

Marriott - **HOT SHOPPES** INC.

1966 ANNUAL REPORT

For The Fiscal Year Ended July 31, 1966





Marriott-HOT SHOPPES

ANNUAL REPORT / 1966

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Location of Operations Inside Back Cover	

LEFT-

View of the pool area at the new
Saddle Brook, New Jersey Marriott Motor Hotel

ANNUAL MEETING

The annual meeting of shareholders will take place at 10:00 A.M. Wednesday, November 9, 1966 in the Twin Bridges Marriott Motor Hotel, Arlington, Virginia (U.S. 1).



FINANCIAL HIGHLIGHTS

	1966 <i>(53 Weeks)</i>	1965	^o / _o Increase
Sales	\$123,933,283	\$98,842,940	25.4 ^o / _o
Earnings before income tax	9,121,433	7,394,231	23.4 ^o / _o
Per cent to sales	7.4 ^o / _o	7.5 ^o / _o	
Net income	5,110,433	4,175,394	22.4 ^o / _o
Per cent to sales	4.1 ^o / _o	4.2 ^o / _o	
Per share*	1.06	.86	
Cash flow (Note B)	10,759,164	7,509,546	
Per share*	2.22	1.55	
Stock dividends (4 ^o / _o)	6,821,757	3,676,443	
Per share*	1.41	.76	
Shareholders' investment	30,878,973	26,180,704	
Per share*	6.38	5.39	
Working capital	6,871,803	9,575,994	
Per share*	1.42	1.97	
Shares outstanding	4,841,044	4,666,991	
Shareholders	13,150	9,668	
Employees	12,500	10,000	
Operating units	150	127	

*Amounts per share are based upon shares outstanding at year end adjusted for the pooling of interest (Note A) and for subsequent stock dividends.

NOTES:

(A) 1965 amounts have been restated to include as a pooling of interest the eight properties acquired on January 4, 1966, in exchange for 313,000 shares of common stock.

(B) Cash flow from operations consists of net income plus depreciation, deferred taxes and other non-cash expense provisions. Beginning in 1966, cash flow also includes the depreciation equivalent included in the installments paid on Lease-Purchase Obligations which were capitalized for the first time as of July 25, 1965.

LEFT-

Luxurious buffet table
prepared by the banquet staff
at the Atlanta Marriott Motor Hotel

To Our Shareholders:

September 9, 1966.

We are pleased to report that 1966, our 39th year, was one of substantial growth and progress. Sales increased 25.4 per cent and net income was up 22.4 per cent. Since 1953, when our stock was first sold to the public, these gains in sales and profits have averaged better than 15 per cent a year.

The company had sales of \$123.9 million in the 53 weeks ended July 31, 1966, versus \$98.8 million in fiscal 1965. Sales have risen every single year of our 39-year history, except for 1942—a war year.

Net income of \$5.1 million in fiscal 1966 compares with a restated \$4.2 million just a year ago. This is equivalent to \$1.06 per share on the 4,841,004 shares outstanding at year end versus \$.86 per share last year.

The steady rise in sales and earnings occurred in all nine divisions of the company, emphasizing the soundness of our policy of wide diversification into almost every type of growing food service. For example, air traffic alone in 1966 is estimated at a record 107.5 million passengers flying 72 billion miles. In this market Marriott In-Flite Services provides over 40,000 meals each day from fifteen flite kitchens coast to coast. The six Marriott Motor Hotels, including the new Saddle Brook Marriott, provided accommodations for over 1,000,000 traveling Americans last year. With an increasing number of young families moving to the suburbs, our Real Estate Department is acquiring new locations in suburban areas for cafeterias, service restaurants and Hot Shoppes Jrs. The Food Service Management Division has made a major breakthrough in the field of institutional feeding and has doubled its sales over last year. This division now provides food service for eight hospitals, four schools, and seventeen business firms in five states from New York to Iowa.

In fiscal 1966, the company opened 25 new

operations, closed one for redecorating and sold one restaurant. The Cafeteria Division opened two units, and the Service Restaurants opened three units. The Food Service Management Division added nine operations, and four more Hot Shoppes Jrs. were opened. A new flite kitchen was added at O'Hare Airport in Chicago. The Atlanta Marriott and Saddle Brook, New Jersey, Marriott were opened this year. With the addition of four new specialty restaurants, located in our new motor hotels, the total number of units in operation is 150 in sixteen states and the District of Columbia.

A number of significant financial events occurred this year. On January 4, 1966, we acquired eight properties, previously leased by the company, in exchange for 313,000 shares of Marriott-Hot Shoppes common stock. The acquisition, which was approved by shareholders at the annual meeting in November, has been accounted for as a pooling of interests. At year end, we owned 23 properties (including six buildings on long-term land leases.)

The company also has favorable options to repurchase 11 properties (including four buildings on long-term land leases) from affiliates of the Marriott Foundation. These Leasehold Interests and the related Lease-Purchase Obligations are reported on the balance sheet for the first time. This change in accounting has reduced working capital (for lease-purchase installments due in the next 12 months) and increased cash flow (for amortization of the leasehold interest) but has had no effect on net income.

