in working capital	**$ 2,973**	$ (38,275)

See accompanying notes to consolidated financial statements.

(1) Summary of Significant Accounting Policies

The company's accounting policies, which conform with generally accepted accounting principles, have been applied on a consistent basis. Significant policies are outlined below.

DEFINITION OF FISCAL YEAR. The company's fiscal year ends on the last Saturday in January. Fiscal 1979 ended on January 26, 1980 and fiscal 1978 on January 27, 1979. Each year is comprised of 52 weeks.

PRINCIPLES OF CONSOLIDATION. The consolidated financial statements include all accounts of the merchandising operations and real estate subsidiaries whose properties are utilized in merchandising operations. Finance, insurance, leasing subsidiaries and several other small non-merchandising subsidiaries are not consolidated. Investments in unconsolidated subsidiaries and an investee company are carried at underlying equity values. Condensed, combined financial information for the unconsolidated merchandise-related finance companies is presented in Note 15. Financial statements for the other unconsolidated financial service subsidiaries (Aristar Holdings, Inc. and subsidiaries) are presented elsewhere in this annual report. All other unconsolidated subsidiaries are in the aggregate not significant. All significant intercompany items and transactions have been eliminated.

Certain prior period balances have been reclassified to conform to the January 26, 1980 presentation.

The service fee paid to the above-mentioned merchandising-related finance companies is included in interest expense in the accompanying consolidated statements of earnings. The pretax earnings of these companies are deducted from interest expense with the result that the interest expense of the merchandising-related finance subsidiaries is combined with interest expense of the consolidated companies.

TRANSLATION OF CANADIAN FINANCIAL STATEMENTS. Inventory, properties and intangible assets of the company's Canadian subsidiaries are translated at exchange rates applicable at the time of acquisition. Other assets and liabilities are translated at period-end exchange rates and income and expense items at average exchange rates in effect during the year, except for depreciation, amortization of excess cost and cost of sales which are translated at exchange rates applicable at time of acquisition.

INVENTORIES. Merchandise inventories are comprised principally of general merchandise and food and are stated at lower of cost (first-in, first-out) or realizable value.

DEPRECIATION. Property and equipment is depreciated over the estimated service lives or, in the case of leasehold improvements, over the period of leases, if shorter. Leased assets are amortized over the period of the related leases. Depreciation and amortization is provided generally on the straight-line method for financial reporting and on accelerated methods for income taxes. The estimated useful lives used for depreciation purposes by the company and its consolidated subsidiaries are:

Buildings	10 to 50 years
Machinery and equipment	2 to 15 years
Furniture and fixtures	3 to 20 years
Autos and trucks	2 to 8 years
Leasehold improvements	period of lease or life of asset, if less

The cost of maintenance and repairs is charged to earnings as incurred. Renewals and betterments are capitalized by additions to property and equipment accounts. On retirement or sale, the difference between cost less accumulated depreciation and proceeds therefrom is charged or credited to income.

EXCESS COST. Excess cost of companies acquired since 1970 is being amortized on the straight-line basis over its estimated life. Prior to January 29, 1978, acquisition costs in excess of fair value for companies acquired prior to 1970 were not being amortized unless, in the opinion of management, they had diminished in value. Based upon management's continuing evaluation, beginning January 29, 1978, the excess of cost over equity relating to companies acquired prior to 1970 is being amortized on a straight-line basis over periods ranging from 10 to 40 years. The effect of this change on net earnings for the 52 weeks ended January 26, 1980 and January 27, 1979 has been to reduce net earnings by approximately $841,000 and $775,000, respectively.

The excess of equity over purchase price is being taken into income over 12 years beginning in the year ended January 28, 1978, the year in which such excess arose.

INCOME TAXES. For financial reporting, deferred income taxes are provided for expenses and income recognized in different periods than for income tax purposes. The company files a consolidated Federal income tax return. The current income tax liability presented in the financial statements includes the current Federal income taxes payable for all companies included in the consolidated Federal income tax return. State income tax returns are filed on a separate company basis.

The deferred income taxes applicable to installment sales for all companies included in the consolidated Federal income tax return are included in the financial statements as a Gamble-Skogmo, Inc. liability.

ACCOUNTS RECEIVABLE. The entire merchandising profit from installment sales is taken into income at the date of sale. The majority of the receivables are revolving charge accounts on which finance charges are taken into income monthly, based on a percentage of outstanding receivables. Accounts receivable include balances due more than one year from the balance sheet date which have been classified as current in accordance with trade practice. The aggregate amounts of such balances at January 26, 1980 and January 27, 1979 have been estimated at approximately $16,000,000 and $17,000,000, respectively.

Certain customer and dealer accounts are sold to merchandising-related finance companies at the gross amount thereof. Such receivables consist of retail receivables from customers and wholesale receivables from dealers. The finance companies retain 10% of the gross purchase price of the receivables purchased as a contract reserve account, or such greater amount as is necessary to maintain a contract reserve account balance equal to 10% of the amount of all outstanding receivables. Under the receivables purchase agreements, the company has agreed that any defaulted accounts may be charged by the finance companies against the contract reserve account. The allowance for doubtful receivables relating to customer and dealer accounts sold is carried on the books of the company which collects the accounts and retains future service charge income thereon.

EARNINGS PER SHARE. Primary earnings per common share has been computed by dividing net income after provision for preferred dividends by the weighted average number of common shares and common equivalent shares (dilutive stock options and warrants) outstanding during the period.

Fully diluted earnings per share has been computed assuming conversion of all convertible preferred stock (with appropriate elimination of preferred dividend requirements) and issuance of all shares reserved for stock options and warrants.

(2) Proposed Merger

On March 12, 1980, the company and The Wickes Corporation announced that they had entered into an agreement in principle for Wickes to acquire the company. The acquisition would involve the formation of a new holding company to act as the parent of both Wickes and the company, and the receipt by the company's stockholders of $33.00 cash plus three-fourths of a share of the new holding company's common stock for each company common share held. Holders of Wickes common stock would receive one share of the new holding company's common stock for each Wickes common share held. The transaction would be taxable to the company's stockholders, but is expected to be tax-free to Wickes' stockholders. The proposed acquisition is subject to the results of ongoing reviews by both companies, to the negotiation and execution of definitive agreements, to the approval of the Boards of Directors and stockholders of both companies and to the receipt of necessary regulatory approvals.

(3) Acquisitions

On November 30, 1977, the company converted its $15,000,000 of 10¾% convertible subordinated notes of Aristar, Inc. into 4,411,764 shares of Aristar, Inc. common stock, thereby increasing its ownership in Aristar, Inc. to approximately 51% of the outstanding common shares. The remainder of the outstanding common shares and all of the outstanding preferred shares of Aristar, Inc. were acquired on January 26, 1979 through the issuance of debentures and notes totaling $49,429,000. Both transactions were accounted for as a purchase, and the combined purchase price totaled $64,972,000. The combined purchase price was less than the fair value of Aristar, Inc.'s net assets and such difference is being taken into income over 12 years. Aristar, Inc. is a holding company whose subsidiaries are engaged in the businesses of consumer finance and related insurance activities and in home furnishing merchandising. The consumer finance and insurance companies are being accounted for by the equity method and, accordingly, the results of their operations are included in the consolidated statements of earnings since the date of acquisition. The assets and liabilities and the results of operations since the date of acquisition of the home furnishings division are included in the consolidated financial statements of the company. On January 26, 1979, Aristar, Inc. transferred to the company the net assets of the home furnishings subsidiaries. As of January 27, 1979, the company contributed the capital stock of Aristar, Inc. to a newly formed subsidiary, Aristar Holdings, Inc. (Aristar). Additionally, the company contributed its investment in the net assets of Gamble Alden Life Insurance Company, Inc., Gamble Alden Agency, Inc. and Gambles International Leasing Company, Inc., wholly owned unconsolidated subsidiaries of the company, and of Gambles C & M

Leasing Company, Inc., an 80%-owned unconsolidated subsidiary, to Aristar. The accounts of these subsidiaries have been combined with Aristar's consolidated financial statements presented elsewhere in this annual report.

On February 28, 1978, the company acquired all of the outstanding shares of Leath and Company (Leath) for cash totaling $21,191,000. Leath is primarily engaged in the retail household furnishing business. The transaction was accounted for as a purchase. The purchase cost was less than the fair value of Leath's net assets at date of acquisition, and such difference has been allocated to fixed assets in accordance with the purchase method of accounting. Since the acquisition was accounted for as a purchase, the results of operations of Leath have been included in the consolidated statements of earnings since the date of acquisition.

On June 3, 1978, the company acquired approximately 70% of the outstanding shares of Howard Bros. Discount Stores, Inc. (Howard Bros.). The remainder of the outstanding shares of Howard Bros. was acquired on July 20, 1978. The purchase price consisted of cash and notes totaling $41,185,000. Notes were issued for $19,447,000 of the total purchase price. The purchase price was in excess of the fair value of Howard Bros. net assets, and such excess is being amortized over 40 years. Howard Bros. is primarily engaged in the operation of discount department stores. Since the acquisition was accounted for as a purchase, the results of operations of Howard Bros. have been included in the consolidated statements of earnings since the date of acquisition.

The following unaudited data represents the results of operations of the company on a pro forma basis as if Aristar, Leath and Howard Bros. had been combined with the company for its full fiscal year ended January 27, 1979.

	(unaudited) 1978
	(in thousands, except per share)
Net sales	$2,018,087
Net earnings	$27,523
Net earnings per share	$6.69

In August and September 1978, the company purchased approximately 20% of the outstanding common stock of Garfinckel, Brooks Brothers, Miller & Rhoads, Inc. (Garfinckel), at a price of approximately $25,855,000. Notes were issued for $9,607,000 of the purchase price and the remainder was in cash. The purchase price was in excess of the book value of Garfinckel's net assets, and such excess is being amortized over 40 years. Included in the 1979 and 1978 results of operations of the company is approximately $2,800,000 and $1,600,000, respectively, representing the company's equity in the net earnings of Garfinckel from the date the company acquired 20% ownership. Garfinckel commenced an action to require divestiture of the common stock purchased and to obtain monetary damages of not less than $10,000,000 and certain other remedies. In August 1979, the company and Garfinckel entered into an agreement settling the action. The agreement provides, in part, that the company will not, without Garfinckel's consent, increase its stock ownership beyond approximately 20% of the outstanding Garfinckel voting stock.

(4) Receivables

	(Thousands) 1979	1978
Equity in installment accounts sold	**$43,385**	$40,579
Other trade receivables	**11,954**	22,543
Dealer accounts	**7,159**	6,752
Miscellaneous, principally affiliates	**21,013**	15,177
Total accounts receivable	**83,511**	85,051
Less: Allowance for doubtful accounts	**21,961**	20,970
Deferred finance charges	**9,962**	4,810
Net receivables	**$51,588**	$59,271

Customer installment accounts, less a portion withheld, were sold to finance subsidiaries and a bank at January 26, 1980 and January 27, 1979 (see Note 15). The allowance for doubtful accounts provides for the exposure on all receivables listed above and those sold to finance subsidiaries. Dealer accounts sold to finance subsidiaries were $33,078,000 at January 26, 1980, and $32,912,000 at January 27, 1979.

(5) Property and Equipment (at cost)

	(Thousands) 1979	1978
Land	**$ 11,122**	$ 11,062
Buildings and equipment	**195,940**	177,488
	207,062	188,550
Less allowance for depreciation	**94,173**	87,445
	112,889	101,105
Leasehold improvements less amortization	**27,003**	21,240
	139,892	122,345
Capitalized leases less amortization (Note 7)	**53,842**	46,523
	$193,734	$168,868

(6) Investment in Investee Company

The company's approximate 20% investment in Garfinckel, Brooks Brothers, Miller & Rhoads, Inc. (Garfinckel) is accounted for by the equity method. Condensed financial information summarized from the consolidated financial statements of Garfinckel, examined by other independent public accountants, is as follows:

	(Thousands)	
	February 2, **1980**	February 3, 1979
Current assets	**$152,604**	$142,742
Fixed assets–net	**85,031**	74,951
Other noncurrent assets	**8,622**	9,205
Total assets	**$246,257**	$226,898
Current liabilities	**$ 65,615**	$ 51,860
Noncurrent liabilities, principally long-term debt	**74,791**	77,087
Stockholders' equity	**105,851**	97,951
Total liabilities and stockholders' equity	**$246,257**	$226,898

	Fifty-two Weeks Ended	Fifty-three Weeks Ended
	February 2, **1980**	February 3, 1979
Net sales	**$391,990**	$364,944
Costs and expenses	**366,808**	337,896
Income from continuing operations before income taxes	**25,182**	27,048
Income taxes	**10,632**	12,341
Net income from continuing operations	**14,550**	14,707
Gain (loss) from discontinued operations, net	**719**	(1,401)
Net income	**$ 15,269**	$ 13,306
Cash dividends paid–common	**$ 5,530**	$ 5,153

At January 26, 1980, the company's investment in Garfinckel, including excess cost over equity, is approximately $28,789,000. The excess cost over equity of $6,912,000 is being amortized over 40 years. The market value of the company's investment in Garfinckel is approximately $15,298,000 at January 26, 1980.

