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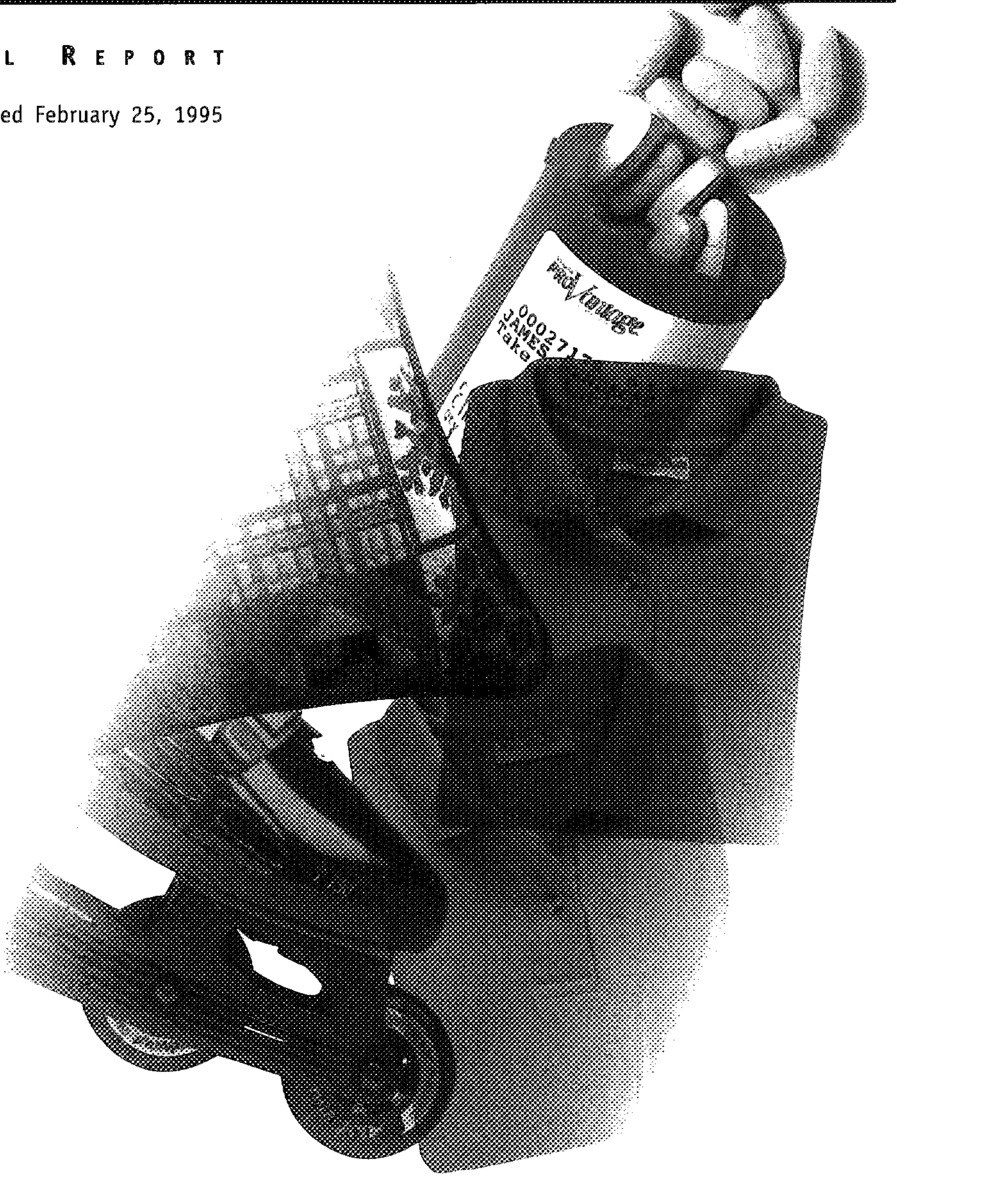
The strategy sound, the progress measurable...
we are solidly positioned to achieve our vision.

1995 Annual Report

Fiscal Year Ended February 25, 1995



ShopKo® STORES INC.

FINANCIAL HIGHLIGHTS
ShopKo Stores, Inc. and Subsidiaries

(Dollars in thousands, except per share data)	Fiscal years ended **February 25, 1995**	Fiscal years ended February 26, 1994
Net Sales	**$1,852,929**	$ 1,738,746
Net Earnings	**37,790**	32,122
Net Earnings Per Common Share	**1.18**	1.00
Dividends Per Common Share	**0.44**	0.44
Shareholders' Equity	**$ 397,275**	$ 373,706
Stores Open at Year End	**124**	117

VISION 2000

THE MISSION OF SHOPKO IS TO BE A "SPECIALTY DISCOUNT RETAILER" THAT IS CONTINUOUSLY COMMITTED TO DIFFERENTIATING OURSELVES TO THE MASS AND MIDDLE AMERICAN FAMILY IN SMALL AND MID-SIZED MARKETS ACROSS SHOPKO, U.S.A.

OUR VISION IS TO OFFER QUALITY MERCHANDISE AND SERVICE TO MEET OUR CUSTOMERS' LIFESTYLE REQUIREMENTS FOR CASUAL APPAREL, HOME, FAMILY AND HEALTH NEEDS WITH STYLE – AT PRICES THAT COMMUNICATE REAL VALUE.

WE WILL BE A TRUE ALTERNATIVE TO NATIONAL DISCOUNT CHAINS AND DEPARTMENT STORES. OUR REGIONAL FOCUS ALLOWS US TO BE FLEXIBLE AND ADAPT TO SERVE OUR CUSTOMERS AND THEIR CHANGING NEEDS.

OUR GOAL IS TO SATISFY EVERY CUSTOMER, EVERY TIME.

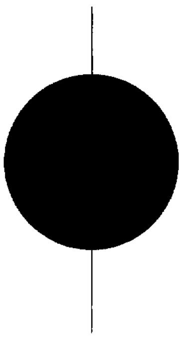
BUSINESS SEGMENT INFORMATION

(In thousands)	Fiscal years ended **February 25, 1995**	Fiscal years ended February 26, 1994
Net Sales		
General Merchandise	**$1,489,919**	$1,411,781
Health Services	**363,010**	326,965
Total Net Sales	**$1,852,929**	$1,738,746
Operating Earnings Before Interest and Income Taxes		
General Merchandise	**$ 67,638**	$ 59,151
Health Services	**36,547**	29,854
Corporate Expenses	**(12,725)**	(14,699)
Income from Operations	**91,460**	74,306
Interest Expense	**(29,042)**	(21,417)
Provision for Income Taxes	**(24,628)**	(20,767)
Net Earnings	**$ 37,790**	$ 32,122

***Net Sales** (in thousands)*

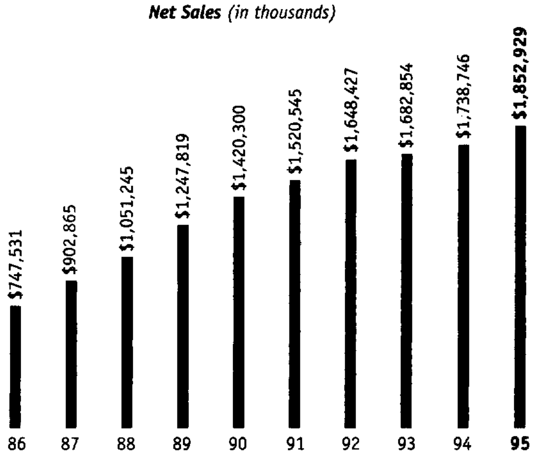
Total $1,852,929

General Merchandise $1,489,919



Health Services $363,010

***Net Sales** (in thousands)*



To our Shareholders:

I am pleased to report that in our sales performance, in our strategic accomplishments and in our progress toward achieving outstanding financial success, we have just completed a very good year.

For the past few years, we have focused our attention, energy and resources on establishing VISION 2000, a comprehensive strategy for achieving dominance in our chosen market niche. Now we are turning the corner: VISION 2000 is no longer a promise, but a reality – and although we are still working on full implementation, there is evidence the payoff has begun.

Sales for fiscal 1995 (year ending February 25, 1995) were $1.85 billion, a 6.6 percent increase over last year's sales of $1.74 billion. Comparable store sales increased by 0.7 percent and net earnings were $37.8 million, compared to $32.1 million in the previous year. This translates to earnings per share of $1.18 compared to $1.00 in fiscal 1994. Although our comparable store sales gains were modest, they were achieved with significantly less clearance sales, and in a year when we scaled back or eliminated several less profitable departments. Moreover, our fourth quarter results showed an even sharper upward turn, yielding earnings per share of $0.59, an 83.6 percent increase over the previous year.

Growth and Achievement

To fully appreciate the significance of these results, we must put them in perspective. It was a very difficult year for retailers: many of our competitors experienced significant declines, with decreases in earnings per share exceeding 50 percent. For ShopKo to realize an 18 percent increase in this environment, and with continued competitive intrusion and aggressive promotional pricing pressure, a powerful factor was working in our favor. That factor was VISION 2000.

Still more evidence that VISION 2000 is working is the recognition that ShopKo is receiving. Our home furnishings division's **Retailer of the Year** award, our Gallup customer service measurements, and a leading consumer publication's survey, rating ShopKo favorably in customer satisfaction, indicate we are satisfying our customers. Customers have also spoken with their pocketbooks, leading to double-digit sales growth in several strategic merchandise categories.

Our success must also be measured by the progress we made in expanding VISION 2000. As promised, last year we opened seven new stores, bringing our total to 124 in 15 states. As promised, we also remodeled 32 stores, bringing 64 percent of our operations into the VISION 2000 format. Our remodeling and related costs will now decrease, opening the door to higher profits.

Another perspective on our success is our Earnings Before Interest, Taxes, Depreciation, and Amortization (EBITDA). VISION 2000 implementation has required substantial capital investment, which tends to blur our performance. By screening out such factors, the EBITDA measure is a valuable indicator of actual earnings power. In fiscal 1995 it was $144.9 million, which represents a record year. Thus, ShopKo has significantly increased its earnings power.

Moving Forward

To strengthen our management team, we have added top caliber professionals like William Podany, our new Executive Vice President. Bill comes to us with more than 16 years of department store experience as a senior merchandising executive for home furnishings, apparel, cosmetics and accessories. His expertise in trend analysis, marketing, buying, vendor partnerships and logistics gives us an enormous advantage as we move closer to our strategic objectives.

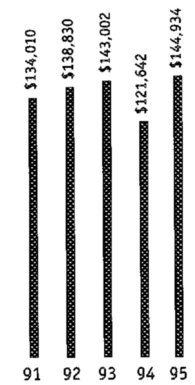
We continue to focus on healthcare, an area of core competency in which we have long been a market leader, and in which there is huge growth potential. This year, for the first time, we have broken out our health segment as a separate component of VISION 2000. Our development of ProVantage™ Health Services, initially a mail service pharmacy, has rapidly expanded to become a prescription benefit management division, allowing us to compete in the managed healthcare arena. This offers us an unparalleled opportunity for growth and profitability.

In short, we have returned to earnings growth. I take great pride in the important accomplishments of our associates. I thank each of them for their tenacious commitment, and their continued confidence in our vision. None of this would have been possible without their contribution to this great team effort. And I thank our shareholders for their patience and loyalty to ShopKo throughout our transition to VISION 2000. Implementation remains on schedule, and we are past the halfway point in the process. We still have much hard work ahead of us, but we have begun to realize the rewards, and can look forward to ever greater rewards in the future.

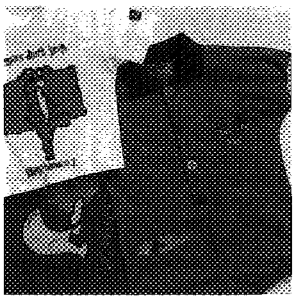
Dale P. Kramer
President and
Chief Executive Officer

Dale P Kramer

Earnings Before Interest, Taxes, Depreciation and Amortization (EBITDA)
(in thousands)

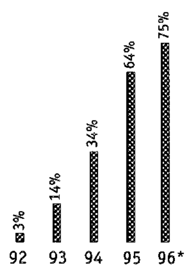


New store openings are festive occasions.