Net working capital at year end amounted to \$6,871,803, and we had \$8,556,293 invested in short-term investments in accordance with our practice of keeping excess funds invested. Long-term financing commitments were made on major new construction projects before the

big rise in interest rates occurred, so that our expansion requirements for the next year are covered at reasonable rates of interest.

The year 1966 had its problems, as does every year, but they have not slowed our growth in sales and net income. Wage costs accelerated their steady climb; food costs turned up sharply early in the year; the airlines strike restricted travel from July 8 to August 18, 1966; preopening expenses of new units (reported separately for the first time in the Income Statement) were \$1,019,949. This compared with \$509,326 for 1965. The interest cost of carrying a greatly enlarged construction program multiplied. We continue to follow a conservative policy of expensing all these charges as they occur and look to efficient operations by management to maintain profit margins.

We recognize that 1967 will repeat some of the old problems and perhaps add some new ones. We are aware that only by providing better and more diverse services to a rapidly growing population can we continue to earn the steady profits that finance growth. As we plan for expansion, increased emphasis is being placed on management development. Our recruiting efforts are being stepped up and training programs for all areas of management are being accelerated. We are developing an organization designed to serve the scope of our activities in the years ahead. Our Employee Profit Sharing Program and our Management Deferred Stock Program are providing worthwhile incentives to all employees.

Building upon the proven formula of continuous research and long-range planning, we have established the blueprints to enable us to continue to grow in the future as we have in the past. To reach our goals, we must continue to depend on the loyalty and fine contribution of Marriott-Hot Shoppes people all over the



country—our employees, our shareholders and patrons—who make the progress of our company possible.

J. Willard Marriott

J. Willard Marriott
Chairman of the Board

J. W. Marriott Jr.

J. W. Marriott Jr.
President

Report On Operations



T. LAWSON COMBS
Vice President, Service Restaurants

The pace of economic activity in the nation today provides fertile ground for expansion in all phases of the food industry. The demand of the public for increasing leisure facilities has a direct correlation with the growth of our company. People find more time to dine out and are more discriminating in their choice of restaurants. The forty-one Hot Shoppes Service Restaurants in seven states and the District of Columbia, met these demands by following the long standing policy of quality food for the whole family at moderate prices. The 385 different food items served each day were de-

veloped to appeal to all tastes, but knowing that growth depends on meeting changing demands, constant research and development of new items is carried on in Hot Shoppes Test Kitchen. New techniques of automation are incorporated wherever possible, and the most modern equipment is provided for all kitchens. In keeping with this program, microwave ovens were added to all curb service restaurants this year. These ovens provide fast service and hot food by enabling the restaurants to prepare food to order in 20 seconds. Another new concept instituted this year is the prototype 150-seat service restaurant. Requiring less space than previous building designs, these restaurants are ideal for shopping centers with limited site area.

BELOW-

Rendering of the new 250-seat prototype service restaurant with Pantry House

RIGHT-

Interior of the new service restaurants recently opened in suburban Washington, D.C.









CHARLES BAKER
Vice President, Cafeterias

Cafeterias continue to expand in shopping centers

Following the population shift to the suburbs, the Cafeteria Division has opened two new restaurants in suburban shopping centers. These include one in NorthPark Center in Dallas, and one in Natick Mall in suburban Boston. This brings the total cafeteria style restaurants now in operation to twenty-one, with six others under construction.

One of the prime objectives of this division is to give greater emphasis to the quality and service available in Hot Shoppes Cafeterias. Quality control in all divisions of the company has received special attention during the past year. In the Cafeteria Division, quality and customer service has been stepped up in two areas. As a merchandising aid to store managers, color photographs of all food items were coordinated with the recipe cards to assure attractiveness and consistency to the variety of food served. In the technical area new guest checking and control systems have been installed to speed service. In addition, convection ovens that cut baking time for pies, breads and custards in half have been added to the kitchens. This means that freshly baked items can be put on display throughout the meal period.