(7) Leases

The company conducts a major part of its operations from leased premises. Capital leases are amortized in accordance with the guidelines established in Statement No. 13 of the Financial Accounting Standards Board, which prescribes the accounting for leases. Lease amortization expense is included in depreciation expense.

The company has leases for warehousing, manufacturing and administrative facilities and equipment. These leases have terms ranging from one to 40 years. The majority of these leases contain provisions to renew the leases for varying periods. In some limited instances the company may, after the initial lease term, purchase the property. In addition, retail store properties are leased for the majority of the company-owned stores. The initial terms usually are between five and 20 years with one or more five-year renewal options. The majority of the store leases provide for a minimum rental plus a percentage of the store's sales in excess of stipulated amounts. Certain of the store leases are in turn sublet to franchise dealers. The majority of these subleases are for the same term as the company's primary lease.

In most cases, management expects that in the normal course of business, leases will be renewed or replaced by other leases.

Commitments as lessee

The following schedule analyzes assets under leases which have been accounted for as capital leases in the accompanying consolidated balance sheets:

	(Thousands)	
	January 26, **1980**	January 27, 1979
Land and buildings	**$73,682**	$70,917
Furnitures, fixtures and equipment	**13,406**	12,078
	87,088	82,995
Less accumulated amortization	**33,246**	36,472
Net leased assets under capital leases	**$53,842**	$46,523

At January 26, 1980, minimum rental payments are as follows:

	(Thousands)	
	Capital leases	Operating leases
Year ended January		
1981	$12,102	$28,998
1982	11,611	25,387
1983	10,481	21,929
1984	9,761	19,026
1985	9,241	16,842
Later years	91,765	92,654
Total minimum lease payments (a)	144,961	$204,836
Less executory costs	3,017	
Net minimum lease payments	141,944	
Less amount representing interest	71,582	
Present value of net minimum lease payments (b)	$ 70,362	

(a) Minimum payments for capital and operating leases have not been reduced by sublease rentals of $12,847,000 and $31,844,000, respectively, due in the future under noncancellable subleases. In addition to minimum future lease payments, contingent rentals may be paid under certain store leases. Contingent rentals for capital leases amounted to $797,000 and $701,000 in 1979 and 1978, respectively.

(b) The January 26, 1980 and January 27, 1979 consolidated balance sheets include current installments of long-term debt of $4,883,000 and $5,454,000 and long-term debt of $65,479,000 and $59,084,000, respectively, related to capital lease obligations.

The following schedule shows the composition of total rental expense for all operating leases:

	(Thousands)	
	1979	**1978**
Minimum rentals	**$33,011**	$31,732
Contingent rentals	**5,432**	4,300
Less–sublease rentals	**(8,402)**	(9,680)
	$30,041	$26,352

Investments as lessor

The company has subleased some store buildings and equipment to independent dealers. Those leases which meet the requirements for capitalization have been accounted for as direct financing leases. The following lists the net investment in direct financing leases at January 26, 1980, and January 27, 1979:

	(Thousands)	
	January 26, **1980**	January 27, **1979**
Total minimum lease payments receivable	**$12,590**	$13,443
Estimated unguaranteed residual value	**118**	629
Less unearned income	**(5,785)**	(6,016)
Net investment	**6,923**	8,056
Less current portion included in miscellaneous receivables	**(1,583)**	(1,649)
Net investment in direct financing leases	**$ 5,340**	$ 6,407

The net investment in direct financing leases is included in "investments" in the accompanying consolidated balance sheets.

Mid-South Development Company, Inc., 50% of the stock of which is owned by officers and directors of Howard Bros. Discount Stores, Inc. (Howard Bros.), a subsidiary of the company, owns 48 store buildings and a warehouse which it leases to Howard Bros. for an annual rental of $3,099,000. In addition, Howard Bros. paid Mid-South Development Company, Inc. $1,761,000 for leasehold improvements for the year ended January 26, 1980. These transactions are made on terms and conditions which compare favorably with transactions between Howard Bros. and unrelated parties.

(8) Long-term Debt

The long-term debt of the operating companies ($114,428,000) is principally unsecured and matures through 2000, paying interest at a weighted average rate of 11.3% (range 5%-15¾%). The long-term debt of the real estate companies ($24,712,000) is mortgage notes maturing through 2001, paying interest at a weighted averate rate of 8.2% (range 5⅛%-10¼%).

Annual sinking fund and principal payments on long-term debt (excluding obligations under capital leases–Note 7) and subordinated income notes (Note 9) during the next five years are as follows:

1980–$31,531,000; 1981–$17,979,000; 1982–$14,284,000; 1983–$13,819,000; 1984–$13,989,000.

(9) Subordinated Income Notes

Subordinated income notes mature through 2009 and pay interest at a weighted average rate of 9.9% (range 7% to 12%). Principal payments aggregating $219,442,000 mature subsequent to the year 2001.

The provisions of the note indentures require that interest be paid currently if earned. If not earned, interest must be paid upon maturity of the notes to the extent not previously paid.

In financial statements filed with the Securities and Exchange Commission, the company includes subordinated income notes under the caption "long-term debt" and does not include the caption "capital accounts."

(10) Pension and Profit Sharing Plans

The company and its subsidiaries have various retirement plans covering substantially all regular full-time employees not covered under union agreements.

It is the company's policy to fund the plans in accordance with Federal funding requirements, and currently, the company is funding normal costs accrued plus amortization of unfunded supplemental actuarial value over a forty-year period. The actuarially computed value of vested benefits exceeds the market value of the Plans' assets plus balance sheet accruals on December 31, 1979, the date of the most recent actuarial report, by approximately $6,038,000. The estimated unfunded supplemental actuarial value of the company's pension plans at December 31, 1979 was $31,588,000.

The contributory profit sharing plans of the company and its subsidiaries provide that the company make minimum annual contributions to the plans based upon contributions made by participating employees, plus additional amounts based on earnings of the company.

Employer contributions to the above plans are irrevocable and, upon termination of the plans, the amounts thereof are not available to the company. Cost of these plans, including costs of pension and thrift sharing plans of the company's Canadian subsidiaries and the company's unconsolidated subsidiaries, but excluding costs under union agreements, were $10,229,000 and $6,864,000 in 1979 and 1978, respectively. Costs of pension plans under union agreements were $4,355,000 and $3,920,000 in 1979 and 1978, respectively. The Gambles Pension Plan is a noncontributory plan administered by a wholly owned life insurance subsidiary. During 1979 and 1978, administrative fees of $242,000 and $224,000, respectively, were charged to the Pension Plan by the life insurance subsidiary.

The company has certain agreements which provide supplementary retirement benefits for certain officers and key employees, generally in the form of monthly payments, under specified conditions, for a period of up to 10 years after retirement, with certain other benefits.

Costs of the plans for the consolidated companies are included in operating and administrative expense in the accompanying consolidated statements of earnings.

The company's Thrift/Sharing and Employee Stock Ownership Plan (Plan) has outstanding borrowings of $8,635,000 at January 26, 1980 ($9,445,000 at January 27, 1979), the proceeds of which were used to purchase common stock of the company on the open market. The repayment of this obligation is guaranteed by the company. Since the current obligation is a term loan due in 1985, and because the company has ultimate responsibility to discharge the obligation through future contributions or in the event of default by the Plan, the obligation has been included in "long-term debt" and "current installments of long-term debt" in the accompanying consolidated balance sheets. Corresponding amounts have been included in "deferred charges and other assets."

(11) Redeemable Preferred Stock

Preferred stock, $40 par value; $1.75 per share dividend–authorized 600,000 shares. Each share is voting, cumulative and convertible into 824/1000ths of a share of common stock until October 31, 1983, on which date conversion rights expire. The stock is redeemable at the option of the company and in the event of involuntary liquidation at $40.00 per share plus accrued and unpaid dividends. Sinking fund requirements, equal to 5% per year of shares issued, commence in 1983. The aggregate preference upon involuntary liquidation at January 26, 1980 is $5,411,000.

Preferred stock, $5 par value; $1.60 per share dividend–authorized 1,400,000 shares. Each share is voting, cumulative and convertible into 8/10ths of a common share to November 30, 1984, (9/10ths of a share to November 30, 1979) on which date conversion rights expire. The stock is redeemable at the option of the company and in the event of involuntary liquidation at $35.00 per share plus accrued and unpaid dividends. Sinking fund requirements, equal to 5% of shares issued, commence in 1984. The aggregate preference upon involuntary liquidation at January 26, 1980 is $4,388,000. Paid-in capital allocated to $5 par value preferred stock is equivalent to the mandatory redemption price in excess of par value.

The changes in redeemable preferred stock are as follows:

	(Thousands) Fifty-two Weeks Ended January 26, 1980	January 27, 1979
$40 par value:		
Beginning of period; 260,439 and 304,868 shares	**$10,418**	$12,195
Conversion to common stock; 7,330 and 44,429 shares	**(294)**	(1,777)
End of period; 253,109 and 260,439 shares	**10,124**	10,418
$5 par value:		
Beginning of period; 468,378 and 481,700 shares	**2,341**	2,408
Conversion to common stock; 134,037 and 13,322 shares	**(669)**	(67)
End of period; 334,341 and 468,378 shares	**1,672**	2,341
Paid-in capital allocated to $5 par value preferred stock, equivalent to mandatory redemption price in excess of par value:		
Beginning of period	**7,782**	8,182
Allocation of paid-in capital resulting from conversion of $5 par value preferred stock to common stock	**(4,021)**	(400)
End of period	**3,761**	7,782
Total $5 par value	**5,433**	10,123
Less treasury stock at par value:		
$40 par value: 117,817 shares	**(4,713)**	(4,713)
$5 par value: 208,971 shares	**(1,045)**	(1,045)
Total treasury stock	**(5,758)**	(5,758)
Total redeemable preferred stock	**$ 9,799**	$14,783

In accordance with a new requirement of the Securities and Exchange Commission adopted in 1979, redeemable preferred stock issues must be presented separately in the consolidated balance sheets. Concurrent with adoption of this requirement, the company adjusted the carrying value of preferred treasury stock from cost to par value in 1979 and reclassified prior year amounts to reflect the current period treatment. As a result, the amount of "total redeemable preferred stock" reflected in the consolidated balance sheets is now equivalent to the total redemption value of the outstanding shares. The net difference between the cost of preferred treasury shares and their par value has been charged to paid-in capital allocated to common stock. Accordingly, paid-in capital allocated to common stock at January 27, 1979 has been decreased by $5,464,000 from the amount previously reported.

(12) Common Stock

Common stock, $5 par value–authorized 10,000,000 shares. Common shares were reserved at fiscal year-end as follows:

	1979	1978
Conversion of preferred stock	**211,777**	350,987
Employee stock options	**—**	1,200
Common stock purchase warrants	**224,000**	224,000
	435,777	576,187

In addition, 73,390 common shares of treasury stock are reserved for issuance under Gambles' Restricted Stock Plan.

Under the company's option plans for executives and key employees, options are granted at market value and are exercisable from one to five years after date of grant. Shares under option were as follows:

	1979	1978
Outstanding beginning of year	**1,200**	29,300
Exercised	**—**	(15,800)
Expired	**(1,200)**	(12,300)
Outstanding end of year	**—**	1,200
Aggregate option price for shares outstanding	**$ —**	$32,400
Shares exercisable	**—**	1,200

Warrants to purchase common stock issued in connection with the sale of subordinated income notes are exercisable at $40.00 per share and expire in January 1984.