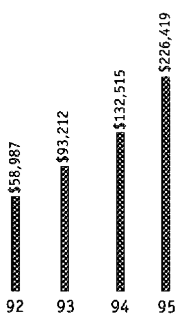
ShopKo is one of the first retailers to carry the popular Winnie the Pooh line of childrens' apparel.

Vision 2000 Rollout



* Based on projections

New Stores Sales
(in thousands)



VISION 2000: A Solid Strategy with Solid Performance

Several years ago we charted a course to ensure continued growth and prosperity for ShopKo well into the future. Today we can say with confidence that our strategy is proving successful.

In the highly competitive retail environment of the 1990s, VISION 2000 differentiates ShopKo by offering a unique shopping experience. We meet the increasing demand for quality, variety and fashion - at prices that provide real value and in a pleasant retail setting. We have defined our niche by establishing a close match between our core competencies and a growing group of consumers: families with more than average education, good taste, busy schedules and keen attention to their budgets. We have improved our own strengths and profit potential in the key focus areas of casual apparel, home, family and health services.

Signs of Success

As a result, we experienced increases in sales and net earnings last year, especially in the merchandise categories our VISION 2000 strategy emphasizes. For example, in remodeled stores we had double-digit increases in infant basics, ladies' accessories, jewelry, intimate apparel, denim fashions and outdoor living. As always, performance in the health services area was stellar. Our solid results were achieved in a year when we scaled back categories that previously contributed over $100 million in sales such as automotive and hardware. These groups were de-emphasized under the VISION 2000 plan. The fact that we increased sales and profits despite the contraction of these categories is particularly convincing proof of the effectiveness of VISION 2000.

A very important element in our strategy to differentiate ShopKo is a strong emphasis on customer service. We believe we now provide a higher level of direct customer service in our stores than any of our competitors. Our Gallup Customer Satisfaction Monitors show consistently strong results: nearly 85 percent of the customers surveyed gave ShopKo top ratings for overall satisfaction. This bears out our belief that VISION 2000 has had a positive impact. In a recent survey by a leading consumer publication we were ranked very favorably in overall customer satisfaction.

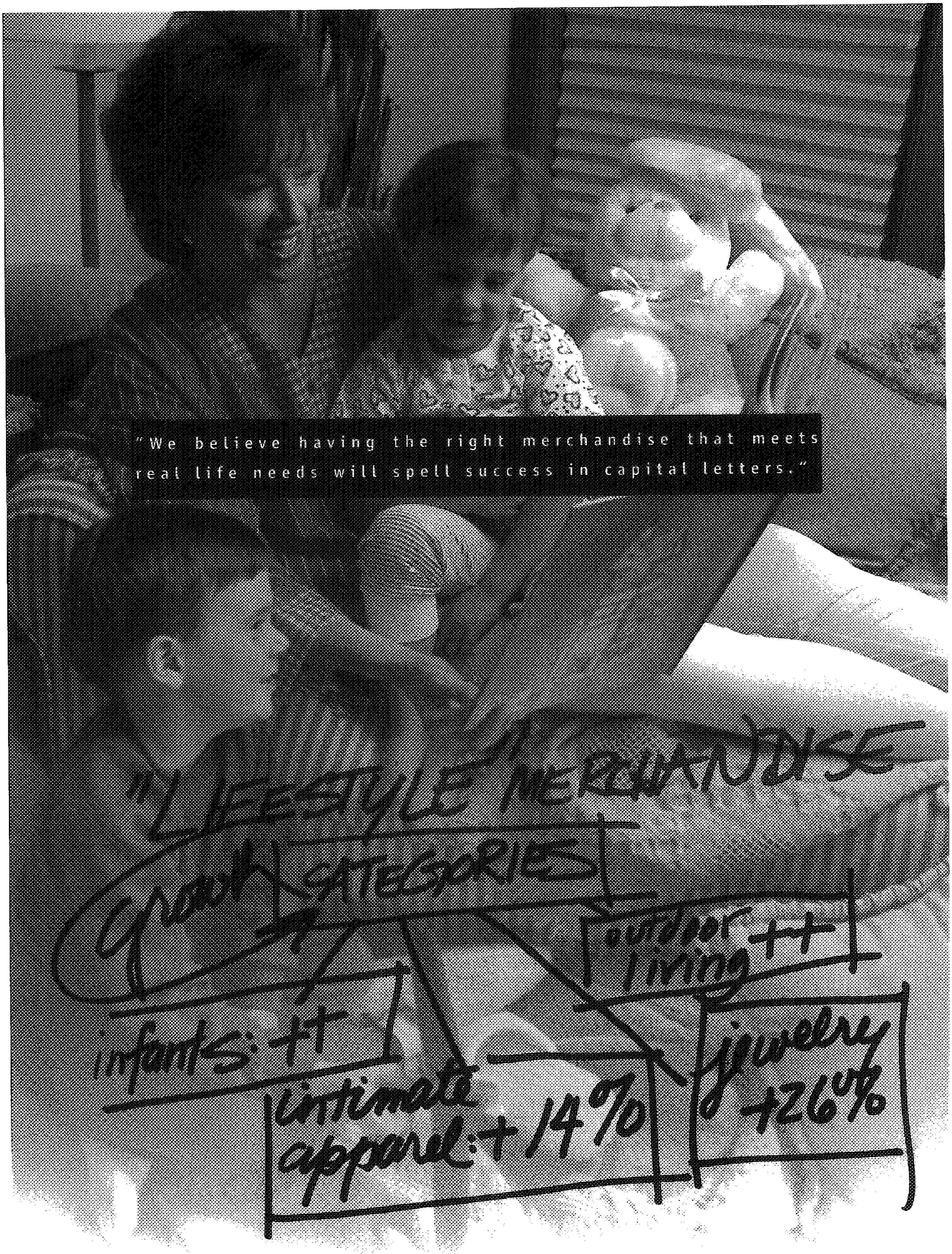
A Strong Foundation

Last year was also a turning point in the development of our infrastructure and information systems. VISION 2000 calls for the strategic centralization of merchandise planning and replenishment. We took a major step in this direction by consolidating our Merchandising and our Planning, Replenishment and Analysis functions into one team, operating in a dynamic partnership that includes our buyers. The result will be more accurate and timely planning, product selection and procurement, pricing and merchandising to meet customer needs by store.

We are committed to leveraging our investment in technology to the greatest extent possible to improve productivity. Several "state-of-the-industry" retail computer systems were installed during the last year to support our strategic centralization initiatives. These systems are expected to significantly improve the company's merchandise planning and inventory control capabilities. Our world-class local area network has been greatly expanded during the last year and now connects over 700 personal computers to deliver timely and useful information as needed throughout the company.

We also continued to implement new systems to increase our efficiency and control expenses. Selling, general and administrative expenses decreased 0.6 percent of sales to 19.2 percent, representing over $10.0 million in improvements. This is particularly meaningful in light of the high cost of operation associated with opening and remodeling a large number of stores. In the long term, such expense control can be translated into even more competitive pricing and improved bottom line profits.

In a difficult and extremely competitive environment, ShopKo has accepted the challenge, determined the necessary changes and is moving steadily forward. We are confident because we know our strengths. We understand the market, have a clearly defined path and have already confirmed the effectiveness of the VISION 2000 strategy in the most convincing language there is: our bottom line.


"We believe having the right merchandise that meets real life needs will spell success in capital letters."
"LIFESTYLE" MERCHANDISE
GROWTH CATEGORIES
outdoor living ++
infants: ++
intimate apparel: +14%
jewelry +26%


Womens
STRATEGY
basics
fashion
more colors
more shapes
related separates
strategic vendor alliances
updated fashion

Merchandise and merchandising are critical components of our VISION 2000 strategy. They make maximum use of several of our core strengths such as the flexibility to respond quickly to evolving consumer tastes. At the same time, they permit us to address the needs of our defined market with precision, providing a new level of customer excitement.

Our strategic focus on the areas of casual apparel, home, family and health services accomplishes several important goals. By meeting the everyday needs of our customers, we give them a good reason to shop in our stores frequently and to visit a variety of departments. To encourage storewide shopping, we have placed a very high priority on offering consistent levels of quality and value across all areas. Our focus on lifestyle basics promotes a high sales volume; and in selecting our product categories we have emphasized those that generate consistent growth.

Knowing the Consumer

Central to the success of VISION 2000 is the merchandise planning and purchasing process. Our philosophy is to understand, monitor and address lifestyle megatrends. Today, for example, American consumers are leading more active, varied lives; as a result, they are dressing far more casually than in the past. In most social and leisure activities, and even in the workplace, they have moved away from formality, preferring comfort and versatility in everyday apparel. Our goal is to meet these basic needs better than anyone else – with emphasis on selection of styles, sizes, colors and choices. This approach has already proven extremely successful for ShopKo in basic and fashion basic categories such as denim, turtlenecks and similar items.

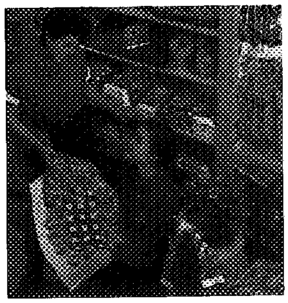
Wide choice, quality brand merchandise and appeal to contemporary tastes are found not only in apparel, but in every ShopKo department. Our home division has helped make us a destination store for home decorating, coordinated tabletop accessories, seasonal and patio furniture, and home holiday items. Customers come to us not only because we have the items they want, but also because we are a source of decorating ideas: our displays help them visualize the merchandise in their own homes. Our strategy has been validated by the industry. We recently received the prestigious **Retailer of the Year** award from the Home Fashion Products Association for our commitment to creatively and aggressively merchandising home textiles.

To remain the leader in this playing field, we are helping all of our buyers become lifestyle experts. With their fingers on the pulse of contemporary America, they are focused on understanding national and regional trends, and on discovering and developing new lifestyle opportunities for ShopKo. A very important resource for them in this effort is the strategic alliance we are building with seasoned vendors who offer great expertise in changing consumer preferences.

Making Our Stores Exciting

In addition to offering the merchandise customers want, we are presenting it with maximum appeal through our approach to merchandising. We display our products so they look great: customers receive an immediate impression of quality, variety, and size and color availability at prices that show real value. To generate immediate interest, a changing display of trend items greets customers as they enter the store. Our merchandise presentation also creates a relaxed, pleasant shopping environment. Departments are easy to locate, making customers feel comfortable and encouraging browsing. Accessories enhance merchandise displays by providing a more complete look. Attentive sales associates are available to answer questions and provide assistance.

We are committed to providing the right merchandise at the right time, offering it in a way that makes customers feel good about shopping in our stores. This strategy not only makes good sense: it is also delivering results.

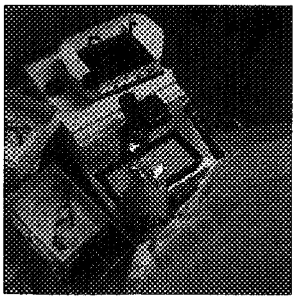


Our customer service received national recognition.

Our emphasis on lifestyles basics keeps consumers coming back.

Coordinated home fashions is a key area in VISION 2000.

"The home textile industry's *Retailer of the Year* award validates a major component of the VISION 2000 strategy."



ShopKo's optical labs provide fast, cost-efficient service.

Prescription benefit management is a major growth area.

ProVantage™ Health Services: Building VISION 2000

Our historical strength in the health services area offers tremendous opportunity for maximizing our growth and earnings potential, and is a key part of our VISION 2000 strategy. As our merchandising strategy distinguishes ShopKo from other retailers, our proven expertise in healthcare clearly differentiates us and serves as a means of market dominance. We have now integrated our retail healthcare departments with additional services that open huge new possibilities.

