FedMart*

1979 Annual Report

Massive bicycle displays demonstrate the Company's commitment to mass merchandising as well as reflecting the popularity of today's life styles.

Highlights

	1979	1978
OPERATIONS FOR THE YEAR		
Total retail sales	$ 975,029	$ 696,325
Net earnings (loss)	(11,103)	3,020
AT YEAR END		
Shareholders' equity	86,298	52,326
Total number of stores	69	58
Retail stores—square footage	5,397,130	4,198,621
Warehouses—square footage	1,273,080	1,138,350
Total assets	$ 321,332	$ 246,797
PER SHARE DATA		
Net earnings (loss)	$ (5.54)	$ 1.34
Net earnings (loss) on a fully diluted basis	(5.54)	1.28
Shareholders' equity	17.54	23.38
Cash dividends	.30	.60

Dollars in thousands except per share data

To our Shareholders:

As indicated to you in prior reports, we have established in the past fiscal year the foundation of a new and modern FedMart, a new Company designed, organized and built to meet the challenges of modern retailing in the 1980's. I wish to demonstrate the magnitude of the undertaking by highlighting the key components of our enormous efforts since the acquisition of the former Two Guys stores in California and the former Globe stores in Arizona and Texas.

We have invested approximately $131,000,000 in the last two years to acquire, modernize and rebuild most of the acquired 32 stores (one of which was converted into a modern, functional Central Office Building), warehouse facilities and other equipment, as well as to bring up to our latest standards many of the old FedMart stores.

Most of the acquired stores were completely remodeled, a complete and modern supermarket was introduced, and the stores were refixtured where necessary, and completely remerchandised. In addition electronic point of sale equipment has been introduced to assist in advanced item movement tracking and inventory control.

We have doubled the number of our employees and had to recruit for all of these new stores store managers, store management personnel and regional supervisory personnel. We also had to build a new buying team with the experience and know-how required to service a modern retail company of our new size. We also had to spend substantial amounts of money and management time to train the thousands of newly hired employees to become familiar with the new and sophisticated FedMart systems and procedures. In addition we undertook a massive multi-media advertising campaign to penetrate the highly competitive Los Angeles market in a substantial manner.

The new stores were in operation for only nine to ten months during the past fiscal year. As these new units mature, they should demonstrate good results in the future as a consequence of improved operating efficiency and higher sales volumes.

In view of these accomplishments of the past fiscal year, we can now look at a company which has a powerful market dominance in its traditional trading areas, has large and modern stores which, contrary to the past, are cohesive in their appearance and merchandising and have an attractive image consistent with the new FedMart standards.

I would like to quantify the above statements. FedMart presently operates 5,647,409 square feet of retail space (69 stores) which is a net increase of 2,667,738 square feet (or 90%) over its square footage of 1977 and of 3,331,338 square feet (or 144%) over its square footage of 1975, when Mr. Hugo Mann acquired control of the Company. The Company's warehousing square footage increased since fiscal 1977 from 516,914 square feet to 1,273,000 square feet, an increase of 146%. The Company now operates a fleet of 52 tractors and 292 trailers.

While the formation of virtually a new company had to have its toll on the bottom line, one has to recognize the values which have been created as a result of the acquisition of the many excellent store and warehouse locations at a price substantially below fair market value. The assets of the West Coast Division of Two Guys were purchased at net depreciated book value and the leases for the former Globe stores had very favorable rent provisions which would no longer be available today.

The net after tax loss for the fiscal year was $11,103,000, which is a reduction from the loss of $13,825,000 reported for the thirty-six weeks ending on May 13, 1979. Moreover, the net after tax loss for the full fiscal year has to be analyzed as to its cash flow impact in order to fully comprehend the event. Depreciation and the addition to the LIFO reserve (which increased to $10,700,000) amountud to $14,852,000.

Our interest and long term debt expense for the past fiscal year amounted to $13,504,000, which was a result, in part, of the previous inadequate capital structure of the Company and the high interest rates. The problem of inadequate capital was corrected in the latter part of the fiscal year. Unfortunately, interest rates keep rising to all-time high levels.

The capital infusion provided by Mr. Mann, and the additional bank borrowings have increased our working capital by $26,321,000 and have brought it to the highest level in the history of the Company, i.e. $48,359,000. The Company's risk capital account (consisting of common stock, preferred stock and subordinated debentures) exceeds $94,000,000, which is in excess of the total assets of the Company at the end of fiscal 1974.

The Company has recently opened four stores, three in Houston, Texas, and one in Phoenix, Arizona. Because of substantial start-up expenses these store openings will have an adverse impact on the results of the first quarter of the new fiscal year.

In retailing it is common to expense most start-up costs, whereas in manufacturing companies start-up expenses are generally capitalized.

In our 1978 annual report I estimated that total retail sales for this past fiscal year would exceed $900,000,000. I am pleased to report that actual total sales for that period were $975,029,000, an increase of 40% over total retail sales of last year. We have accomplished these sales despite (i) the sudden gasoline shortage which started in California in April/May and which accounted for substantially reduced gasoline sales in terms of gallons, (ii) the recession which was triggered by the gasoline shortage and which was accompanied by generally lower retail sales, and (iii) the planned delay of the opening of the former Houston Globe stores resulting from the turn-key approach adopted by us.

The present restrictive policy of our Government and the Federal Reserve Board, resulting in all-time high interest rates for an industrial nation, is a big burden on our Company in its present stage, both in terms of a very high interest expense, as well as a substantially reduced spendable income level of our customers. It is unfortunate that our Government believes that skyrocketing inflation, generated primarily by the explosion of oil prices, a factor which cannot be influenced by traditional economic means, would have to be fought primarily with tight and super-expensive money. The high cost of energy and money will force the consumer to change traditional lifestyle habits and to become more and more cost and quality conscious. FedMart's one stop shopping concept—food and general merchandise under one roof, and its policy to carry quality merchandise only at every day low prices—will help today's consumer who shops at FedMart to save time, gasoline, and money.

Heinz L. Gundlach
Vice Chairman of the Board
and President

November 28, 1979

The Company's Business

Merchandising and Operations.

The Company offers a wide range of retail merchandise with an emphasis on products appealing to the value-conscious shopper. FedMart stores generally differ from most of their competitors by combining items typically found in general merchandise stores and supermarkets on one floor under one roof, usually in free-standing units, with central check-out counters serving most departments. In addition to the integrated general merchandise supermarket centers, most store locations include gasoline and auto service centers adjacent to the main store. The Company offers approximately 40,000 different items, with fewer items stocked in the smaller stores. The Company has increased the selection of sizes and variety of national brand-name products to reflect consumer preferences.

The Company's general merchandise product lines include men's, women's and children's basic, seasonal and fashion ready-to-wear clothing, shoes, household domestics and notions, housewares, electrical appliances, paints and hardware, health and beauty aids, in-store automotive products and accessories, nursery, patio and garden supplies, sporting goods, toys, books, records, furniture, carpeting, major appliances, cameras, radios, stereos and televisions, jewelry and other hard and soft lines. Supermarket product lines include groceries, meats, produce, bakery and dairy products, cheeses and delicatessen items, frozen foods, beer, wines and liquors (where permitted by local law), beverages, candy, sundries, cigarettes and other items typically found in supermarkets. In addition to national and regional brand-name products, the Company sells many products under its private labels, primarily the "FM" registered trademark. Private label merchandise is promoted on the basis of lower prices for brand-name quality. Most stores have separate pharmacy departments where prescription and non-prescription drugs are sold, and licensed independent optometrists are located at many of the larger stores. Many FedMart stores also include in-store cafeterias, snack bars or service delicatessen sections. Several stores include do-it-yourself building materials and supplies. Tires, batteries, other auto accessories and auto repair and servicing are provided at service centers adjacent to most FedMart stores, gasoline stations are at most stores, and car washes are at five stores. The Company operates a photo processing and finishing laboratory in San Diego which serves the customers of all FedMart stores.

FedMart stores are operated primarily on a self-service basis, with sales people available to advise and assist customers particularly in the furniture, jewelry, major appliance, nursery, do-it-yourself building materials and camera departments and in the auto centers. Merchandising policy is based on mass merchandising, fast inventory turnover and low overhead costs.

	Percentage of Net Sales					
Class of Products	1979	1978 (A)	1978 (B)	1977	1976	1975
Food and Sundries	56.2%	54.2%	57.6%	57.5%	56.6%	59.4%
Hardlines	25.5	26.4	24.1	23.8	23.7	20.2
Softlines	9.6	8.9	7.2	7.2	7.3	6.7
Pharmacy	2.7	3.1	3.3	3.5	3.7	4.1
Gasoline	3.7	4.6	5.0	5.3	5.8	6.4
Auto Center	2.3	2.8	2.8	2.7	2.9	3.2
TOTAL	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%

(A) Including stores not yet converted to FedMart stores
(B) Excluding stores not yet converted to FedMart stores

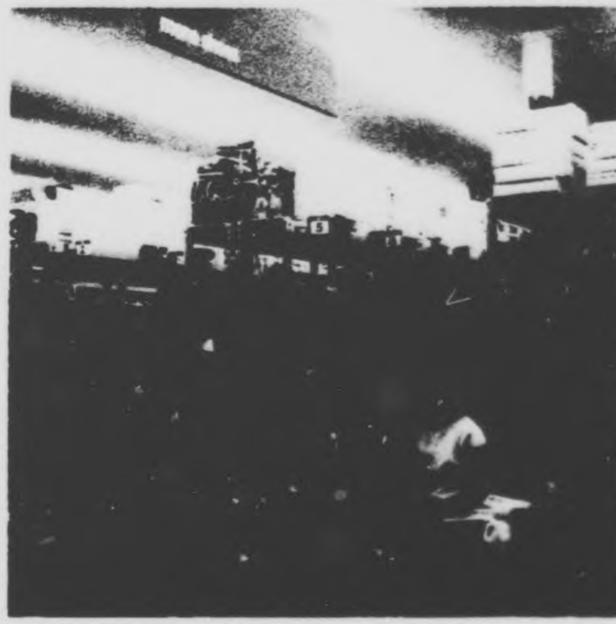
Expansion, Integration and Modernization Program.

