West Marine

We make boating more fun!™

1999 annual report

about West Marine

West Marine, Inc. is the nation's largest specialty retailer of recreational and commercial boating supplies and apparel. The Company provides customers with leading national brands of marine hardware, electronics and apparel, along with its own well-regarded lines of high-value private-label products.

The Company offers its broad assortment to consumers and professionals in the marine industry through its Stores, Catalog (including Internet business) and Port Supply (wholesale) divisions. Over 3,500 associates in 38 states across the country provide our customers with friendly, knowledgeable service, competitive prices and a "No Hassle" satisfaction guarantee.

At the end of 1999, the Stores division operated 227 retail locations under the names West Marine and E&B Marine. With over twice the number of retail locations as the nearest competitor, West Marine makes more products conveniently available to more boaters than anyone else in its industry.

The Company also serves the needs of boaters worldwide who have access to over 40,000 products through our Catalog division. Items offered are pictured and described in detail in our print catalogs and on our website. The Company is well known for providing its customers with technical information and advice on product selection through its experienced associate team and through 'West Advisor' articles published in catalogs and on the website.

The Company's Port Supply division is the country's largest wholesale distributor of marine equipment. It provides products and services to boat manufacturers, marine services, commercial vessel operators and government agencies.

West Marine
We make boating more fun!™

Selected Financial Data

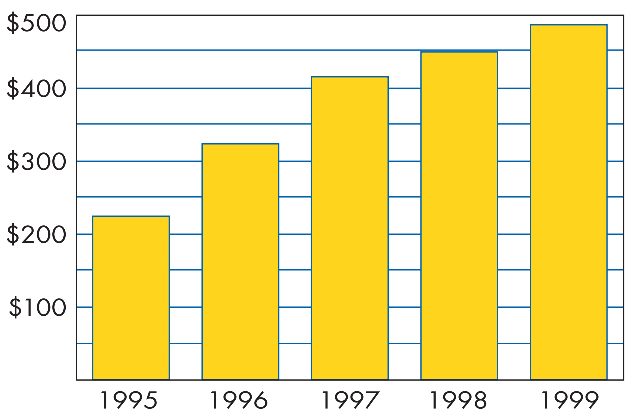
(in thousands, except per share and operating data)

	1999	1998	1997	1996	1995
Consolidated Income Statement Data:					
Net sales	**$486,491**	$449,296	$ 415,208	$323,300	$224,204
Income from operations	**20,395**	8,665	29,116	21,156	16,198
Income before income taxes	**14,765**	2,594 (1)	25,487	19,490 (2)	14,819
Net income	**8,711**	1,098 (1)	15,173	11,566 (2)	8,975
Net income per common and common equivalent share:					
Basic	**$ 0.51**	$ 0.06 (1)	$ 0.91	$ 0.73 (2)	$ 0.64
Diluted	**$ 0.50**	$ 0.06 (1)	$ 0.86	$ 0.68 (2)	$ 0.61
Consolidated Balance Sheet Data:					
Working capital	**$130,539**	$ 143,974	$ 149,242	$ 92,948	$ 58,619
Total assets	**286,860**	279,545	275,888	211,514	95,845
Long-term debt	**71,843**	94,367	92,960	37,997	8,284
Operating Data:					
Stores open at year-end	**227**	212	184	151	72
Comparable stores net sales increase	**1.8%**	1.2%	5.0%	5.4%	9.0%

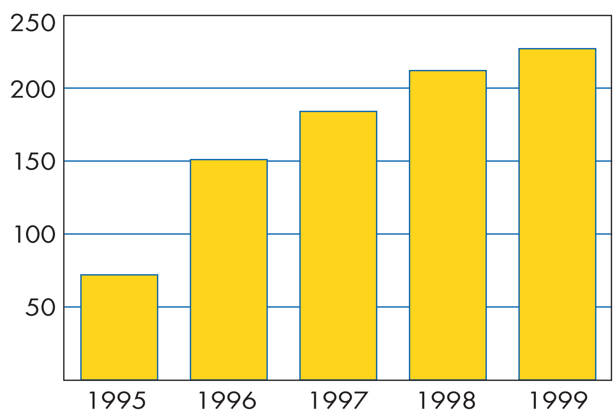
(1) Includes a $3.3 million pre-tax charge for expenses related to the distribution center move in 1998. The impact of this charge represents $0.08 per basic and diluted share.

(2) Includes a $3.0 million pre-tax charge for expenses related to the integration of E&B Marine, Inc. in 1996. The impact of this charge represents $0.11 and $0.10 per basic and diluted share, respectively.

Net Sales (in millions)



Stores Open at Year-End



Dear Shareholders,

The story of fiscal 1999 is about building momentum as we entered the new millennium. It's about hard work, new initiatives and, I'm pleased to report, significantly increased profitability over fiscal 1998. West Marine achieved net sales of $486.5 million, up 8.3% from $449.3 million in 1998. Our net income rebounded to $8.7 million, or $0.50 per diluted share, compared to net income of $1.1 million or $0.06 per diluted share in fiscal 1998. Gross margins compared to last year were up 155 basis points, primarily through leveraging purchasing and distribution costs, reduced shipping expenses and shift to a more profitable product mix.

momentum

In 1999, the Company focused on improved execution as we renewed our commitment to delivering "better than expected" service to our customers. Issues that had impacted both service levels and our profitability in 1998 were aggressively addressed and resolved prior to the critical second and third quarter selling season in 1999. I'm pleased to report that our distribution centers consistently improved upon their productivity and accuracy goals throughout the year and are well positioned for the 2000 boating season.

In 1999, the Company focused on improved execution as we renewed our commitment to delivering "better than expected" service to our customers

We broadened our store presence in 1999 with the opening of 17 new locations in Boardman, OH, Lafayette, LA, Oshkosh, WI, Slidell, LA, Pittsburgh, PA, Albany, NY, Pt. Washington, NY, Rehoboth Beach, DE, North East, MD, Anchorage, AK, Hermitage, TN, Henderson, NV, Southwest Harbor, ME, Traverse City, MI, Midvale, UT, Narragansett, RI, and Point Richmond, CA. With 227 stores in 38 states, we now have over twice as many retail store locations as our nearest competitor. We continue to maintain our dominant presence nationwide.

West Marine was a pioneer in transforming the marine supply industry from a patchwork of waterfront chandleries to bright, well organized stores staffed by friendly, experienced boaters. This year, in conjunction with a leading retail architecture and design group, we

Our new prototype store in Point Richmond, California is a far cry from the waterfront chandleries that once dominated the marine supply industry. Created in conjunction with an award-winning retail architecture and design group, this new store presents both merchandise and information in a visually exciting way that's designed to make the shopping experience fun while enabling the stores' staff to efficiently serve a large volume of customers. We plan to incorporate many of the features of this prototype store in the 24 stores slated for remodeling in 2000.

The Company continues to strengthen its offerings to powerboaters by more fully addressing on-water activities.

Early in 2000 we will aggressively expand our water sports selection throughout the chain.

We will also introduce Mercury outboards in our stores under an exclusive dealer agreement.

Merchandise is arranged to enable customers to select everything needed to complete a project without the need to hunt from one aisle to the next. In 2000, all stores will also have Internet access to our website and over 40,000 products in our online inventory, far more than can be accommodated in even our largest stores. Customers can choose to pick up their order at the store or have it delivered to their home or business directly from our distribution centers.

Key areas of the store feature signage, displays and detailed step-by-step instructions to lead customers through a logical selection process with or without a sales associate's assistance. Much of the information presented is derived from our famous West Advisors that have been adapted from our catalog pages for use in a retail environment.

developed a new concept store in Point Richmond, California that further advances the art and science of marine retailing.