In June 1978, stockholders approved the 1978 Restricted Stock Plan under which a maximum of 300,000 shares of Gambles' common stock held in treasury were reserved for issuance. Under the Plan, participants are awarded shares of common stock by a committee of the Board of Directors. The purchase price of the stock is payable at the end of the restricted period, June 1983 through October 1984, and is the fair value of a share of common stock on the date the award was granted. The purchase price may be reduced by a performance factor which is based on the cumulative compound growth of Gambles' earnings per share during the restricted period on a performance base established by such committee.

(13) Retained Earnings

Retained earnings of certain unconsolidated subsidiaries are restricted as to payment of dividends in the amount of $81,268 000 at January 26, 1980.

(14) Consumer Credit Operations

The results of the consumer credit operations are as follows:

	(Thousands)	
	1979	**1978**
Finance charge income	**$71,692**	$71,869
Operating expense (including credit sales expense, collection expense, and provision for doubtful accounts)	**48,217**	48,918
Interest expense	**34,693**	29,267
Income taxes (credit)	**(5,609)**	(3,158)
Total expenses	**77,301**	75,027
Net income (loss) from consumer credit operations	**$ (5,609)**	$ (3,158)

Finance-charge income and operating expense are included in operating and administrative expense in the accompanying consolidated statements of earnings. Interest expense is calculated based upon the average cost of borrowings of the finance subsidiaries of 10.0% in 1979 and 9.0% in 1978 applied to the average balance of customer receivables reduced by deferred income taxes. An effective rate of 50% is assumed in calculating income taxes.

(15) Condensed Combined Finance Companies

Gambles Credit Corporation and Gambles Canada Acceptance, Ltd., unconsolidated wholly owned finance subsidiaries of the company, purchase accounts receivable from the merchandise companies, withholding 10% of the receivable balances pending collection. The finance companies charge a service fee which is calculated to produce earnings sufficient to cover fixed charges, principally interest on borrowings, at one and one half times. Such service fee is included in the consolidated statements of earnings as interest expense.

The condensed combined balance sheets of Gambles Credit Corporation and Gambles Canada Acceptance, Ltd. are as follows:

	(Thousands)	
	1979	**1978**
Assets:		
Customer and dealer accounts receivable	**$466,933**	$438,702
Other assets	**21,343**	23,923
	$488,276	$462,625
Liabilities and Stockholders' Equity:		
Notes payable and current installments of long-term debt	**$151,514**	$106,777
Contract reserve account, applicable to customer and dealer accounts receivable	**46,693**	43,870
Other liabilities	**2,786**	3,108
Long-term debt	**193,597**	223,909
	394,590	377,664
Stockholders' equity	**93,686**	84,961
	$488,276	$462,625

The net earnings of these finance companies were $8,725,000 in 1979 and $6,896,000 in 1978. The pretax earnings of these finance companies are deducted from interest expense in the accompanying consolidated statements of earnings (see Note 16).

(16) Interest Expense

The principal components of interest expense are shown in the following table:

	(Thousands)	
	1979	**1978**
Service fee on receivables sold to finance companies	**$48,361**	$42,088
Interest on long-term debt*	**43,959**	36,255
Interest on short-term borrowings**	**6,740**	7,360
	99,060	85,703
Less pretax earnings of finance companies	**16,261**	13,765
Less interest income***	**8,516**	11,730
Net interest expense	**$74,283**	$60,208

*Includes amortization of debt discount and issuance expenses of $1,548,000 and $860,000 for 1979 and 1978, respectively.

**Includes $293,000 in 1979 on amounts payable to combined finance subsidiaries and $1,153,000 in 1979 to other unconsolidated subsidiaries.

***Includes $2,876,000 and $5,393,000 in 1979 and 1978, respectively, from the combined finance subsidiaries, and $967,000 and $567,000 in 1979 and 1978, respectively, from other unconsolidated subsidiaries.

(17) Income Taxes

Income tax expense is comprised as follows:

	(Thousands)	
	1979	**1978**
Current tax expense:		
Federal	**$(2,929)**	$(3,073)
Canadian	**7,958**	4,020
State and local	**1,741**	1,983
Deferred tax expense:		
Federal and state	**2,116**	6,193
Canadian	**795**	173
	$ 9,681	$ 9,296

Deferred taxes arose from timing differences related to the following:

	(Thousands)	
	1979	**1978**
Store closing costs	**$ —**	$1,004
Installment receivables	**5,094**	4,852
Interest accrual	**(83)**	(70)
Benefit of investment tax credit carry forward	**(1,820)**	—
Benefit of operating loss carry forward	**(2,672)**	—
Undistributed foreign earnings	**750**	—
Retirement benefits	**(539)**	183
Data processing costs	**871**	(226)
Depreciation	**766**	345
Other–net	**544**	278
	$2,911	$6,366

A reconciliation of the 1979 and 1978 U.S. Federal statutory tax rates of 46.0% and 47.9%, respectively, to the actual effective rates is as follows:

	1979	**1978**
U.S. Federal Statutory tax rate	**46.0%**	47.9%
State income tax, net of Federal tax benefit	**4.5**	4.7
Investment tax credit	**(8.2)**	(5.8)
Translation adjustment on Canadian earnings	**(.4)**	9.5
Capital gain transactions taxed at lower tax rate	**(.7)**	(3.0)
Canadian inventory tax credit	**(2.9)**	(2.9)
Canadian dividend tax	**3.4**	—
Goodwill amortization	**3.6**	(1.4)
Permanent differences arising from income recognition of purchase accounting adjustments	**(6.0)**	(1.5)
Other–net (not individually significant)	**4.5**	(5.0)
	43.8%	42.5%

Deferred income taxes from timing differences on installment sales are included in the financial statements as current liabilities. Deferred income taxes applicable to installment sales at January 26, 1980 have been reduced by the current period tax benefit of an operating loss carry forward of $2,672,000 (expiring in January 1987) and investment tax credit carry forwards of $3,661,000 (of which $513,000 expire in January 1986 and $3,148,000 expire in January 1987). All other deferred income taxes are included in deferred credits as follows: $2,103,000 at January 27, 1979 and $4,558,000 at January 26, 1980.

It is the policy of the company to accrue taxes on the earnings of the Canadian subsidiary companies which are intended to be remitted to the parent company in the near future. No provision for income or dividend withholding taxes has been made on approximately $46,700,000 of undistributed earnings of the Canadian companies that have been indefinitely reinvested in the subsidiaries' businesses.

Investment tax credits are used to reduce income taxes in the year the property is acquired ($1,820,000 in 1979 and $1,270,000 in 1978).

Internal Revenue Service examinations of Federal income tax returns for the company have been completed through January 25, 1975. An examination for the years ended January 31, 1976 and January 29, 1977 is in progress. The company believes that all taxes due have been fully paid or provided for.

(18) Commitments and Litigation

The company has guaranteed indebtedness and lease payments of unconsolidated subsidiaries of approximately $45,345,000 and $23,290,000, respectively. In addition, the company, as a result of a corporate reorganization in 1964, may be liable for the payment of $14,406,000 of long-term debt of an unconsolidated finance subsidiary. The company has also guaranteed loans and other debt with banks of $5,312,000 at January 26, 1980.

A number of lawsuits and inquiries and complaints from state regulatory agencies are pending against Aldens, Inc., a subsidiary of the company. These proceedings relate to the legality of certain credit and finance charge practices. Notwithstanding the above, management is of the opinion that Aldens is presently in compliance with applicable state laws. If such lawsuits are tried and decided adversely, it is impossible to predict what amounts, if any, might be awarded, although a theoretical liability in the millions of dollars could be involved. Aldens has been unsuccessful in substantially all cases that have been finally adjudicated, but is vigorously defending each pending case. Management is of the opinion that ultimate resolution of the pending matters or possible litigation involving finance charges, taken in the aggregate, will not materially affect the company's financial position.

(19) Business Segment Information

Business segment information for the fiscal years ended January 26, 1980 and January 27, 1979 set forth on page 36 is an integral part of these financial statements.

(20) Quarterly Financial Information (Unaudited)

Set forth below are financial data showing results of operations for the four fiscal quarters of 1979 and 1978. In the opinion of management, all adjustments (consisting only of normal recurring accruals) necessary for a fair presentation have been included.

In thousands, except per share, for the thirteen weeks ended

	April 28, **1979**	July 28, **1979**	Oct. 27, **1979**	Jan. 26, **1980**
Net sales	**$455,574**	**$487,299**	**$512,501**	**$597,629**
Cost of sales	**343,868**	**369,193**	**383,167**	**433,372**
Net earnings (loss)	**(983)**	**6,470**	**2,573**	**23,124**
Earnings (loss) per share:				
Primary	**(.28)**	**1.56**	**.60**	**5.58**
Fully diluted	**(.28)***	**1.47**	**.59**	**5.28**
	April 29, **1978**	July 29, **1978**	Oct. 28, **1978**	Jan. 27, **1979**
Net sales	$415,135	$457,233	$501,420	$580,856
Cost of sales	317,298	348,217	378,716	436,184
Net earnings	1,007	5,294	2,980	13,943
Earnings per share:				
Primary	.19	1.24	.70	3.42
Fully diluted	.19*	1.16	.68	3.18

*antidilutive

(21) Supplementary Data on Changing Prices (Unaudited)

The United States has experienced rapid inflation during the past 10 years which, because of the length of time, distorts traditional accounting measurements of income and capital. The Financial Accounting Standards Board (FASB) in September 1979, issued Statement No. 33, Financial Reporting and Changing Prices, in an effort to provide readers of the traditional historical financial statements with information to assist them in assessing the impact of inflation.

The following information is intended to provide certain measurements of the effects of inflation on Gambles' operations and other financial data adjusted for the effects of inflation in compliance with the requirements of this accounting pronouncement. The reader should keep in mind that the information herein presented is an estimate of the approximate effect of inflation and not a precise measurement.

The FASB has prescribed two methods for measuring the effects of inflation, both of which have been applied in the schedules that follow.

Under the first method, data provided is adjusted for "general inflation" (constant dollar). The Consumer Price Index-All Urban Consumers (CPI-U) is used as the gauge or measure of the general inflation rate. The objective is to match revenues with expenses, expressed in dollars of the same equivalent value or purchasing power (constant dollars).

The second prescribed method involves adjustments for "changes in specific prices" (current costs). Here the objective is to measure the company's resources and their consumption at the current cost of replacement instead of at the historical costs as recorded in the traditional financial statements. Current cost adjustments for inventory and cost of sales were determined by the use of external price indices and by direct pricing from vendors' price lists. Adjustments for property and equipment and their related depreciation were determined by the use of both internal and external price indices. Pricing of land was accomplished by the use of quotations and appraisals.

Consolidated Statement of Earnings Adjusted for Changing Prices

Fifty-two weeks ended January 26, 1980

	As Reported in the Financial Statements	Adjusted for General Inflation (Constant Dollars)	Adjusted for Changes in Specific Prices (Current Costs)
	(Dollars in thousands, except per share data)		
Net sales	$2,053,003	$2,053,003	$2,053,003
Costs and expenses:			
Cost of sales, including certain occupancy and buying costs	1,529,600	1,573,142	1,552,186
Operating and administrative	407,911	407,911	407,911
Depreciation and amortization	21,298	29,459	32,779
Interest	74,283	74,283	74,283
Total Costs and Expenses	2,033,092	2,084,795	2,067,159
Other income–net	2,169	2,169	2,169
Earnings (loss) before income taxes and equity in net earnings of unconsolidated subsidiaries and investee company	22,080	(29,623)	(11,987)
Income taxes	(9,681)	(9,681)	(9,681)
Equity in net earnings of Aristar Holdings, Inc. and subsidiaries	16,601	16,601	16,601
Equity in net earnings of other unconsolidated subsidiaries and investee company	2,184	2,184	2,184
Net earnings (loss)	$ 31,184	$ (20,519)	$ (2,883)
Net earnings (loss) per common share	$7.52	$ (5.19)	$ (.86)
Gain from decline in purchasing power of net amounts owed	$ –	$ 78,514	$ 78,514
Net assets at year-end	$ 257,197	$ 344,264*	$ 377,461*
Excess of increase in general price level over increase in specific prices of inventories and property and equipment held during the year	$ –	$ –	$ 26,791**

*Investments in unconsolidated subsidiaries and investee company included at historical cost/nominal dollar amount.