With a quarter century of experience in the retail pharmacy business, ShopKo pioneered a strategy that has proven enormously successful over time in terms of customer satisfaction and profitability. Professionally operated by pharmacists who regard customers as patients, the ShopKo pharmacies filled 60 percent more prescriptions per day than the average competing national chain drugstore.

In 1978, ShopKo became the first discount retailer to enter the optical business, staffing our optical centers with doctors of optometry and offering eye exams in a professional office setting.

We fabricate eyeglasses in our centralized optical lab or in-store finishing labs, satisfying the demand many customers have for one-hour or same-day optical service. The value, service and professionalism found in these centers set ShopKo apart from the competition, which in smaller markets typically consists of independent optical offices.

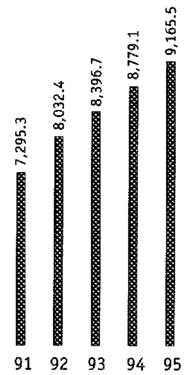
Having filled almost 540,000 eyeglass and contact lens prescriptions last year, ShopKo produces 34 percent more sales per store than the average mass merchant optical retailer.

The Future: Healthcare Cost Management

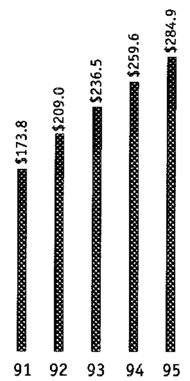
Our newest customers are more than 627,000 individuals represented by corporations, employee groups and insurance companies. We have achieved this through ProVantage™ Health Services, our prescription benefit management division launched in 1993. With initial sales and marketing efforts targeting growth-oriented Midwestern companies, ProVantage™ clients today include Briggs & Stratton, Harley Davidson, Schneider National and American Medical Security, one of the fastest growing insurance companies in the country. Our marketing has expanded to include several states and major metropolitan areas we believe represent the greatest opportunity for growth.

Today, corporations are paying more than 33 percent of escalating healthcare costs in the United States; benefit managers and insurance companies nationwide are seeking managed healthcare options to reduce this significant operating expense. Prescription drug benefits represent the fastest-growing component of these costs, having tripled in the past ten years, and with pharmacies and optical centers in nearly all ShopKo stores, we have expanded our healthcare strategy to capitalize on that demand – not only in ShopKo markets, but across the country. With our existing skills, technology, experience, infrastructure and resources, this strategy positions ShopKo to provide employee groups and insurance companies with prescription benefit plans that substantially reduce prescription costs, ultimately reducing the overall cost of healthcare.

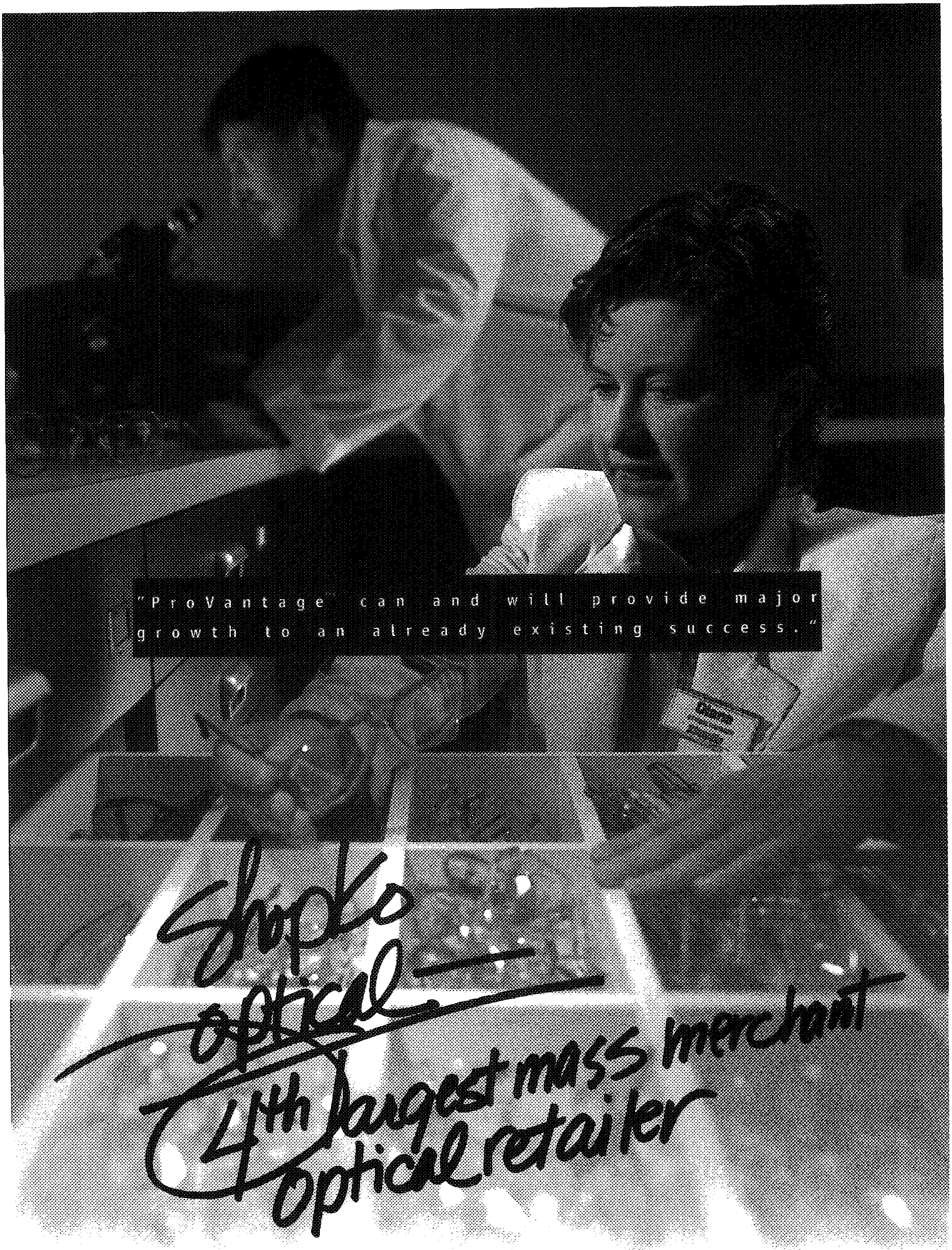
ProVantage™ Health Services
Retail Prescriptions-Optical and Pharmacy
(in thousands)

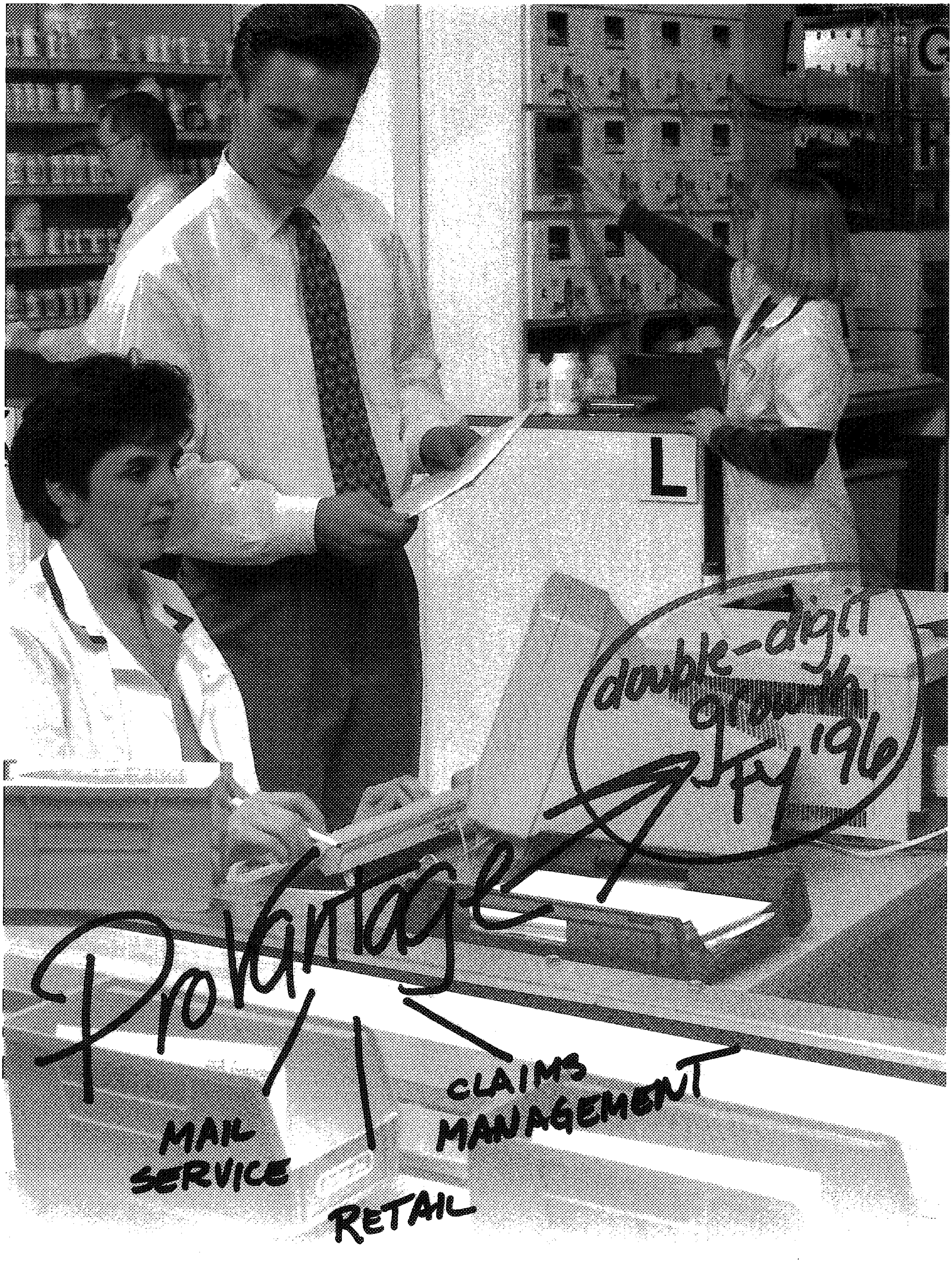


ProVantage™ Health Services
Retail Sales
(in millions)



Optical
Pharmaceutical


"ProVantage can and will provide major growth to an already existing success."
Shopko optical
4th largest mass merchant optical retailer


double-digit growth FY'96
Provantage
MAIL SERVICE
RETAIL
CLAIMS MANAGEMENT

Growing Momentum

Enrollment in managed healthcare programs is expanding dramatically, and pharmacy benefits are increasingly part of the package. Twenty-five percent of all prescriptions are now dispensed with the participation of prescription benefit managers (PBMs) working to control pharmacy costs for their corporate clients. By supervising decisions regarding which drugs are dispensed and whether they are dispensed by retail or mail-service pharmacies, PBMs are becoming more and more influential in the pharmacy market.

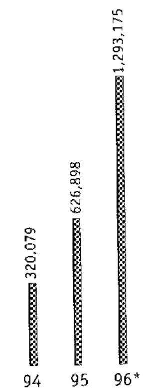
ShopKo's January 1995 acquisition of a national claims processor, Bravell, firmly established ProVantage™ Health Services as a PBM. Now ProVantage™ can offer its corporate customers custom prescription benefit plan design, a network of approximately 40,000 retail pharmacies, program administration, and claims and benefit processing. With this expanded network of pharmacies, ProVantage™ is able to provide prescription coverage to individuals living in virtually every city in America with a population greater than 5,000.