This new store presents both merchandise and information in a visually exciting way that's designed to make the shopping experience fun while enabling a minimal store staff to efficiently serve a large volume of customers. Key areas of the store feature signage, displays and detailed step-by-step instructions to lead customers through a logical selection process with or without a sales associate's assistance.

As planned, 1999 was a year of transition and, in many areas of the Company, a year of transformation.

Merchandise is arranged to enable customers to select everything needed to complete a project without having to hunt from aisle to aisle. In 2000, all stores will also have Internet access to our website and over 40,000 products in our online inventory, far more than can be accommodated in even our largest stores. Online customers will have the option of picking up their order at the store or having it delivered to their home directly from our distribution centers.

Sales through our Catalog division were up 7% over 1998. Continuing a trend we've seen over the past several years, our International sales were particularly strong and grew by 20% in 1999. To better serve the demand internationally, we launched a new program to offer customers in Canada, the UK, France, Germany and Australia fully-loaded pricing. This means that the published price in those countries is the price they will pay with all duties and taxes pre-calculated. These orders are already pre-cleared through customs, enabling us to provide faster international delivery than ever before.

innovation

Our Port Supply wholesale division had an outstanding 1999 with sales up over 23% compared to the prior year. Dramatically improved order fill-rates attributable to the stabilization of the distribution centers accounted for much of the increase in sales. In mid-2000, Port Supply will launch its business-to-business e-commerce website for which we have high expectations.

As planned, 1999 was a year of transition and, in many areas of the

Our website was totally redesigned and relaunched in 1999. westmarine.com enables customers to get the information and assistance they need to make intelligent product choices 24 hours a day from anywhere in the world.

Our online store enables us to picture and describe a much broader range of products than can be accommodated in even our largest stores. Breadth of selection and 24 hour access to it from anywhere in the world has made electronic commerce the fastest-growing distribution channel in history.

Among the most frequently visited areas of the site are our online West Advisors and Technical Information areas. Knowledgeable advice on the products we sell has always been a key component of the West Marine brand. The ability of the Internet to provide easy access to this information makes it an invaluable resource for customers worldwide.

More than just an online store, our website includes news, feature stories and other information of interest to boaters. There are lots of reasons for boaters to visit our site, whether or not they need to make a purchase.

Company, a year of transformation. Aggressive new programs in marketing, merchandising, e-commerce, distribution, store operations and information systems involved every member of our outstanding associate team. Accountability is becoming accepted as a core value at West Marine and we are committed to improving execution, reducing expense and managing the culture to improve customer service and associate satisfaction.

execution

Our people were challenged to critically assess the methods they use to reach their goals and to explore promising alternative strategies. For example, we began a pilot program in cooperation with the Senn-Delaney unit of Arthur Andersen to simplify store operations and establish a strong selling culture to compliment our excellent service culture. Every aspect of the pilot stores processes were evaluated.

Unnecessary procedures were eliminated, increasing time with customers, and a selling program was added which yielded encouraging results. The lessons learned in this pilot will be rolled out to our larger stores beginning in early 2000.

A highlight of 1999 was the mid-year launch of our redesigned website, www.westmarine.com. As e-commerce continues to grow in importance, we have committed the people and resources that will be required to develop ours into a world-class site for boaters. Since going “live” with our site in July, sales through year-end have dramatically increased over the same period a year ago. As is true of our Catalog division, our internet site has generated strong international sales. If you haven’t yet seen our new site, I urge you to log on and let me know what you think of it.

We will be rolling out the West Advantage customer affinity program nationwide in Spring 2000.

In other initiatives, we broadened our reach to both current customers and potential new customers through an innovative partnership with key vendors in our highly successful Key Season marketing program. Also in 1999, we tested several versions of a new

The West Advantage Program

Our new West Advantage program is designed to enable us to serve more of our customer's needs. A series of pilot programs launched in the summer of 1999 generated an overwhelmingly positive response from our customers and the program will be rolled out nationwide in Spring 2000.


The West Advantage Club

$10 Reward Certificate

Signature: Date: 26nov94 FOR STORE USE ONLY Store #: 018

Please sign and present this Certificate to the cashier the next time you visit a West Marine store. Or if you're making a purchase through the catalog or internet, simply provide the certificate number.

You can redeem this Certificate for up to $10 (no change will be given) on any product you purchase from West Marine, including sales tax.

ATTN Cashier: Ring through register as a dollar discount transaction.

West Marine

One of the most popular features of the West Advantage program is a points system that lets customers earn reward certificates good for dollars-off their West Marine purchases.

All West Advantage members are enrolled in our TheftGuard program which provides a $1000 reward for information leading to the conviction of anyone caught stealing or damaging a member's vessel.

In 2000 we will offer customers a new West Marine credit card. This program will reward our loyal customers and, we hope, will attract new customers by offering the option of deferred billing on major purchases.

Modeled on the success of our boat insurance program, we have partnered with a financial services firm to offer a boat financing program and with Vessel Assist Association of America to offer towing services. These services, along with our Electronics, Outboard Motor and Inflatable Boat Repair Centers and our Rigging Shop make West Marine a one-stop source for our customers.

customer affinity program in selected markets. These tests generated extremely favorable customer response and we will be rolling out the West Advantage customer affinity program nationwide in Spring 2000.

I am proud of what the Company has accomplished this year and excited about the prospects for 2000 and beyond.

To cope with the demands of a vital and growing Company, we've strengthened our management team by aggressively recruiting talented executives from top retailers across the country.

We are committed to the goal of making boating more fun for our customers by serving them with better selection, better pricing and better service through each of our sales channels. As we enter the year 2000, momentum is on our side. We have streamlined our supply chain, implemented improved forecasting, and shortened lead times to ensure that the right products are in the right places at the right times for our customers. We have revamped store inventories and merchandise assortments in all categories to provide our customers with appropriate selection and greater depth of inventory of key products.

Overall, we have improved cash flow and have strengthened the balance sheet as reflected in debt levels decreasing by $15.6 million or 16.2% less than in 1998. Our inventories are in line and we are ready to do business in 2000.

commitment

I am proud of what the Company has accomplished this year and excited about the prospects for 2000 and beyond. I'd like to offer my personal thanks to our outstanding associate team for their dedication, enthusiasm and spirit of innovation. I also thank our board of directors for their continued help and active involvement; our customers and suppliers for their continued support; and to you—our investors, for your continuing confidence in our future.

Sincerely,

John Edmondson
President and Chief Executive Officer

West Marine is proud to provide support for an extremely diverse range of worthwhile organizations through our Sponsorships and Donations program. This program makes charitable contributions in support of boating, local communities and the preservation and protection of the marine environment.

We believe that kids who get into boating are far more likely to stay out of trouble. In recognition of this, West Marine has made support for youth boating a primary focus of our donations and sponsorship programs.

Boating safety is one of our primary areas of focus. West Marine supports a wide range of organizations across the country dedicated to helping boaters learn to maintain and operate their boats safely, whether they're crossing a pond or crossing an ocean.

With more stores in more cities and towns across the country than anyone else in the marine business, we are privileged to be part of so many wonderful communities. We are committed to supporting the communities in which we do business.

As boaters, we have a vested interest in maintaining our waterways. Working together with organizations across the country, we're helping to turn the tide from exploitation to preservation of our fragile marine ecosystems.