The Company is pursuing a policy of expansion through acquisition of existing facilities from others, enlargements and/or modernization and remodeling of existing stores and construction of new facilities. As part of its expansion through acquisition, in January 1978 the Company acquired the assets of the West Coast Division of the Two Guys Discount Department Stores which included 22 Two Guys stores in Southern California, an office and warehouse complex, other facilities and related inventories. In June and November 1978 the Company acquired the lease rights and related furniture, fixtures and equipment of ten former Globe Discount Stores in the Phoenix, Tucson and Houston areas.

During the late Summer and Fall of 1978, the Company re-opened 23 stores under the FedMart name after completion of extensive remodeling, refixturization and merchandising, and the introduction of complete supermarket departments at most of these stores.

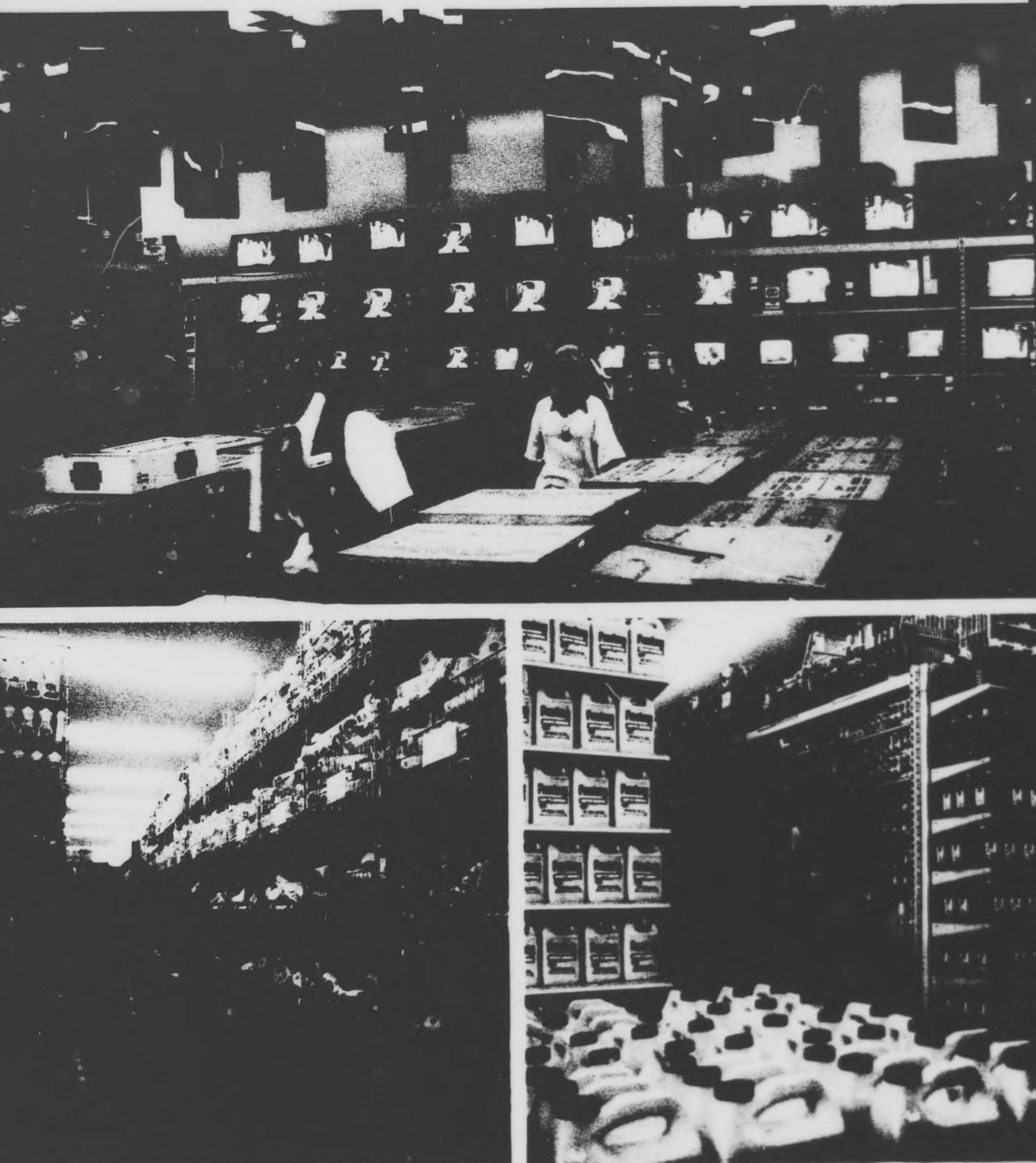
Improvements in Merchandising.

The introduction of shoe departments into 27 of the larger stores in August 1979 contributes to the Company's one-stop shopping concept and reinforces the softlines area by offering the customers another way to save. In many of the stores, the Company has increased the floor space devoted to softlines, with a more extensive variety of softlines, including fashion merchandise, now being offered. Additional space is also being given to other relatively high gross margin items such as unfinished and self-assembly furniture, lighting fixtures, giftware and jewelry. New display techniques and new fixtures have been installed to enhance the impact of mass-merchandising. New decor and color concepts have been implemented, as has an extensive in-store sign system to enable customers to locate merchandise quickly. The Company recently has commenced a generic "Bright Yellow Wrap" program offering approximately 50 food and household grocery products on a lower cost basis made possible by reduced expenses of packaging, display and marketing of such products.



Quality footwear was introduced into many FedMart stores in 1979 in self-service shoe departments.

The Company's trailer fleet has been enlarged and modernized to meet the growing need for fast and efficient delivery to stores.



New display techniques and fixtures have been installed in a variety of departments to enhance the impact of FedMart mass merchandising.

Store of the 80's.

In July 1979 the Company opened its "store of the 80's" on Woodridge Drive in Houston, Texas, featuring many techniques used in European hypermarkets. The Woodridge store was designed to make optimum use of floor space in order to reduce the cost of doing business and to reduce the expense of distribution and store handling. Massive wall-to-wall displays carry reserve stock and heighten impulse selling. New types of steel fixtures are being used for most hardlines and food items. Roll carts and steel bins are used on the floor and in the receiving room. Clothes are displayed on fashionable fixtures. Three similar stores have since been opened, two in Houston and one in Phoenix.

The store of the 80's is another in the chain to use SCORE--Store Computer for Order and Receiving Entries. SCORE is a key element in FedMart's comprehensive management information system which soon will link all of the retail locations to central headquarters and distribution centers. It provides a superior method of receiving, inventory control and merchandise replenishment.

The remodeled Sports Arena store includes a large, new furniture department with a unique, self-service carpeting section.

Store Operations.

The Company's stores generally vary in size from approximately 20,000 square feet (in our older units) to 208,000 square feet of gross main building area (in our new units).

The Company presently operates 69 stores, of which 42 are located in Southern California, including 15 in San Diego County and 21 in the greater metropolitan Los Angeles area. Fifteen stores are located in Texas, 11 in Arizona and one in New Mexico. The aggregate gross main building area of all FedMart stores now consists of approximately 5,667,400 square feet. The gross main building area of 31 FedMart stores exceeds 100,000 square feet each.

The Company has also been actively pursuing its program of enlarging, modernizing and remodeling previously existing FedMart stores. In November 1979 the Company celebrated the enlarging of its Sports Arena Boulevard flagship store to a 208,000 square foot unit. The Company disposed of a leased Two Guys facility in Oxnard, California in January 1979, and the Company sold two owned facilities in San Diego, California, one in Redlands, California, one in Houston, Texas and one in Phoenix, Arizona in the past twelve months. Additional stores will be closed in the future, particularly stores that lack satisfactory profits, smaller stores and stores in outlying areas which are not compatible with the Company's mass merchandising approach.

Advertising.

The Company's use of advertising increased significantly in fiscal 1979 in order to support its expansion program. A multi-media strategy is now employed to effectively reach and communicate with consumers. The principal medium is print. Preprints are distributed primarily in newspapers but door-to-door distribution and direct mail are also utilized where necessary. The Company also allocates a significant portion of its advertising budget to television and radio.