**At January 26, 1980, current cost of inventory was $369,858 and current cost of property and equipment, net of accumulated depreciation was $312,825.

Note: As required by Statement No. 33, income taxes are not adjusted.

As specified in Statement No. 33, only the inventory component of cost of sales and depreciation expense has been restated from historical costs in computing net earnings (loss) adjusted for general inflation, resulting in a reduction in net earnings of $51,703,000. The comparable adjustment under the current cost method results in a $34,067,000 reduction in net earnings.

Income taxes have not been adjusted from historical statements. As a result, the effective tax rates are substantially higher under either method.

The principal difference between the two methods is the $20,956,000 increase in cost of sales under the general inflation method versus the specific price method. The effect of inflation on Gambles in this respect is less than the general rate of inflation.

Depreciation expense has been adjusted upwards under both methods as a result of restating the company's property and equipment from old historical dollars to those measured by general inflation and by changes in specific prices. The increase in expense is greater under the specific price method due to the more rapid rise in the current cost of property and equipment owned by Gambles, as compared to the rise in the rate of inflation in general.

The gain from decline in purchasing power of net amounts owed represents the future benefit to Gambles from holding net monetary liabilities during 1979 when the purchasing power of the dollar declined, thus requiring less purchasing power to satisfy these net liabilities. (Monetary assets and liabilities are those amounts fixed in terms of dollars and do not change with inflation.)

Net assets at year-end reflect equity and is presented after adjustment for both general inflation and specific price increases. In both restatements the significant increase in net assets is the result of the adjustment of property and equipment to current values as reflected by the two methods of computation.

Consolidated Five-Year Comparison of Selected Supplementary Financial Data Adjusted for Effects of General Inflation

	Historical	Adjustment	Adjusted
Net Sales (In thousands) For Year Ended			
January 31, 1976	$1,559,043	$553,984	$2,113,027
January 29, 1977	1,590,372	450,543	2,040,915
January 28, 1978	1,634,122	333,092	1,967,214
January 27, 1979	1,954,644	226,338	2,180,982
January 26, 1980	2,053,003	–	2,053,003
Market Price Per Common Share at Year-End			
January 31, 1976	$ 24¼	$ 7¾	$ 32
January 29, 1977	22⅞	5¾	28⅝
January 28, 1978	27¾	4⅞	32⅝
January 27, 1979	27¼	2	29¼
January 26, 1980	33⅞	(1⅞)	32
Cash Dividends Declared Per Common Share For Year Ended			
January 31, 1976	$ 1.40	$ .50	$ 1.90
January 29, 1977	1.40	.40	1.80
January 28, 1978	1.40	.29	1.69
January 27, 1979	1.40	.16	1.56
January 26, 1980	1.50	–	1.50

The average Consumer Price Index-All Urban Consumers used to adjust net sales and cash dividends declared per common share for each year ended in January is as follows: 1976, 162.1; 1977, 171.2; 1978, 182.5; 1979, 196.9; 1980, 219.7.

All information presented is stated in terms of the average purchasing power of the dollar in the fiscal year ended January 26, 1980 (average 1979 dollars). Hence, all data shown is presented in a common unit of measurement. The CPI-U was used to restate all amounts in average 1979 dollars.

Accountants' Report

PEAT, MARWICK, MITCHELL & CO.
Certified Public Accountants
1700 IDS Center
Minneapolis, Minnesota 55402

The Board of Directors and Stockholders
Gamble-Skogmo, Inc.:

We have examined the consolidated balance sheets of Gamble-Skogmo, Inc. and consolidated subsidiaries as of January 26, 1980 and January 27, 1979 and the related consolidated statements of earnings, retained earnings, common stock and other stockholders' equity and changes in financial position for the years then ended and the consolidated balance sheets of Aristar Holdings, Inc. (wholly owned by Gamble-Skogmo, Inc.) and subsidiaries as of January 31, 1980 and 1979 and the related consolidated statements of earnings and retained earnings, 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.

In our opinion, the aforementioned consolidated financial statements present fairly the financial position of Gamble-Skogmo, Inc. and consolidated subsidiaries at January 26, 1980 and January 27, 1979 and of Aristar Holdings, Inc. and subsidiaries at January 31, 1980 and 1979 and the results of their operations and the changes in their financial position for the years then ended,in conformity with generally accepted accounting principles applied on a consistent basis.

Peat, Marwick, Mitchell & Co

March 20, 1980

Business Segment Information

The company's merchandising businesses operate in six primary business segments: general merchandising–retail, general merchandising–wholesale, mass merchandising, food and drug, catalog, and Canadian merchandising. General merchandising–retail, includes operations that are primarily oriented toward retailing a wide variety of consumer goods. General merchandising–wholesale, comprises the operations primarily making sales to dealers. Mass merchandising includes retail general merchandise stores operating on high volume and low margin, including certain operations now discontinued. Food and drug includes groceries and drugs and other drug store merchandise. Catalog includes catalog and direct mail merchandising operations. Canadian merchandising comprises all Canadian merchandising operations. Set forth below is certain information about these business segments.

Net Sales and Operating Earnings (Thousands)

	Net Sales					Operating Earnings				
Year Ended January	**1980**	**1979**	**1978**	**1977**	**1976**	**1980**	**1979**	**1978**	**1977**	**1976**
Business Segments:										
General Merchandising–Retail	**$ 352,291**	$ 306,687	$ 209,399	$ 187,659	$ 180,500	**$15,875**	$20,412	$ 9,470	$10,195	$ 7,848
General Merchandising–Wholesale	**213,207**	210,680	220,826	218,722	207,920	**10,863**	11,518	7,820	10,214	13,026
Mass Merchandising	**244,774**	263,524	118,552	131,742	145,653	**14,192**	2,706	(952)	1,036	2,710
Food and Drug	**799,834**	730,351	670,490	627,186	616,639	**17,809**	12,434	11,728	11,587	10,951
Catalog	**249,365**	256,009	228,331	226,622	220,205	**26,287**	28,701	27,163	24,626	24,462
Canadian Merchandising	**202,839**	199,933	204,552	218,274	204,810	**17,674**	8,856	7,058	15,090	19,039
Eliminations	**(9,307)**	(12,540)	(18,028)	(19,833)	(16,684)	**—**	—	—	—	—
Net Sales	**$2,053,003**	$1,954,644	$1,634,122	$1,590,372	$1,559,043					
Operating Earnings						**102,700**	84,627	62,287	72,748	78,036
General corporate expenses						**(6,337)**	(2,533)	(7,098)	(4,886)	(5,571)
Interest expense, net of interest income						**(74,283)**	(60,208)	(42,496)	(39,846)	(35,920)
Earnings before taxes and equity in net earnings of unconsolidated subsidiaries and investee company						**$22,080**	$21,886	$12,693	$28,016	$36,545

Identifiable Assets, Depreciation and Capital Expenditures (Thousands)

	Identifiable Assets			Depreciation		Capital Expenditures	
Year Ended January	**1980**	**1979**	**1978**	**1980**	**1979**	**1980**	**1979**
Business Segments:							
General Merchandising–Retail	**$ 214,229**	$ 160,847	$ 122,744	**$ 4,564**	$ 4,116	**$11,362**	$ 7,352
General Merchandising–Wholesale	**127,853**	131,714	135,870	**1,154**	1,225	**1,628**	2,387
Mass Merchandising	**128,659**	150,880	65,545	**4,266**	3,911	**16,078**	4,902
Food and Drug	**146,272**	124,452	115,282	**5,945**	5,193	**21,184**	12,356
Catalog	**353,297**	364,061	365,462	**2,425**	2,236	**3,523**	5,141
Canadian Merchandising	**165,207**	141,378	151,284	**2,439**	3,077	**2,074**	1,398
Eliminations	**(420,240)**	(394,832)	(367,907)		—	**—**	—
	715,277	678,500	588,280	**20,793**	19,758	**55,849**	33,536
Corporate	**102,439**	89,509	110,958	**505**	42	**494**	523
Investment in unconsolidated subsidiaries and investee company	**258,803**	236,007	152,071	**—**	—	**—**	—
	$1,076,519	$1,004,016	$851,309	**$21,298**	$19,800	**$56,343**	$34,059

Consolidated Statements of Earnings and Retained Earnings (Note 2)

ARISTAR HOLDINGS, INC. AND SUBSIDIARIES

(All dollars in thousands)

	1979 Year Ended January 31, 1980	1978 Year Ended January 31, 1979
Revenue:		
Interest and fees applicable to notes and contracts receivable	**$72,654**	$61,257
Leasing rentals, fees and related finance charges	**31,511**	17,587
Insurance premiums	**83,526**	44,093
Investment and other income (including gain on sale of real estate of $1,139, in 1979)	**16,175**	10,518
Total revenue	**203,866**	133,455
Expenses:		
Interest and debt expense (Notes 7 and 9)	**38,226**	26,757
Personnel costs (Note 11)	**26,134**	21,660
Insurance claims and benefit provisions	**61,714**	27,308
Provision for credit losses	**8,265**	6,960
Other operating expenses	**45,000**	28,785
Total expenses	**179,339**	111,470
Earnings before income taxes, preferred stock requirements and minority interest	**24,527**	21,985
Income taxes (Note 8)	**7,644**	7,360
Earnings before preferred stock requirements and minority interest	**16,883**	14,625
Preferred stock requirements (Note 10)	**—**	(1,075)
Earnings before minority interest	**16,883**	13,550
Minority interest in earnings of Aristar, Inc. and Gambles C&M Leasing (Note 2)	**(282)**	(4,626)
Earnings applicable to Gamble-Skogmo common stock	**16,601**	8,924
Retained earnings beginning of year (Notes 2 and 10)	**33,064**	24,250
Cash dividends on common stock	**—**	(110)
Retained earnings end of year (Notes 2 and 10)	**$49,665**	$33,064

See accompanying notes to consolidated financial statements.

Consolidated Balance Sheets

ARISTAR HOLDINGS, INC. AND SUBSIDIARIES

(All dollars in thousands)

	1979 January 31, 1980	1978 January 31, 1979
Assets		
Cash (Note 7)	**$ 10,889**	$ 25,792
Notes and contracts receivable (Note 3)	**442,476**	354,220
Less:		
Unearned finance charges	**80,622**	59,365
Allowance for doubtful accounts	**10,373**	9,681
Notes and contracts receivable–net	**351,481**	285,174
Net investment in direct financing leases (Note 4)	**29,833**	40,312
Marketable securities (Note 5)	**141,457**	65,821
Equipment on operating leases–net	**71,378**	44,909
Property and equipment–net	**5,168**	1,732
Assets held in separate account (Note 1)	**35,117**	29,739
Mortgage and other notes receivable	**10,979**	11,393
Deferred charges (Note 6)	**18,478**	7,689
Other assets	**21,657**	14,170
TOTAL ASSETS	**$696,437**	$526,731

	1979	1978
Liabilities and Stockholders' Equity		
Liabilities:		
Notes payable: (Note 7)		
Banks	**$ 13,000**	$ 82,900
Affiliates	**10,741**	—
Commercial paper (Note 7)	**53,489**	—
Equipment financing obligations (Note 7)	**55,439**	56,127
Accounts payable and accrued expenses	**11,534**	16,200
Due to affiliates (Notes 8 and 15)	**644**	4,656
Deposits and other liabilities	**8,455**	4,810
Federal and state income taxes (Note 8)	**15,390**	14,027
Insurance claims and benefit reserves	**74,393**	38,307
Unearned insurance premiums and commissions	**32,947**	21,748
Liabilities and participants' equity in separate account (Note 1)	**35,117**	29,739
Long-term debt (Note 9)	**239,112**	126,279
Total liabilities	**550,261**	394,793
Minority interests	**1,381**	1,099
Stockholders' equity (Notes 2 and 10):		
Common stock	**1**	1
Paid-in surplus	**97,271**	98,597
Retained earnings	**49,665**	33,064
Less:		
Net unrealized loss on marketable equity securities (Note 5)	**(2,142)**	(823)
Total stockholders' equity	**144,795**	130,839
Contingent liabilities and commitments (Notes 12 and 13)		
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	**$696,437**	$526,731

See accompanying notes to consolidated financial statements.

