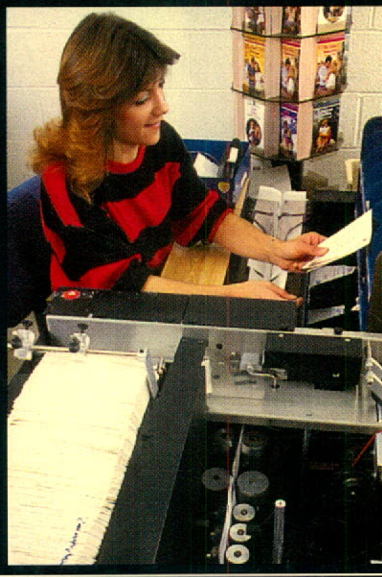
# Torstar Corporation Annual Report 1986

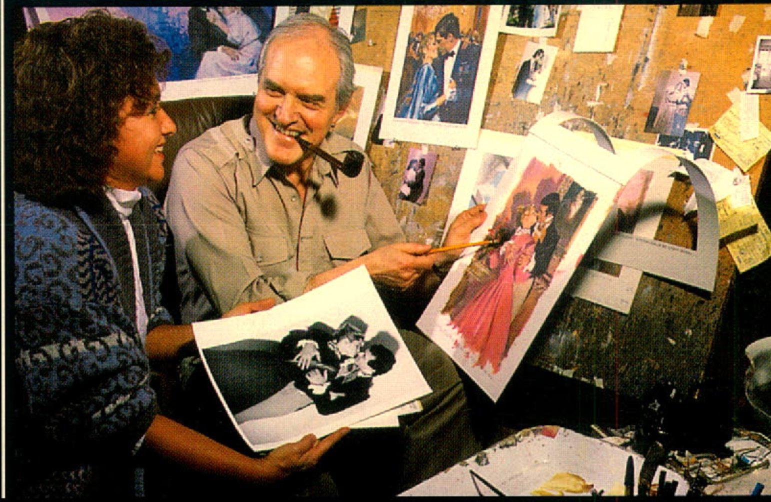
**The Toronto Star  Harlequin  Metroland  Miles Kimball**



TORSTAR





Torstar Corporation is a broadly based information and entertainment communications company. Its operations include The Toronto Star, Canada's largest daily newspaper; Metroland Printing, Publishing & Distributing, commercial printers, publishers of community newspapers and distributors of advertising materials; Harlequin Enterprises, the world's largest publisher of romance fiction; Miles Kimball, direct mail catalogue marketers of home, gift and business products; and Marshall Editions, a packager of hard-cover, non-fiction books.

Torstar operates on a worldwide basis with about half of its revenues generated outside Canada.

Torstar has a 22.4 per cent interest in Southam Inc., a Canadian communications and information company. Southam's properties include daily newspapers, a financial weekly, magazines, book stores and commercial printing.

## On the cover

Torstar and its operating divisions employ 4,500 full-time and 2,300 part-time people in 16 countries around the world. The pictures on the front and back cover show employees at work and depict examples of the company's community involvement and employee support programs. The cover photos are miniatures of pictures that appear in the report.

## Annual meeting

The annual meeting of shareholders will be held at 10 a.m. on Wednesday, June 24, 1987, at One Yonge St., Toronto, Canada.

## Corporate office

One Yonge St., Toronto, Canada, M5E 1P9
Telephone (416) 367-4595

## Transfer agent and registrar

National Trust Co.

## Listed

Class B shares
$1.70 First Preference shares
Toronto and Montreal Stock Exchanges