A key component of ProVantage™ Health Services' prescription benefit management is the establishment of a formulary: by encouraging generic substitutions whenever possible, and providing incentives and disincentives that persuade patients to utilize medications that are most effective therapeutically or economically, a formulary can maximize therapeutic outcomes and control costs.

The future for ProVantage™ lies in managing the overall costs of patients' healthcare with the help of an integrated patient information database. As we prepare to enter the 21st century, successfully tracking patient prescription usage and medical outcomes will lead to fewer trips to emergency rooms and physicians. We are now collecting the data that will lead to the development of clinical programs based on treatment effectiveness and outcomes analysis.

The seamless integration of retail optical centers, pharmacies, mail service pharmacy and pharmacy claims processing positions ShopKo and ProVantage™ Health Services to take advantage of the explosive growth predicted for the managed healthcare industry. Next year alone, we are likely to see a double-digit increase in health services sales, and we expect dramatic expansion to follow. The health services foundation ShopKo has built over the past quarter century thus promises significant opportunity for the future.

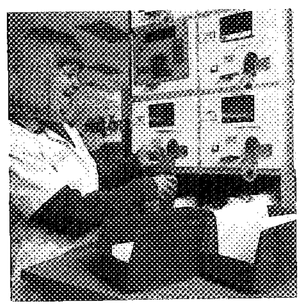
ProVantage™ Health Services
Number of Lives Under Contract



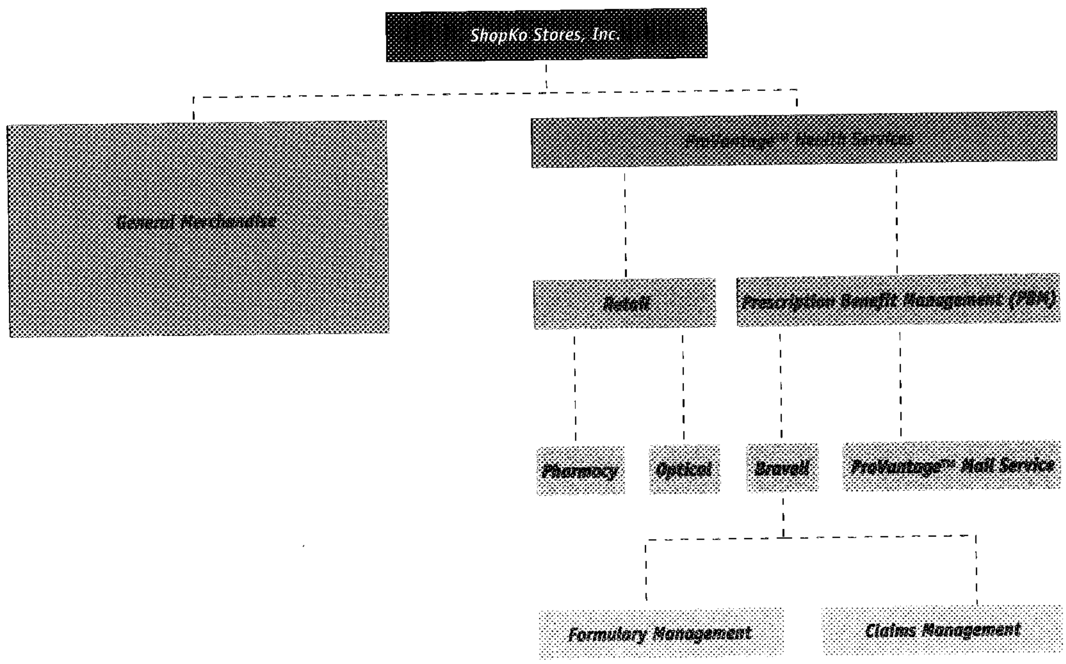
*Based on projections

Patient consultation sets ShopKo pharmacies apart.

ShopKo's healthcare department offers convenience, choice and value.



ShopKo provides prescription coverage coast to coast.



ShopKo Stores, Inc. and Subsidiaries

RESULTS OF OPERATIONS

The following table sets forth items from the Company's Consolidated Statements of Earnings as a percentage of net sales:

	Fiscal years ended		
	Feb. 25, 1995 (52 Wks.)	Feb. 26, 1994 (52 Wks.)	Feb. 27, 1993 (52 Wks.)
Revenues:			
Net sales	**100.0%**	100.0%	100.0%
Licensed department rentals and other income	**.7**	.7	.7
	100.7	100.7	100.7
Costs and expenses:			
Cost of sales	**73.7**	73.9	72.8
Selling, general and administrative expenses	**19.2**	19.8	19.4
Depreciation and amortization expenses	**2.9**	2.8	2.6
	95.8	96.5	94.8
Income from operations	**4.9**	4.2	5.9
Interest expense	**1.6**	1.2	1.1
Earnings before income taxes	**3.3**	3.0	4.8
Provision for income taxes	**1.3**	1.2	1.8
Net earnings	**2.0%**	1.8%	3.0%

Depreciation and amortization expenses, which previously were a component of cost of sales and selling, general and administrative expenses, have been reclassified as a separate expense line item for all periods presented.

Fiscal 1995 Compared to Fiscal 1994

In fiscal 1995, the Company elected to report segment information about its operations in the general merchandise and health services businesses for all periods presented. General merchandise is conducted through retail stores. Health services include professional health care services provided in the retail stores and prescription benefit management services, pharmacy mail service and claims processing activities, which are generally provided through other facilities.

Net sales for fiscal 1995 (52 weeks) increased $114.2 million or 6.6% over fiscal 1994 (52 weeks). The Company opened seven new stores and remodeled 32 stores in fiscal 1995. Comparable store sales increased 0.7% for fiscal 1995 compared to 1.2% in fiscal 1994. Comparable store sales increases for a fiscal year are based upon those stores which were open for the entire preceding fiscal year.

General merchandise sales increased $78.1 million or 5.5% over fiscal 1994. Management attributes this sales increase to the opening of seven new stores. Comparable store general merchandise sales decreased 0.2%. Management believes general merchandise sales were negatively impacted by increased competition, reduced clearance sales this year compared to last year, the planned contraction of several departments and the disruption caused by the remodeling of 32 stores during fiscal 1995.

Health services sales increased $36.1 million or 11.0% over fiscal 1994. Management attributes this increase to increases in comparable store sales, expansion into claims processing activities, growth of the pharmacy mail service and the opening of seven new stores. Health services comparable store sales increased 4.5%, which is due to increased business in the Company's retail pharmacy and optical centers. Health services comparable store sales increases for a fiscal year are based upon sales generated from health care services provided in those retail stores which were open for the entire preceding fiscal year. Sales from prescription benefit management services, pharmacy mail service and claims processing activities are not included.

Gross margins as percentages of sales were 26.3% and 26.1% for fiscal 1995 and 1994, respectively. The gross margin for fiscal 1995 includes a LIFO credit of $2.0 million and a $5.5 million charge to reduce certain inventories to market value. The gross margin for fiscal 1994 includes a LIFO charge of $3.7 million. Gross margin, before LIFO expense, was 26.2% in fiscal 1995 as compared to 26.3% in fiscal 1994.

Selling, general and administrative expenses decreased 0.6% of net sales to 19.2% compared with 19.8% in fiscal 1994. The percentage decrease is primarily due to expense control initiatives, which were partially offset by increased costs associated with the operation of seven new stores and 32 store remodels during fiscal 1995.

Depreciation and amortization expenses as percentages of sales were 2.9% and 2.8% for fiscal 1995 and 1994, respectively. The increase is primarily due to the opening of new stores and the remodeling of existing stores to the Vision 2000 format.

The Company's operating earnings (earnings before interest and income taxes) increased 23.1% to $91.5 million in fiscal 1995 from $74.3 million in fiscal 1994. General merchandise operating earnings (earnings before corporate expenses, interest and income taxes) increased 14.3% to $67.6 million in fiscal 1995 compared to $59.2 million in fiscal 1994. This increase is primarily due to expense control initiatives. Health services operating earnings increased 22.4% in fiscal 1995 to $36.5 million compared to $29.9 million in fiscal 1994. This increase is primarily due to increased sales and increased gross margin percentage.

Interest expense in fiscal 1995 increased from the prior year by 0.4% of net sales to 1.6% of net sales. The increase is primarily due to long-term borrowing which principally funded new stores, the Company's remodeling program and additional related working capital.

The effective tax rate for fiscal 1995 was 39.4% as compared to 39.3% for fiscal 1994.

Fiscal 1994 Compared to Fiscal 1993

Net sales for fiscal 1994 increased $55.9 million, or 3.3%, over fiscal 1993. The Company opened eight new stores in fiscal 1994 (including two relocated stores). Comparable store sales increased 1.2% for fiscal 1994 compared to 1.5% in fiscal 1993.

General merchandise sales increased $26.5 million or 1.9% over fiscal 1993. Management attributes this sales increase to the opening of six additional stores. Comparable store general merchandise sales decreased 0.4%. Management believes general merchandise sales were negatively impacted by unfavorable economic conditions, increased competition, lower consumer confidence and unseasonable spring weather.

Health services sales increased $29.4 million or 9.9% over fiscal 1993. Management attributes this increase to increases in comparable store sales and the opening of six additional stores. Health services comparable store sales increased 8.6%. This is primarily due to increased business in the Company's retail pharmacy and optical centers.

Gross margins as percentages of sales were 26.1% and 27.2% for fiscal 1994 and 1993, respectively. Pre-tax LIFO expense was $3.7 million for fiscal 1994 as compared to $1.8 million for fiscal 1993. Gross margin, before LIFO expense, was 26.3% in fiscal 1994 as compared to 27.3% in fiscal 1993. The Company attributes the decrease in gross margin percent to the continuation of competitive pricing pressure in the discount marketplace, increased promotional activity and lower than expected sales in various apparel and seasonal categories.

Selling, general and administrative expenses increased 0.4% of net sales to 19.8% compared with 19.4% in fiscal 1993. The percentage increase is due to low comparable sales growth, increased costs related to the Company's new stores, remodeling programs and continued investment in centralizing certain merchandise and replenishment functions.

Depreciation and amortization expenses as percentages of sales were 2.8% and 2.6% for fiscal 1994 and 1993, respectively. The increase is primarily due to the opening of new stores and the remodeling of existing stores to the Vision 2000 format.

The Company's operating earnings (earnings before interest and income taxes) decreased 25.5% to $74.3 million in fiscal 1994 from $99.7 million in fiscal 1993. General merchandise operating earnings (earnings before corporate expenses, interest and income taxes) decreased 28.7% to $59.2 million in fiscal 1994 from $82.9 million in fiscal 1993. This decrease is primarily due to the decrease in gross margin percentage. Health services operating earnings increased 3.5% to $29.9 million in fiscal 1994 compared to $28.9 million in fiscal 1993. This increase is primarily due to increased sales which were partially offset by higher selling, general and administrative expenses.

Interest expense in fiscal 1994 increased from the prior year by 0.1% of net sales to 1.2% of net sales. The increase is primarily due to increased borrowings, partially offset by lower long-term borrowing rates.

The effective tax rate for fiscal 1994 increased to 39.3% as compared to 38.5% for fiscal 1993. The increase is the result of the passage of the Omnibus Budget Reconciliation Act of 1993. Accordingly, the Company recorded additional tax expense of $0.8 million or $0.03 per share.

Accounting Changes

In fiscal 1994, the Company adopted Statement of Financial Accounting Standards ("SFAS") No. 106, "Employers' Accounting for Postretirement Benefits Other than Pensions" and SFAS No. 109, "Accounting for Income Taxes."

SFAS No. 106 requires the Company to accrue the estimated cost of retiree benefits, other than pensions, during employees' credited service period. The Company elected to immediately recognize the accumulated postretirement benefit obligation, resulting in a charge to earnings of $0.6 million or $0.02 per share.

SFAS No. 109, which requires the Company to use the liability method of computing deferred income taxes, had no effect on reported net earnings.