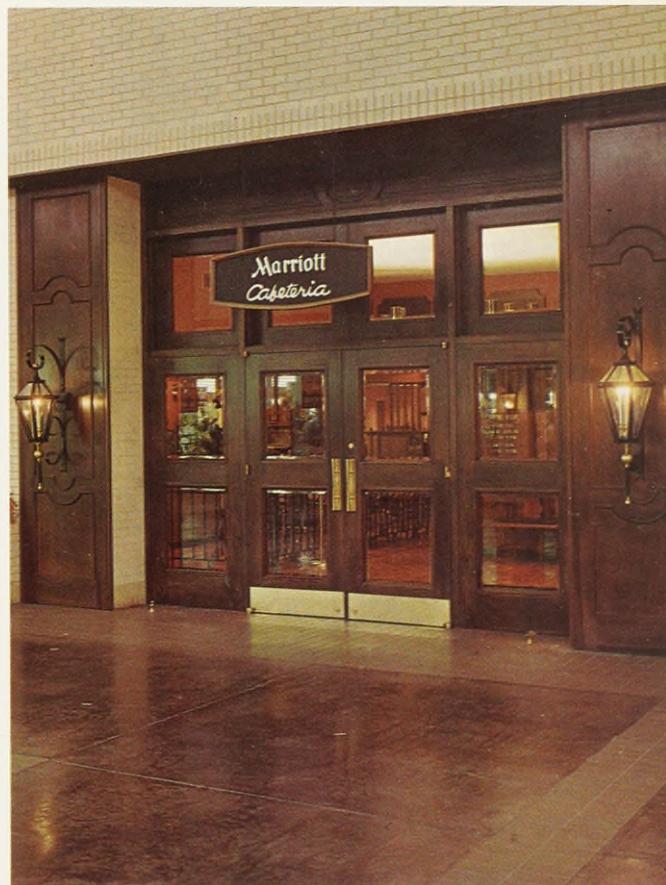
LEFT-

Interior of the new cafeteria in Natick Mall near Boston, Mass.

RIGHT-

Exterior of Dallas Cafeteria in the NorthPark Shopping Center.

To make the public aware of the quality image a new advertising campaign was created featuring individual food items, and the exacting standards required in their preparation. The basic idea of this campaign is that good food doesn't just happen—it is carefully planned.





LEONARD LEFEVE
Vice President, Thruway & Turnpike Restaurants

Thruway sales increase with record tourist traffic

The record tourist traffic on all the thruways and turnpikes throughout the east coast created sizable increases in sales in our units on the New York Thruway, Delaware Turnpike and Sunshine State Parkway.

The New York Thruway showed a 9.25 per cent increase in traffic, with a total of 35,000,000 vehicles. Our operations on the New York Thruway are between New York City and Albany, approximately one-third of the length of the road. The Sunshine State Parkway had a traffic increase of 19.58 per cent, with a total of 8,500,000 vehicles.



With the constant increase each year on the thruways and turnpikes that we serve there is a constant expansion of facilities in order that the demands of the traveling public can be met. The Delaware Turnpike opened its new air conditioned snack bar, that can serve approximately 1500 people an hour, and seats were added to the coffee shop. On the New York Thruway renovations of all units were completed, and, in most cases, facilities were improved to take care of the added customers. On the Sunshine State Parkway two of the units were renovated to enable us to make operating improvements.

The Merchandising Division is presently working to find improved methods of food production to enable us to provide faster service of freshly cooked food to the increasing number of customers that are expected in the coming year.

LEFT-

Serving area of the new Snack Bar facility on Delaware's John F. Kennedy Memorial Highway.

RIGHT-

Entrance to restaurant on the Florida Sunshine State Parkway at Okahumpka.







H. H. SHALLER, Brigadier General USA (Retired)
Vice President, Marriott In-Flite Services

New flight kitchen opened

The traveling public is also very much in evidence when we check the airline figures. Marriott In-Flite Services provided over 14,000,000 meals and snacks to twenty-six major airlines from fifteen flite kitchens coast to coast. This included both national and international carriers, with menu requirements ranging from simple sandwiches to gourmet dinners. To better service airline customers, a new flite kitchen was added to the present facilities at

LEFT-

Marriott In-Flite Services serving American Airlines, one of its clients, at O'Hare International Airport, Chicago, Ill.

BELOW-

Rendering of new flight kitchen at Tampa International Airport.

Chicago O'Hare Airport. This flite kitchen, plus two other kitchens, provides for the growing demand of airlines at the busiest airport in the nation. In Florida a new airline flite kitchen is under construction at Tampa International Airport. This building was designed to blend with the architectural plans proposed for the new Tampa Airport building. As air traffic increases at the major airports throughout the country, Marriott In-Flite Services is prepared to enlarge its scope of operation in this highly specialized field, new accounts are being solicited; and improved food techniques are being inaugurated. A staff of over 2400 highly trained employees is constantly providing for the ever increasing needs of this division.





JAMES E. DURBIN
Vice President, Marriott Motor Hotels



JORGEN VILTOFT
Vice President, Marriott Motor Hotel Restaurants

Marriott Motor Hotels open in Atlanta and Saddle Brook

There are now 2450 rooms available at six Marriott Motor Hotels, located in Washington, D.C.; Dallas; Philadelphia; Atlanta and Saddle Brook, New Jersey. Our Real Estate Department carefully researches all future sites, keeping in mind the fact that convention business continues to be one of the most important sources of revenue for the motor hotels. Accessibility for family travelers and businessmen are added prerequisites that point to the desirability of locations near airports and major interstate highways.

Future expansion plans include a Chicago Marriott, with an all year around swimming pool and a Houston Marriott, both to be completed in 1968, as well as Marriott Motor Hotels in Boston and a second one in northern New Jersey.

This year we opened two new hotels, both with broad scope convention and banquet facilities. In Atlanta the new 500-room Marriott has a grand ballroom where dinner may be served to as many as 4000 guests. The new Saddle Brook Motor Hotel also has ample banquet space. As always, emphasis is placed on the service of quality food at all the Marriott Motor Hotels; a famous European chef has been placed in charge of all banquet preparations. In addition, each of the hotels have a family restaurant or coffee shop, and a specialty restaurant on the premises. In the past year the exciting new Las Columnas Restaurant was opened in the Dallas Marriott. This restaurant specializes in the finest food from Spain, France, Italy, Greece and America. There are presently twelve restaurants in operation in the Marriott Motor Hotels.