Management's Discussion and Analysis of Financial Condition and Results of Operations

Company Overview

West Marine distributes its merchandise through three divisions, Stores (retail and wholesale) under the names of West Marine and E&B Marine, and Catalog (retail and Internet) as well as Port Supply (wholesale). West Marine operated 227 Stores in 38 states as of January 1, 2000, compared to 212 Stores in 34 states as of January 2, 1999. All references to 1999, 1998, and 1997 refer to the Company's fiscal years ended on January 1, 2000, January 2, 1999, and January 3, 1998, respectively. 1999 and 1998 were 52-week years. 1997 was a 53-week year.

Results of Operations

The following table sets forth certain income statement components expressed as a percent of net sales:

	1999	1998	1997
Net sales	**100.0%**	100.0%	100.0%
Cost of goods sold including buying and occupancy	**73.2%**	74.8%	70.4%
Gross profit	**26.8%**	25.2%	29.6%
Selling, general and administrative expenses	**22.6%**	22.6%	22.6%
Expenses related to distribution center move	**—**	0.7%	—
Income from operations	**4.2%**	1.9%	7.0%
Interest expense	**1.2%**	1.4%	0.8%
Income before income taxes	**3.0%**	0.5%	6.2%
Provision for income taxes	**1.2%**	0.3%	2.5%
Net income	**1.8%**	0.2%	3.7%

1999 Compared to 1998

West Marine's fiscal 1999 results reflect continuing progress in the implementation of the Company's strategic plan to improve operating fundamentals and execute initiatives to stimulate growth. In 1999, West Marine achieved record net sales of $486.5 million, an increase of $37.2 million, or 8.3%, over net sales of $449.3 million in 1998. Net income of $8.7 million, or $0.50 per diluted share, in 1999 compares to net income of $1.1 million, or $0.06 per diluted share, in 1998. Results of operations for 1998 included $3.3 million of expenses incurred by the Company for the relocation and consolidation of West Marine's two East Coast distribution facilities into a single facility located in Rock Hill, South Carolina.

Net sales attributable to the Company's Stores division increased $25.7 million, or 7.0%, to $395.5 million in 1999, primarily due to the addition of 17 new Stores, which contributed $18.8 million to net sales growth. Comparable Store net sales increased $6.9 million, or 1.8%, in 1999. Port Supply net sales increased $8.6 million, or 23.1%, in 1999 primarily as a result of the Company's continued territory expansion, new sales marketing programs, and significant improvements in the Company's distribution center fill rates and merchandise shipment rates. Catalog net sales increased $2.7 million, or 6.5%, to $44.4 million. Catalog net sales included Internet sales of $2.3 million and $0.6 million, respectively, in 1999 and 1998.

Gross profit increased 14.9% in 1999 compared to 1998. Gross profit as a percentage of net sales increased to 26.8% in 1999 from 25.2% in 1998, primarily reflecting reduced distribution and shipping costs, as well as a shift to a more profitable product mix.

Selling, general and administrative expenses increased $8.5 million, or 8.4%, in 1999, primarily due to increases in direct expenses related to growth in Stores, consulting costs related to process improvements, and higher marketing costs. Selling, general and administrative expenses as a percentage of net sales were unchanged from 1998.

Income from operations increased $11.7 million, or 135.4%, from 1998 to 1999. As a percentage of net sales, income from operations increased to 4.2% in 1999, from 1.9% in 1998.

Interest expense declined $441,000, or 7.3%, in 1999 compared to 1998, primarily as a result of lower average borrowings partially offset by a rise in interest rates.

1998 Compared to 1997

Net sales for 1998 increased 8.2% to $449.3 million compared to $415.2 million in 1997. This increase was primarily attributable to the increase in net sales from the Company's Stores. Stores net sales increased 10.5% to $369.8 million. The increase in Stores net sales was primarily due to 28 additional West Marine Stores opened in 1998. Net sales from comparable West Marine Stores increased 1.2% and contributed $3.8 million, or 10.9% of the increase. The E&B Marine locations entered the Company's comparable Stores net sales base in August 1997. Catalog net sales decreased 7.8% to $41.7 million. The Company believes that the decrease in Catalog net sales was attributable to new Store openings by the Company and its competitors, in addition to service problems related to the distribution center. Port Supply net sales increased 5.6% to $37.3 million, resulting primarily from the Company's continued territory expansion and additional van delivery routes.

Gross profit decreased 7.7% in 1998 compared to 1997. Gross profit as a percentage of net sales decreased to 25.2% in 1998 from 29.6% in 1997, primarily reflecting increased payroll, equipment rental and supply expenses at the Rock Hill distribution center as well as increased inventory shrink.

Selling, general and administrative expenses increased $7.7 million, or 8.2%, in 1998, primarily due to increases in direct expenses related to the growth in Stores. Stores direct expense represented approximately 72.1% of the $7.2 million increase. As a percentage of net sales, selling, general and administrative expenses remained relatively flat due to the Company's advertising and promotional cost reduction efforts.

In the first quarter of 1998, the Company incurred $3.3 million of expenses for the relocation and consolidation of West Marine's two East Coast distribution facilities into a single facility located in Rock Hill, South Carolina.

Income from operations decreased $20.5 million, or 70.2%, from 1997 to 1998. As a percentage of net sales, income from operations decreased to 1.9% in 1998 from 7.0% in 1997.

Interest expense increased $2.4 million or 67.3%, in 1998 compared to 1997, primarily as a result of higher average borrowings under the Company's line of credit during 1998.

Liquidity and Capital Resources

During 1999, the Company's primary sources of capital have been income from operations and bank borrowings. Net cash provided by operations during 1999 was $35.3, consisting primarily of earnings after tax of $22.8 million excluding depreciation and amortization, a $12.4 million increase in accounts payable and accrued expenses, a $3.1 million increase in provision for deferred income taxes and a $2.5 increase in prepaid expenses and other current assets offset by a $5.8 million increase in inventory. The inventory increase was attributable to a contingency plan for possible Y2K operating and receiving issues. Net cash used in investing activities was $18.7 million primarily for the purchase of property and equipment. Net cash used in financing activity was $14.5 million, consisting of $15.6 repayment of the Company's line of credit and long-term debt offset by $1.2 million received from the exercise of stock options and the net sales of common stock pursuant to the associate stock purchase plan.

West Marine's primary cash requirements are related to capital expenditures for new Stores, including leasehold improvement costs and fixtures, and merchandise inventory for Stores. The Company expects to spend approximately $13.0 million on capital expenditures during 2000. The Company intends to pay for its expansion through cash generated from operations and bank borrowings. The Company believes that cash from operations together with the current credit line will be sufficient to fund the Company throughout 2000.

At the end of 1999, the Company had outstanding a $40.0 million senior guarantee note which matures on December 23, 2004, with the first annual principal payment due on December 23, 2000. During 1999, the note was amended to bear interest at 7.6%. The note is unsecured, and contains certain restrictive covenants including fixed charge coverage and debt to capitalization ratios, and minimum net worth.

The Company has an $80.0 million credit line. In January 2000, the line was amended to extend the due date to January 2, 2003. Depending on the Company's election at the time of borrowing, the line bears interest at either the bank's reference rate or LIBOR plus a factor ranging from 1.0% to 2.25%. At the end of 1999, borrowings from the credit line were $39.5 million bearing interest at rates ranging from 7.78% to 9.0%. At the end of 1998, borrowings from the credit line were $53.0 million bearing interest at rates ranging from 6.1% to 7.4%.

In addition, the Company has available a $2.0 million revolving line of credit with a bank, expiring January 2, 2003. The line bears interest at the bank's reference rate (8.50% at the end of 1999) and has a ten-day paydown requirement. At the end of 1999 and 1998, no amounts were outstanding under the revolving line of credit.