Ten Year Summary of Operations and other Financial Data

Fiscal Year	1979	1978	1977	1976	1975
SUMMARY OF OPERATIONS					
Total retail sales	$975,029	$696,325	$542,773	$459,967	$381,491
Net sales and other income	963,442	684,877	532,815	447,363	366,032
Cost of sales and expenses	961,949	669,704	515,918	432,429	353,388
Depreciation and amortization	10,522	5,574	3,906	3,350	2,796
Interest and long-term debt expense	13,504	4,600	3,008	3,080	2,827
Total costs and expenses	985,975	679,878	522,832	438,859	359,011
Earnings (loss) before income taxes	(22,533)	4,999	9,983	8,504	7,021*
Income taxes (credits)	(11,430)	1,979	4,520	3,985	3,327
Net earnings (loss)	(11,103)	3,020	5,463	4,519	3,259†*
Earnings (loss) per share:**					
Primary	(5.54)	1.34	2.69	3.32	2.81†*
Fully diluted	(5.54)	1.28	2.48	2.99	2.52†*
Cash dividends per share	.30	.60	.60	.60	.60
Stock dividends per share	—	—	—	—	—
OTHER FINANCIAL DATA					
Cash flow from operations	(3,983)	11,023	10,043	7,174	6,736
Capital expenditures	48,935	81,730	13,072	5,370	13,439
Cash dividends	670	1,345	1,352	815	727
AT YEAR END					
Current assets	138,370	99,490	58,365	57,028	46,405
Current liabilities	90,011	77,452	39,690	42,021	32,491
Working capital	48,359	22,038	18,675	15,007	13,914
Net property and equipment	175,881	140,882	66,721	58,438	56,571
Long term debt:					
Mortgages and bank loans	97,098	56,357	14,045	18,174	15,153
Subordinated debt	8,332	25,236	9,523	9,799	10,070
Capitalized lease obligations	35,525	29,223	13,027	13,250	13,458
Shareholders' equity	86,298	52,326	51,489	35,143	31,502*
Total assets	321,332	246,797	130,996	121,256	106,477
Number of shares outstanding	2,225,702	2,237,956	2,248,811	1,351,858	1,361,602
Number of shareholders of record	3,786	3,737	3,699	3,664	3,769
Number of stores in operation	69	58	48	47	44
Book value per share**	17.54	23.38	22.90	26.00	23.14

NOTES:

Fiscal years 1970 through 1978 have been restated to reflect the application of FASB No. 13.

*LIFO method of accounting for inventories adopted for 1975 had the effect of reducing net earnings and shareholders' equity by $904,000 and per share earnings by $0.78 primary and $0.66 fully diluted.

**Adjusted for stock dividends.

†After cumulative effect (prior to September 2, 1974) of change in accounting method for vacation pay which reduced net earnings by $435,000 and per share earnings by $0.38 primary and $0.32 fully diluted.

1974	1973	1972	1971	1970
$319,128	$274,631	$232,454	$195,800	$181,564
300,838	258,190	217,233	177,893	161,087
288,358	246,585	207,295	171,631	152,856
2,631	2,465	2,585	2,317	2,100
2,429	2,228	2,273	1,928	1,814
293,418	251,278	212,153	175,876	156,770
7,420	6,912	5,080	2,017	4,317
3,671	3,380	2,453	894	2,260
3,749	3,532	2,627	1,123	2,057
3.33	2.76	1.94	.83	1.53
2.96	2.51	1.80	.85	1.45
.60	.50	.40	.40	.40
2%	2%	2%	2%	2%
6,485	5,835	5,704	4,279	4,886
4,570	8,257	4,486	12,946	5,148
634	592	512	502	493
38,120	34,979	31,416	29,059	26,156
26,858	26,624	21,505	20,601	18,253
11,262	8,355	9,911	8,458	7,903
47,326	45,768	41,789	43,236	37,762
20,714	15,405	16,606	18,990	15,345
10,323	10,559	7,937	8,065	8,230
5,895	5,633	4,809	4,902	3,005
21,506	21,266	21,127	18,810	17,990
89,485	83,760	76,373	75,413	67,242
1,067,203	1,193,163	1,292,950	1,269,423	1,244,533
4,020	4,063	4,215	4,298	4,265
44	42	43	43	40
20.15	17.47	15.68	13.96	13.36

Dollars in thousands except per share data.

Common Stock Prices:

The Company's common stock is traded on the American and Pacific Stock Exchanges (Ticker Symbol FMI). The range of market prices on the American Stock Exchange and cash dividends paid during the last two fiscal years are shown in the following table.

FMI	American Stock Exchange Market Prices		Cash Dividend declared per Share
	High	Low	
Year ended September 3, 1978			
First quarter	$16¼	$12⅝	—
Second quarter	13⅜	12½	30¢
Third quarter	12⅞	11⅛	—
Fourth quarter	15	11⅞	30¢
			60¢
Year ended September 2, 1979			
First quarter	$21	$14⅝	—
Second quarter	17⅝	15¾	30¢
Third quarter	19½	17⅜	—
Fourth quarter	18	14¼	—
			30¢

Management's Discussion and Analysis of the Summary of Operations

Fiscal 1979 as compared with Fiscal 1978.

Total retail sales for the 52-week year ended September 2, 1979 were $975,029,000, an increase of $278,704,000, or 40.0% over the $696,325,000 reported for the prior 53-week year. During late Summer and Fall of 1978, twenty-three previously acquired stores were reopened as FedMart units after completion of extensive remodeling, refixturization and merchandising, and the introduction of complete supermarket departments at 18 of these stores. This year's sales included $297,987,000 of sales in the new units, whereas last year's sales included $58,917,000 of sales of the stores acquired in January 1978 prior to their conversion to FedMart units.

The percentage of cost of sales to net sales was 79.0% for fiscal 1979, compared to 78.7% for 1978. Selling, administrative and warehousing expenses were 21.7% of net sales, compared with 20.0% for 1978. This increase reflected heavy start-up costs incurred in reopening the 23 new stores and reorganizing the warehousing and distribution facilities of the Company. Gains arising from real estate transactions amounted to $2,767,000 in 1979, compared with $1,064,000 in 1978, of which amounts $2,102,000 and $928,000 occurred during the respective fourth quarters.

The substantial increase in depreciation and interest expense during fiscal 1979 was primarily a result of extensive remodeling of the 23 previously acquired stores opened during the Fall of 1978, significant remodeling of other stores in the chain and substantial additional acquisitions of new equipment.

The after-tax loss for the full fiscal year 1979 amounted to $11,103,000 compared with net earnings of $3,020,000 for fiscal 1978. The LIFO reserve at September 2, 1979 amounted to $10,708,000, which was $4,330,000 higher than at the end of fiscal 1978. Had the average cost, or first-in first-out method been used, the 1979 pretax loss would have been $18,203,000, and the after-tax loss would have been $8,850,000. The 1978 pretax and after-tax earnings would have been $6,834,000 and $3,920,000 respectively.

Income tax credits for fiscal 1979 amounted to 50.7% of pretax losses compared with an effective tax rate of 39.6% for fiscal 1978. The higher than statutory effective tax rate in 1979 was primarily due to the recognition of approximately $800,000 of investment tax credits in the calculation of the overall income tax credits for fiscal 1979.

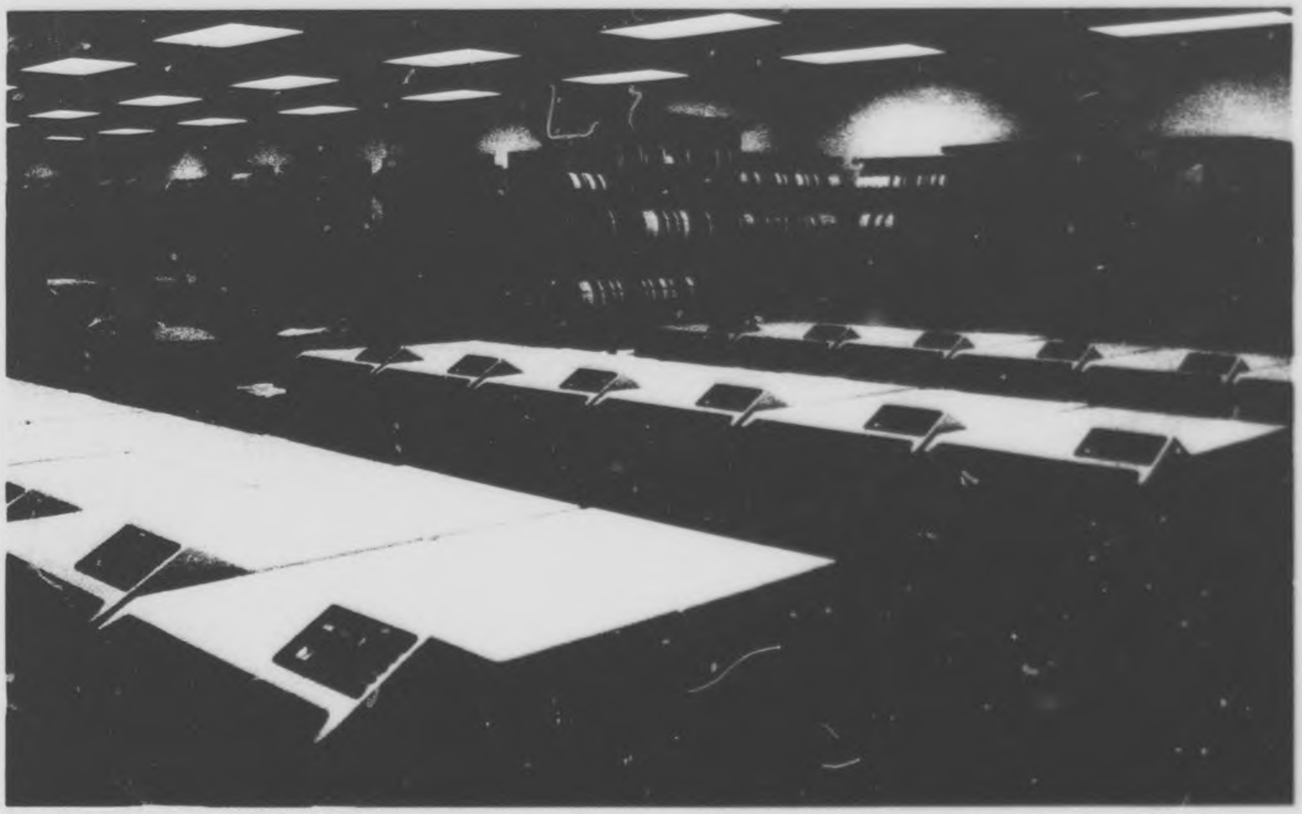
Fiscal 1978 as compared with Fiscal 1977.