LIQUIDITY AND CAPITAL RESOURCES

The Company relies on cash generated from its operations, with the remaining needs being met from short-term and long-term borrowings. Cash provided from net earnings before depreciation and amortization was $91.3 million, $79.5 million and $93.3 million in fiscal years 1995, 1994 and 1993, respectively. The Company's principal uses of cash are for increases in working capital and capital expenditures.

Working capital increased to $187.3 million at the end of fiscal 1995 from $118.8 million at the end of fiscal 1994 and $81.8 million at the end of fiscal 1993. The increase in working capital in fiscal 1995 resulted principally from increases in inventory as a result of additional inventory in basic categories and the opening of new stores.

On November 9, 1994, the Company issued $100 million 9.0% senior unsecured notes due November 15, 2004. The net proceeds of $98.9 million, after underwriting and issuance costs, were used to reduce the Company's short-term borrowings and to provide for working capital needs and other general corporate purposes.

On October 4, 1993, the Company replaced its $107.5 million revolving credit agreement with a $175.0 million revolving line of credit. This credit agreement is with a consortium of banks, is unsecured and has a term of three years, subject to an extension for an additional year. As of

February 25, 1995, the Company had $15.0 million outstanding under the revolving credit agreement. The weighted average interest rate on borrowings under the revolving credit agreement for fiscal 1995 was 4.8%.

On August 25, 1993, the Company issued $100 million 6.5% senior unsecured notes due August 15, 2003. The net proceeds of $98.7 million, after underwriting and issuance costs, were used to reduce the Company's short-term borrowings and to provide for working capital needs and other general corporate purposes.

Capital Expenditures

The Company spent $94.6 million on capital expenditures in fiscal 1995, compared to $133.8 million in fiscal 1994 and $91.1 million in fiscal 1993. The following table sets forth the components of the Company's capital expenditures (in millions):

	Fiscal Year		
	1995	1994	1993
New stores	**$ 31.3**	$ 82.4	$ 32.9
Remodeling and refixturing	**45.2**	29.4	24.7
Distribution centers	**2.8**	0.7	21.9
Management information and point-of-sale equipment and systems	**14.8**	20.1	10.5
Other	**0.5**	1.2	1.1
Total	**$ 94.6**	$ 133.8	$ 91.1

A portion of capital expenditures (such as land, site preparation and building construction) is made for new stores in one or more fiscal years prior to their opening. The fiscal year in which such expenditures occur varies depending on the timing of the store opening.

The Company opened seven new stores and remodeled 32 stores in fiscal 1995. Present plans are to open five new stores and remodel 13 stores in fiscal 1996. New store and remodeling plans for fiscal 1997 are under review. Furthermore, the Company may consider the acquisition of existing stores (either at single sites or in groups as part of an existing business) which may be in addition to the new store openings in fiscal 1996 and which may replace, in whole or in part, new store construction in years after fiscal 1996. The Company's plans with respect to store openings and remodeling may be reviewed and revised from time to time in light of changing conditions. In certain instances, the Company's ability to proceed with projects is subject to successful negotiation of site acquisitions or leases and the availability of financing, and the timing of projects is subject to normal construction and other delays. Thus, it is possible that not all of the projects described above will be commenced and that other projects will be added. The Company's total capital expenditures for new stores, remodels and management information systems is not anticipated to exceed $80.0 million in fiscal 1996.

In comparison to periods of slower expansion, accelerated expansion increases certain of the Company's expenses, particularly pre-opening costs, depreciation and interest expense. The relative increase in these expenses as a percentage of sales is also impacted by the delay between the incurrence of the expenses and the realization of expected sales growth due to such expenditures.

In addition to the above capital expenditures, the Company acquired 97% of the outstanding common stock of Bravell, Inc. for approximately $17.3 million. The Company may be required to make additional payments of up to $13.0 million, contingent upon future results of Bravell's operations. The acquisition, which was completed on January 3, 1995, was accounted for as a purchase. Bravell is a pharmacy benefit management firm that provides custom prescription benefit plan design, program administration and claims and benefit processing services to insurance companies and self-funded medical plan sponsors. The results of Bravell's operations since the date of acquisition have been included in the fiscal 1995 consolidated statements of earnings.

The existing $175 million revolving credit agreement and funds generated from operations are expected to be sufficient to fund the projected total capital expenditure and working capital needs through fiscal 1996. However, if the Company were to make a large acquisition of multiple stores or a health care business, additional financing may be required.

Inflation

Inflation has not had a significant effect on the results of operations of the Company or its internal and external sources of liquidity.

Eight Year Financial Summary

ShopKo Stores, Inc. and Subsidiaries

	Fiscal years ended							
	Feb. 25, 1995 (52 Weeks)	Feb.26, 1994(1) (52 Weeks)	Feb. 27, 1993 (52 Weeks)	Feb. 29, 1992 (53 Weeks)	Feb. 23, 1991 (52 Weeks)	Feb. 24, 1990(2) (52 Weeks)	Feb. 25, 1989 (52 Weeks)	Feb. 27, 1988 (52 Weeks)
Summary of Operations (Millions) (7)								
Net sales	**$ 1,853**	$ 1,739	$ 1,683	$ 1,648	$ 1,521	$ 1,420	$ 1,248	$ 1,051
Licensed department rentals and other income	**12**	12	11	11	12	11	10	9
Gross margin	**488**	453	457	452	417	396	360	298
Selling, general and administrative expenses	**356**	344	326	325	296	282	262	221
Depreciation and amortization expenses	**53**	47	43	40	39	35	31	25
Interest expense	**29**	21	18	17	21	20	16	13
Earnings before income taxes	**62**	53	81	81	73	70	61	48
Net earnings	**38**	32	50	50	45	43	37	27
Per Share Data (Dollars)								
Net earnings per common share	**$ 1.18**	$ 1.00	$ 1.56	$ 1.55(3)	$ 1.41(3)	$ 1.33(3)	$ 1.15(3)	$ 0.85(3)
Cash dividends declared per common share (4)	**0.44**	0.44	0.44	0.11				
Financial Data (Millions)								
Working capital	**$ 187**	$ 119	$ 82	$ 79	$ 70	$ 59	$ 57	$ 37
Property and equipment-net	**618**	578	493	445	432	412	369	313
Total assets	**1,110**	953	792	706	692	648	576	485
Total debt (5)	**429**	337	225	193	215	237	231	193
Total shareholders' equity	**397**	374	355	320	273	228	186	149
Capital expenditures	**95**	134	91	53	59	80	91	88
Financial Ratios								
Current ratio	**1.7**	1.5	1.4	1.4	1.4	1.3	1.4	1.3
Return on beginning assets	**4.0%**	4.1%	7.1%	7.2%	7.0%	7.4%	7.6%	6.9%
Return on beginning shareholders' equity	**10.1%**	9.0%	15.7%	18.1%	19.7%	22.9%	24.8%	22.3%
Total debt as % of total capitalization (6)	**50.9%**	46.2%	37.9%	36.7%	42.8%	50.0%	53.9%	54.9%
Other Year End Data								
Stores open at year end	**124**	117	111	109	104	98	87	75
Average store size-square feet	**90,260**	90,440	89,500	87,400	87,200	87,000	85,900	84,700

(1) The effect of adopting Statement of Financial Accounting Standards ("SFAS") No. 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions," resulted in a decrease in net earnings of $0.6 million ($0.02 per share). Adoption of SFAS No. 109, "Accounting for Income Taxes," had no effect on reported net earnings or financial position.

(2) Includes the effect of a change in the method of accounting for LIFO inventories which increased net earnings by $3.0 million.

(3) The number of common shares used in the computation is the total number of shares of the Company's Common Stock outstanding upon completion of the initial public offering.

(4) First quarterly dividend was declared in the fourth quarter of fiscal 1992.

(5) Total debt includes short-term debt, current portion of long-term obligations, long-term obligations and payable to related party.

(6) Total capitalization includes shareholders' equity, total debt and non-current deferred income taxes.

(7) Depreciation and amortization expenses, which previously were a component of cost of sales and selling, general and administrative expenses, have been reclassified as a separate expense line item for all periods presented.

Consolidated Statements of Earnings

ShopKo Stores, Inc. and Subsidiaries

(In thousands, except per share data)	**February 25, 1995 (52 Weeks)**	February 26, 1994 (52 Weeks)	February 27, 1993 (52 Weeks)
	Fiscal years ended		
Revenues:			
Net sales	**$1,852,929**	$1,738,746	$1,682,854
Licensed department rentals and other income	**12,433**	11,509	11,174
	1,865,362	1,750,255	1,694,028
Costs and expenses:			
Cost of sales	**1,364,913**	1,285,232	1,225,248
Selling, general and administrative expenses	**355,515**	343,381	325,778
Depreciation and amortization expenses	**53,474**	47,336	43,275
	1,773,902	1,675,949	1,594,301
Income from operations	**91,460**	74,306	99,727
Interest expense	**29,042**	21,417	18,274
Earnings before income taxes	**62,418**	52,889	81,453
Provision for income taxes	**24,628**	20,767	31,394
Net earnings	**$ 37,790**	$ 32,122	$ 50,059
Net earnings per common share	**$ 1.18**	$ 1.00	$ 1.56
Weighted average number of common shares outstanding	**32,014**	32,001	32,000

See notes to consolidated financial statements.

CONSOLIDATED BALANCE SHEETS

ShopKo Stores, Inc. and Subsidiaries

(In thousands)	**February 25, 1995**	February 26, 1994
Assets		
Current assets:		
Cash and cash equivalents	**$ 12,598**	$ 2,570
Receivables, less allowance for losses of $3,590 and $2,133, respectively	**42,067**	30,324
Merchandise inventories	**400,623**	328,854
Other current assets	**13,456**	8,759
Total current assets	**468,744**	370,507
Other assets and deferred charges	**22,943**	4,361
Property and equipment – net	**618,064**	578,181
Total assets	**$1,109,751**	$ 953,049

Liabilities and Shareholders' Equity		
Current liabilities:		
Short-term debt	**$ 15,000**	$ 26,200
Accounts payable – trade	**149,293**	147,152
Accrued compensation and related taxes	**24,612**	21,851
Accrued other liabilities	**61,858**	42,812
Accrued income and other taxes	**29,955**	12,849
Current portion of long-term obligations	**755**	879
Total current liabilities	**281,473**	251,743
Long-term obligations	**413,580**	309,604
Deferred income taxes	**17,423**	17,996
Shareholders' equity:		
Preferred stock; none outstanding		
Common stock; Shares outstanding, 32,005 in 1995 and 32,016 in 1994	**320**	320
Additional paid-in capital	**242,843**	242,978
Retained earnings	**154,112**	130,408
Total shareholders' equity	**397,275**	373,706
Total liabilities and shareholders' equity	**$1,109,751**	$ 953,049

See notes to consolidated financial statements.