ABOVE-
Atlanta Motor Hotel pool area at night.

UPPER RIGHT-
Dining on the terraced bi-level suite at the Marriott Motor Hotel in Atlanta.

RIGHT-
Elegant decor of Fairfield Inn family restaurant, Atlanta Marriott

FAR RIGHT-
Enjoying the fine food at the Sirloin & Saddle in the Atlanta Marriott.







PETER PLAMONDON
Vice President, Hot Shoppes Jrs.

New source of volume provided by Hot Shoppes Jrs.

One of the phenomena of the restaurant industry in recent years has been the success of fast service carry-out restaurants. This type of operation taps a new source of volume while staying within the range of company knowledge in the food business. The company's responsiveness to this new idea has precipitated the building of four Hot Shoppes Jrs. in the past fiscal year: in Virginia, Pennsylvania, Maryland and Texas. Plans for the future include rapid expansion in these geographic locations, plus several others. As development continues new ideas in equipment design and operation are being instituted.

As an added customer convenience, all Hot Shoppes Jrs. have seats ranging in number from 40 in the prototypes to 100 seats in several of the new units to be opened next year. A fully developed program for management trainees will be the backbone for this future expansion. These company trained employees will provide the special services that make the Hot Shoppes Jrs. unique in the fast service carry-out field.

LEFT-

View, at night, of the Hot Shoppes, Jr. in Abington, a suburb of Philadelphia.

ABOVE-

Efficient preparation of hamburgers speeds up service at the Hot Shoppes, Jr.

RIGHT-

Counter & dining area at the Hot Shoppes, Jr.





ROBERT C. KOEHLER
Director, Food Service Management

Food Service Management doubles business

One of the fastest growing divisions in the company—The Food Service Management Division—has doubled its business in the last year. Presently serving in twenty-nine locations, from New York to Iowa, this division provides schools, hospitals and business with a full range of food services, including cafeterias, executive dining rooms, banquets, vending and patient bed-side feeding.

The quality standards applied to our contract food service, as dictated by our commercial food standards, are unique. The same quality food served in Hot Shoppes restaurants is served in all institutional operations.

In the specialized field of hospital feeding our technological skills are rapidly advancing, and our highly trained personnel is constantly testing new ideas in therapeutic menu planning. Schools and college cafeterias are offered a wide variety of menu items prepared to exacting specifications, and industrial feeding is tailored to company requirements. Economic trends indicate an acceleration in the construction of new hospitals, industrial plants and schools. Future expansion is expected in these areas as demands for qualified food service management grows.

TOP-

Women's Dining Hall at Catholic University.

RIGHT-

Conveyor belt assembly of patients' trays in the kitchen of Cafritz Hospital.

FAR RIGHT-

Employees dining in the new International Business Machine Cafeteria, which opened recently in Gaithersburg, Maryland.





10 YEAR FINANCIAL HISTORY

Marriott-Hot Shoppes, Inc. and Subsidiaries

Dollars in Thousands	1966 (53 weeks)	1965	1964	1963
OPERATIONS				
Sales	123,933	98,843	84,726	74,597
% Increase for the year	25.4%	16.7%	13.6%	4.3%
Income before income taxes	9,121	7,394	5,555	4,158
Federal and state income taxes	(4,391)	(3,388)	(2,510)	(1,754)
Investment tax credit	380	169	155	67
Net income	5,110	4,175	3,200	2,471
% Increase for the year	22.4%	30.5%	29.5%	8.8%
Per sales dollar	4.1%	4.2%	3.8%	3.3%
Return on shareholders' investment	19.5%	19.0%	17.0%	15.1%
Cash flow from operations	10,759	7,510	6,658	5,725
ASSETS EMPLOYED				
Net working capital	6,872	9,576	10,247	9,209
Fixed assets	26,319	23,192	21,788	17,513
Leasehold interests (NOTE B)	33,409	18,178	—	—
Other assets	1,066	864	520	563
SOURCE OF FUNDS				
Mortgages and notes	5,212	5,992	6,895	5,814
Lease-purchase obligations (NOTE B)	25,878	15,249	—	—
Deferred taxes and compensation	5,697	4,388	3,516	2,649
Shareholders' investment	30,879	26,181	22,001	18,822
PER SHARE DATA (NOTE C)				
Net income	1.06	.86	.66	.51
Cash flow from operations	2.22	1.55	1.37	1.18
Dividends				
Cash	—	—	—	—
Stock—per cent	4%	4%	4%	4%
cash equivalent	1.41	.76	.41	.38
Shareholders' investment	6.38	5.39	4.52	3.86
Quoted market price at year end	26.50	23.57	10.63	9.99
OTHER DATA				
Shares outstanding (adjusted)	4,841,044	4,853,671	4,868,068	4,870,004
Number of operating units	150	127	120	111
Number of employees	12,500	10,000	9,600	9,100
Number of shareholders	13,150	9,668	7,572	6,150