Total retail sales were $696,325,000 for the 53-week fiscal 1978, an increase of $153,552,000, or 28.3% over the sales of the 52-week fiscal 1977. Sales of FedMart stores exclusive of stores acquired in fiscal 1978 were $635,408,000, an increase of $92,635,000, or 17.1% over sales in fiscal 1977. Two of the acquired stores were reopened late in August 1978 after having been converted to "FedMarts" and contributed approximately $2,000,000 to fiscal 1978 sales. Sales of the 22 stores acquired in January 1978 while operated under the "Two Guys" name were $58,917,000, 14 stores having been closed after inventory liquidation sales. Of the closed stores, 12 were reopened as "FedMarts" during the first three months of fiscal 1979 and an additional 9 acquired stores were operating under the FedMart name at November 30, 1978.

Net sales were $678,659,000 for fiscal 1978, $624,277,000 for FedMart operations and $54,382,000 for Two Guys stores.

Cost of sales were 78.7% of net sales. The FedMart operations cost of sales percentage was 79.1% of applicable net sales, as compared with 79.5% in last year's period, or a decrease of .4% representing improved gross margins. The Two Guys cost of sales percentage was 73.9% of Two Guys net sales.

Selling, administrative and warehousing expenses were 20.0% of fiscal 1978 sales. Such expenses for FedMart operations were 18.6% of applicable net sales, compared with 18.0% for fiscal 1977. The .6% increase in expenses of FedMart operations was after the effect of reduced California property taxes, and was primarily in connection with preparing the Company for the



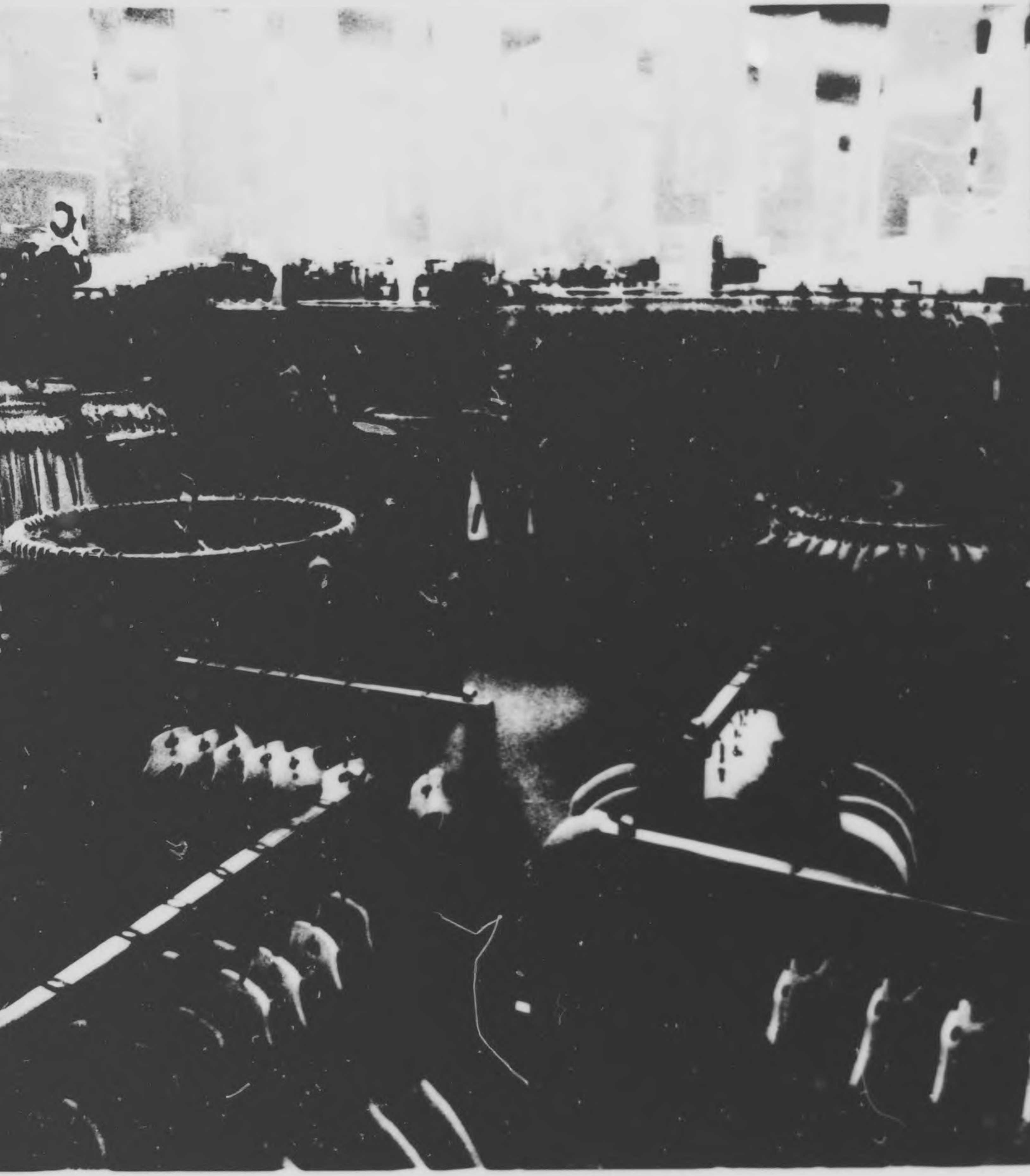
operation of the acquired stores as FedMarts. Such additional costs consisted of staffing and training expenses for new personnel and other pre-opening expenses plus expenses relating to moving into a new central office building. Expenses for the Two Guys stores were 36.2% of Two Guys sales, and do not include $3,651,000 of interest, property taxes, rent and depreciation applicable to stores closed in the spring of 1978 charged against a reserve established for anticipated costs in connection with accounting for the acquisition.

Depreciation and interest expense increased due primarily to the acquisition of the Two Guys stores and related assets.

FedMart operations pretax earnings were $12,200,000 in fiscal 1978 compared with $9,983,000 in fiscal 1977 attributable primarily to the higher sales volume and a $1,064,000 gain on real estate transactions during fiscal 1978. After the loss attributable to the Two Guys stores of $7,201,000, consolidated pretax earnings were $4,999,000.

The income tax provision for fiscal 1978 represented 39.6% of pretax income, compared with 45.3% for fiscal 1977. The decrease in the effective tax rate is due to the higher relationship of investment tax credits to earnings before income taxes.

Advanced computer technology is employed to provide management with sophisticated information systems.



The clothing departments are enjoying a higher penetration of total store sales due to upgraded selection, quality and presentation of merchandise.

Bright, colorful and attractive displays of produce are an integral part of the wide appeal of complete Fe: Mart food departments.

In 1979 FedMart offered shoppers an alternative way to save money by introducing the "Bright Yellow Wrap" generic line of food and sundry products.

Consolidated Financial Statements

The Fed-Mart Corporation and Subsidiaries

Consolidated Balance Sheets

September 2, 1979 and September 3, 1978

	1979	1978 (restated)
Assets		
Current assets:		
Cash and short term securities	$ 7,532	$ 4,624
Accounts and notes receivable, less allowance for doubtful receivables of $178,000 in 1979 and $150,000 in 1978	7,239	6,262
Refundable income taxes	8,109	713
Merchandise inventories	113,263	86,170
Prepaid expenses	2,227	1,721
Total current assets	138,370	99,490
Property and equipment, partially encumbered, at cost (notes 4, 6, 7 and 13):		
Land	29,418	29,795
Buildings and improvements	130,153	101,374
Furniture, fixtures and equipment	49,945	35,264
	209,516	166,433
Less accumulated depreciation and amortization	33,635	25,551
Net property and equipment	175,881	140,882
Investments and other assets	7,081	6,425
	$321,332	$246,797
Liabilities and Shareholders' Equity		
Current liabilities:		
Current installments of mortgages and debentures	$ 3,105	$ 3,083
Current portion of obligations arising under capital leases	2,422	1,446
Accounts payable	64,046	54,723
Accrued expenses and other liabilities (note 5)	20,438	18,200
Total current liabilities	90,011	77,452
Bank loans (note 6)	60,000	19,000
Mortgages and notes payable (note 7)	37,098	37,357
Obligations arising under capital leases (note 13)	35,525	29,223
Other liabilities	1,385	—
Deferred income tax (note 10)	2,180	5,582
Deferred credits	503	621
Subordinated debentures (note 8)	2,887	3,186
Convertible subordinated debentures (note 8)	5,445	6,050
Subordinated loans from majority shareholder (note 8)	—	16,000
Shareholders' equity (notes 6, 8, 9 and 11):		
Preferred stock. Authorized 1,000,000 shares, issued 46,000 shares of 9¾% cumulative preferred at stated value	46,000	—
Common stock, without par value. Authorized 5,000,000 shares; issued 2,225,702 shares in 1979 and 2,237,956 in 1978 at stated value	32,540	32,716
Additional paid-in capital	1,440	1,440
Retained earnings	6,318	18,170
Net shareholders' equity	86,298	52,326
Commitments and contingent liabilities (notes 13 and 14)		
	$321,332	$246,797