Consolidated Statements of Cash Flows

ShopKo Stores, Inc. and Subsidiaries

(In thousands)	Fiscal years ended February 25, 1995 (52 Weeks)	February 26, 1994 (52 Weeks)	February 27, 1993 (52 Weeks)
Cash flows from operating activities:			
Net earnings	**$ 37,790**	$ 32,122	$ 50,059
Adjustments to reconcile net earnings to net cash provided by operating activities:			
Depreciation and amortization	**53,474**	47,336	43,275
Provision for losses on receivables	**287**	63	143
Loss (gain) on the sale of property and equipment	**421**	(1,410)	(240)
Deferred income taxes	**(3,764)**	5,995	(68)
Change in assets and liabilities:			
Receivables	**(5,611)**	(9,317)	(3,926)
Merchandise inventories	**(71,769)**	(65,521)	(30,122)
Other current assets	**(1,504)**	(397)	(1,213)
Other assets	**(2,059)**	(1,025)	(558)
Accounts payable	**2,142**	21,369	9,258
Accrued liabilities	**31,486**	4,590	8,649
Net cash provided by operating activities	**40,893**	33,805	75,257
Cash flows from investing activities:			
Payments for property and equipment	**(94,600)**	(133,842)	(91,060)
Proceeds from the sale of property and equipment	**6,982**	4,644	408
Business acquisition, net of cash acquired	**(15,885)**		
Net cash (used in) investing activities	**(103,503)**	(129,198)	(90,652)
Cash flows from financing activities:			
Net proceeds from long-term obligations	**98,939**	98,714	197,112
Change in short-term debt	**(11,200)**	11,175	15,025
Change in common stock	**(135)**	185	
Dividends paid	**(14,087)**	(14,080)	(14,080)
Reduction in capital lease obligations	**(879)**	(823)	(784)
Payments to related party			(181,167)
Net cash provided by financing activities	**72,638**	95,171	16,106
Net increase (decrease) in cash and cash equivalents	**10,028**	(222)	711
Cash and cash equivalents at beginning of year	**2,570**	2,792	2,081
Cash and cash equivalents at end of year	**$ 12,598**	$ 2,570	$ 2,792
Supplemental cash flow information:			
Noncash investing and financial activities –			
Capital lease obligations incurred	**$ 4,992**	$ 1,769	$ —
Cash paid during the period for:			
Interest	**$ 27,734**	$ 23,248	$ 15,642
Income taxes	**$ 12,910**	$ 15,467	$ 31,879

See notes to consolidated financial statements.

Consolidated Statements of Shareholders' Equity

ShopKo Stores, Inc. and Subsidiaries

(In thousands, except per share data)	Common Stock Shares	Common Stock Amount	Additional Paid-in Capital	Retained Earnings
Balances at February 29, 1992	32,000	$ 320	$ 242,793	$ 76,388
Net earnings				50,059
Cash dividends declared on common stock - $0.44 per share				(14,080)
Balances at February 27, 1993	32,000	320	242,793	112,367
Net earnings				32,122
Issuance of common stock	16		185	
Cash dividends declared on common stock - $0.44 per share				(14,081)
Balances at February 26, 1994	32,016	320	242,978	130,408
Net earnings				37,790
Cancellation of common stock	(16)		(185)	
Issuance of common stock	5		50	
Cash dividends declared on common stock - $0.44 per share				(14,086)
Balances at February 25, 1995	32,005	$ 320	$ 242,843	$ 154,112

See notes to consolidated financial statements.

ShopKo Stores, Inc. and Subsidiaries

A. Summary of Significant Accounting Policies

Organization and Basis of Presentation:

The consolidated financial statements include the accounts of ShopKo Stores, Inc. and all its subsidiaries ("ShopKo" or the "Company"). All significant intercompany accounts and transactions have been eliminated. The Company, which is a Minnesota corporation, was incorporated in 1961. On October 16, 1991, the Company sold 17,250,000 common shares or 54% of equity ownership in an initial public offering. Prior to completion of the offering, the Company was a wholly owned subsidiary of Supermarket Operators of America, Inc., ("SOA") which, in turn, is wholly owned by SUPERVALU INC. ("SUPERVALU"). As of February 25, 1995, 46% of the Company's common stock was owned by SUPERVALU.

Accounting and Reporting Changes:

In fiscal 1994, the Company adopted Statement of Financial Accounting Standards ("SFAS") No. 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions" and SFAS No. 109, "Accounting for Income Taxes." See Notes E and G.

In fiscal 1995, the Company elected to report segment information about its operations in the general merchandise and health services businesses. See Note K.

Cash and Cash Equivalents:

The Company records all highly liquid investments with a maturity of three months or less as cash equivalents.

Receivables:

Receivables consist of amounts collectible from merchandise vendors for promotional and advertising allowances, from third party pharmacy insurance carriers, from drug manufacturers for formulary fees and from store customers for optical, main store layaway and pharmacy purchases. Substantially all amounts are expected to be collected within one year.

Merchandise Inventories:

Merchandise inventories are stated at the lower of cost or market. Cost, which includes certain distribution and transportation costs, is determined through use of the last-in, first-out (LIFO) method for substantially all inventories. If the first-in, first-out (FIFO) method had been used to determine cost of inventories, the Company's inventories would have been higher by approximately $37.0 million at February 25, 1995, $39.0 million at February 26, 1994 and $35.3 million at February 27, 1993.

Property and Equipment:

Property and equipment are carried at cost. The cost of buildings and equipment is depreciated over the estimated useful lives of the assets. Buildings and certain equipment (principally computer and retail store equipment) are depreciated using the straight-line method. Remaining properties are depreciated on an accelerated basis. Useful lives generally assigned are: buildings-25 to 50 years; retail store equipment-8 to 10 years; warehouse, transportation and other equipment-3 to 10 years. Costs of leasehold improvements are amortized over the period of the lease or the estimated useful life of the asset, whichever is shorter, using the straight-line method. Property under capital leases is amortized over the related lease term using the straight-line method. Interest on property under construction of $1.3, $2.1 and $1.1 million was capitalized in fiscal years 1995, 1994 and 1993, respectively.

The components of property and equipment are (in thousands):

	Feb. 25, 1995	Feb. 26, 1994
Property and equipment at cost:		
Land	**$107,532**	$111,149
Buildings	**441,665**	400,185
Equipment	**278,391**	262,604
Leasehold improvements	**50,581**	41,836
Property under construction	**23,081**	26,495
Property under capital leases	**19,591**	14,599
	920,841	856,868
Less accumulated depreciation and amortization:		
Property and equipment	**294,798**	271,626
Property under capital leases	**7,979**	7,061
Net property and equipment	**$618,064**	$578,181

Accounts Payable:

Accounts payable include $10.7 million at February 26, 1994 of issued checks which had not cleared the Company's bank accounts, reduced by deposits in transit and cash on deposit in the Company's depository banks.

Pre-opening Costs:

Pre-opening costs of retail stores are charged against earnings in the year of the store openings.

Income Taxes:

In fiscal 1995 and fiscal 1994, the amounts reflected in the provision for income taxes are based on applicable federal statutory rates, adjusted for permanent differences between financial and taxable income, in accordance with Statement of Financial Accounting Standards ("SFAS") No. 109, "Accounting for Income Taxes." Prior to fiscal 1994, the provision for income taxes was calculated in accordance with SFAS No. 96, "Accounting for Income Taxes."

Net Earnings Per Common Share:

Net earnings per common share are computed by dividing net earnings by the weighted average number of common shares outstanding. Outstanding stock options do not have a significant dilutive effect on earnings per share.

Reclassifications:

Certain reclassifications have been made to the fiscal 1994 and fiscal 1993 consolidated financial statements to conform to those used in fiscal 1995.

B. Acquisitions

On January 3, 1995, the Company completed the acquisition of Bravell, Inc. ("Bravell"). The transaction was accounted for as a purchase, whereby the Company acquired 97% of the outstanding common stock of Bravell for approximately $17.3 million. The Company may be required to make additional payments of up to $13.0 million, contingent upon future results of Bravell's operations. Bravell is a pharmacy benefit management firm that provides custom prescription benefit plan design, program administration and claims and benefit processing services to insurance companies and self-funded medical plan sponsors.

The allocation of the purchase price of Bravell was based on fair values at the date of acquisition. The estimates are based on available information and are subject to change upon completion of the appraisal process. The excess of the purchase price over the fair value of the net assets acquired ("goodwill") of approximately $16.7 million is being amortized on a straight-line basis over 22 years. The results of Bravell's operations since the date of acquisition have been included in the consolidated statement of earnings.

Bravell records as sales the amounts billed to insurance companies and self-funded medical plan sponsors and the amounts billed to drug manufacturers for formulary fees. Cost of sales includes the amounts paid to network pharmacies and the amounts paid to plan sponsors for shared formulary fees.

C. Short-Term Debt

As of February 25, 1995, the Company had a $175.0 million revolving credit agreement with a consortium of banks. The credit agreement is unsecured and will expire October 4, 1996, subject to an extension for an additional year. The Company pays an annual facility and commitment fee of 1/4 of one percent. As of February 25, 1995, the Company had outstanding $15.0 million under this agreement. The weighted average interest rate on borrowings under the credit agreement for fiscal 1995 was 4.8%.

The Company also issues letters of credit during the ordinary course of business as required by foreign vendors. As of February 25, 1995, the Company had $56.4 million of unused letters of credit.

D. Long-Term Obligations and Leases

(In thousands)	**Feb. 25, 1995**	Feb. 26, 1994
Senior Unsecured Notes, 9.0% due November 15, 2004, less unamortized discount of $287	**$ 99,713**	$ —
Senior Unsecured Notes, 8.5% due March 15, 2002, less unamortized discount of $258 and $295 respectively	**99,742**	99,705
Senior Unsecured Notes, 9.25% due March 15, 2022, less unamortized discount of $518 and $537 respectively	**99,482**	99,463
Senior Unsecured Notes, 6.5% due August 15, 2003, less unamortized discount of $236 and $263 respectively	**99,764**	99,737
Industrial Revenue Bond, 6.4% due May 1, 2008	**1,000**	1,000
Capital lease obligations	**14,634**	10,578
	414,335	310,483
Less current portion	**755**	879
Long-term obligations	**$413,580**	$309,604

On November 9, 1994, the Company issued $100 million 9.0% senior unsecured notes due November 15, 2004. The notes provide for semi-annual interest payments payable on May 15 and November 15 of each year. There is no sinking fund applicable to the notes and the notes are not redeemable prior to maturity. The net proceeds of $98.9 million, after underwriting and issuance costs, were used to reduce the Company's short-term borrowings and to provide for working capital needs and other general corporate purposes.

On August 25, 1993, the Company issued $100 million 6.5% senior unsecured notes due August 15, 2003. The notes provide for semi-annual interest payments payable on August 15 and February 15 of each year. There is no sinking fund requirement and the notes are not redeemable prior to maturity. The net proceeds of $98.7 million, after underwriting and issuance costs, were used to reduce the Company's short-term debt and to provide for working capital needs and other general corporate purposes.

The notes contain certain covenants which, among other things, restrict the ability of the Company to consolidate, merge or convey, transfer or lease its properties and assets substantially as an entirety, to create liens or to enter into sale and leaseback transactions.

The underwriting and issuance costs of all the long-term obligations are being amortized over the terms of the notes using the straight-line method. At February 25, 1995 and February 26, 1994, $3.2 million and $2.6 million remained to be amortized over future periods. Amortized expense for these costs was $0.2, $0.2 and $0.1 million in fiscal years 1995, 1994 and 1993, respectively.

The Company leases certain stores under capital leases. Many of these leases include renewal options, and occasionally, include options to purchase.

Amortization of property under capital leases was $0.9, $0.8 and $0.9 million in fiscal years 1995, 1994 and 1993, respectively. Minimum future obligations under capital leases in effect at February 25, 1995 are as follows (in thousands):

Year	Lease Obligations
1996	$ 2,339
1997	2,342
1998	2,216
1999	2,220
2000	2,112
Later	22,333
Total minimum future obligations	33,562
Less interest	18,928
Present value of minimum future obligations	$ 14,634

The present values of minimum future obligations shown above are calculated based on interest rates ranging from 7.4% to 13.4%, with a weighted average of 10.8%, determined to be applicable at the inception of the leases.

Interest expense on the outstanding obligations under capital leases was $1.2, $1.0 and $1.1 million in fiscal years 1995, 1994 and 1993, respectively.

Contingent rent expense, based primarily on sales performance, for capital and operating leases was $0.5, $0.5 and $0.6 million in fiscal years 1995, 1994 and 1993, respectively.

In addition to its capital leases, the Company is obligated under operating leases, primarily for land and buildings. Minimum future obligations under operating leases in effect at February 25, 1995 are as follows (in thousands):

Year	Lease Obligations
1996	$ 3,561
1997	3,404
1998	3,331
1999	2,939
2000	2,860
Later	51,773
Total minimum obligations	$ 67,868

Total minimum rental expense, net of sublease income, related to all operating leases with terms greater than one year was $2.9, $2.7 and $2.6 million in fiscal years 1995, 1994 and 1993, respectively.