Both of the aforementioned credit lines are unsecured and contain various covenants which require maintaining certain financial ratios, including debt to earnings and current

Liquidity and Capital Resources (cont.)

ratios. The covenants include minimum levels of net worth and limitations on the level of certain investments. These covenants also restrict the repurchase or redemption of the Company's common stock and payment of dividends, investments in subsidiaries and annual capital expenditures.

At the end of 1999, the Company had $364,000 of outstanding stand-by letters of credit, compared to $100,000 at year-end 1998. At the end of 1999 and 1998, the Company had $520,000 and $613,000, respectively, of outstanding commercial letters of credit.

During 1999 and 1998, the weighted average interest rates in effect were 6.9% and 6.4%, respectively.

Year 2000 and Other System Enhancements

During 1999, the Company implemented a plan to ensure its computer systems and applications were compliant for the year 2000 ("Y2K"). Systems programming and testing of the modifications were completed during the first six months of 1999, and final integration testing and conversions to new systems were completed and implemented in the third quarter of 1999. The Company did not experience any significant adverse effects of Year 2000 system modifications.

Due to the Company's focus on Y2K issues during 1999, certain other planned systems enhancement and improvement projects were deferred until 2000. The deferral of these projects is not expected to have a material adverse effect on the Company's results of operations, financial condition, or liquidity.

As of January 1, 2000, the Company had incurred a total of $280,000 to convert systems to Y2K compliance. In the opinion of management, no additional expenses will be incurred related to the Y2K systems conversion.

Also during 1999, the Company successfully upgraded certain systems to improve operational efficiencies, improve services to customers, and provide better information to management. System upgrades in 1999 included the point of sale (POS) system, the wholesale sales system, the warehouse management, and the basic operating systems on the AS400 system.

Seasonality

Historically, the Company's business has been highly seasonal. The Company's expansion into new markets has made it even more susceptible to seasonality, as an increasing percentage of Stores sales occur in the second and third quarters of each year. In 1999, 62.8% of the Company's net sales and all of its net income occurred during the second and third quarters, principally during the period from April through July, which represents the peak boating months in most of the Company's markets. Management expects net sales to become more susceptible to seasonality and weather as the Company continues to expand its operations.

Business Trends

West Marine's growth in net sales has been principally fueled by geographic expansion through the opening of new Stores and, to a lesser extent, by comparable Stores net sales increases. Although the Company believes that the Catalog and Port Supply divisions will continue to grow, future Company net sales and profit growth, if any, will be increasingly dependent on the opening and profitability of new Stores. The Company's Catalog division continues to face market share erosion in markets where Stores have been opened by either the Company or competitors. Management expects that this trend may continue. To address the growing significance of e-commerce in the marketplace, the Company redesigned its website to target all segments of boating enthusiasts. Since launching the site, sales have dramatically increased over 1998 sales. The Company has allocated resources to further develop the website to generate increases in international and domestic sales.

In most of the Company's product categories, prices have remained stable or have declined over the last three years, a trend which management expects is likely to continue. As a result, net sales increases during such periods have not been attributable to increases in prices. In recent years, competition has increased which has adversely affected the Company's gross profits. These competitive and pricing pressures are likely to continue.

Market Risk

The Company does not undertake any specific actions to cover its exposure to interest rate risk and is not a party to any interest rate risk management transactions. The Company does not purchase or hold any derivative financial instruments.

A 69 basis point change in interest rate (10% of the Company's weighted average interest rate) affecting the Company's floating financial instruments would have an effect of approximately $280,000 on the Company's pretax income and cash flows over the next year, and would have an immaterial effect on the fair value of the Company's fixed rate financial instruments (see Note 3).

"Safe Harbor" Statement Under the Private Securities Litigation Reform Act of 1995

The statements in this filing that relate to future plans, events, expectations, objectives or performance (or assumptions underlying such matters) are forward-looking statements that involve a number of risks and uncertainties. Set forth below are certain important factors that could cause the Company's actual results to differ materially from those expressed in any forward-looking statements.

The Company's Catalog division has faced market share erosion in areas where Stores have been opened by either the Company or its competitors. Management expects this trend to continue. The Company's growth has been fueled principally by the Company's Stores operations. The Company's continued growth depends to a significant degree on its ability to continue to expand its operations through the opening of new

"Safe Harbor" Statement (cont.)

Stores and to operate these Stores profitably, as well as increasing net sales at its existing Stores. The Company's planned expansion is subject to a number of factors, including the adequacy of the Company's capital resources and the Company's ability to locate suitable Stores sites and negotiate acceptable lease terms, to hire, train and integrate employees and to adapt its distribution and other operations systems. In addition, acquisitions involve a number of risks, including the diversion of management's attention to the assimilation of the operations and personnel of the acquired business, potential adverse short-term effects on the Company's operating results and amortization of acquired intangible assets.

The market for recreational watersports and boating supplies is highly competitive. Competitive pressures resulting from competitors' pricing policies have adversely affected the Company's gross profit and such pressures are expected to continue. In addition, the Company's operations could be adversely affected if unseasonably cold weather, prolonged winter conditions or extraordinary amounts of rainfall were to occur during the peak boating season in the second and third quarters.

Additional factors which may affect the Company's financial results include inventory management issues, the impact of e-commerce, fluctuations in consumer spending on recreational boating supplies, environmental regulations, demand for and acceptance of the Company's products and other risk factors disclosed from time to time in the Company's SEC filings.

Consolidated Balance Sheets

(in thousands, except share data)

	Year-End 1999	Year-End 1998
ASSETS		
Current assets:		
Cash	**$ 3,231**	$ 1,024
Accounts receivable, net	**5,101**	4,660
Merchandise inventories, net	**165,838**	160,069
Prepaid expenses and other current assets	**9,029**	11,574
Total current assets	**183,199**	177,327
Property and equipment, net	**66,036**	60,219
Intangibles and other assets, net	**37,625**	41,999
Total Assets	**$ 286,860**	$ 279,545
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	**$ 30,810**	$ 23,759
Accrued expenses	**9,828**	4,548
Deferred taxes	**3,333**	3,263
Current portion of long-term debt	**8,689**	1,783
Total current liabilities	**52,660**	33,353
Long-term debt	**71,843**	94,367
Deferred items and other non-current obligations	**2,460**	2,055
Total liabilities	**129,963**	129,775
Stockholders' equity:		
Preferred stock, $.001 par value: 1,000,000 shares authorized; no shares outstanding	**—**	—
Common stock, $.001 par value: 50,000,000 shares authorized; issued and outstanding: 17,190,274 at January 1, 2000 and 16,984,528 at January 2, 1999	**17**	17
Additional paid-in capital	**107,015**	105,599
Retained earnings	**52,865**	44,154
Total stockholders' equity	**159,897**	149,770
Total Liabilities and Stockholders' Equity	**$ 286,860**	$ 279,545

See notes to consolidated financial statements.

Consolidated Statements of Income

(in thousands, except per share and Store data)

	1999	1998	1997
Net sales	**$ 486,491**	$ 449,296	$ 415,208
Cost of goods sold including buying and occupancy	**356,215**	335,956	292,395
Gross profit	**130,276**	113,340	122,813
Selling, general and administrative expense	**109,881**	101,391	93,697
Expenses related to distribution center move	**—**	3,284	—
Income from operations	**20,395**	8,665	29,116
Interest expense	**5,630**	6,071	3,629
Income before taxes	**14,765**	2,594	25,487
Provision for income taxes	**6,054**	1,496	10,314
Net income	**$ 8,711**	$ 1,098	$ 15,173
Net income per common and common equivalent share:			
Basic	**$ 0.51**	$ 0.06	$ 0.91
Diluted	**$ 0.50**	$ 0.06	$ 0.86
Weighted average common and common equivalent shares outstanding:			
Basic	**17,086**	16,893	16,648
Diluted	**17,557**	17,520	17,583
Stores open at end of period	**227**	212	184

See notes to consolidated financial statements.