See accompanying notes to consolidated financial statements

Amounts in thousands

Consolidated Statements of Operations

Years ended September 2, 1979 and September 3, 1978

	1979	1978
		(restated)
Sales:		
Total retail sales	$975,029	$696.325
Less leased department sales	20,399	17.864
Retail sales of owned departments	954,630	678.461
Wholesale sales	110	198
Net sales	954,740	678.659
Other income:		
Rental income from leased departments and tenants	3,581	3.177
Gains arising from real estate transactions	2,767	1.064
Interest	415	620
Sundry	1,939	1.357
Net sales and other income	963,442	684.877
Costs and expenses:		
Cost of sales	754,696	533.812
Selling, administrative and warehousing expenses	207,253	135.892
Depreciation and amortization	10,522	5.574
Interest and long-term debt expense	14,197	7.222
Less interest capitalized	(693)	(2.622)
Total costs and expenses	985,975	679.878
Earnings (loss) before income taxes	(22,533)	4.999
Income taxes (credits) (note 10)	(11,430)	1.979
Net earnings (loss)	$ (11,103)	$ 3.020
Earnings (loss) per share (note 15):		
Primary	$ (5.54)	$ 1.34
Fully diluted	$ (5.54)	$ 1.28

Amounts in thousands except per share data

Consolidated Statements of Retained Earnings

Years ended September 2, 1979 and September 3, 1978

	1979	1978
		(restated)
Balance at beginning of year	$ 18,170	$ 17,076
Net earnings (loss) for the year	(11,103)	3,020
	7,067	20,096
Less deductions:		
Cash dividends—$.30 per share in 1979 and $.60 per share in 1978	670	1,345
Excess of cost over stated value of shares retired (12,254 shares in 1979 and 10,855 shares in 1978)	79	96
Cost of 22,047 treasury shares retired	—	485
Total deductions	749	1,926
Balance at end of year	$ 6,318	$ 18,170

See accompanying notes to consolidated financial statements

Amounts in thousands except per share data

Consolidated Statements of Changes in Financial Position

Years ended September 2, 1979 and September 3, 1978

	1979	1978
		(restated)
Sources of working capital:		
Net earnings (loss)	$ (11,103)	$ 3,020
Items which do not use working capital:		
Depreciation and amortization	10,522	5,574
Deferred income taxes	(3,402)	2,429
Working capital (used) provided by operations	(3,983)	11,023
Proceeds from Class A preferred stock	15,000	–
Issuance of Class B preferred stock upon conversion of subordinated loans	26,000	–
Proceeds from Class C preferred stock	5,000	–
Proceeds from long-term debt:		
Mortgages assumed—Two Guys acquisition	–	26,086
Subordinated loan	10,000	16,000
Bank loans	41,000	19,000
Other notes and mortgages	2,798	159
Increase in other liabilities	1,385	–
Disposals of property and equipment	3,414	1,996
Obligations arising under capital leases	9,843	17,953
	$110,457	$ 92,217
Uses of working capital:		
Additions to property and equipment:		
Two Guys acquisition including capitalized leases	–	55,417
Other	48,935	26,313
Conversion of subordinated loans to Class B preferred stock	26,000	–
Current installments and repayment of bank loans, mortgages, obligations arising under capitalized leases and debentures	7,502	4,977
Cash dividends	670	1,345
Purchase of common stock	255	253
Other	774	548
Increase in working capital	26,321	3,364
	$110,457	$ 92,217
Changes in components of working capital:		
Increase in current assets:		
Cash	2,908	387
Accounts and notes receivable	977	1,924
Refundable income taxes	7,396	713
Merchandise inventories	27,093	37,502
Prepaid expenses	506	599
	38,880	41,125
Increase (decrease) in current liabilities:		
Current installments of mortgages, debentures and obligations arising under capital leases	998	3,101
Accounts payable	9,323	32,206
Income taxes	–	(1,494)
Accrued expenses and other liabilities	2,238	3,948
	12,559	37,761
Increase in working capital	$ 26,321	$ 3,364

See accompanying notes to consolidated financial statements

Amounts in thousands

Notes to Consolidated Financial Statements

September 2, 1979 and September 3, 1978

(1) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Fiscal Year:
The Company reports on a 52-53 week year ending the Sunday nearest August 31. Fiscal 1979 includes 52 weeks; fiscal 1978 includes 53 weeks.

Principles of Consolidation:
The accompanying financial statements include the accounts of the Company and its wholly-owned subsidiaries. The Company's investments in wholly-owned subsidiaries and a 50%-owned partnership are carried on the equity basis. All significant inter-company accounts and transactions are eliminated in consolidation.

Merchandise Inventories:
Substantially all of the merchandise inventories at both the stores and warehouses are valued on the last-in, first-out (LIFO) cost basis. Had the lower of average cost or market been used, inventory would have been approximately $10,700,000 and $6,400,000 higher than reported at September 2, 1979 and September 3, 1978, respectively. On a first-in, first-out (FIFO) basis, the net loss for fiscal 1979 would have been approximately $8,850,000, as compared to net earnings of $3,920,000 for fiscal 1978, and total preferred and common equity would have been approximately $91,525,000 at September 2, 1979, as compared to $55,450,000 at September 3, 1978.

Property and Equipment:
The provision for depreciation for financial purposes is computed using the straight-line method and composite lives of from 20 to 33⅓ years for buildings and improvements and lives of from 3 to 15 years for furniture, fixtures and equipment.

The costs of maintenance and repairs are charged to expense when incurred. Expenditures for renewals and replacements are capitalized. Upon disposal of assets, the cost and related accumulated depreciation or amortization are eliminated from the accounts and any net gain or loss is credited or charged directly to earnings.

The Company capitalizes interest and real estate taxes on land held for future development or sale and construction in progress. Capitalized interest is computed based on interest expense of mortgages and certain other debt.

Income Taxes:
The Company and its wholly-owned subsidiaries file their Federal income tax returns on a consolidated basis. Investment credits are reflected as a reduction of the Federal income tax provision in the year realized.

Pre-Opening Expenses:
Expenses relating to the opening of new stores are expensed as incurred.

(2) CHANGE IN ACCOUNTING METHOD FOR LEASES — FASB #13

Effective September 4, 1978 the Company changed its method of accounting for leases in accordance with Financial Accounting Standards Board Statement No. 13. The effect of this change on the results of operations for the two fiscal years ended September 2, 1979 and September 3, 1978 was not significant. Statement No. 13 requires that financial statements for prior periods be restated to reflect financial results as though the Statement had been in effect for those periods and, accordingly, the financial statements as of, and for the fiscal year ended September 3, 1978 have been restated. The effect of this change on net earnings, earnings per share and retained earnings as previously reported for the fiscal year ended September 3, 1978 is as follows (amounts in thousands except per share data):

Earnings:	As previously reported	Adjustment	As restated
Net earnings	$3,182	(162)	3,020
Earnings per share:			
Primary	1.42	(.08)	1.34
Fully diluted	1.34	(.06)	1.28

Retained Earnings:

Balance at beginning of year as previously reported	$17,712	
Adjustment for the cumulative effect to August 28, 1977 of applying the new method of accounting for leases		(636)
Balance at beginning of year as restated	$17,076	

(3) ACQUISITION

Effective January 14, 1978 the Company acquired the West Coast Two Guys Discount Department Stores ("Two Guys") and related assets from Vornado, Inc. and certain of its subsidiaries. Pursuant to its acquisition plan, the Company closed 14 stores in the Spring of 1978 and conducted inventory liquidation sales at such locations. One of such stores has been converted into the Company's central headquarters. Extensive remodeling and refixturization, including the introduction of food departments was completed at most of the 13 other closed locations.

The acquisition has been accounted for as a purchase and accordingly the Company's cost of approximately $71,112,000 (including a reserve of approximately $4 million for costs to be incurred in connection with the store closing and remodeling program) has been allocated to the assets acquired based upon independent appraisals, which exceeded the Company's cost allocated to those assets.

The consolidated statement of earnings for the year ended September 3, 1978 includes sales of $58,917,000 and losses before income tax credits of $7,201,000 applicable to the Two Guys operation since its acquisition. In addition, $3,651,000 of interest, property taxes, rent and depreciation applicable to the stores closed in the Spring have been charged against the reserve for anticipated costs in connection with accounting for the acquisition and, therefore, are not included in determining the Two Guys' losses.