Certain operating leases require payments to be made on an escalating basis. The accompanying consolidated statements of earnings reflect rent expense on a straight-line basis over the term of the leases. An obligation of $1.1 million and $0.8 million, representing pro rata future payments, is reflected in the accompanying consolidated balance sheets at February 25, 1995 and February 26, 1994, respectively.

E. INCOME TAXES

Effective at the beginning of fiscal 1994, the Company adopted Statement of Financial Accounting Standards ("SFAS") No. 109, "Accounting for Income Taxes." This statement supersedes SFAS No. 96, "Accounting for Income Taxes." SFAS No. 109, which requires the Company to use the liability method of computing deferred income taxes, had no effect on reported net earnings or financial position.

Deferred income taxes reflect the net tax effect of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Components of the Company's net deferred tax liability are as follows (in thousands):

	1995	1994
Deferred tax liabilities:		
Property and equipment	**$ 19,752**	$ 20,901
LIFO inventory valuation	**5,210**	6,580
Other	**3,462**	1,575
Total deferred tax liabilities	**28,424**	29,056
Deferred tax assets:		
Reserves and allowances	**(13,070)**	(9,902)
Capital leases	**(1,380)**	(1,416)
Total deferred tax assets	**(14,450)**	(11,318)
Net deferred tax liability	**$ 13,974**	$ 17,738

The provision for federal and state income taxes includes the following (in thousands):

	1995	1994	1993
Current			
Federal	**$24,379**	$ 12,562	$ 26,269
State	**4,488**	2,560	5,343
General business and other tax credits	**(475)**	(350)	(150)
Deferred	**(3,764)**	5,995	(68)
Total provision	**$24,628**	$ 20,767	$ 31,394

The effective tax rate varies from the statutory federal income tax rate for the following reasons:

	1995	1994	1993
Statutory income tax rate	**35.0%**	35.0%	34.0%
State income taxes, net of federal tax benefits	**4.1**	4.1	4.4
Other	**0.3**	0.2	0.1
Effective income tax rate	**39.4%**	39.3%	38.5%

During fiscal 1994, enacted changes in the federal income tax laws increased the Company's income tax rate. The liability method of accounting for income taxes requires the effect of a tax rate increase on current and accumulated deferred income taxes to be reflected in the period in which the rate increase was enacted. Accordingly, in fiscal 1994, the Company recorded an additional tax expense of $0.8 million or $0.03 per share.

Provision is made for deferred income taxes and future income tax benefits applicable to temporary differences between financial and tax reporting. The sources of these differences and the effects of each are as follows (in thousands):

	1995	1994	1993
Depreciation	**$ (247)**	$ 1,398	$ 254
Inventory valuation reserves	**(2,261)**	—	—
LIFO inventory valuation	**(1,370)**	5,370	(75)
Bad debt and return reserves	**(806)**	22	291
Other	**920**	(795)	(538)
Total deferred tax (benefit) expense	**$ (3,764)**	$ 5,995	$ (68)

Other temporary differences between financial and tax reporting include amortization and interest relating to capital leases and certain provisions for expenses which are not deducted for tax purposes until paid.

F. Preferred and Common Stock

The Company has 20,000,000 shares of $0.01 preferred stock authorized but unissued.

There are 75,000,000 shares of $0.01 par value common stock authorized with 32,005,000 and 32,016,000 shares issued and outstanding at February 25, 1995 and February 26, 1994, respectively.

The Company's Stock Option Plan allows the granting of stock options to various officers, directors and other employees of the Company at prices not less than 100 percent of fair market value, determined by the closing price on the date of grant. The Company has reserved 2,400,000 shares for issuance under the plan. These options vest at the rate of 40% on the second anniversary of the grant date and 20% annually thereafter for officers and employees and at the rate of 60% on the second anniversary of the date of grant and 20% annually thereafter for non-employee directors. Changes in the options are as follows (shares in thousands):

	Shares	Price Range
Outstanding, February 29, 1992	1,539	$ 15.00
Granted	56	15.00 - 16.25
Canceled and forfeited	(90)	15.00
Outstanding, February 27, 1993	1,505	15.00 - 16.25
Granted	627	10.13 - 15.00
Canceled and forfeited	(208)	10.88 - 16.25
Outstanding, February 26, 1994	1,924	10.13 - 16.25
Granted	250	10.00 - 11.00
Canceled and forfeited	(238)	10.00 - 16.25
Outstanding at February 25, 1995	1,936	10.00 - 16.25
Exercisable at February 25, 1995	709	15.00 - 16.25

In fiscal 1994, the Company adopted a Restricted Stock Plan which provides awards of up to 200,000 shares of common stock to key employees of the Company. Plan participants are entitled to cash dividends and to vote their respective shares. Restrictions limit the sale or transfer of the shares during a restricted period. There are 5,000 and 16,000 shares of restricted stock outstanding at February 25, 1995 and February 26, 1994, respectively.

G. Employee Benefits

Substantially all employees of the Company are covered by a defined contribution profit sharing plan. In fiscal 1995 and fiscal 1994, the plan provided for two types of company contributions; an amount determined annually by the Board of Directors and an employer matching contribution equal to one-half of the first 6 percent of compensation contributed by participating employees. The fiscal 1993 contribution was determined at the discretion of the Board of Directors. Contributions were $6.7, $5.6 and $4.4 million for fiscal years 1995, 1994 and 1993, respectively.

The Company also has a change of control severance agreement with certain key officers. Under this agreement, the officers are entitled to a lump-sum cash payment equal to a multiple of one, two or three times their annual salary plus a multiple of one, two or three times their average annual bonus for the three fiscal years immediately preceding the date of termination.

In fiscal 1994, the Company adopted Statement of Financial Accounting Standards ("SFAS") No. 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions." SFAS No. 106 requires the Company to accrue the estimated cost of retiree benefits, other than pensions, during employees' credited service period. The cost of these benefits, which are principally health care, was previously expensed as claims were incurred. The Company elected to immediately recognize the accumulated postretirement benefit obligation, resulting in a charge to earnings of $0.6 million or $0.02 per share.

The net periodic costs for postretirement benefits include the following (in thousands):

	1995	1994
Service cost for benefits accumulated during the year	**$ 78**	$ 77
Interest cost on accumulated benefit obligation	**60**	60
Net periodic postretirement benefit cost	**$ 138**	$ 137

The Company's postretirement health care plans currently are not funded. The accumulated postretirement benefit obligations are as follows (in thousands):

	February 25, 1995	February 26, 1994
Retirees	$ 347	$ 367
Active plan participants	728	770
Total accumulated postretirement obligations	$ 1,075	$ 1,137

The assumed discount rate used in determining the accumulated postretirement benefit obligation was 7% in both fiscal 1995 and fiscal 1994.

The assumed health care cost trend rate used in measuring the accumulated postretirement benefit obligation was 14% for fiscal 1995 decreasing one percent each successive year until it reaches 6% in fiscal 2003 after which it remains constant. A 1% increase in the health care trend rate would have an immaterial effect on the accumulated postretirement benefit obligation at the end of fiscal 1995 and fiscal 1994 and the net periodic cost for the fiscal years.

H. Related Party Transactions

In accordance with service agreements entered into in connection with the initial public offering, general, administrative and other services were allocated to the Company from SUPERVALU. The Company also provided services and allocated general, administrative and other expenses to two wholly owned subsidiaries of SUPERVALU. In such cases, allocations were made using procedures deemed appropriate to the nature of the services involved. Management believes the allocations were made on a reasonable basis. Although these allocations do not necessarily equal the costs which would have been or may be incurred by the Company on a stand-alone basis, management believes that any variance in costs would not be material. The service agreements between ShopKo and SUPERVALU expired in early fiscal 1994.

Selling, general and administrative expenses include the following allocations (in thousands):

	1994	1993
From SUPERVALU to ShopKo	$ 96	$ 1,584
From ShopKo to wholly owned subsidiaries of SUPERVALU	$ 323	$ 2,507

Purchases of inventory from SUPERVALU were $2.7, $9.7 and $15.4 million for the fiscal years 1995, 1994 and 1993, respectively.

Also, as a result of the initial public offering, the Company and SUPERVALU entered into certain other agreements of which the following are still in effect:

A food products supply agreement under which the Company has agreed to purchase from SUPERVALU, through October 16, 1998, all of the Company's requirements for certain products sold in any food store owned or operated by the Company and located within the geographic areas serviced by SUPERVALU.

A registration rights agreement under which SOA (and certain affiliates of SUPERVALU) has the right to require the Company to file up to three registration statements under the Securities Act.

I. Fair Values of Financial Instruments

The following disclosure is made in accordance with the requirements of Statement of Financial Accounting Standards ("SFAS") No. 107, "Disclosures about Fair Value of Financial Instruments." The following methods and assumptions were used by the Company in estimating its fair value disclosures for financial instruments.

Cash, accounts receivable and accounts payable: The carrying amounts of these items are a reasonable estimate of their fair value.

Short-term debt and long-term obligations: The carrying amounts of the Company's borrowings under its short-term revolving credit agreement and its capital leases approximate their fair value. The fair values of the Company's long-term obligations are estimated using discounted cash flow analysis based on interest rates that are currently available to the Company for issuance of debt with similar terms and remaining maturities.

The carrying amounts and fair values of the Company's financial instruments at February 25, 1995 are as follows (amounts in thousands):

	Carrying Amount	Fair Value
Short-term debt	$ 15,000	$ 15,000
Long-term obligations:		
Senior Unsecured Notes, due November 15, 2004	99,713	106,871
Senior Unsecured Notes, due March 15, 2002	99,742	102,927
Senior Unsecured Notes, due March 15, 2022	99,482	108,601
Senior Unsecured Notes, due August 15, 2003	99,764	91,228
Industrial Revenue Bond, due May 1, 2008	1,000	1,000

J. UNAUDITED QUARTERLY FINANCIAL INFORMATION

Unaudited quarterly financial information is as follows:

	Fiscal Year (52 Weeks) Ended February 25, 1995				
(In thousands, except per share data)	First (16 wks)	Second (12 wks)	Third (12 wks)	Fourth (12 wks)	Year (52 wks)
Net sales	$514,926	$381,297	$470,919	$485,787	$1,852,929
Gross margins*	135,411	99,910	120,718	131,977	488,016
Net earnings	4,980	2,750	11,303	18,757	37,790
Net earnings per common share	0.16	0.09	0.35	0.59	1.18
Weighted average shares	32,016	32,016	32,016	32,014	32,014
Dividends declared per common share	0.11	0.11	0.11	0.11	0.44
Price range per common share**	12-10¼	10⅜-9¾	10⅝-9¾	9¾-8⅝	12-8⅝

	Fiscal Year (52 Weeks) Ended February 26, 1994				
(In thousands, except per share data)	First (16 wks)	Second (12 wks)	Third (12 wks)	Fourth (12 wks)	Year (52 wks)
Net sales	$474,599	$355,297	$446,286	$462,564	$1,738,746
Gross margins*	127,154	92,372	121,794	112,194	453,514
Net earnings	5,719	2,126	14,061	10,216	32,122
Net earnings per common share	0.18	0.07	0.44	0.32	1.00
Weighted average shares	32,000	32,000	32,000	32,001	32,001
Dividends declared per common share	0.11	0.11	0.11	0.11	0.44
Price range per common share**	15⅞-12½	13⅛-10⅝	11½-9¾	12-10	15⅞-9¾

*Gross margins for previous quarters have been adjusted since depreciation and amortization expenses, which previously were a component of cost of sales and selling, general and administrative expenses, have been reclassified as a separate expense line item on the Consolidated Statements of Earnings.

**Price range per common share reflects the highest and lowest stock market prices on the New York Stock Exchange during the quarter.