Consolidated Statements of Changes in Financial Position

ARISTAR HOLDINGS, INC. AND SUBSIDIARIES

(All dollars in thousands)

	1979 Year Ended January 31, 1980	1978 Year Ended January 31, 1979
SOURCES OF FUNDS:		
Operations:		
Earnings applicable to Gamble-Skogmo common stock	**$ 16,601**	$ 8,924
Add (deduct) items not requiring funds for the current period:		
Provision for credit losses	**8,265**	6,960
Depreciation and amortization	**22,659**	16,379
Deferred income taxes (Note 8)	**815**	(2,148)
Provision for unpaid insurance claims and future benefits	**37,687**	2,160
Increase in unearned insurance premiums and commissions	**11,199**	3,421
Decrease in accrued expenses and accounts payable	**(4,666)**	(2,226)
Total funds provided by operations	**92,560**	33,470
Increase in long-term debt	**134,762**	—
Decrease in net investment in direct financing leases	**10,479**	12,351
Increase in due to affiliates	**6,729**	3,762
Decrease in investments in and advances to subsidiaries	**—**	34,894
(Increase) decrease in other assets	**(7,487)**	4,717
Increase in notes payable to banks	**—**	29,939
Increase (decrease) in equipment financing obligations–net	**(688)**	8,353
Increase in Federal and State income taxes	**548**	3,588
Tax benefit from utilization of a purchased subsidiary's loss carry forward (reflected as a reduction of goodwill) (Note 8)	**—**	56
Increase (decrease) in insurance claims and benefit reserves	**(1,601)**	1,726
Increase in minority interests	**282**	6,974
Newly issued common stock to Gamble (Note 10)	**—**	1
Stock options exercised (Note 10)	**—**	64
Cancellation of treasury stock upon merger (Note 10)	**—**	4,175
Increase (decrease) in paid-in surplus (Note 10)	**(1,326)**	58,429
Increase in net unrealized loss on marketable equity securities	**1,319**	633
Decrease in carrying value of marketable equity securities	**(1,319)**	(633)
Increase in deposits and other liabilities	**3,645**	873
Increase in commercial paper	**53,489**	—
Total Sources	**$291,392**	$203,372
USES OF FUNDS:		
Increase (decrease) in cash	**$ (14,903)**	$ 5,276
Increase in notes and contracts receivable–net	**73,552**	49,267
Increase in marketable securities	**76,955**	4,974
Additions to equipment on operating leases–net	**44,777**	33,148
Increase in property and equipment–net	**3,778**	1,716
Increase in mortgages and other receivables	**606**	6,315
Increase in deferred charges	**14,798**	9,939
Decrease in notes payable to banks	**69,900**	32,100
Advancement of maturity on senior debt	**12,278**	—
Decrease in long-term debt	**9,651**	2,016
Acquisition of minority interest (Note 10)	**—**	42,706
Preferred stock requirements (Note 10)	**—**	(1,075)
Dividends paid–common stock	**—**	110
Dividends paid–preferred stock (Note 10)	**—**	2,439
Cancellation of preferred and common stock (Note 10)	**—**	13,410
Other–net	**—**	1,031
Total Uses	**$291,392**	$203,372

See accompanying notes to consolidated financial statements.

(1) Summary of Significant Accounting Policies

PRINCIPLES OF CONSOLIDATION. The consolidated financial statements include the accounts of Aristar Holdings, Inc. (Holdings), a wholly owned subsidiary of Gamble-Skogmo, Inc. (Gamble), and its finance, leasing, insurance and related management subsidiaries after elimination of all material intercompany balances and transactions (see Note 2). The insurance subsidiaries are included in the accompanying financial statements as of their fiscal years ended December 31. Certain amounts in prior years have been reclassified to conform to the current year's presentation.

ALLOWANCE FOR DOUBTFUL ACCOUNTS. At the end of each month, the unpaid balance of all loans where there has been no payment of at least one half of one contractual installment in the preceding six months are charged against the allowance for doubtful accounts. The allowance is then adjusted to an amount which, in management's judgment, is sufficient to cover estimated losses in the portfolio. In evaluating the adequacy of the allowance, consideration is given to recent loan loss experience and such other factors which in management's judgment deserve current recognition in estimating losses.

INVESTMENTS IN SECURITIES. Bonds are stated at amortized cost. Preferred stocks which must be redeemed are carried at cost not in excess of redemption price. The marketable equity securities are reported at market value and any resulting unrealized gains or losses are credited or charged to stockholders' equity (See Note 5). Gain or loss on the sale of securities included in operating income for the period is computed principally on the specific identification method.

PROPERTY AND EQUIPMENT. Property is stated at cost, less accumulated depreciation and amortization computed on the straight-line method over the estimated useful life of the asset. Expenditures for new property and equipment, and for renewals and betterments, are generally capitalized; expenditures for maintenance and repairs are charged to income as incurred. Fully depreciated furniture and equipment and fully amortized leasehold improvements are removed from assets and related accumulated depreciation accounts. Gains and losses on retirement and disposals are included in income.

DEFERRED CHARGES. Expenditures that are deferred are amortized over the periods in which the benefit is expected to be realized. Amortization is computed principally on the straight-line method (except for insurance acquisition costs) over the following periods:

	Years
Long-term debt expense	5-25
Premiums on purchased accounts	6
Insurance acquisition costs	3-30
Excess cost of subsidiary over equity	15 and 40
Unamortized initial direct costs of operating leases	1

INTEREST AND FEES ON LOANS. Finance charges included in notes and contracts receivable (precomputed charges) are deferred and proportionate amounts are included in income over the term of the loan using the "sum of the digits" method (Rule of 78), and recognized as revenues principally on the collection basis. Finance charges on such loans written for terms in excess of 84 months are recognized as revenues on an actuarial basis. Finance charges on simple interest loans are recorded principally on the collection basis. Delinquency fees on precomputed accounts are recorded as the cash is received. Deferment charges are credited to deferred income when collected and proportionate amounts are included in income over the term of the loan.

INSURANCE PREMIUMS AND ACQUISITION EXPENSES. Premium income applicable to life insurance and annuities (other than single payment annuities) is reported as earned when due. Policy and contract benefits and expenses are associated with premium income in a manner that results in recognition of profits over the lives of the policies. This association is accomplished by means of the provisions for future policy benefits and the deferral and subsequent amortization of policy acquisition costs.

Insurance premiums on credit life and accident and health policies are deferred and proportionate amounts are included in income over the term of the policy (on the "pro rata" method for level coverage and principally on the "sum-of-the-digits" method for decreasing coverage).

Casualty insurance premiums (other than credit property and unemployment insurance) and accident and health insurance premiums are earned over the term of the policies based on the pro rata method. Credit property and unemployment insurance premiums are recognized based on the average of the pro rata and sum-of-the-digits methods.

The costs of acquiring ordinary life insurance business (commissions, certain policy issuance and other underwriting and sales expenses) have been deferred. These deferred acquisition costs are being amortized to income over the premium-paying periods of the related policies in proportion to the ratio of the expected annual premium revenue to the expected total premium revenue. Such expected premium revenue is estimated using the same assumptions as are used for calculating the liabilities for future policy benefits. The cost of acquiring single premium annuity business (principally commissions and premium taxes) is deferred and amortized to income in relation to an anticipated revenue stream of 10 years.

Acquisition expenses relating to casualty, credit life and accident and health insurance premiums (commissions, premium taxes and certain other acquisition expenses) are deferred and amortized to income over the terms of the policies. The method of computing such deferred acquisition expenses limits the deferral to the lower of

(a) the amount of unearned premiums remaining after deducting expected losses, loss expenses and run-off expenses that will be incurred as the premiums are earned, or (b) the acquisition expenses applicable to the unearned premiums.

INSURANCE CLAIMS AND BENEFIT RESERVES. Liabilities for future policy benefits are generally computed based upon assumptions as to future investment yield, mortality and withdrawals. The liability for policy and contract claims represents management's estimate of the ultimate liability associated with unpaid policy claims. This liability is based primarily upon past experience and may be more or less than the amount ultimately paid when the claims are settled. Changes in the estimated cost to settle unpaid claims are charged or credited to operations as the estimates are revised.

LEASING INCOME. Holdings' leasing subsidiaries are primarily engaged in leasing automotive equipment to corporate fleet users under operating and direct financing lease arrangements. For financial accounting purposes, the cost of the equipment on operating leases is recorded at the inception of the lease as an asset and is depreciated over the lease term to the expected residual value. The initial lease term typically covers a period of twelve months and thereafter may be extended at the option of the lessee on a month-to-month basis. Initial direct costs associated with such leases are deferred and amortized over the lease term on a straight-line basis. Rental income is recognized as it becomes due. For direct financing leases the aggregate rental payments due during the lease term are recorded at inception of the lease. The excess of such rental payments over the cost of the related equipment, after establishing residual values, represents the unearned finance charge, which is taken into income over the term of the lease using the interest method. Initial direct costs are charged to income as incurred and an equivalent amount of unearned finance charge is recognized as revenue in the same period.

INCOME TAXES. Prior to the merger of Aristar, Inc. with a wholly owned subsidiary of Gamble, Aristar, Inc. and its subsidiaries, other than its life insurance subsidiary, filed consolidated Federal income tax returns. Subsequent to the merger, Aristar Holdings, Inc. and its subsidiaries, other than the life insurance subsidiaries, filed a consolidated Federal income tax return with its parent, Gamble-Skogmo, Inc. Income taxes of Holdings are provided as though Holdings were filing its own consolidated income tax return. Currently payable Federal income taxes, excluding the life insurance subsidiaries, are paid to Gamble. Income taxes are allocated between Holdings and its non-insurance subsidiaries in proportion to the respective contribution to consolidated income or loss. Dividends paid by the subsidiaries are generally not taxable; however, under certain conditions dividends paid by the life insurance subsidiaries would be taxable. Management does not intend to declare any such taxable dividends. Deferred income taxes are provided on elements of income that are recognized for financial reporting purposes either earlier or later than such items are recognized for income tax purposes. For financial reporting purposes, Holdings defers the investment tax credit on leased equipment that it anticipates will be recaptured in future periods. The remaining investment tax credit is treated as a reduction of income tax expense in the year the equipment is placed in service.

SEPARATE ACCOUNT. Assets held and liabilities related to the separate account represent funds held applicable to the Gambles Pension Plan, which is administered by the insurance subsidiary. Income and expenses attributable to the separate account funds are not included in the accompanying consolidated financial statements. Such insurance subsidiary receives administrative fees and annuity considerations from the separate account.

(2) Acquisition of Aristar and Corporate Reorganization

Aristar, Inc. became a 51%-owned subsidiary of Gamble on November 30, 1977 as a result of the conversion by Gamble of $15 million of subordinated convertible notes issued by Aristar, Inc. On January 26, 1979, Aristar, Inc. became a wholly owned subsidiary as a result of the acquisition described in Note 3 of Notes to Consolidated Financial Statements of Gamble-Skogmo, Inc. and consolidated subsidiaries. This acquisition of Aristar, Inc. has been accounted for as a purchase. Accordingly, the accounts of Aristar, Inc. acquired through the purchase have been adjusted to fair value as of the dates of acquisition, November 30, 1977 and January 26, 1979 and the results of their operations have been included in the financial statements since the respective dates of acquisition with appropriate adjustment for minority interests prior to January 26, 1979. The adjustments to reflect the acquisition resulted in a decrease in paid-in surplus of $5,351,000 at January 26, 1979 and an increase to paid-in surplus of $44,493,000 (including capitalization of retained earnings of approximately $41,700,000) at November 30, 1977.

On January 18, 1979, Aristar, Inc. sold, at book value, substantially all of the net receivables relating to its home furnishings subsidiaries to several banks. On January 26, 1979, Aristar, Inc. transferred substantially all of the remaining assets, net of certain liabilities, of these subsidiaries to Gamble at Aristar, Inc.'s historical book value. Substantially all of the results of operations of these subsidiaries were reflected in the consolidated financial statements of Gamble for the year ended January 27, 1979 and, therefore, are not included in the accompanying financial statements.