The pro forma data reflecting results of operations as though the acquisition had occurred as of August 29, 1977 has not been included because the Company has been advised by Vornado that separate financial statements for the acquired business (which represented only one portion of the West Coast division) were not available since such separate financial statements have not been previously prepared. The Company believes that the inclusion of such data on an estimated basis may be misleading.

(4) PROPERTY AND EQUIPMENT

Property and equipment includes $8,659,000 as of September 2, 1979 and $8,465,000 as of September 3, 1978 of land held for future development or sale. The Company capitalized interest and real estate taxes of $272,000 in 1979 and $415,000 in 1978 applicable to such land. As more fully described in note 3, the Company also capitalized certain costs incurred in connection with the acquisition of the West Coast Division of Two Guys Discount Department Stores.

(5) ACCRUED EXPENSES AND OTHER LIABILITIES

Accrued expenses and other liabilities consist of the following:

	(Thousands)	
	September 2, 1979	September 3, 1978
Taxes, other than income taxes	$ 7,350	$ 6,907
Accrued payroll	3,429	1,902
Accrued vacation pay	3,477	2,756
Accrued employee benefit plans	2,495	1,711
Other accruals	3,687	4,924
	$20,438	$18,200

(6) BANK LOANS

On August 22, 1978 the Company entered into a Credit Agreement with a group of banks which provided for a revolving credit line aggregating $45,000,000, which amount was increased to $47,000,000 by an amendment to the Credit Agreement on August 31, 1979. The revolving period extends to June 30, 1981 when the Company may convert the amount then owing into a term note payable in four semi-annual installments of $3,200,000 beginning December 31, 1981 and six semi-annual installments of $5,700,000 beginning December 31, 1983.

At the Company's option interest is based on the agent bank's prime lending rate or the rate at which dollars are offered by the agent bank to prime banks in the London Interbank Eurodollar (LIBOR) market, each of which are increased by specified percentages. Such rates ranged from 12¼% to 13¾% at September 2, 1979. A commitment fee of ½ of 1% per annum is payable on the unused portion of the credit line during the revolving period. The Company has agreed to maintain compensating balances with the banks equal to 10% of the unused credit line, 15% of the borrowings based on the prime rate, and amounts necessary for compliance by the banks with Federal regulations for Eurodollar borrowings. (There were no such Federal requirements during fiscal 1979.)

The Credit Agreement, as amended, contains, among other provisions, a requirement for the Company to maintain certain minimum levels of equity, working capital and current ratios, certain limitations with respect to cash or other distributions and a maximum debt to equity ratio (as such terms are defined in the Agreement), all of which were complied with at September 2, 1979 and September 3, 1978.

On August 31, 1979 the Company also amended its agreements with European lenders to provide additional loan commitments aggregating $25 million U.S. dollars. The loans mature September 30, 1983 when the Company may extend the loans for another three years. The loans are secured by mortgages on four properties with a net book value of approximately $15,551,000 at September 2, 1979.

Interest is based on the rate at which deposits are offered to banks by prime banks in the London Interbank Eurodollar (LIBOR) Market which is increased by specified percentages. Such rates ranged from 12-13/16% to 12-15/16% at September 2, 1979. A commitment fee of ½ of 1% is payable on the unused portion of the commitment. The Loan Agreements, as amended, provide for financial covenants similar to those in the Credit Agreement for the revolving credit line, all of which were complied with at September 2, 1979.

The Company also has a seasonal line of credit in the amount of $5 million from two U.S. Banks with compensating balance requirements equal to 10% of the aggregate of the unused credit line and 15% of the amounts borrowed. Interest is payable on amounts borrowed at ¼ of 1% in excess of the prime rate. The average amount of short-term borrowings was not significant in fiscal 1979 or 1978 and the maximum amount borrowed at any month end was $3 million.

See note 8 for maturities of bank loans for each of the five years subsequent to September 2, 1979.

(7) MORTGAGES AND NOTES

A summary of noncurrent mortgages and loans follows:

	(Thousands)	
	September 2, 1979	September 3, 1978
5½% to 10% mortgage notes secured by land and buildings with a net book value of $64,548,000	$34,992	$36,512
Other notes payable	2,106	845
	$37,098	$37,357

See note 8 for maturities of mortgages and notes for each of the five years subsequent to September 2, 1979.

(8) SUBORDINATED LOAN AND DEBENTURES

Noncurrent subordinated loan and debentures consist of the following:

	(Thousands)	
	September 2, 1979	September 3, 1978
6¾% convertible subordinated debentures	$ 5,445	$ 6,050
6½% junior subordinated debentures less debentures held in treasury—$196,200 in 1979 and $222,300 in 1978	924	1,054
9% subordinated capital debentures	1,963	2,132
Subordinated loan	—	16,000
	$ 8,332	$25,236

The 6¾% subordinated debentures are due March 1, 1989, and are convertible through February 28, 1989. Sinking fund requirements are 10% annually commencing March 1, 1980. See note 9 for conversion information.

The 6½% junior subordinated debentures are due February 1, 1987, and the sinking fund requirements are $156,000 annually on each January 31 through 1986. The $156,000 is used to retire outstanding debentures.

The 9% subordinated capital debentures are due February 1, 1988, and are payable in semi-annual installments of $189,000, including interest and have been discounted using a 10% imputed interest rate.

The subordinated loan outstanding at September 3, 1978 of $16,000,000 and another $10,000,000 subordinated loan made to the Company in November 1978 were cancelled as of May 13, 1979 in consideration of the issuance of 26,000 shares of 9¾% Class B Cumulative Preferred Stock.

Maturities of all classes of subordinated debentures and bank loans, mortgages, leasehold obligations and other notes payable (summarized in notes 6, 7 and 13) for each of the five years subsequent to September 2, 1979, are summarized below:

	(Thousands) 1980	1981	1982	1983	1984
Bank loans—revolving	$ —	$ —	$ 6,400	$ 6,400	$11,400
Mortgages and notes	2,175	2,364	1,623	1,305	1,378
Debentures	930	947	967	988	1,011
Obligations arising under capital leases	2,422	2,665	2,530	2,638	2,873
Total	$5,527	$5,976	$11,520	$11,331	$16,662

(9) SHAREHOLDERS' EQUITY

Changes in preferred stock, common stock and additional paid-in capital during 1979 and 1978 are summarized as follows:

	9¾% cumulative Preferred stock Shares	Amount	(Thousands) Common stock Shares	Amount	Additional paid-in capital
Balance at Aug. 28, 1977			2,271	$32,873	$1,440
Stated value of shares retired			(33)	(157)	
Balance at Sept. 3, 1978			2,238	32,716	1,440
Preferred stock issued:					
Class A—for cash	15	$15,000			
Class B—in exchange for cancellation of subordinated loans	26	26,000			
Class C—for cash	5	5,000			
Stated value of shares retired			(12)	(176)	
Balance at September 2, 1979	46	$46,000	2,226	$32,540	$1,440

All classes of 9¾% Cumulative Preferred Stock which are non-voting and non-convertible are, for all purposes, deemed to be on a parity with each other, and the terms are substantially the same. A cumulative dividend of 9¾% per annum is payable each November 1 and May 1. The Preferred Stock may be called for redemption at any time by the Company without premium. If not called, the shares will be redeemed in five equal annual installments commencing May 1, 1989, at $1,000 per share.

The provisions of the bank loans and debentures impose, among other things, certain limitations with respect to cash or other distributions. At September 2, 1979, the most restrictive of these provisions precluded the Company from declaring dividends on any shares until the Company has earned at least $5,327,000 cumulative after September 2, 1979, as well as an amount equal to any shares redeemed and the amount of the dividend. The Company anticipates that the Board of Directors will not declare the dividend due November 1, 1979, on its Preferred Stock in the amount of $1,982,000.

Of the authorized and unissued common stock, 265,934 shares at September 2, 1979, and September 3, 1978, were reserved for conversion of the 6¾% subordinated debentures issued February 1, 1969. The conversion price of $22.75 per share in 1979 and 1978 is subject to adjustment in certain specified instances. In addition, the Company's majority shareholder has an option to purchase one share of the Company's common stock for every share issued upon conversion of these debentures if such conversion reduces his percentage interest to less than 51% of the shares outstanding immediately after such conversion of debentures. The purchase price of the shares which may be acquired pursuant to the option was $20.28 at both September 2, 1979 and September 3, 1978.

(10) INCOME TAXES

The provision for income taxes is made up of the following components:

	(Thousands) September 2, 1979	September 3, 1978
Current:		
Federal	$ (8,046)	$ (485)
State	18	35
Total current	(8,028)	(450)
Deferred:		
Federal	(3,384)	2,104
State	(18)	325
Total deferred	(3,402)	2,429
Total provision	$(11,430)	$1,979

The effective Federal tax provision rates were different than 48% primarily due to the utilization of investment credits of $495,000 in fiscal 1978 and $800,000 in fiscal 1979 which was recognized as a reduction in deferred Federal income taxes.