Consolidated Statements of Stockholders' Equity

(in thousands, except per share data)

	Common Stock Shares	Common Stock Amount	Additional Paid-in Capital	Retained Earnings	Total Stockholders' Equity
Balance at year-end, 1996	16,494,205	$16	$ 98,632	$ 27,883	$ 126,531
Net income				15,173	15,173
Exercise of stock options	245,838	1	1,789		1,790
Tax benefit from exercise of non-qualified stock options			1,916		1,916
Sale of common stock pursuant to associate stock purchase plan	46,025		908		908
Balance at year-end, 1997	16,786,068	17	103,245	43,056	146,318
Net income				1,098	1,098
Exercise of stock options	122,821		933		933
Tax benefit from exercise of non-qualified stock options			677		677
Sale of common stock pursuant to associate stock purchase plan	75,639		744		744
Balance at year-end, 1998	16,984,528	17	105,599	44,154	149,770
Net income				**8,711**	**8,711**
Exercise of stock options	**67,599**		**276**		**276**
Restricted stock award			**138**		**138**
Tax benefit from exercise of non-qualified stock options			**113**		**113**
Sale of common stock pursuant to associate stock purchase plan	**138,147**		**889**		**889**
Balance at year-end, 1999	**17,190,274**	**$17**	**$ 107,015**	**$ 52,865**	**$ 159,897**

See notes to consolidated financial statements.

Consolidated Statements of Cash Flows

(in thousands)

	1999	1998	1997
OPERATING ACTIVITIES:			
Net income	**$ 8,711**	$ 1,098	$ 15,173
Adjustments to reconcile net income to net cash provided by (used in) operating activities:			
Depreciation and amortization	**14,075**	11,926	8,604
Provision for deferred income taxes	**3,092**	298	4,704
Provision for doubtful accounts	**533**	586	315
Non-cash compensation expense	**138**	—	
Changes in assets and liabilities:			
Accounts receivable	**(974)**	(243)	(1,576)
Merchandise inventories	**(5,769)**	6,221	(43,559)
Prepaid expenses and other current assets	**2,545**	86	(3,808)
Other assets	**141**	(10)	195
Accounts payable	**7,051**	(2,870)	(6,998)
Accrued expenses	**5,393**	(231)	(3,529)
Deferred items	**405**	166	125
Net cash provided by (used in) operating activities	**35,341**	17,027	(30,354)
INVESTING ACTIVITIES:			
Purchases of property and equipment	**(18,681)**	(17,487)	(24,470)
Net cash used in investing activities	**(18,681)**	(17,487)	(24,470)
FINANCING ACTIVITIES:			
Net borrowings (repayments) on line of credit	**(13,500)**	950	15,050
Borrowings (repayments) on long-term debt	**(2,118)**	(2,153)	37,192
Sale of common stock pursuant to associate stock purchase plan	**889**	744	908
Exercise of stock options	**276**	933	1,790
Net cash provided by (used in) financing activities	**(14,453)**	474	54,940
Net increase in cash	**2,207**	14	116
Cash at beginning of period	**1,024**	1,010	894
Cash at end of period	**$ 3,231**	$ 1,024	1,010
Other cash flow information			
Cash paid for interest	**$ 6,190**	$ 6,480	$ 4,096
Cash paid for income taxes	**4,302**	4,918	8,338
Equipment acquired through non-cash capital lease transactions	**—**	2,545	2,996
Tax benefit from exercise of non-qualified stock options	**113**	677	1,916

See notes to consolidated financial statements.

Notes to Consolidated Financial Statements

Note 1: Summary Of Significant Accounting Policies

BUSINESS — West Marine, Inc. (the "Company"), a Delaware corporation, is a specialty retailer and wholesaler of boating supplies and apparel, which it markets through 227 retail Stores in the United States and mail order catalogs.

PRINCIPLES OF CONSOLIDATION — The consolidated financial statements include the accounts of West Marine, Inc. and its subsidiaries. Intercompany balances and transactions are eliminated in consolidation.

FISCAL YEAR — The Company's fiscal year-ends on the Saturday closest to December 31 based on a 52 or 53-week year. The years 1999, 1998, and 1997 ended on January 1, 2000, January 2, 1999, and January 3, 1998, respectively. 1999 and 1998 were 52-week years. 1997 was a 53-week year.

ACCOUNTING ESTIMATES — The preparation of consolidated financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates.

MERCHANDISE INVENTORIES are stated at the lower of cost (first-in, first-out method) or market. Cost includes acquisition and distribution costs that have been capitalized in merchandise inventories in order to better match net sales with these related costs.

DEFERRED CATALOG AND ADVERTISING COSTS — The Company capitalizes the direct cost of producing and distributing its catalogs. Capitalized catalog costs are amortized, once the catalog is mailed, over the expected net sales period, which is generally six months. Deferred catalog costs amounted to $110,000 and $1,893,000 at year-end 1999 and 1998, respectively. Advertising costs, which are expensed as incurred, amounted to $14.0 million, $12.6 million, and $13.8 million in 1999, 1998 and 1997, respectively.

PROPERTY AND EQUIPMENT is stated at cost. Furniture and equipment is depreciated using the straight-line method over the estimated useful lives of the various assets, which range from three to five years. Leasehold improvements are amortized over the lesser of the lease term or the estimated useful lives of the improvements. Whenever events or changes in circumstances have indicated that the carrying amount of its assets might not be recoverable, the Company, using its best estimates based on reasonable and supportable assumptions and projections, has reviewed for impairment the carrying value of long-lived assets.

PRE-OPENING COSTS are expensed as incurred.

INTANGIBLES AND OTHER ASSETS — The excess of cost over tangible net assets acquired is amortized over periods ranging from 5 to 40 years. Debt issuance costs are amortized over the terms of the related credit agreements. The Company periodically assesses the recoverability of the carrying value of its goodwill based on a review of projected undiscounted cash flows of the related operations. Accumulated amortization at the end of 1999 and 1998 was $5.0 million and $3.7 million, respectively.

DEFERRED RENT — Certain of the Company's operating leases contain predetermined fixed increases of the minimum rental rate during the lease term. For these leases, the Company recognizes the related rental expense on a straight-line basis over the life of the lease and records the difference between the amount charged to rent expense and the rent paid as deferred rent.

INCOME TAXES — The Company's income taxes are accounted for under the provisions of Statement of Financial Accounting Standards No. 109, "Accounting for Income Taxes", which requires the asset and liability method of accounting.

FAIR VALUE OF FINANCIAL INSTRUMENTS — The carrying values of cash, accounts receivable, accounts payable and long-term debt approximate the estimated fair values.

STOCK-BASED COMPENSATION — The Company accounts for stock-based awards to employees using the intrinsic value method in accordance with Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees". Accordingly, no compensation cost has been recognized for its fixed cost stock option plan or its Associate Stock Purchase Plan. In 1999, the Company recognized $138,000 of compensation expense related to a restricted stock award.

RECLASSIFICATIONS — Certain 1998 and 1997 amounts have been reclassified to conform with the 1999 presentation.

COMPREHENSIVE INCOME — Comprehensive income consists of net income or loss for the current period and other comprehensive income (incomes, expenses, gains and losses that currently bypass the income statement and are reported directly as a separate component of equity). The Company's comprehensive net income equals net income for all periods presented.