As of January 27, 1979, Gamble contributed the capital stock of Aristar, Inc. to a newly formed subsidiary, Aristar Holdings, Inc. Additionally, Gamble contributed the capital stock of Gambles C & M Leasing Company, an 80%-owned subsidiary, and Gambles International Leasing Corporation, a wholly owned subsidiary, to Aristar Holdings, Inc. and the capital stock of Gamble Alden Life Insurance Company (GALIC) and Gamble Alden Agency, Inc., wholly owned insurance subsidiaries, to Aristar, Inc. GALIC was subsequently merged with a previously owned insurance subsidiary of Aristar, Inc. to form John Alden Life Insurance Company, Inc. (JALIC). For financial statement purposes, these transactions have been reflected as of January 31, 1979, and the accounts of these subsidiaries have been combined for all periods presented. References made to Holdings throughout the financial statements refer to Aristar Holdings, Inc. References made to Aristar throughout the financial statements refer to Aristar, Inc., a subsidiary of Holdings, which includes the finance, insurance and related management subsidiaries of Aristar, but excludes the leasing subsidiaries of Holdings.

(3) Notes and Contracts Receivable

Notes and contracts receivable and maximum terms of loans made as of January 31 were:

	Notes and Contracts Receivable		Maximum Term (Months)	
	1980	**1979**	**1980**	**1979**
	(Thousands)			
Direct cash loans:				
Precomputed interest	**$313,163**	$244,362	**144**	96
Interest bearing	**80,804**	69,207	**144**	84
Retail contracts	**48,509**	40,651	**48**	36
Total	**$442,476**	$354,220		

The weighted average contractual term of all loans and contracts made during the years ended January 31, 1980 and 1979 were approximately 40 and 34 months, respectively. Experience of Aristar, however, has shown that a majority of direct cash loans and many, although not a majority, of the retail contracts will be renewed prior to contractual maturity dates. During the years ended January 31, 1980 and 1979 cash collections (excluding collection of deferred income) on notes and contracts receivable were $194,849,000 and $162,420,000, respectively and the ratio of cash collections to average balances (net of unearned income) were 60% and 55%, respectively.

(4) Net Investment in Direct Financing Leases

The net investment in direct financing leases held by the leasing subsidiaries consists of amounts due from lessees on such leases over the lease periods as follows:

	Years ended January 31,	
	1980	**1979**
	(Thousands)	
Aggregate future rentals–due in installments	**$10,421**	$17,322
Equipment residual values	**21,231**	26,233
	31,652	43,555
Unearned finance charges	**(1,819)**	(3,243)
Total	**$29,833**	$40,312

Although substantially all lease periods used in deriving the January 31, 1980 and January 31, 1979 net investment in direct financing leases expire within one year, the actual amounts received from leases may vary considerably due to extensions, early terminations and other changes to the equipment on lease. The net investment in direct financing leases at January 31, 1980 and January 31, 1979 included approximately $6,917,000 and $9,269,000, respectively, due from affiliated companies. Equipment under lease agreements with affiliated companies signed after January 1, 1977 is reflected on the January 31, 1980 and January 31, 1979 balance sheets as equipment on operating leases and amounted to approximately $5,300,000 and $3,600,000 net of accumulated depreciation of approximately $1,600,000 and $900,000, respectively. Leasing revenues from affiliated companies for the years ended January 31, 1980 and 1979 aggregated approximately $2,343,000 and $2,311,000, respectively.

(5) Marketable Securities

At January 31, (December 31 for the life insurance subsidiaries) investments in marketable securities were:

	1980			1979		
	Cost	Carrying Value	Quoted Market Value	Cost	Carrying Value	Quoted Market Value
	(Thousands)					
Common stock	**$ 19,915**	**$ 18,185**	**$ 18,185**	$13,615	$12,993	$12,993
Preferred stock	**2,013**	**1,601**	**1,591**	2,118	1,917	1,917
Government obligations	**15,530**	**15,530**	**14,677**	12,584	12,584	11,374
Corporate obligations	**87,041**	**87,041**	**83,471**	29,455	29,455	28,748
Certificates of deposit and other	**16,926**	**16,926**	**16,926**	6,891	6,891	6,891
Bonds of affiliate	**2,174**	**2,174**	**1,562**	1,981	1,981	1,981
Total	**$143,599**	**$141,457**	**$136,412**	$66,644	$65,821	$63,904

At January 31, 1980, the marketable equity securities portfolio included gross unrealized gains of $230,000 and gross unrealized losses of $2,372,000. At March 18, 1980, gross unrealized losses increased to $5,367,000. Management does not foresee or anticipate any circumstances which would require the sale of any marketable equity securities at a significant loss. These investments are in companies that appear to be financially sound with no indication of any difficulties that would permanently impair the value of their stock. Net realized gains included in the determination of net earnings for the years ended January 31, 1980 and 1979 are $1,938,000 and $1,508,000, respectively.

(6) Deferred Charges

Deferred charges, net of amortization, as of January 31 were:

	1980	1979
	(Thousands)	
Long-term debt expense	**$ 3,394**	$ 136
Premiums on purchased accounts	**2,197**	26
Insurance acquisition costs (December 31)	**11,991**	6,637
Unamortized initial direct costs of operating leases	**227**	192
Excess cost of subsidiary over equity	**669**	698
Total	**$18,478**	$7,689

(7) Short Term Debt

As described in Note 9, Aristar executed on January 24, 1980 a five-year term credit facility for an aggregate (U.S.) $60,000,000 with three Canadian banks. Proceeds from this issue were used, in part, to retire the balance of approximately $26,000,000 of notes payable to banks under Aristar's Revolving Credit Agreement dated October 2, 1978. Subsequent to the retirement of these notes payable to banks, the Revolving Credit Agreement was terminated effective January 30, 1980. Coincident with the termination of its Revolving Credit Agreement, Aristar established open lines of credit with various banks for an aggregate of $61,000,000. Such lines of credit were unused at January 31, 1980, and are considered to be available to support outstanding commercial paper.

Borrowings, if any, under such lines of credit provide for interest at the prime lending rate. Additionally, while there are no compensating balance agreements which legally restrict funds, Aristar is expected to and has agreed to maintain average compensating cash balances equal to 10% of each line plus 10% of any loans outstanding under such lines. For the year ended January 31, 1980 average compensating balances maintained, including those maintained under the Revolving Credit Agreement, amounted to $19,000,000 and compensating balances maintained at January 31, 1980 were approximately $6,100,000.

On August 14, 1979, Aristar began selling commercial paper. Since that time outstanding commercial paper has averaged $57,900,000 and at January 31, 1980 amounted to $53,489,000. Proceeds from the above referenced Canadian bank loan were, in part, used to reduce commercial paper outstanding. Original maturities of such paper range up to 270 days. The weighted average remaining term of commercial paper outstanding at January 31, 1980 approximated 23 days.

Additionally, Aristar has borrowed from time to time during the year ended January 31, 1980 from Gamble on a short-term basis. Such borrowings are made available to Aristar by Gamble when it has excess cash available. Interest paid on such borrowings by Aristar is based upon the then current commercial paper rate of Gamble. Maximum borrowings under this arrangement by Aristar at the end of any month during the year was $12,600,000, but no such borrowings were outstanding at January 31, 1980. Average borrowings from Gamble for the year were $3,065,000 and total interest paid Gamble was $385,000. The maximum aggregate short-term debt outstanding, including borrowings under the Revolving Credit Agreement, commercial paper and borrowings from Gamble at the end of any month was $119,496,000 and $109,800,000 during the years ended January 31, 1980 and 1979, respectively. The average aggregate of such debt outstanding for the respective years ended January 31, 1980 and 1979 was $96,431,000 and $85,985,000. Weighted average interest rates on such debt outstanding at January 31, 1980 and 1979, respectively, was 16.4% and 14.4%, respectively. Weighted average interest rates during the years ended January 31, 1980 and 1979 on the average of such debt outstanding was 14.9% and 11.1%, respectively. Such weighted average interest rates are determined based on outstanding principal amounts and exclude costs of maintaining compensating balances.

A leasing subsidiary of Holdings had separate borrowings of $55,439,000 and $56,127,000 at January 31, 1980 and 1979, respectively, under equipment financing obligations with financial subsidiaries of vehicle manufacturers, principally at ½% to 1½% above prime lending rates. Such obligations are payable in installments correlated with rental receipts for collateralized lease equipment and further provide that such subsidiary may not declare or pay any cash dividends. Additionally, at January 31, 1980, the leasing subsidiaries have certain other notes which are payable to affiliates, including Gamble-Skogmo, Inc., totaling $10,741,000 and provide for interest rates of from 10.2% to 14.2%. Total interest expense with respect to affiliated notes was $604,000 and $381,000 for the years ended January 31, 1980 and 1979, respectively. Average total short-term borrowings of the leasing subsidiaries for the years ended January 31, 1980 and 1979 were $64,940,000 and $64,590,000, respectively, and the weighted average interest rates during the respective periods were 11.3% and 8.0%. The weighted average interest rates at January 31, 1980 and 1979 were 13.7% and 10.6%.

During the year ended January 31, 1980, Holdings borrowed separately $13,000,000 from a domestic bank. Such note is payable on demand and provides for an interest rate of 1% above the prime lending rate. Proceeds from this issue were used principally to purchase certain marketable securities from the insurance subsidiaries of Aristar.

(8) Income Taxes

The components of income tax expense, including amounts currently payable to Gamble for companies included in the consolidated return of Gamble, as shown in the accompanying statement of consolidated earnings are as follows:

	Years Ended January 31, 1980	1979
	(Thousands)	
Currently Payable:		
Federal	**$ 2,758**	$ 6,021
Gamble	**3,456**	3,191
State	**453**	35
Foreign	**162**	205
Charge equivalent to tax benefit from utilization of purchased subsidiary's loss carry forward	**—**	56
Deferred	**815**	(2,148)
Total	**$ 7,644**	$ 7,360

Deferred taxes are provided on elements of income that are recognized for financial reporting purposes either earlier or later than such items are recognized for income tax purposes. The elements of income on which deferred taxes are provided, and the related tax effects, are as follows:

	Years Ended January 31, 1980	1979
	(Thousands)	
Depreciation	**$ 45**	$(2,439)
Insurance premiums, acquisition costs and other insurance related items	**1,879**	919
Finance charges	**(171)**	43
Reversal of over accrual of deferred state taxes	**(400)**	—
Other	**(538)**	(671)
Total	**$ 815**	$(2,148)

Income taxes applicable to income before income taxes (pretax income) differ from the amounts determined by multiplying pretax income by the statutory Federal income tax rate of 46% and approximately 48% for the years ended January 31, 1980 and 1979, respectively. A reconciliation between these amounts is as follows:

	Years Ended January 31, 1980	1979
	(Thousands)	
Income taxes at statutory rate	**$11,283**	$10,510
Increase (reduction) in taxes resulting from:		
Insurance subsidiaries:		
Dividends subject to 85% exclusion	**(199)**	(13)
Investment income taxes at capital gains rate	**(135)**	(30)
Income exclusion available under Internal Revenue Code (See Below)	**(2,351)**	(1,478)
State taxes (net of Federal income tax benefit)	**303**	83
Permanent differences arising from income recognition of purchase accounting adjustments	**(342)**	(494)
Benefit arising from utilization of capital loss carry forward	**(264)**	(426)
Benefit from investment tax credit	**(488)**	—
Reversal of over accrual of deferred state taxes	**(400)**	—
Other–net	**237**	(792)
Income tax as shown in accompanying Consolidated Statements of Earnings and Retained Earnings	**$ 7,644**	$ 7,360

Under provisions of the Internal Revenue Code, the life insurance subsidiaries are permitted to exclude from taxable income amounts determined under a formula; at December 31, 1979, the accumulated amount of this untaxed income was approximately $26,200,000. Although such amounts are taxable under certain circumstances, the life insurance subsidiaries do not intend to take, or fail to take, any action that would cause all or part of these amounts to be included in taxable income; accordingly, deferred income taxes have not been provided on these amounts.

The income tax returns of a former life insurance subsidiary of Aristar for the calendar years 1973 and 1974 have been examined. A preliminary Revenue Agent's Report has been issued and indicates a proposed tax deficiency. The company submitted a request for "technical advice" to the National Office of the Internal Revenue Service in connection with one substantial issue. A favorable ruling has been received. Additionally, a formal protest of the proposed deficiency has been filed by Aristar, and, in management's opinion, ultimate liability for any assessment on the remaining issues would not be material.