Deferred tax expense results from timing differences in the recognition of revenue and expense for tax and financial statement purposes. The sources of these differences and the tax effect of each were as follows:

	(Thousands) September 2, 1979	September 3, 1978
Excess depreciation	*	$ 876
Capitalized carrying costs:		
Interest		1,245
Taxes		428
Rents		80
Timing differences arising from capital leases		(321)
Vacation pay expense		56
Installment sale to real estate subsidiary in separate return year		88
Bond discount		(74)
Estimated liabilities		253
Rent income		(70)
Other		(132)
		$2,429

*At September 2, 1979, the Company had a tax net operating loss carryforward of approximately $6,050,000. In addition the Company had approximately $800,000 of investment and new jobs tax credit carryforwards. If not utilized to offset future taxable income or tax, these carryforwards will expire in 1986. For financial statement purposes the tax carryforwards have been recognized by reducing net deferred tax credits in the amount of $3,384,000. To the extent these carryforwards are utilized in future years for income tax purposes, the net deferred tax credits will be restored at the then current rates.

Based on currently anticipated operations, the Company does not expect cash outlays for income taxes to exceed the tax provisions to be provided during the next three years.

The Federal income tax returns of the Company have been examined by the Internal Revenue Service through the year ended August 29, 1976. Management believes adequate provision has been made in the accounts for tax liabilities which may become payable with respect to years subject to examination.

(11) EMPLOYEE STOCK OPTIONS

Under the Company's qualified stock option plan, options to purchase common stock of the Company may be granted to employees to purchase shares for a period of up to five years at prices equivalent to market value at dates of grant.

A summary of stock options granted (adjusted for 2% stock dividend, where applicable), exercised, cancelled, outstanding, exercisable and available for granting follows:

	Number of shares	Option price Per share	Total
Outstanding and exercisable at August 28, 1977—granted in 1973	3,120	$19.11-19.59	$ 60,625
Granted during year ended September 3, 1978	45,000	12.25-13.50	557,500
Cancelled during year ended September 3, 1978	(3,120)	19.11-19.59	(60,625)
Outstanding and exercisable at September 3, 1978	45,000	12.25-13.50	557,500
Granted during year ended September 2, 1979	3,000	16	48,000
Outstanding and exercisable at September 2, 1979	48,000	$12.25-16.00	$605,500
Available for granting:			
At September 3, 1978	10,287		
At September 2, 1979	7,287		

(12) PROFIT SHARING PLANS

The Company has two profit-sharing plans for its employees to which the Company contributes amounts as determined by the Board of Directors. The cost of such plans amounted to $710,000 in 1978. For 1979, the Company did not make any contributions to the plans.

(13) LONG-TERM LEASES AND COMMITMENTS

The Company owns about half of the real estate used in its store and warehouse operations. The remainder of its operations are conducted on real estate which is leased. The standard lease period is for 20 to 25 years, and most leases contain renewal options. Portions of both owned and leased real estate are leased or sublet under leases or subleases expiring at various dates over the next 40 years. In addition, the Company uses certain vehicles and equipment under lease agreements expiring at various dates over the next 10 years.

In November 1976 the Financial Accounting Standards Board issued Statement No. 13 "Accounting for Leases." Certain leases in effect at December 31, 1976, which were being accounted for by the operating method are now classified and accounted for as "capital leases" under Statement No. 13.

The following schedule analyzes assets that have been accounted for as capital leases and are reported in the accompanying balance sheet:

	(Thousands) September 2, 1979	September 3, 1978
Buildings	$30,987	$28,229
Equipment	10,281	4,107
	41,268	32,336
Less accumulated amortization	(6,480)	(3,882)
Net leased assets under capital leases	$34,788	$28,454

At September 2, 1979, minimum rental payments due under all leases are as follows:

	(Thousands) Capital leases	Operating leases
1980	$ 5,763	$ 2,339
1981	5,717	2,243
1982	5,513	1,915
1983	5,388	1,727
1984	5,366	1,709
Later years	44,939	22,479
Total minimum rental payments (a)	$72,686	$32,412
Imputed interest (rates ranging from 6.00% to 10.125%)	(34,739)	
Present value of net minimum rental payments (b)	$37,947	

(a) Minimum rental payments under capital and operating leases have not been reduced by minimum sublease rentals of $1,136,000 and $10,483,000 respectively due in the future under noncancellable subleases and do not include contingent rentals that may be paid under certain leases.

(b) Presented in the accompanying balance sheet at September 2, 1979 as current and noncurrent obligations under capital leases of $2,422,000 and $35,525,000, respectively.

Total rental expense for the years ended September 2, 1979 and September 3, 1978 was as follows:

	(Thousands) September 2, 1979	September 3, 1978
Operating leases:		
Minimum rentals	$6,962	$3,576
Contingent rentals	57	55
	7,019	3,631
Capital leases, contingent rent	924	647
Total rent expense	$7,943	$4,278

Contingent rentals are determined on the basis of a percentage of sales in excess of stipulated minimums for certain store facilities. Most of the Company's leases provide for the Company to pay taxes, insurance, maintenance and certain other operating expenses applicable to the leased premises. Management expects that in the normal course of business, leases that expire will be renewed or replaced by other leases.

The Company's net investment as lessor or sublessor in capital leases or subleases is insignificant.

(14) CONTINGENT LIABILITIES

In March 1976 a former chairman and president of the Company commenced two actions against members of the Company's Board of Directors; the Company is not a party to these actions. Judgment was entered in favor of the defendants in both of those actions. An appeal in one of those actions has been decided in favor of the defendants and an appeal in the other currently is pending. In a related action, on November 16, 1976, the day prior to the commencement of a rights offering to the Company's shareholders, an action was filed against the Company and its directors seeking, among other things, the involuntary winding up and dissolution of the Company, and damages from certain defendants other than the Company. A trial date of October 15, 1979 was vacated by the court and no new trial date has been set. The individual defendants in the three related actions may assert a right to indemnification from the Company.

In April 1976 an action under the Federal False Claims Act was commenced against various operators of retail pharmacies in the San Diego area, including the Company. The complaint alleges that the various defendants filed claims for Medi-Cal prescriptions exceeding the maximum amount permitted by law. Summary judgment was entered in favor of the Company on jurisdictional grounds and an appeal by the plaintiff currently is pending.

In June 1977 a public interest group and others filed an alleged class action, on behalf of all Southern California consumers of beef, against various meat packing companies, including some of those from which the Company previously purchased meat, asking for injunctive relief and damages based upon allegations that the defendants mislabeled beef and acted together to inflate artificially the price of beef. In October 1979 the complaint was amended to add as parties additional meat packing companies, as well as five retail chains, including the Company.

In April 1979 the State of Arizona issued a deficiency assessment against the Company for uncollected sales tax on sales at the Company's store located on the Navajo reservation.

The Company intends to vigorously defend against these actions and it is the opinion of the Company, based in part on the advice of its legal counsel, that the outcome of the matters described above will not have a material adverse effect on the Company's financial position.

(15) EARNINGS (LOSS) PER COMMON SHARE

Fiscal 1979:

Primary loss per common share is based on the weighted average number of common shares outstanding during the year of 2,232,237 and the adjustment to earnings of $1,259,000 reflecting the preferred dividend requirements. As the effects of stock options and convertible debentures were anti-dilutive, the fully diluted loss per common share is the same as the primary loss per common share.

Fiscal 1978:

Primary earnings per common share are based on the weighted average number of common shares outstanding of 2,247,676 during 1978, which assumes the exercise of options at option prices which were lower than the average market price during the year.

Fully diluted earnings per common share is based on the weighted average number of common shares outstanding during the year of 2,516,781, which assumes the conversion at the beginning of the year of convertible debentures outstanding at the end of the year, and the adjustment to earnings reflecting the after tax effect of the related interest, and reflects the additional dilution due to options, resulting from the use of quarter-end market prices in those quarters where such prices were higher than average market prices.

(16) SUMMARY OF QUARTERLY DATA (Unaudited)

The Company's interim quarters consist of 12-week periods with the final quarter comprising a 16 or 17-week period. A summary of the unaudited data for fiscal 1978 (restated—see note 2) and 1979 follows (in thousands, except per share data):

	12-week periods ended			17-week period ended
Fiscal 1978:	November 20, 1977	February 12, 1978	May 7, 1978	September 3, 1978
Net sales and other income	$127,184	$155,536	$169,219	$232,938
Cost of sales	100,341	121,694	131,220	180,557
Net earnings	697	1,698	18	607
Earnings per share:				
Primary	.31	.76	.01	.26
Fully diluted	.30	.69	.01	.28

	12-week periods ended			16-week period ended
Fiscal 1979:	November 26, 1978	February 18, 1979	May 13, 1979	September 2, 1979
Net sales and other income	$181,851	$251,423	$228,141	$302,027
Cost of sales	142,153	199,206	182,738	230,599
Net earnings (loss)	(5,305)	(1,954)	(6,566)	2,722
Earnings (loss) per share	(2.36)	(.87)	(2.95)	.64

The results of operations for interim periods are not necessarily indicative of results for a full year partly due to the seasonal nature of the Company's business. Additionally, cost of sales calculations for interim periods include estimates of the annual LIFO provision and annual cost to retail percentages, which cannot be actually determined until year-end LIFO inventories are determined.

Certain adjustments in connection with determining year-end inventory valuations and annual income tax credits were recorded at year-end. These adjustments had the effect of decreasing cost of sales by approximately $1,200,000 and increasing net earnings for the 16 weeks ended September 2, 1979 by approximately $3,000,000 of which approximately $2,400,000 related to income tax credits.