CAPITALIZED INTEREST — The Company's policy is to capitalize interest on debt incurred that is directly related to major construction projects. During 1999, 1998, and 1997, the Company incurred approximately $6.1 million, $6.7 million, and $4.2 million of interest, respectively, of which approximately $423,000, $576,000, and $587,000, respectively, was capitalized.

Note 1: Summary of Significant Accounting Policies (cont.)

NET INCOME PER SHARE — Basic net income per share excludes dilution and is computed by dividing net income available to common stockholders by the weighted average number of common shares outstanding for the period. Diluted net income per share reflects the potential dilution that could occur if options to issue common stock were exercised into common stock.

The following is a reconciliation of the Company's basic and diluted net income per share computations (shares in thousands):

	1999		1998		1997	
	Shares	Per Share Amount	Shares	Per Share Amount	Shares	Per Share Amount
Basic	**17,086**	**$0.51**	16,893	$0.06	16,648	$0.91
Effect of dilutive stock options	**471**	**(0.01)**	627	0.00	935	(0.05)
Diluted	**17,557**	**$0.50**	17,520	$0.06	17,583	$0.86

The following options were not included in the computation of diluted EPS because such options' exercise price was greater than the average market price of the common shares (shares in thousands):

	1999	1998	1997
Options to purchase shares of common stock	**2,703**	1,895	563
Exercise prices	**$8.31 – $34.50**	$11.13 – $34.50	$24.74 – $34.50
Expiration dates	**March 2003– August 2009**	March 2003– August 2008	February 2004– May 2007

NEW ACCOUNTING PRONOUNCEMENTS — In June 1999, the Financial Accounting Standards Board ("FASB") issued SFAS No. 137, "Accounting for Derivative Instruments." SFAS 137 extends the effective date of SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities" which established accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts, and for hedging activities. The statement requires that an entity recognize all derivatives as either assets or liabilities in the statement of financial position and measure those instruments at fair value. As amended by SFAS 137, SFAS 133 is effective for fiscal years beginning after June 15, 2000 and is not to be applied retroactively. In the opinion of management, SFAS No. 133 will not have a material effect on the Company's financial position or results of operations.

Note 2: Property and Equipment

Property and equipment consisted of the following at year-end 1999 and 1998 (in thousands):

	Year-End 1999	Year-End 1998
Furniture and equipment	**$ 37,540**	$ 32,245
Computer equipment	**44,388**	34,233
Leasehold improvements	**29,857**	27,141
Land and building	**806**	728
Total, at cost	**112,591**	94,347
Accumulated depreciation and amortization	**(46,555)**	(34,128)
Total property and equipment, net	**$ 66,036**	$ 60,219

Note 3: Lines of Credit and Long-Term Debt

At the end of 1999, the Company had outstanding a $40.0 million senior guarantee note which matures on December 23, 2004, with the first annual principal payment due on December 23, 2000. During 1999, the note was amended to bear interest at 7.6%. The note is unsecured, and contains certain restrictive covenants including fixed charge coverage and debt to capitalization ratios, and minimum net worth.

The Company has an $80.0 million credit line. In January 2000, the line was amended to extend the due date to January 2, 2003. Depending on the Company's election at the time of borrowing, the line bears interest at either the bank's reference rate or LIBOR plus a factor ranging from 1.0% to 2.25%. At the end of 1999, borrowings from the credit line were $39.5 million bearing interest at rates ranging from 7.78% to 9.0%. At the end of 1998, borrowings from the credit line were $53.0 million bearing interest at rates ranging from 6.1% to 7.4%.

In addition, the Company has available a $2.0 million revolving line of credit with a bank, expiring January 2, 2003. The line bears interest at the bank's reference rate (8.50% at the end of 1999) and has a ten-day paydown requirement. At the end of 1999 and 1998, no amounts were outstanding under the revolving line of credit.

Both of the aforementioned credit lines are unsecured and contain various covenants which require maintaining certain financial ratios, including debt to earnings and current ratios. The covenants include minimum levels of net worth and limitations on the level of certain investments. These covenants also restrict the repurchase or redemption of the Company's common stock and payment of dividends, investments in subsidiaries and annual capital expenditures.

At the end of 1999, the Company had $364,000 of outstanding stand-by letters of credit, compared to $100,000 at year-end 1998. At the end of 1999 and 1998, the Company had $520,000 and $613,000, respectively, of outstanding commercial letters of credit.

Note 3: Lines Of Credit And Long-Term Debt (cont.)

The weighted average interest rate paid on debt in 1999 was 6.9%, compared to 6.4% in 1998.

At year-end 1999 and 1998, long-term debt consisted of the following (in thousands):

	Year-End 1999	Year-End 1998
Lines of credit	**$ 39,500**	$ 53,000
Note payable	**40,000**	40,000
Capital lease obligations (interest at 3.6% to 8.7%)	**1,032**	3,150
	80,532	96,150
Less current portion of long-term debt	**(8,689)**	(1,783)
	$ 71,843	$ 94,367

At year-end 1999, future minimum principal payments on long-term debt were as follows (in thousands):

2000	$ 8,689
2001	8,311
2002	8,032
2003	47,500
2004	8,000
	$ 80,532

Note 4: Related Party Transactions

The Company purchases merchandise from a supplier in which the Company's Principal Stockholder owns stock and is a member of the board of directors. Additionally, the Principal Stockholder's brother is the president and his father is a member of the board of directors and a major stockholder of the supplier. The Company's cost of sales during 1999, 1998, and 1997 included $7.2 million, $6.4 million, and $5.2 million, respectively, related to purchases from such related party. Accounts payable to the supplier at year-end 1999 and 1998 were $215,000 and $384,000, respectively.

The Company leases its corporate headquarters and two retail Stores from three partnerships in which the Company's Principal Stockholder is the general partner (see Note 5). In addition, one retail Store is leased directly from the Principal Stockholder.

Note 5: Leases

The Company leases certain equipment, retail Stores, its distribution centers and its corporate headquarters. The Company also sublets space at various locations with both month-to-month and noncancelable sublease agreements. The operating leases of certain Stores provide for rent adjustments based on the consumer price index and planned rent increases.

The aggregate minimum annual rental payments and sublease income under noncancelable leases in effect at year-end 1999 were as follows (in thousands):

	Capital Leases	Operating Leases	Sublease Income	Net Lease Commitments
2000	$ 702	$ 15,665	$ 53	$ 16,314
2001	314	17,968	20	18,262
2002	32	16,015	16	16,031
2003		14,957	16	14,941
2004		12,846	5	12,841
Thereafter		20,299	—	20,299
Total minimum lease commitment	1,048	$ 97,750	$ 110	$ 98,688
Less amount representing interest	(16)			
Present value of obligations under capital leases	1,032			
Less current portion	(689)			
Long-term obligations under capital leases	$ 343			

The cost and related accumulated amortization of assets under capital leases aggregated $5.5 million and $2.1 million, respectively, at year-end 1999 and $5.5 million and $1.1 million, respectively, at year-end 1998.

A summary of rent expense by component for 1999, 1998, and 1997 follows (in thousands):

	1999	1998	1997
Minimum rent	**$ 20,027**	$ 19,219	$ 15,942
Percent rent	**176**	178	182
Sublease income	**161**	159	202
Rents paid to related parties	**1,253**	1,161	1,065

Note 6: Stock Option Plans

Fixed Stock Option Plans

The Company's 1990 Stock Option Plan ("the 1990 Plan") provides for options to be granted to employees and directors for the purchase of an aggregate of 2.1 million shares of common stock at prices not less than 100% of the fair market value at the date of grant. Options under this plan are generally exercisable equally over five years from the date of the grant, unless otherwise provided.