(9) Long-term Debt

Long-term debt at January 31 was comprised of:

	(Thousands) 1980	1979
Senior debentures:		
5%, due October 15, 1981–discounted $563 and $893, respectively	**$ 12,531**	$ 12,086
9½%, due October 15, 1989–discounted $188 and $569, respectively	**6,771**	20,102
4¾%, due May 15, 1990–discounted $11,292 and $8,665, respectively	**23,708**	15,160
Senior Notes:		
5%, due April 1, 1979–discounted $20	**—**	666
9⅜%, due October 1, 1983 (issued by leasing subsidiary and guaranteed by Gamble-Skogmo, Inc.)	**7,500**	9,500
8¼%, due April 30, 1982 (issued by leasing subsidiary and guaranteed by Gamble-Skogmo, Inc.)	**5,000**	5,000
6⅞%, due December 1, 1987–discounted $850 and $999, respectively	**7,412**	7,986
8½%, due October 1, 1993–discounted $3,107 and $3,364, respectively	**27,140**	28,054
10½% bank notes, due August 3, 1984	**25,000**	—
Bank term-loan, due January 24, 1985, at interest rates varying with London Interbank Offer Rate or domestic prime rate	**60,000**	—
Total Senior Debt–discounted $16,000 and $14,510, respectively	**175,062**	98,554
Senior Subordinated Notes:		
5½%, due April 1,1979–discounted $6	**—**	184
4¾%, due May 1, 1983–discounted $269 and $375, respectively	**2,397**	2,866
7½%, due December 1, 1988–discounted $716 and $824, respectively	**5,282**	5,598
8⅜%, due December 15, 1992–discounted $1,675 and $1,831, respectively	**11,325**	11,691
Total Senior Subordinated Debt–discounted $2,660 and $3,036, respectively	**19,004**	20,339
Junior Subordinated Notes:		
5½%, due June 1, 1981–discounted $84 and $156, respectively	**1,248**	1,832
10¾%, Convertible, due January 15, 1986–discounted $247 and $300, respectively	**4,853**	5,554
10%-15%, Floating Rate, due October 1, 1999	**14,000**	—
Total Junior Subordinated Debt–discounted $331 and $456, respectively	**20,101**	7,386
Subordinated Capital Notes; 10½% due January 1, 1991	**24,945**	—
Total–discounted $18,991 and $18,002, respectively	**$239,112**	$126,279

The long-term debt of Aristar, Inc. was discounted to fair value at dates of acquisition (see Note 10). Such discount is being amortized over the remaining term of the debt. Aggregate maturities and net sinking fund requirements in the five years ending subsequent to January 31, 1980 are:

	Senior Debt	Senior Subordinated Notes	Junior Subordinated Notes	Total
		(Thousands)		
1981	$ 6,663	$2,334	$1,516	$10,513
1982	18,082	2,334	1,516	21,932
1983	10,832	2,334	850	14,016
1984	5,332	2,332	850	8,514
1985	88,832	1,666	850	91,348

Under the provisions of the 9½% Senior Debentures due October 15, 1989, the holders of the debentures were entitled to request advancement of their maturity up to a maximum of $12,500,000. On October 15, 1979, an aggregate of $12,278,000 of such debentures were advanced to maturity pursuant to such provision.

During the year ended January 31, 1980, Aristar placed with the public, through a "best efforts" underwriting, an aggregate of $25,000,000 of 10½% Subordinated Capital Notes due January 1, 1991. These notes provide for the monthly payment of interest, are subordinated in right of payment to all present and future indebtedness of Aristar and do not provide for a sinking fund for the retirement of principal. Proceeds from this issue of approximately $22,600,000, net of commissions and other expenses, were used to reduce notes payable to banks.

During the year ended January 31, 1980, Aristar executed a Senior Note Agreement for a total of $25,000,000 due August 3, 1984 with several domestic banks. The Agreement provides for an annual rate of interest of 10½%, no sinking fund requirement, and the optional prepayment by Aristar after four years. Proceeds from this issue were used to reduce notes payable to banks.

Effective January 24, 1980, a Senior Term Loan Agreement was executed with certain foreign banks. This Agreement provides a credit facility expiring January 24, 1985 for an aggregate (U.S.) $60,000,000. Under the terms of the Agreement, Aristar has the option, from time to time, to borrow either domestic funds at interest rates on a floating basis of 109% of the domestic prime rate or to borrow Eurodollars at interest rates on a floating basis at the average London Interbank Offer Rate (LIBOR) for Eurodollars plus ⅝'s of 1% for the first two years and LIBOR plus ¾'s of 1% for the last three years. This Agreement further provides that Aristar may prepay all or part of the debt after the first two years. In the event that any part of the debt is repaid, the banks would be committed to lend up to the full amount of the facility and any unused commitment would carry a fee of ½ of 1% per annum. No compensating balances are provided by this Agreement. At January 31, 1980, the interest rate at ⅝% over LIBOR was 14¹⁵⁄₁₆%. Proceeds of $60,000,000 from this issue were used to retire the balance of approximately $26,000,000 of notes payable to banks under Aristar's Revolving Credit Agreement (see Note 7), to reduce outstanding commercial paper and for general corporate purposes.

Aristar has offered to the public on a "best efforts" underwriting basis $35,000,000 of Junior Subordinated Notes due October 1, 1999. Such Notes provide for interest at 13% per annum through June 30, 1980 and subsequently on a floating rate basis at ½% above the prime lending rate, with a minimum interest rate of 10% and a maximum of 15%. The Notes provide for quarterly payment of interest, except that monthly interest payments are provided at the option of noteholders of $5,000 or more, and are subordinated in right of payment to all present and future senior indebtedness of Aristar. A sinking fund is not provided for the retirement of principal. Total proceeds, estimated at $32,400,000, assuming all Notes were to be sold and net of commissions and other expenses, will be used to reduce short-term borrowings incurred in the ordinary course of financing activities of Aristar and for general corporate purposes. The Notes were initially offered in January 1980 and as of February 29, 1980 a total of approximately $14,000,000 of such Notes had been sold.

(10) Capital Stock and Surplus

As described in Note 2 of the Notes to Consolidated Financial Statements of Aristar Holdings, Inc. and subsidiaries, on January 26, 1979, the stockholders of Aristar approved the merger of Aristar with a wholly owned subsidiary of Gamble. Under the terms of the merger, holders of Aristar's common stock (other than Gamble) received 10% Gamble Senior Subordinated Sinking Fund Debentures due to 1989, and holders of Aristar's Preferred Stock, Series A and B, received new Gamble senior subordinated installment 5% and 5½% notes due to 1992 and 1996, respectively. Pursuant to the merger the outstanding common and preferred stock was canceled and contributed to Aristar's paid-in surplus, and Gamble became the sole holder of the 1,000 shares of Aristar's common stock exchanged.

During the year ended January 31, 1979, options for Aristar's common stock totaling 53,400 shares were exercised and 6,500 shares were exchanged for cash. No options expired during the period. Prior to the merger, Aristar reached agreement with each holder of the stock options for the disposition of such person's options. Accordingly, at January 31, 1979, there were no stock options outstanding. The holders of Aristar's 10¾% Convertible Subordinated Notes continue to have the right to conversion to Gamble senior subordinated debentures.

Pursuant to the reorganization referred to in Note 2 of the Notes to Consolidated Financial Statements of Aristar Holdings, Inc. and subsidiaries, Gamble transferred the capital stock of certain insurance subsidiaries to Aristar and the capital stock of certain leasing subsidiaries to Holdings. These transfers have been accounted for in a manner similar to that of a "pooling of interests" and, accordingly, paid-in surplus and retained earnings have been retroactively adjusted to reflect these transfers.

The following is a summary of the changes in preferred and common stock and paid-in surplus for the years ended January 31, 1980 and 1979:

	Preferred Stock		Common Stock		Paid-in Surplus	
	1980	**1979**	**1980**	**1979**	**1980**	**1979**
			(Thousands)			
Beginning balance	**$ —**	$9,984	**$1**	$4,726	**$98,597**	$40,168
Preferred stock requirements		1,075				
Preferred stock dividends paid		(2,439)				
Employee stock options exercised				64		114
Adjustments to reflect fair value at date of acquisition–January 26, 1979						(5,351)
Purchase of minority interests						42,706
Transfers of subsidiaries						11,725
Cancellation of stock outstanding		(8,620)		(4,790)		13,410
Cancellation of stock in treasury						(4,175)
Newly issued stock				1		
Recognition of tax effect on fair value adjustments					**(1,659)**	
Utilization of tax benefit carry forwards					**333**	
Ending balance	**$ —**	$ —	**$1**	$ 1	**$97,271**	$98,597

During the year ended January 31, 1980, certain tax effects related to the original fair value acquisition adjustments were recorded. Such tax effects decreased paid-in surplus by $1,659,000, decreased long-term debt discount by $5,524,000, decreased unearned income by $2,560,000 and increased marketable securities by $1,305,000. The effect of recording such adjustments in the current year is not material to the financial statements for any period.

Provisions of certain of Aristar's long-term debt agreements restrict the payment of dividends or redemptions of stock up to a maximum prescribed proportion of cumulative earnings and provide for the maintenance of minimum levels of equity and maximum leverage ratios. At January 31, 1980, an aggregate of approximately $26,600,000 of consolidated Aristar, Inc. retained earnings is available for payment of dividends or redemption of stock. With respect to the life insurance subsidiaries, retained earnings available for distribution as dividends are limited to the statutory unassigned surplus (approximately $24,777,000 at December 31, 1979) as determined in accordance with accounting practices prescribed by state insurance regulatory authorities. The excess of generally accepted accounting principles retained earnings over statutory unassigned surplus, is unavailable for payment of dividends. With respect to Gambles C & M Leasing Company, dividend payments are precluded under provisions of its equipment obligations with finance subsidiaries of automobile manufacturers. Retained earnings of Gambles C & M Leasing Company at January 31, 1980 and 1979 were $5,360,000 and $4,233,000, respectively.

(11) Retirement Plan

Aristar and its subsidiaries, excluding the insurance subsidiaries, have a non-contributory retirement plan covering substantially all of their employees, including certain of the insurance subsidiaries' employees. The insurance and leasing subsidiaries participate in the Gambles Pension Plan. The Gamble pension plan agreement provides for annual contributions based upon the actuarially computed normal cost as defined in the pension plan plus amortization of unfunded supplemental actuarial value over a forty-year period. The policy of Aristar is to fund current statutory requirements. Pension expense for Holdings and subsidiaries for the years ended January 31, 1980 and 1979 was $305,000 and $239,000, respectively. On July 1, 1978, Aristar amended its retirement plan to increase plan benefits. Unfunded costs attributable to the amendment at January 31, 1980 were $1,805,000.

Holdings and all subsidiaries participate in the Gambles Thrift/Sharing and Employee Stock Ownership Plan which provides for annual contributions equal to 25% of contributions made by participating employees plus additional amounts based on earnings of Gamble. Total expense for Holdings and subsidiaries thrift contribution was $429,000 and $62,000 for the years ended January 31, 1980 and 1979, respectively.

Employer contributions to both plans are irrevocable and upon termination of the plans the amounts thereof are not available to the participating companies.

(12) Leases

At January 31, 1980, Holdings and subsidiaries were lessees of office space, principally for loan offices, with terms of three years or less, except for the lease for the offices of the management subsidiary of Aristar which has a term of ten years.

Under operating leases that have initial or remaining noncancelable lease terms in excess of one year, approximate aggregate annual minimum rentals are:

Years Ending January 31,	Gross Rentals	Sublease Income	Net Rentals
		(Thousands)	
1981	$ 2,819	$ 341	$ 2,478
1982	2,459	327	2,132
1983	2,117	327	1,790
1984	1,609	223	1,386
1985	1,014	223	791
Later years	1,984	186	1,798
Total minimum future rentals	$12,002	$1,627	$10,375

Holdings has no material amount of capital leases and there would be an immaterial effect on the financial statements had such leases been capitalized.