	1962	1961	1960 (53 weeks)	1959	1958	1957	Compound Growth
63							
97	71,516	58,980	54,945	46,029	40,784	36,003	15.5%
0/0	21.5%	7.1%	19.4%	12.9%	13.3%	23.4%	
58	3,929	3,125	3,205	3,755	2,974	2,638	16.0%
54)	(1,657)	(1,400)	(1,640)	(1,816)	(1,397)	(1,297)	
67	—	—	—	—	—	—	
71	2,272	1,725	1,565	1,939	1,577	1,341	18.0%
0/0	31.7%	10.2%	(19.3%)	22.9%	17.6%	35.0%	
0/0	3.2%	2.9%	2.8%	4.2%	3.9%	3.7%	
0/0	16.1%	14.0%	14.5%	21.7%	20.2%	19.7%	
25	5,314	4,191	3,417	3,436	2,832	2,398	19.5%
09	7,062	6,025	2,771	3,970	3,787	3,022	7.5%
13	16,376	15,853	18,421	14,373	11,175	10,703	
63	1,136	676	990	772	374	270	
14	6,404	7,283	9,022	7,733	6,000	6,000	
49	1,879	1,190	829	612	425	253	
22	16,352	14,080	12,330	10,816	8,940	7,822	16.5%
51	.47	.35	.32	.40	.33	.28	
18	1.09	.86	.70	.71	.58	.49	
0/0	—	—	—	.03	—	.08	
38	.42	.38	.24	.19	.12	—	
86	3.36	2.89	2.54	2.23	1.86	1.64	
99	10.25	11.20	7.52	6.88	3.13	2.66	
04	4,870,004	4,870,004	4,854,974	4,854,974	4,788,113	4,768,287	
11	103	101	86	75	74	75	8.5%
00	8,800	8,600	7,000	6,500	6,000	5,800	9.0%
50	5,812	4,660	5,807	3,438	3,130	2,932	16.5%

NOTES:

A. Figures have been restated on a comparable basis except for the change in lease accounting as of July 25, 1965.

B. Leasehold interests and lease-purchase obligations capitalized as of July 25, 1965, included 5 properties which prior to 1961 were owned by the company and included in fixed assets and mortgage indebtedness.

C. Per share data is based on shares outstanding at the end of each year adjusted for annual stock dividends and for 2 for 1 splits in December 1960 and April 1965.

CONSOLIDATED BALANCE SHEET

Marriott-Hot Shoppes, Inc. and Subsidiaries July 31, 1966 and July 25, 1965

ASSETS	1966	1965
Current Assets:		
Cash	\$ 1,217,734	\$ 2,847,454
Savings deposits	28,500	1,278,000
Marketable securities, at cost (approximates market)	8,527,793	4,317,588
Reimbursable construction costs under sale-leaseback and landlord agreements (Note 2)	1,802,400	9,500,836
Accounts receivable	4,208,629	3,351,637
Reserve for uncollectible accounts	(46,011)	(30,249)
Inventory, at lower of average cost or market:		
Food and sundry items	3,078,428	2,529,767
Operating supplies	1,219,068	1,107,249
Prepaid expenses	578,931	320,734
Total current assets	<u>20,615,472</u>	<u>25,223,016</u>
Fixed Assets, at cost:		
Land and land improvements	4,006,739	3,301,079
Buildings and improvements	10,736,336	9,532,637
Leasehold improvements	7,296,700	6,526,427
Furniture and equipment	15,448,416	12,234,174
Automotive equipment	2,344,251	1,847,479
Construction in progress	1,899,802	3,092,956
	<u>41,732,244</u>	<u>36,534,752</u>
Depreciation and amortization	(15,413,015)	(13,343,133)
Total fixed assets	<u>26,319,229</u>	<u>23,191,619</u>
Leasehold Interest, at cost, in property and equipment under lease-purchase obligations, including improvements thereon (Note 2)		
Amortization	35,554,451	18,705,619
Total leasehold interests	<u>(2,145,170)</u>	<u>(527,667)</u>
	<u>33,409,281</u>	<u>18,177,952</u>
Other Assets	<u>1,065,778</u>	<u>864,004</u>
Total Assets	<u>\$ 81,409,760</u>	<u>\$ 67,456,591</u>

The accompanying notes to consolidated financial statements are an integral part of this balance sheet.

LIABILITIES

1966

1965

Current Liabilities:

Accounts payable	\$ 3,334,416	\$ 3,374,497
Construction contract accruals	1,426,468	2,500,126
Salaries, wages and bonuses	2,659,638	2,843,331
Rents, utilities, insurance, taxes, etc.	2,409,135	2,078,864
Income taxes (Note 3)	1,911,920	2,569,330
Current portion of mortgages and notes payable	395,657	988,623
Current portion of lease-purchase obligations	<u>1,606,435</u>	<u>1,292,251</u>
Total current liabilities	<u>13,743,669</u>	<u>15,647,022</u>

Mortgages and Notes Payable, excluding current portion (Note 4) 5,211,848 5,991,776

Lease-Purchase Obligations, excluding current portion (Note 2) 25,878,270 15,249,381

Deferred Liabilities:

Income taxes	5,249,000	4,118,928
Deferred stock compensation (Note 5)	<u>448,000</u>	<u>268,780</u>
Total deferred liabilities	<u>5,697,000</u>	<u>4,387,708</u>

Shareholders' Investment:

Common stock—\$1.00 par value; Authorized—10,000,000 shares; issued (Note 5)	4,870,004	4,682,696
Capital surplus	18,200,474	11,566,025
Earned surplus	<u>8,447,438</u>	<u>10,158,762</u>
	31,517,916	26,407,483
Treasury stock, at cost, 28,960 and 15,705 shares	<u>(638,943)</u>	<u>(226,779)</u>
Total shareholders' investment	<u>30,878,973</u>	<u>26,180,704</u>

Total Liabilities and Shareholders' Investment \$ 81,409,760 \$ 67,456,591

CONSOLIDATED INCOME AND SURPLUS

Marriott-Hot Shoppes, Inc. and Subsidiaries for the 53 weeks ended July 31, 1966 and 52 weeks ended July 25, 1965

<u>INCOME</u>	1966 (53 Weeks)	1965
SALES	<u>\$123,933,283</u>	<u>\$ 98,842,940</u>
DEDUCTIONS:		
Cost of sales and operating expenses	91,249,179	72,384,108
Administrative and general expenses	6,060,018	5,207,293
Rent (Note 2)	5,347,055	6,610,432
Depreciation and amortization (Note 2)	4,339,439	2,606,156
Taxes—payroll and other	3,589,484	2,818,076
Advertising and sales promotional expenses	1,636,998	1,281,472
Interest expense and income, net (Note 2)	1,569,728	31,846
Pre-opening expenses of new operating units	1,019,949	509,326
	<u>114,811,850</u>	<u>91,448,709</u>
NET INCOME BEFORE INCOME TAXES	9,121,433	7,394,231
FEDERAL AND STATE INCOME TAXES (Note 3)	4,011,000	3,218,837
NET INCOME	<u>\$ 5,110,433</u>	<u>\$ 4,175,394</u>
 <u>SURPLUS</u>		
	1966	
	<i>Earned</i>	<i>Capital</i>
BALANCE , beginning of period	\$ 10,158,762	\$ 11,566,025
ADD —Net income	5,110,433	—
Quoted market value in excess of par value of common stock issued as stock dividend	—	6,634,449
DEDUCT —4% stock dividend; 187,308 shares at quoted market value	(6,821,757)	—
BALANCE , end of period	<u>\$ 8,447,438</u>	<u>\$ 18,200,474</u>

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

STATEMENT OF SOURCE AND APPLICATION OF FUNDS

Marriott-Hot Shoppes, Inc. and Subsidiaries for the 53 weeks ended July 31, 1966 and 52 weeks ended July 25, 1965

Funds were provided by:	1966 <i>(53 Weeks)</i>	1965
Cash flow from operations—		
Net income for the year	\$ 5,110,433	\$ 4,175,394
Depreciation (Note 2)	4,339,439	2,606,156
Deferred tax provisions	1,130,072	602,843
Deferred stock compensation	179,220	125,153
Total	10,759,164	7,509,546
New lease-purchase obligations (Note 2)	12,600,000	—
Disposals of fixed assets	2,116,660	1,375,417
Additions to long-term debt	—	242,525
Total funds provided	25,475,824	9,127,488
Funds were expended for:		
Fixed assets	8,113,762	7,132,996
Leasehold interest (Note 2)	16,701,276	—
Other assets	201,774	342,156
Debt retirement—mortgages and notes	779,928	935,806
lease-purchase obligations (Note 2)	1,971,111	—
Treasury stock	412,164	205,951
Total funds expended	28,180,015	8,616,909
Increase (decrease) in working capital	\$ (2,704,191)	\$ 510,579
Working capital:		
Beginning of year	\$ 9,575,994*	\$ 10,248,043
End of year	6,871,803	10,758,622
Net change	\$ (2,704,191)	\$ 510,579

* Adjusted for change in lease accounting (Note 2)

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

Notes to Consolidated Financial Statements

Marriott-Hot Shoppes, Inc. and Subsidiaries

(1) Acquisition:

The acquisition on January 4, 1966, of 8 properties formerly leased by the company in exchange for 313,000 shares of common stock (approved by shareholders at the 1965 annual meeting) has been accounted for as a pooling of interests, and the financial statements have been restated on this basis.

(2) Leases:

Beginning with fiscal 1966, the company adopted the policy, recommended by the American Institute of Certified Public Accountants, of capitalizing, at the discounted amount of future rentals, leases which are in substance installment purchases of equipment and property. The cost of leasehold improvements made by the company on such properties has been reclassified from fixed assets to leasehold interests. The consolidated balance sheet as of July 25, 1965, has been restated to reflect this change.

As of July 31, 1966, capitalized leases extend to 19¹/₄ years with average annual rentals of approximately \$3,000,000, which cover interest at 5³/₈ to 6 per cent and principal amortization of mortgages and provide a nominal profit to the lessor. The statement of consolidated income for the 53 weeks ended July 31, 1966, includes interest of \$1,274,000 and amortization of \$1,627,000, which amounts approximate the rentals that would have been included under the previous practice.