The Company's 1993 Omnibus Equity Incentive Plan as amended (the "1993 Plan") provides for options to be granted for the purchase of an aggregate of 5.2 million shares of common stock at prices not less than 85% of fair market value at the date of the grant. Options under this plan are generally exercisable equally over five years from the date of the grant, unless otherwise provided.

The Company's Non-employee Director Stock Option Plan ("the Director Plan") has reserved 200,000 shares of common stock for issuance to non-employee directors of the Company. Options are granted at 100% of fair market value at the date of the grant, and are generally exercisable six months after the grant date.

Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation" ("SFAS 123") requires the disclosure of pro forma net income and earnings per share had the Company adopted the fair value method of accounting for stock-based compensation as of the beginning of 1995. Under SFAS 123, the fair value of stock-based awards is calculated through the use of option pricing models, even though such models were developed to estimate the fair value of freely tradable, fully transferable options without vesting restrictions, which significantly differ from the Company's stock option awards. These models also require subjective assumptions, including future stock price volatility

	Number of Shares	Weighted Average Exercise Price
Outstanding at year-end 1996 (1,084,741 exercisable at a weighted average price of $7.37)	2,697,379	$ 11.09
Granted (weighted average fair value at grant date: $18.29)	543,929	25.31
Exercised	(245,838)	7.33
Canceled	(242,089)	16.87
Outstanding at year-end 1997 (1,384,874 exercisable at a weighted average price of $9.89)	2,753,381	13.72
Granted (weighted average fair value at grant date: $9.16)	1,452,906	13.71
Exercised	(122,821)	7.49
Canceled	(563,357)	18.68
Outstanding at year-end 1998 (1,563,633 exercisable at a weighted average price of $10.90)	3,520,109	13.14
Granted (weighted average fair value at grant date: $6.03)	**739,236**	**8.87**
Exercised	**(67,599)**	**4.14**
Canceled	**(113,344)**	**16.93**
Outstanding at year-end 1999 (2,184,843 exercisable at a weighted average price of $11.74)	**4,078,402**	**$ 12.24**

Additional information regarding options outstanding at year-end 1999 is as follows:

Outstanding Options				Exercisable Options	
Range of Exercise Prices	Shares Outstanding	Weighted Avg. Remaining Contractual Life (Years)	Weighted Avg. Exercise Price	Shares	Weighted Avg. Exercise Price
$ 0.43 – $ 7.81	1,375,034	6.55	$ 5.90	638,174	$ 3.76
$ 8.25 – $ 12.50	1,532,500	6.71	$ 10.55	964,126	$ 11.09
$ 14.75 – $ 34.50	1,170,868	6.78	$ 21.90	582,543	$ 21.53
$ 0.43 – $ 34.50	4,078,402	6.67	$ 12.24	2,184,843	$ 11.74

At year-end 1999, 1,372,468 shares were available for future grants under the 1993 Plan, and 61,208 shares were available under the Director Plan. The Company does not intend to grant any additional options under the 1990 Plan.

Note 6: Stock Option Plans (cont.)

and expected time to exercise, which greatly affect the calculated values. The Company's calculations were made using the Black-Scholes option pricing model with the following weighted average assumptions: four to eight year expected life from date of grant; stock volatility of 56%, 63%, and 62%, respectively, in 1999, 1998, and 1997; risk-free interest rates of 4.96% to 5.59% in 1999, 5.03% to 5.27% in 1998, and 5.65% to 6.44% in 1997; and no dividends during the expected term. The Company's calculations are based on a single option valuation approach and forfeitures are recognized as they occur. If the computed fair values of the 1999, 1998, and 1997 awards had been amortized to expense over the vesting period of the awards, pro forma net income would have been $7.2 million in 1999 ($0.42 per basic share and $0.41 per diluted share), $0.1 million in 1998 ($0.01 per basic and diluted share), and $14.4 million in 1997 ($0.86 per basic share and $0.82 per diluted share). The impact of outstanding non-vested stock options granted prior to 1995 has been excluded from the pro forma calculation. Accordingly, the 1999, 1998, and 1997 pro forma adjustments are not indicative of future period pro forma adjustments, when the calculation will apply to all future applicable stock options.

Associate Stock Purchase Plan

The Company has a stock-buying plan covering all eligible associates. Participants in the plan may purchase West Marine stock through regular payroll deductions. The stock is purchased on the last business day of April and October at 85% of the fair market value. In 1999, 1998, and 1997, respectively, 138,121, 75,639, and 46,025 shares were issued under the plan at weighted average prices of $6.53, $9.85, and $17.74, respectively. The weighted average fair value of the 1999, 1998, and 1997 awards was $9.22, $13.12 and $22.95, respectively. At the end of 1999, 62,039 shares were reserved for future issuances under the stock-buying plan.

Note 7: Income Taxes

The components of the provision for income taxes for 1999, 1998, and 1997 are as follows (in thousands):

	1999	1998	1997
Currently payable:			
Federal	**$ 2,646**	$ 998	$ 4,827
State	**316**	200	783
Total current	**2,962**	1,198	5,610
Deferred:			
Federal	**2,791**	633	3,944
State	**301**	(335)	760
Total deferred	**3,092**	298	4,704
Total current and deferred	**$ 6,054**	$ 1,496	$ 10,314

Note 7: Income Taxes (cont.)

The provision for income taxes consisted of the following:

	1999	1998	1997
Statutory federal tax rate	**35.0 %**	35.0 %	35.0 %
Non-deductible permanent items	**3.1**	18.1	1.8
State income taxes, net of federal tax benefit	**4.6**	4.6	4.6
Settlement of prior year's taxes	**—**	7.1	—
Other	**(1.7)**	(7.1)	(0.9)
Effective tax rate	**41.0 %**	57.7 %	40.5 %

Deferred income taxes reflect the impact of "temporary differences" between amounts of assets and liabilities for financial reporting purposes and such amounts measured by tax laws. Temporary differences that give rise to deferred tax assets (liabilities) are as follows (in thousands):

	1999	1998
Current:		
Reserves	**$ 604**	$ 449
Net operating loss carryforwards	**139**	923
Paid time off	**649**	362
State tax benefit	**(137)**	(272)
Change of tax accounting method	—	21
Deferred catalog costs	**(823)**	(1,194)
Capitalized inventory costs	**(3,020)**	(2,938)
Cash discounts	**(921)**	(818)
Other	**176**	204
Total current	**(3,333)**	(3,263)
Noncurrent:		
Deferred rent	**671**	488
Fixed assets	**(2,155)**	14
Reserves	**195**	195
Net operating loss carryforward	**1,402**	2,466
Other	**72**	44
Total noncurrent	**185**	3,207
Total current and noncurrent	**(3,148)**	(56)

At year-end 1999, the Company had unused federal tax net operating loss carryforwards, attributable to E&B Marine, of approximately $6.2 million, which expire in the years 2002 through 2003. The utilization of the tax loss carryforwards may be limited in subsequent years as a result of prior ownership changes as required under sections 381 and 382 of the Internal Revenue Code.

Note 8: Employee Benefit Plans

The Company has a defined contribution savings plan covering all eligible associates. The Company matches 33% of an employee's contribution up to 5% of the employee's annual compensation. The Company's contributions to the plan for 1999, 1998, and 1997 were $391,000, $366,000, and $330,000, respectively.

In 1998, the Company adopted SFAS 132, "Employer's Disclosures about Pensions and Other Post-Retirement Benefits." SFAS 132 standardizes the disclosure requirements for pensions and other post-retirement benefits to the extent practicable.