Rental expense for the years ended January 31, 1980 and 1979 is summarized as follows:

	1980	1979
	(Thousands)	
Office space	**$2,799**	$2,308
Computer equipment	**1,086**	682
Other (principally office equipment)	**224**	31
Sublease income	**(327)**	(190)
Total	**$3,782**	$2,831

(13) Contingencies

The maximum amount of risk retained by JALIC and its subsidiaries on any one life is $75,000, depending on age and classification of the risk. The excesses are reinsured with other life insurance companies on a yearly renewable term basis. At December 31, 1979, life insurance in force aggregated approximately $1,745,000,000 ($1,724,000,000 at December 31, 1978) after reduction by approximately $136,000,000 ($129,800,000 at December 31, 1978) for reinsurance. Accident and health premiums ceded aggregated approximately $-0- in 1979 and $463,000 in 1978. Reinsurance ceded could become a liability in the event that the reinsurers should be unable to meet the obligations assumed under the reinsurance agreements.

(14) Business Segments

The following table provides information regarding the operations of Holdings and subsidiaries by industry segment for the years ended January 31:

	1980	1979
	(Thousands)	
Revenues		
Consumer finance	**$ 85,870**	$ 69,190
Insurance	**97,540**	54,802
Leasing	**31,738**	17,587
Corporate (principally investment income)	**63**	—
Eliminations*	**(11,345)**	(8,124)
Total	**$203,866**	$133,455
Income before income taxes, preferred stock requirements and minority interests		
Consumer finance	**$ 11,278**	$ 11,826
Insurance	**11,410**	8,162
Leasing	**2,083**	1,997
Corporate expenses (net of revenues)	**(244)**	—
Total	**$ 24,527**	$ 21,985
Identifiable assets		
Consumer finance	**$370,628**	$299,187
Insurance	**204,597**	135,592
Leasing	**108,831**	91,952
Corporate assets	**12,381**	—
Total	**$696,437**	$526,731

*Previously presented amounts had reflected inter-segment eliminations within the respective business segment. Such amounts have been reclassified to conform with current year presentation.

As more fully described in Note 2 of Notes to Consolidated Financial Statements of Aristar Holdings, Inc. and Subsidiaries, Gamble acquired an equity interest in Aristar, Inc. (which has consumer finance and insurance operations) in November 1977. Minority interests in Aristar, Inc. were eliminated in January 1979. The financial service businesses changed their fiscal year in 1979 to January 31 (December 31 for insurance operations). Eliminations consist principally of intercompany insurance commissions and leasing rentals and fees.

The writing of credit insurance coverages is viewed by management as an integral part of the consumer finance business, and revenues and income from such coverages (excluding associated investment income) which originated from loans and contracts written by the consumer finance offices of Aristar are included in the consumer finance segment of business. Amounts previously presented for 1979 reflected all insurance-related revenue and income within that business segment. Revenue and income for 1979 have been restated to reflect the revised grouping of credit insurance. Both revenue and income from consumer finance have been increased $3,186,000 in 1979 with offsetting decreases in insurance revenue and income. The amount represents increased insurance commissions, computed on a retrospective earnings basis, related to credit insurance written by consumer finance offices. Corporate assets consist principally of certain investments in marketable securities of Holdings. Related investment carrying costs, net of related investment income, are included in corporate expenses.

Revenue from insurance includes premium income (and associated investment income) derived from sales of credit-related and other coverages to customers, dealers and other related parties of Gamble and affiliated companies. Such premium income accounted for 15% and 28% of total insurance revenue for the years ended January 31, 1980 and 1979, respectively.

Revenue from leasing includes leasing rentals and fees and related finance charges derived from equipment leased to Gamble and affiliated companies. Such revenues comprised 7% and 13% of total leasing revenue for the years ended January 31, 1980 and 1979, respectively.

(15) Transactions with Affiliates

Aristar's management subsidiary performs certain service functions for the home furnishings subsidiaries of Gamble for which it received fees totaling $690,000 for the year ended January 31, 1980. Additionally, Aristar is reimbursed for any disbursements made on behalf of affiliated companies, including interest attributable to such disbursements. For the year ended January 31, 1980, interest expense reimbursements paid by affiliated companies and included in interest expense totaled $469,000. Additionally, Aristar has borrowed from Gamble, from time to time, on a short-term basis to supplement its other short-term borrowings. Interest expense on such borrowings is computed at the then current commercial paper rate of Gamble and such expense totaled $989,000 for the year ended January 31, 1980.

As described in Note 2, Aristar sold approximately $35,000,000 of net receivables relating to the home furnishings subsidiaries prior to their transfer to Gamble. In connection with the sale of these receivables, Aristar received from the banks which purchased the receivables a service fee in consideration for maintaining and servicing the accounts on behalf of the banks. The receivables not sold to these banks, as well as certain reserves for future performance on the sold receivables, were transferred to Gamble in connection with the reorganization described in Note 2 and the responsibility for servicing these receivables was transferred to a subsidiary of Gamble. By agreement with this subsidiary, Aristar has paid a service fee to this subsidiary in an amount which is considered sufficient to reimburse it for any detrimental effect on net earnings resulting from providing maintenance and collection services on the sold receivables. In the year ended January 31, 1980, Aristar paid in aggregate of $2,482,000 in service fees to this subsidiary and earned $789,000 fees from the banks. The net expense of $1,693,000 was included in general operating expenses for the year. On March 11, 1980, the remaining balance of $3,619,000 of the net receivables sold was repurchased by Aristar from the banks and Aristar intends to sell such receivables to a finance subsidiary of Gamble. This purchase and intended sale will result in no material gain or loss to Aristar. Management believes that such service fees were fair and reasonable under the circumstances and that, after giving effect to the reduction in carrying costs to Aristar related to this portfolio, the net effect on the results of Aristar's operations was not material.

Certain employees of Holdings and its subsidiaries participate in the 1978 Restricted Stock Plan of Gamble, as described in Note 12 of Notes to Consolidated Financial Statements of Gamble-Skogmo, Inc. and Consolidated Subsidiaries. Holdings records as expense during the restricted period the reduction in the purchase price of the stock based on the then cumulative achievement in the performance factor. Such expense recorded for the years ended January 31, 1980 and 1979 was $219,000 and $144,000, respectively.

For other information with respect to transactions between the insurance and leasing subsidiaries and affiliated companies, see Notes 4, 7 and 14 of Notes to Consolidated Financial Statements of Aristar Holdings, Inc. and Subsidiaries.

OFFICERS

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Chairman of the Board and Chief Financial Officer

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Senior Vice President

HERBERT D. FROEMMING
Senior Vice President and Controller

BRUCE F. ANTENBERG
Vice President for Finance

DONALD G. DREBLOW
Vice President for Public Relations

STANLEY J. EDWARDS
Vice President for Distribution

CHARLES H. GAUCK
Vice President, Secretary and General Counsel

DAVID A. HEIDER
Vice President and Assistant to the Chairman

WILLIAM A. HICKEY
Vice President for Personnel

FRANK T. MATTHEWS
Vice President for Real Estate, Store Design and Construction

PAUL P. SENIO
Vice President for Taxation

NORMAN M. STECK
Vice President and Treasurer

LEE G. SWYGMAN
Vice President for Credit

CARLE R. WUNDERLICH
Vice President

RICHARD B. MILLER
Assistant Vice President

JOHN H. STUBSTAD
Assistant Vice President

DANIEL J. McATHIE
Assistant Controller

DENNIS E. McCARDLE
Assistant Controller–Tax Compliance

WILLIAM E. OPPENHEIMER
Assistant Secretary

FOUNDER-HONORARY CHAIRMAN
Bertin C. Gamble, *Retired*

DIRECTORS

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Chairman of the Board and Chief Financial Officer

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President and Chief Executive Officer

ROBERT E. CRAIGHEAD
Senior Vice President

PHILIP B. HARRIS
Retired; Former Chairman and Chief Executive Officer, Northwestern National Bank of Minneapolis

ARTHUR G. JOHNSON
Retired; Former Executive Vice President

ELLSWORTH L. JOHNSON
Chairman, First American Care Facilities, Inc.

WENDA WEEKES MOORE
Chairman, Board of Regents, University of Minnesota

GEORGE S. MOORE
Retired; Former Chairman, Citicorp and Citibank, N.A.

BURR L. ROBBINS
Retired; Former President, General Outdoor Advertising Company, Inc.

MELVIN ROTH
President, Red Owl Stores, Inc.

CARLE R. WUNDERLICH
Vice President; President, Aldens, Inc.

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Wenda Weekes Moore

FINANCE COMMITTEE
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Philip B. Harris
Wayne E. Matschullat
George S. Moore

COMPENSATION COMMITTEE
George S. Moore, Chairman
Philip B. Harris
Arthur G. Johnson

TRANSFER AGENTS

Citibank, N.A.
15th Floor, Tube 20
111 Wall Street
New York, New York 10043

The First National Bank of Chicago
One First National Plaza
Chicago, Illinois 60670

REGISTRARS

The Chase Manhattan Bank, N.A.
One Chase Manhattan Plaza
New York, New York 10015

Continental Illinois National Bank and Trust Company of Chicago
231 South LaSalle Street
Chicago, Illinois 60693

NOTE TRUSTEES

Senior Subordinated Sinking Fund Debentures:
Irving Trust Company
One Wall Street
New York, New York 10015

Subordinated Income Capital Notes:
Northwestern National Bank of St. Paul
55 East Fifth Street
St. Paul, Minnesota 55101

Aristar, Inc. 4¾% Senior Debentures, 5% Senior Debentures and 9½% Senior Debentures:
Irving Trust Company
One Wall Street
New York, New York 10015

Gambles Credit Corporation Senior Notes:
The First National Bank of Chicago
One First National Plaza
Chicago, Illinois 60670

Gambles Credit Corporation Subordinated Notes:
National City Bank of Minneapolis
75 South Fifth Street
Minneapolis, Minnesota 55402

GAMBLE-SKOGMO, INC.
5100 Gamble Drive
Minneapolis, Minnesota 55481

GAMBLE-SKOGMO, INC., MERCHANDISING GROUP

ALDENS
Chicago, IL

Mail order merchandising catalog company.

GAMBLE DEPARTMENT STORES
Chicago, IL

19 conventional department stores operating in medium-size cities.

GAMBLE STORES
Minneapolis, MN

41 company and 852 dealer-owned stores, located in smaller towns selling "do-it-yourself" products.

HOWARD BROS. DISCOUNT STORES
Monroe, LA

95 stores merchandising national brand products at discount prices in 10 Sunbelt states.

JM MCDONALD COMPANY
Hastings, NE

68 stores selling men's, women's and children's apparel and accessories, plus 67 fabric stores, principally in Western and Plains states.

LEATH-MAXWELL HOME FURNISHINGS
Chicago, IL

51 Leath and 76 Maxwell Home Furnishings outlets, located in the Midwest and the Southeast.

WOMAN'S WORLD SHOPS
LaMesa, CA

70 stores featuring branded women's fashion apparel in large and half sizes, located in major metropolitan markets.

MACLEODS
Winnipeg, Manitoba Canada

72 company and 195 dealer-owned hardlines stores in Canada's Western provinces.

MODE O'DAY
Burbank, CA

34 company and 713 dealer-owned stores merchandising women's fashions nationwide and 21 Double Up stores retailing junior fashions in the West.

RASCO STORES
Burbank, CA

80 large variety stores in Western states; 49 Toy World stores in Southern California; 28 Rasco-Tempo general merchandise stores in Northern California and the Midwest.

RED OWL STORES
Hopkins, MN

84 company and 277 dealer-owned food stores located in the Midwest.

SNYDER DRUG STORES
Hopkins, MN

47 company and 85 dealer-owned drug stores located in the Midwest.

STEDMANS
Toronto, Ontario Canada

53 company and 206 dealer-owned stores selling soft lines and variety goods in all Canadian provinces.

GAMBLE-SKOGMO, INC., FINANCIAL SERVICES GROUP • ARISTAR

BLAZER FINANCIAL SERVICES
Coral Gables, FL

312 offices in 23 states offering consumer, investment and home equity loans to individuals and purchasing installment sales contracts from local retail stores.

GAMBLES C & M LEASING COMPANY
Minneapolis, MN

Provides vehicle leasing and management services to corporate fleet clients.

GAMBLES INTERNATIONAL LEASING CORPORATION
Minneapolis, MN

Offers a full range of equipment leasing services, principally to Gamble-Skogmo and its subsidiaries.

JOHN ALDEN INSURANCE COMPANIES
Coral Gables, FL

With over $2 billion of insurance in force, markets life insurance in conjunction with consumer credit purchases; life and accident insurance by direct mail; package plans for small businesses; and single premium deferred annuity contracts.