In addition to the foregoing leases, the company has other leases which are not required to be capitalized and which have terms up to a maximum of 33 years with an average of 12 years as of July 31, 1966. Minimum average rentals for leases expiring after three years amount to approximately \$1,700,000 as of July 31, 1966. Most of these leases have renewal privileges and require additional rentals under percentage clauses relating to sales.

Additional lease-purchase commitments aggregating \$20,300,000 at July 31, 1966, have been made with corporations owned by the Marriott Foundation for projects which will be completed during the next 12 months. Under one of these commitments, the Foundation has paid \$4,000,000 to the company as an advance of a portion of the purchase price. The Foundation in turn has borrowed such funds from an institutional lender and until completion of the sale-leaseback the company is contingently

liable as guarantor of the loan. This amount has been netted against reimbursable construction costs under sale-leaseback and landlord agreements.

(3) Federal Income Taxes:

The company and its subsidiaries file separate income tax returns. Federal income tax returns for years prior to 1961 have been examined and settled or accepted as filed. The Federal income tax returns for years 1961, 1962, and 1963 are currently being examined by the Internal Revenue Service. Although the company has not received the Revenue Agent's report, it understands that, among other things, the agent is questioning intercompany rent payments. Any adjustments of such rent payments would tend to increase income taxes; however, the results of the examination can not be determined at this time. In the opinion of management, based on advice from tax counsel, any adjustments resulting from the examination will not have, in the aggregate, a material adverse effect on the company's consolidated financial position or consolidated earnings set forth in the accompanying financial statements.

The provision for income taxes has been reduced by the investment credit in the amount of \$380,000 and \$168,900 for fiscal periods 1966 and 1965. The provision includes deferred income taxes of \$1,130,072 and \$602,843 for fiscal periods 1966 and 1965, respectively, relating to accelerated depreciation taken on fixed assets and on leasehold interests under lease-purchase obligations.

(4) Mortgages and Notes:

Mortgages and notes payable includes mortgages of \$4,979,715, maturing in 1982 with interest rates of 4¹/₄ to 5⁷/₈ per cent and notes of \$232,133, maturing to 1976 with interest rates of 4¹/₂ to 6 per cent.

(5) Deferred Stock Compensation:

Deferred stock bonus awards and contracts have been made with one hundred ten management employees which contingently vest pro rata until retirement, after which the vested shares are distributed in ten annual installments. Adjusted for forfeitures, stock dividends and splits, a total of 103,696 shares have been awarded, of which 19,826 shares had vested on July 31, 1966.

AUDITORS' REPORT

TO THE SHAREHOLDERS AND BOARD OF DIRECTORS, MARRIOTT-HOT SHOPPES, INC.:

We have examined the consolidated balance sheet of MARRIOTT-HOT SHOPPES, INC. (a Delaware corporation) AND SUBSIDIARIES as of July 31, 1966, and the related statements of consolidated income and surplus and source and application of funds for the fifty-three weeks then ended. Our examination was 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 accompanying consolidated balance sheet and statements of consolidated income and surplus and source and application of funds present fairly the financial position of Marriott-Hot Shoppes, Inc. and Subsidiaries as of July 31, 1966, and the results of their operations and the source and application of their funds for the fifty-three weeks then ended, in conformity with generally accepted accounting principles which, except for the change (which we approve) in accounting for lease-purchase obligations as explained in Note 2 to the consolidated financial statements, were applied on a basis consistent with that of the preceding period.

ARTHUR ANDERSEN & CO.

Washington, D.C.,
September 9, 1966.

DIRECTORS OF THE COMPANY



J. WILLARD MARRIOTT
Chairman of the Board

J. W. MARRIOTT JR.
President, Marriott-Hot Shoppes, Inc.

ALICE S. MARRIOTT
Vice President, Marriott-Hot Shoppes, Inc.



MILTON A. BARLOW
President, Barlow Properties, Inc.

JAMES M. JOHNSTON
Senior Partner, Johnston, Lemon & Co.

DON G. MITCHELL
Chairman of the Board, General Time Corp.



LOUIS W. PRENTISS
Major General USA (Retired), Executive Vice President,
American Roadbuilders Association

JOHN W. KLUGE
Chairman of the Board & President, Metromedia Inc.

Transfer Agent
American Security & Trust Company, Fifteenth Street and Pennsylvania Avenue, N.W., Washington, D.C. 20013

Registrar
The Riggs National Bank, 1503 Pennsylvania Avenue, N.W., Washington, D.C. 20013

Executive Offices
Marriott-Hot Shoppes, Inc., 5161 River Road, Washington, D.C. 20016

Legal Counsel
Whiteford, Hart, Carmody & Wilson, 815 Fifteenth Street, N.W., Washington, D.C. 20005

Auditors
Arthur Andersen & Co., 815 Connecticut Avenue, N.W., Washington, D.C. 20006