The Company has a suspended defined benefit plan ("the Defined Benefit Plan"), under which the minimum benefit contribution is calculated by the plan actuaries. The Defined Benefit Plan provides an existing participant with the excess, if any, of amounts required under the Company's pension formula over the value of the retiree's account balance as of the date the Defined Benefit Plan was suspended (January 28, 1994). A discount rate of 6.75% and 5.25% and a rate of return on assets of 8% were used by the actuary in determining the Defined Benefit Plan status at year-end 1999 and 1998, respectively. The Defined Benefit Plan invests primarily in publicly traded stocks and bonds.

The actuarial present value of the benefit obligations for 1999 and 1998 was (in thousands):

	1999	1998
Changes in Benefit Obligation		
Benefit obligation at beginning of year	**$ 3,892**	$ 3,409
Interest cost	**211**	198
Actuarial loss (gain)	**(824)**	326
Benefits paid	**(56)**	(41)
Benefit obligation at end of year	**$ 3,223**	$ 3,892
Change in Plan Assets		
Fair value of plan assets at beginning of year	**$ 3,138**	$ 2,710
Actual return on plan assets	**715**	469
Employer contribution	**—**	—
Benefits paid	**(56)**	(41)
Fair value of plan assets at end of year	**$ 3,797**	$ 3,138
Funded status	**$ 574**	$ (754)
Unrecognized net actuarial gain	**(1,352)**	(61)
Accrued pension liability	**$ (778)**	$ (815)
Components of Net Periodic Pension Cost		
Interest cost	**$ 211**	$ 198
Expected return on plan assets	**(248)**	(214)
Net periodic benefit	**$ (37)**	$ (16)

Note 9: Segment Information

The Company has three divisions (Stores, Catalog, and Wholesale ("Port Supply")) which all sell after-market recreational boating supplies directly to customers. The customer base overlaps between Stores and Port Supply and between Stores and Catalog. All processes for all divisions within the supply chain are commingled, including purchases from merchandise vendors, distribution center activity, and customer delivery.

The Stores division qualifies as a reportable segment under SFAS 131 as it is the only division that represents 10% or more of the combined revenue of all operating segments when viewed on an annual basis. Segment assets are not presented, as the Company's assets are commingled and are not available by segment. Contribution is defined as net sales, less product costs and direct expenses. Following is financial information related to the Company's business segments (in thousands):

	1999	1998	1997
Net sales:			
Stores	**$395,519**	$ 369,781	$ 334,623
Other	**90,972**	79,515	80,585
Consolidated net sales	**$486,491**	$449,296	$ 415,208
Contribution:			
Stores	**$ 50,184**	$ 45,754	$ 49,557
Other	**13,951**	9,943	10,337
Consolidated contribution	**$ 64,135**	$ 55,697	$ 59,894
Reconciliation of consolidated contribution to net income:			
Consolidated contribution	**$ 64,135**	$ 55,697	$ 59,894
Less:			
Cost of goods sold not included in consolidated contribution	**(26,609)**	(28,431)	(18,014)
General and administrative expenses	**(17,131)**	(15,317)	(12,764)
Expenses related to distribution center move	**—**	(3,284)	—
Interest expense	**(5,630)**	(6,071)	(3,629)
Income tax expense	**(6,054)**	(1,496)	(10,314)
Net income	**$ 8,711**	$ 1,098	$ 15,173

Quarterly Financial Data

(In thousands, except per share data)

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Fiscal 1999				
Net sales	**$ 93,572**	**$ 176,867**	**$ 128,888**	**$ 87,164**
Gross profit	**22,128**	**53,041**	**35,511**	**19,596**
Income (loss) from operations	**(2,997)**	**19,354**	**6,347**	**(2,309)**
Net income (loss)	**(2,778)**	**10,505**	**3,085**	**(2,101)**
Net income (loss) per common and common equivalent share:				
Basic	**$ (0.16)**	**$ 0.61**	**$ 0.18**	**$ (0.12)**
Diluted	**$ (0.16)**	**$ 0.60**	**$ 0.18**	**$ (0.12)**
Stock trade price:				
High	**$ 13 1/4**	**$ 15 1/4**	**$ 14 1/8**	**$ 9 1/2**
Low	**$ 7 7/8**	**$ 8**	**$ 7 1/2**	**$ 7 9/16**
Fiscal 1998				
Net sales	$ 84,198	$ 159,462	$ 121,673	$ 83,963
Gross profit	21,871	47,124	32,016	12,329
Income (loss) from operations (1)	(4,318)	16,825	6,354	(10,196)
Net income (loss) (1)	$ (3,567)	$ 9,133	$ 2,929	$ (7,397)
Net income (loss) per common and common equivalent share:				
Basic	$ (0.21)	$ 0.54	$ 0.17	$ (0.44)
Diluted	$ (0.21)	$ 0.52	$ 0.17	$ (0.42)
Stock trade price:				
High	$ 30 1/8	$ 28 5/16	$ 18 7/8	$ 12
Low	$ 21 1/16	$ 16	$ 7 3/8	$ 6 7/16

(1) Loss from operations and net loss for the first quarter of 1998 is net of a $3.3 million pre-tax charge for expenses related to the distribution center move in 1998.

West Marine, Inc. common stock trades on the NASDAQ National Market System under the symbol WMAR.

Independent Auditors' Report

Deloitte & Touche LLP

The Board of Directors and Stockholders
West Marine, Inc.,

We have audited the accompanying consolidated balance sheets of West Marine, Inc. and subsidiaries (the "Company") as of January 1, 2000 and January 2, 1999 and the related consolidated statements of income, stockholders' equity and cash flows for each of the three fiscal years in the period ended January 1, 2000. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated 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 and 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 the Company at January 1, 2000 and January 2, 1999 and the results of its operations and its cash flows for each of the three fiscal years in the period ended January 1, 2000 in conformity with generally accepted accounting principles.

Deloitte & Touche LLP

San Francisco, California
February 17, 2000

Company Data

Board of Directors

Randolph K. Repass
Chairman of the Board

John Edmondson
President and Chief Executive Officer
of the Company

Richard E Everett
President of Stores Division
and Chief Operating Officer of the Company

James P. Curley
CEO of FGF Holdings

Geoffrey A. Eisenberg
Former Senior Vice President
Merchandising of the Company

David McComas
President and Chief Operating Officer,
Eye Care Centers of America, Inc.

Walter Scott
Chairman of the Board,
Scott, Woolf and Associates

Henry Wendt
Chairman, Global Health Care Partners,
a unit of DLJ Merchant Banking

Executive Officers

John Edmondson
President and Chief Executive Officer

Richard E Everett
President of Stores Division
and Chief Operating Officer

Joe DiRocco
Senior Vice President, Marketing

Mike Edwards
Executive Vice President,
Merchandise Planning and Allocation

Patrick Murphy
Senior Vice President, Distribution and Logistics

Russell Solt
Senior Vice President and Chief Financial Officer

Corporate Information

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San Francisco, California 94111

Independent Auditors
Deloitte & Touche LLP
50 Fremont Street
San Francisco, California 94105

SEC Forms
Copies of the Company's Securities and Exchange Commission annual reports on Form 10-K and quarterly Form 10-Qs (exclusive of exhibits) are available without charge upon written request to:
Investor Relations, West Marine, Inc.,
500 Westridge Drive
Watsonville, California 95076
(831) 761-4110

Forms 10-Q, 10-K and Annual Report are available on-line at www.westmarine.com.

The Company does not distribute quarterly reports to its shareholders.

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CORPORATE HEADQUARTERS

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