K. BUSINESS SEGMENT INFORMATION

The Company conducts business in two business segments: general merchandise and health services. General merchandise is conducted through retail stores. Health services include professional health care services provided in the retail stores and prescription benefit management services, pharmacy mail service and claims processing activities, which are generally provided through other facilities.

Information about the Company's operations in the different businesses is as follows (in thousands):

	1995	1994	1993
Net sales			
General merchandise	**$1,489,919**	$1,411,781	$1,385,331
Health services	**363,010**	326,965	297,523
Total net sales	**$1,852,929**	$1,738,746	$1,682,854
Earnings before income taxes			
General merchandise	**$ 67,638**	$ 59,151	$ 82,940
Health services	**36,547**	29,854	28,858
Corporate	**(12,725)**	(14,699)	(12,071)
Interest expense	**(29,042)**	(21,417)	(18,274)
Earnings before income taxes	**$ 62,418**	$ 52,889	$ 81,453
Assets			
General merchandise	**$ 950,719**	$ 846,052	$ 714,342
Health services	**91,208**	58,586	38,159
Corporate	**67,824**	48,411	39,224
Total assets	**$1,109,751**	$ 953,049	$ 791,725
Depreciation and amortization expenses			
General merchandise	**$ 49,542**	$ 44,375	$ 40,467
Health services	**3,439**	2,629	2,376
Corporate	**493**	332	432
Total depreciation and amortization expenses	**$ 53,474**	$ 47,336	$ 43,275
Capital expenditures			
General merchandise	**$ 89,346**	$ 120,988	$ 86,348
Health services	**4,740**	11,398	2,896
Corporate	**514**	1,456	1,816
Total capital expenditures	**$ 94,600**	$ 133,842	$ 91,060

Independent Auditors' Report

To the Board of Directors and Shareholders
ShopKo Stores, Inc.:

We have audited the consolidated balance sheets of ShopKo Stores, Inc. and Subsidiaries as of February 25, 1995 and February 26, 1994 and the related consolidated statements of earnings, shareholders' equity and cash flows for each of the three years (52 weeks) in the period ended February 25, 1995. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of ShopKo Stores, Inc. and Subsidiaries as of February 25, 1995 and February 26, 1994, and the results of their operations and their cash flows for each of the three years (52 weeks) in the period ended February 25, 1995 in conformity with generally accepted accounting principles.

DELOITTE & TOUCHE LLP
Milwaukee, Wisconsin
March 31, 1995

Shareholders' Information

ShopKo Stores, Inc. common shares are listed on the New York Stock Exchange under the symbol "SKO" and in the newspapers as "ShopKo." As of April 24, 1995, ShopKo's common shares were held by 2,740 record owners.

Transfer Agent and Registrar

For help with questions regarding lost, stolen or destroyed stock certificates, non-receipt of dividend checks, consolidation of accounts, transferring of shares and name and address changes call Norwest Banks at 1-800-468-9716.

1995 Annual Meeting

The annual meeting of shareholders will be held June 14, 1995 at 10 a.m. at the Ramada Inn, 2750 Ramada Way, Green Bay, Wisconsin.

Investor Relations/Form 10-K

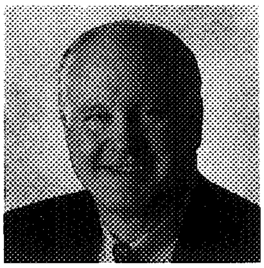
A copy of the company's 1995 Form 10-K annual report to the Securities and Exchange Commission will be furnished without charge to any shareholder upon writtten request.

Quarterly reports are furnished to shareholders of record by the company's stock transfer agent. Any shareholder whose stock is not registered in the shareholder's name will be furnished quarterly reports without charge upon written request.

All written requests should be directed to:

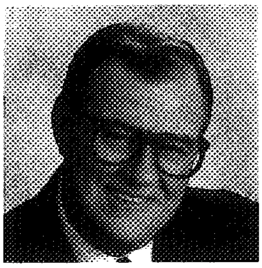
Investor Relations Department
ShopKo Stores, Inc.
P.O. Box 19060
Green Bay, WI 54307-9060

Board of Directors

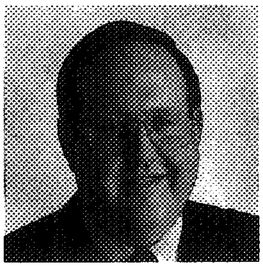


Michael W. Wright
Chairman of the Board
Chairman, President and
Chief Executive Officer
of SUPERVALU

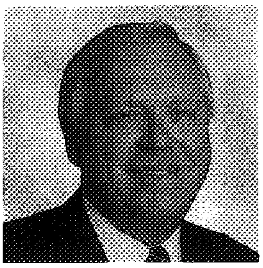
Dale P. Kramer
President and Chief
Executive Officer
of ShopKo



William J. Tyrrell
Vice Chairman of
the Board, Former
President of ShopKo



Jeffrey C. Girard
Executive Vice President
and Chief Financial
Officer of SUPERVALU



Jack W. Eugster
Chairman, President and
Chief Executive Officer
of The Musicland Group, Inc.

Officers

Dale P. Kramer
President and Chief
Executive Officer

Michael J. Bettiga
Senior Vice President of
Health Services

Oscar R. Cavazos
Vice President, Divisional
Merchandise Manager

Roger J. Chustz
Senior Vice President, General
Merchandise Manager, Apparel

Lawrence J. Clark
Vice President, Finance

Richard W. Cooper
Vice President, Distribution,
Transportation

C. Scott Copeland
Senior Vice President of
Store Marketing

Joseph A. Coffini
Vice President, Managed
Care Services

Rose A. Downs
Vice President, Operations
Administration

Gary B. Hammond
Senior Vice President of Stores

Steven T. Harig
Senior Vice President of
Planning, Replenishment
and Analysis, Distribution

David S. Haugen
Regional Vice President

Thomas D. Hendra
Senior Vice President,
General Merchandise Manager,
Hardlines/Home

Jeffrey A. Jones
Senior Vice President and
Chief Financial Officer

Richard T. Laucks
Vice President, Loss Prevention

David A. Liebergen
Senior Vice President of Human
Resources and Secretary

Peter R. Lynn
Senior Vice President of
Planning and Research

L. Terry McDonald
Senior Vice President
of Advertising

Dennis L. Nonnemacher
Vice President, Divisional
Merchandise Manager

Steven C. Peters
Vice President, Divisional
Merchandise Manager

William J. Podany
Executive Vice President of
Merchandising and Marketing

Randy L. Roiko
Vice President, Merchandise
Operations

Dennis R. Ruebel
Vice President,
Merchandising/Mfg. Health
Services

Steve M. Ryman
Vice President, Divisional
Merchandise Manager

James J. Sage
Regional Vice President

Walter B. Sandlin
Vice President, Divisional
Merchandise Manager

Jeffery R. Simons
Vice President and Controller

James W. Smekal
Vice President, Divisional
Merchandise Manager

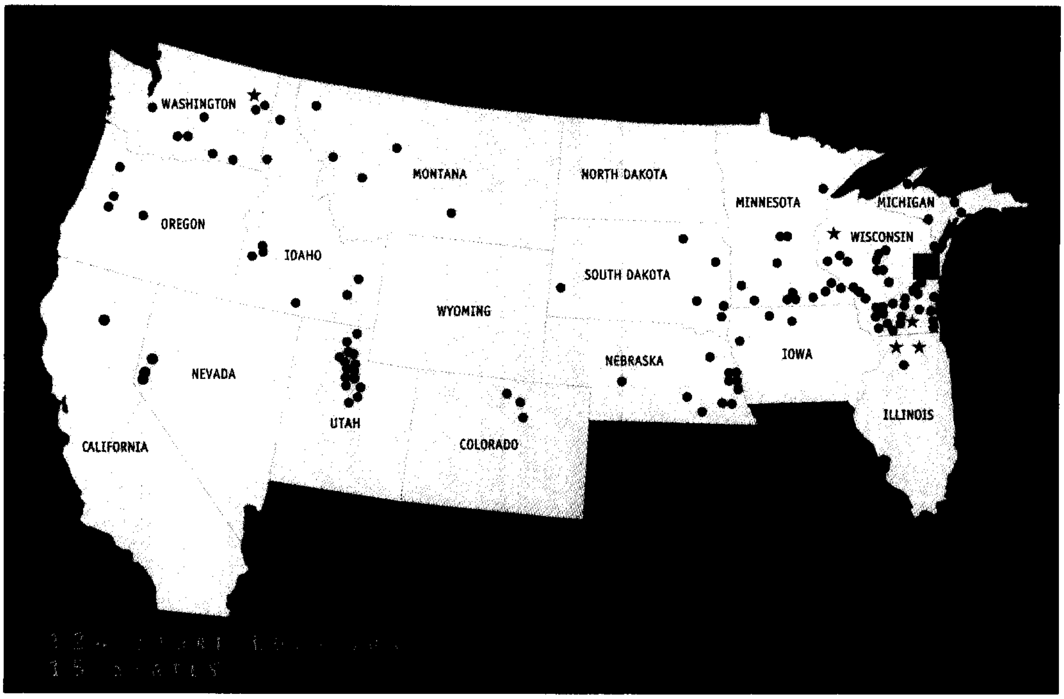
Jean R. Srour
Vice President, Divisional
Merchandise Manager

James F. Tucker
Senior Vice President of
Information Services and Chief
Information Officer

Larry J. Vick
Vice President, Divisional
Merchandise Manager

Michael F. Wilson
Vice President, Store Planning

3299



● ShopKo Stores

■ General Office
Green Bay, Wisconsin

△ Distribution Centers
Boise, Idaho
De Pere, Wisconsin
Omaha, Nebraska

★ Fiscal 1996 New ShopKo Store Locations
Delavan, Wisconsin
Rice Lake, Wisconsin
Belvidere, Illinois
Freeport, Illinois
Spokane, Washington

California (1)
Redding

Colorado (3)
Fort Collins
Longmont
Loveland

Idaho (8)
Boise (2)
Chubbuck
Coeur d'Alene
Idaho Falls
Lewiston
Nampa
Twin Falls

Illinois (1)
Dixon

Iowa (3)
Mason City
Sioux City
Spencer

Michigan (4)
Escanaba
Houghton
Kingsford
Marquette

Minnesota (13)
Albert Lea
Austin
Duluth
Fairmont
Hutchinson
Mankato
Marshall
Rochester (2)
St. Cloud (2)
Winona
Worthington

Montana (5)
Billings
Great Falls
Helena
Kalispell
Missoula

Nebraska (11)
Bellevue
Grand Island
Hastings
Lincoln (2)
Norfolk
North Platte
Omaha (4)

Nevada (3)
Reno (2)
Sparks

Oregon (4)
Bend
Eugene (2)
Salem

South Dakota (6)
Aberdeen
Mitchell
Rapid City
Sioux Falls (2)
Watertown

Utah (15)
Brigham City
Layton
Logan
Murray
Ogden
Orem
Provo
Riverdale
Salt Lake City (2)
Sandy City
Spanish Fork
West Bountiful
West Jordan
West Valley City

Washington (8)
Kennewick
Lacey
Spokane (2)
Union Gap
Walla Walla
Wenatchee
Yakima

Wisconsin (39)
Appleton
Ashwaubenon
Beaver Dam
Beloit
Chippewa Falls
De Pere
Eau Claire
Fond du Lac
Fort Atkinson
Grafton
Green Bay (2)
Janesville
Kenosha
Kimberly
La Crosse (2)
Madison (3)
Manitowoc
Marinette
Marshfield
Menasha
Monona
Monroe
Neenah
Onalaska
Oshkosh
Racine
River Falls
Rothschild
Sheboygan
Stevens Point (2)
Watertown
Wausau
West Bend
Wisconsin Rapids

ShopKo STORES INC.
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