(17) REPLACEMENT COST INFORMATION (Unaudited)

In compliance with requirements of the Securities and Exchange Commission, the Company has developed estimated replacement costs for its inventories and property and equipment as of September 2, 1979 and September 3, 1978, together with related amounts of cost of sales and depreciation calculated on the basis of replacement cost for the years then ended.

These rules were established by the Commission to provide investors with information about the effect of current inflationary conditions on the business. The information developed by the Company confirms the significant impact of inflation on the cost of doing business.

The replacement cost information together with a description of estimating techniques is included in the Company's Form 10-K filed with the Commission and is available on request.

Report of Independent Accountants

The Board of Directors
The Fed-Mart Corporation:

We have examined the consolidated balance sheets of The Fed-Mart Corporation and subsidiaries as of September 2, 1979 and September 3, 1978, and the related consolidated statements of operations, 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 The Fed-Mart Corporation and subsidiaries at September 2, 1979 and September 3, 1978 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 after restatement for the change, with which we concur, in the method of accounting for leases as described in note 2 to the consolidated financial statements.

Peat, Marwick, Mitchell & Co.

October 31, 1979
San Diego, California

Form 10-K Report:
A copy of the Company's Annual Report on Form 10-K filed with the Securities and Exchange Commission will be made available to shareholders without charge by written request addressed to:
Shareholder Relations
The FedMart Corporation
3851 Rosecrans Street, San Diego, California 92110

Transfer Agent and Registrar:
Common Stock—
Security Pacific National Bank
Los Angeles, California

Trustees:
6¾% Convertible Subordinated Debentures—
Bank of America National Trust & Savings Association, Los Angeles, California;
6½% Junior Subordinated Debentures—
Security Pacific National Bank, Los Angeles, California;
9% Subordinated Capital Debentures—
United California Bank, Los Angeles, California

Legal Counsel:
Stroock & Stroock & Lavan

Stock Exchanges:
American Stock Exchange
Pacific Stock Exchange

Auditors:
Peat, Marwick, Mitchell & Co.

The FedMart Corporation
Corporate Offices
3851 Rosecrans Street, San Diego, California 92110

Directors

Hugo Mann*
Chairman of the Board of The FedMart Corporation, Chief Executive Officer of Mann Group of retail enterprises in West Germany

Heinz L. Gundlach*
Vice-Chairman of the Board and President of The FedMart Corporation

Robert B. Anderson
Chairman of Robert B. Anderson & Co., Ltd., International Business Consultants (Secretary of U.S. Treasury, Eisenhower Administration)

Peter T. Dixon*
Vice President, Loeb Rhoades, Shearson & Co., Investment Bankers

David Lubart
A Senior Partner, Stroock & Stroock & Lavan, Attorneys

*Member of the Executive Committee of the Board of Directors

Officers

Hugo Mann
Chairman of the Board and Chief Executive Officer

Heinz L. Gundlach
Vice Chairman of the Board and President

David L. Doten
Executive Vice President—Operations

Edward B. Maron, Jr.
Executive Vice President—Merchandising

Robert H. Quayle, III
Executive Vice President—Merchandising

Lawrence M. Sherman
Executive Vice President—Legal and Administration, Secretary

Norman J. Alpert
Senior Vice President—General Merchandise Manager

Daniel Goodman
Senior Vice President—General Merchandise Manager

Thomas H. Riches
Senior Vice President—Arizona Division Manager

Raymond A. Stone
Senior Vice President—General Merchandise Manager

James J. Vigue
Senior Vice President—Los Angeles Division Manager

Frank W. Wilson
Senior Vice President—San Diego Division Manager

Ray Balwierczak
Vice President—Warehousing and Distribution

Charles Burnett
Vice President—General Merchandise Manager

Dale A. Christy
Vice President—Management Information Systems

John J. Harris
Vice President—Merchandising Planning

William F. Motts
Vice President—Corporate Facilities

Leland Pollock
Vice President—Meat Operations

Edward P. Samiljan
Vice President—Photofinishing Division

John M. Shanklin
Vice President and Controller

John M. Spear
Vice President and Treasurer

Harry Steiner
Vice President—TBA Operations

Rudolph Welch
Vice President—Texas Division Manager

Nathan Zechter
Vice President—Advertising

Store Locations

Arizona: Mesa, Phoenix (4), Tempe, Tucson (3), Yuma, Window Rock.

California: Alhambra, Anaheim, Calexico, Chula Vista (3), Covina, Culver City, El Cajon (3), East Los Angeles, Escondido, Garden Grove (2), Goleta (2), Huntington Beach, Indio, La Habra, La Mesa, Lancaster, Long Beach (3), Manhattan Beach, National City, Northridge, Oceanside, Ontario, Oxnard, Pacoima, Rialto, San Bernardino (2), San Diego (5), South Gate, Torrance.

New Mexico: Las Cruces.

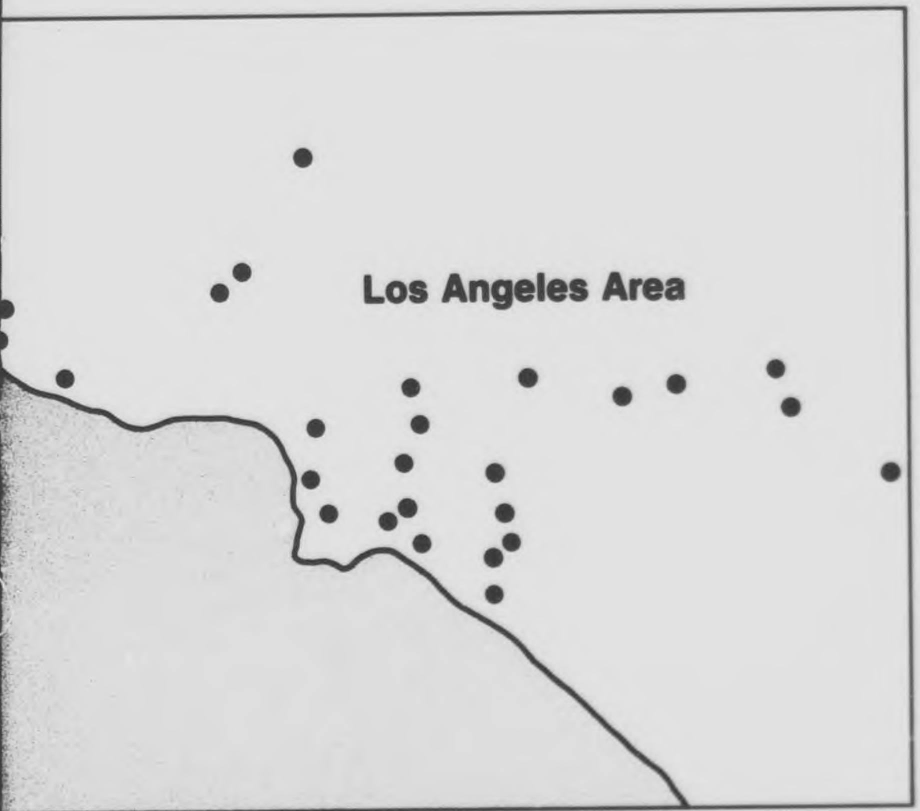
Texas: Brownsville, College Station, Dallas (2), El Paso (2), Houston (6), San Antonio (2), Victoria.

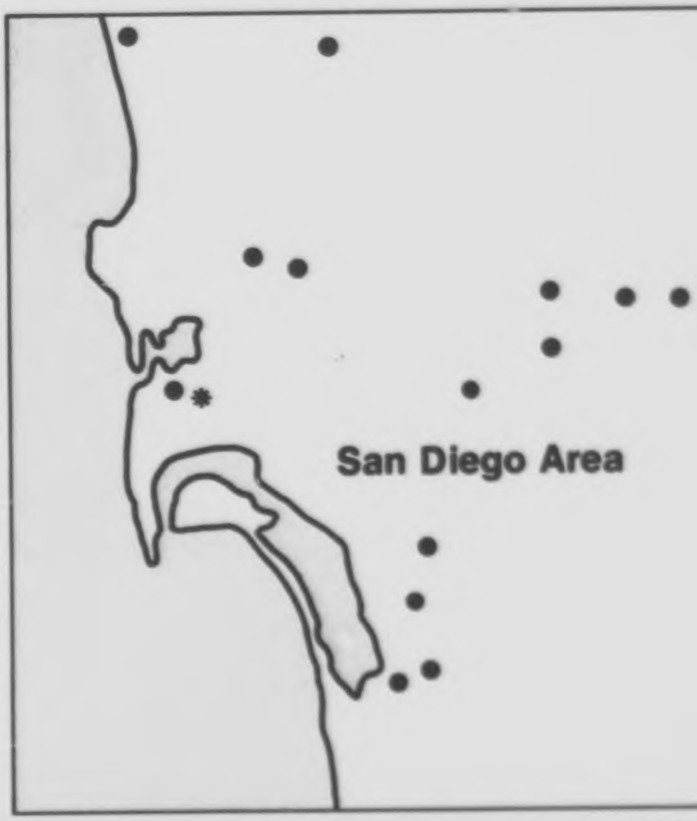
Warehouses: San Diego, Los Angeles, Phoenix, Houston, San Antonio.

Photofinishing: TruColor Foto, San Diego.

FedMart*

***America's Greatest General Store**





Since August 1978 the Company opened 26 new stores. All stores are located in the rapidly growing sunbelt region of the country.