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IN MEMORIAM

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ROGER J. WHITEFORD

DIRECTOR
MARRIOTT-HOT SHOPPES INC.
1952 - 1965

Senior Partner
Whiteford, Hart, Carmody & Wilson

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Corporate Executives



J. WILLARD MARRIOTT
Chairman of the Board



J. W. MARRIOTT, JR.
President



ALICE S. MARRIOTT
Vice President



WOODROW D. MARRIOTT
Senior Vice President



JAMES E. DURBIN
Vice President, Marriott Motor Hotels



J. FRANKLIN GROFF
Vice President, Architecture & Construction



G. MICHAEL HOSTAGE
Group Vice President



FRANK C. KIMBALL
Vice President and General Counsel



ROBERT E. KOEHLER
Vice President, Finance and Treasurer



FOSTER M. KUNZ
Vice President, Industrial Relations, Personnel



RICHARD F. SCHOFF
Group Vice President



H. H. SHALLER, Brigadier General USA (Retired)
Vice President, Marriott In-Flite Services



BETTY L. CUSHWA
Secretary & Assistant Vice President



CHARLES BAKER
Vice President, Cafeterias



FRED BOULINEAU
Controller



T. LAWSON COMBS
Vice President, Service Restaurants



J. ROBERT DROEGE
Vice President, Marriott Motor Hotels



WINTHROP W. GRICE
Vice President, Marriott Motor Hotels



ROBERT C. KOEHLER
Director, Food Service Management



LEONARD LEFEVE
Vice President, Thruway & Turnpike Restaurants



JAMES H. PFLAGING
Vice President, Marriott In-Flite Services



PETER PLAMONDON
Vice President, Hot Shoppes Ints.



MERRILL TRIBE, Brigadier General USA (Retired)
Vice President, Procurement



JORGEN VILTOFT
Vice President, Marriott Motor Hotel Restaurants



CALVIN WIENGES
Vice President, Marriott In-Flite Services



GEORGE YOUNG
Vice President, Central Supply (Commissary)

Marriott-Hot Shoppes, Inc. Operations

Service Restaurants

WASHINGTON, D.C. (8)

MARYLAND

Langley Park
Hyattsville (3)
Silver Spring
Bethesda
College Park
Wheaton
Rockville
District Heights
Greenbelt
Hillandale

VIRGINIA

Arlington (4)
Alexandria
Falls Church (2)
Springfield
Fredericksburg
Richmond

FLORIDA

No. Miami Beach
Miami
Kendall

UTAH

Salt Lake City (2)

PENNSYLVANIA

Philadelphia (4)

NORTH CAROLINA

Greensboro

TEXAS

Dallas

Hot Shoppes Jr.

VIRGINIA

Arlington

MARYLAND

Marlow Heights
Rockville

PENNSYLVANIA

Philadelphia

TEXAS

Dallas

Cafeterias

WASHINGTON, D.C. (6)

MARYLAND

Hyattsville
Wheaton
Baltimore (2)

TEXAS

Dallas

VIRGINIA

Norfolk
Newport News
Richmond (2)
Falls Church

MASSACHUSETTS

Boston - Natick

NEW JERSEY

Moorestown

UTAH

Salt Lake City

PENNSYLVANIA

Pittsburgh

OHIO

Cleveland

Thruways & Turnpikes

FLORIDA

Pompano Beach
West Palm Beach
Fort Pierce
Fort Drum
Canoe Creek
Turkey Lake
Okahumpka

NEW YORK

Sloatsburg
Plattekill
Modena
Ulster
Malden
New Baltimore

DELAWARE

Newark

Hotels

VIRGINIA

Twin Bridges
Key Bridge

PENNSYLVANIA

Philadelphia

TEXAS

Dallas

NEW JERSEY

Saddle Brook
Newark

GEORGIA

Atlanta

Specialty Restaurants

VIRGINIA

Marriott Key Bridge
Marriott Twin Bridges (2)

DISTRICT OF COLUMBIA

Universal Building - Conn. Ave.

MARYLAND

Wheaton Plaza Shopping Center

PENNSYLVANIA

Philadelphia Marriott (3)

TEXAS

Dallas Marriott (2)

NEW JERSEY

Saddle Brook Marriott (2)

OHIO

Cleveland

GEORGIA

Atlanta Marriott (2)

Airline Flight Kitchens

VIRGINIA

Dulles
National (2)

MARYLAND

Baltimore - Friendship

FLORIDA

Miami (4)
Tampa

NEW YORK

New York City (3)

TEXAS

Dallas

NEW JERSEY

Newark

ILLINOIS

Chicago (3)

CALIFORNIA

Los Angeles

Food Service Management

Schools

DISTRICT OF COLUMBIA

VIRGINIA

Greenway

MARYLAND

Stevenson
Bethesda

Hospitals

DISTRICT OF COLUMBIA (5)

VIRGINIA

Alexandria (2)
Arlington

Industrial & Commercial

DISTRICT OF COLUMBIA (3) (Government)

VIRGINIA

Norfolk
Martinsville
Waynesboro (2)
Falls Church
Richmond

MARYLAND

Chevy Chase
Silver Spring
Gaithersburg

IOWA

Clinton

NEW YORK

Endicott
Buffalo
Johnson City

NORTH CAROLINA

Winston-Salem

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