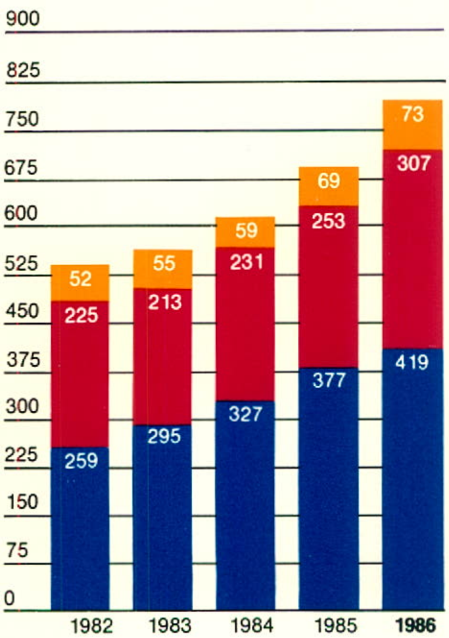
## Contents

# Torstar Corporation Financial Highlights



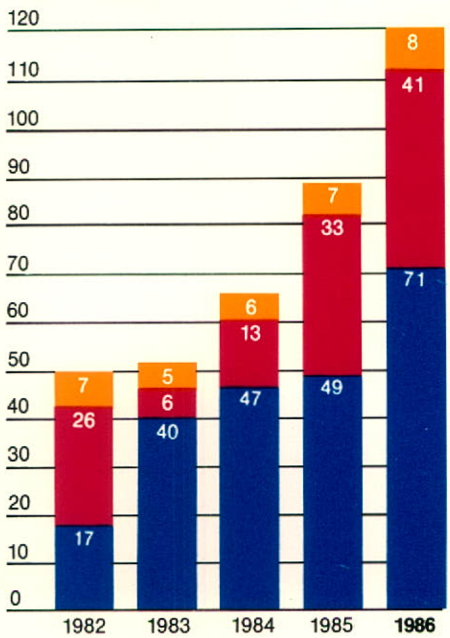
| | | 1986 | 1985 |
|---|---|---|---|
| **Operating Results** (thousands of dollars) | Operating revenue | **$799,664** | $699,296 |
| | Operating profit | **115,493** | 84,780 |
| | Income before equity in earnings of Southam Inc. | **56,560** | 45,955 |
| | Income from continuing operations | **69,554** | 51,894 |
| **Operating Ratios** | Operating profit — per cent of revenue | **14.4%** | 12.1% |
| | Income before equity in earnings of Southam Inc. — per cent of revenue | **7.1%** | 6.6% |
| | Net income from continuing operations — per cent of average shareholders' equity | **17.6%** | 19.9% |
| **Per A and B Share** (adjusted for 2 for 1 split in 1986) (in dollars) | Income from continuing operations (fully diluted) | **$1.75** | $1.58 |
| | Shareholders' equity (after deducting preference shares) | **9.63** | 8.57 |
| | Price range high/low | **35.38/16.63** | 16.88/8.25 |
| **Financial Position** (thousands of dollars) | Long-term debt | **$175,607** | $211,301 |
| | Shareholders' equity | **414,137** | 375,326 |

Operating Revenue
(millions of dollars)



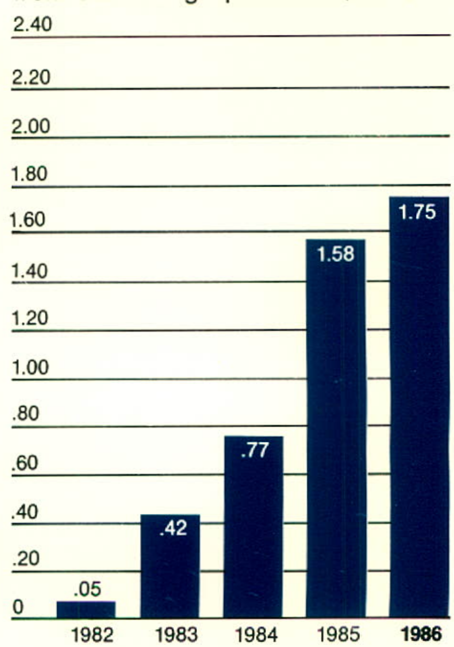

■ Newspapers and Printing
■ Book Publishing
■ Catalogue Marketing

Segmented Operating Profit
(millions of dollars)




■ Newspapers and Printing
■ Book Publishing
■ Catalogue Marketing

Earnings Per Share*
from Continuing Operations (dollars)




* Fully diluted

Torstar Corporation achieved new performance records in 1986 with newspapers, printing, book publishing and direct marketing all contributing increased revenue and income.

Consolidated revenue rose to $799.7 million, up 14.4 per cent from the previous high in 1985. Record consolidated operating profit of $115.5 million was 36.2 per cent higher than the 1985 level of $84.8 million.

Operating profit from newspapers and printing grew by 43.7 per cent, from book publishing by 27.1 per cent and from catalogue marketing by 7.1 per cent.

Income from continuing operations was $69.6 million or $1.75 per Class A and Class B share, compared with $51.9 million or $1.58 per share in 1985.

The 1986 financial statements include Torstar's equity of $13 million in the earnings of Southam Inc. for a full year in contrast to $5.9 million for four months in 1985. The average number of shares outstanding in 1986 was higher than in 1985 because the August, 1985 investment in Southam involved the issue of Torstar shares.

In August, 1986 the Southam Family Group exercised its option to purchase 1,590,000 Southam shares from Torstar for $26.1 million. Torstar now holds 14,290,000 common shares in Southam or 22.4 per cent of Southam's outstanding shares.

Our decision in November, 1986 to discontinue the Torstar Books division had an adverse effect on profits. Torstar Books lost $4.3 million after tax on its 1986 operations. Extraordinary losses for the year, due primarily to write-downs of Torstar Books assets, were $9.8 million. These losses reduced overall net income to $55.4 million or $1.39 per share, compared to 1985 net income of $50.1 million or $1.53 per share.

The newspaper results reflect the generally strong Ontario economy and increased demand for advertising and printing. Both The Toronto Star and Metroland newspapers achieved higher advertising volumes.

The Toronto Star circulation and readership continued to grow in 1986. Total circulation of The Star increased to more than 205 million copies for the year. Metroland expanded the frequency of publication for some of its newspapers and added new heatset offset press capacity. Further expansion in 1987 will increase Metroland's total press investment over three years to $20 million.

The book publishing and direct marketing division had another good year. Revenue growth for Harlequin at the retail level was particularly strong in overseas markets, reflecting aggressive product and marketing programs.

Harlequin operates in 14 countries outside Canada and the United States. It commenced a licensing arrangement in South Korea in 1987 and may eventually publish in the Chinese languages.

In North America, book club sales continued to grow dramatically while a decline in the romance fiction retail market began to moderate. Earnings were helped by improved distribution and operating efficiencies.

Substantial investment in Harlequin's direct marketing operations should generate additional revenue and income in 1987 and beyond.

In catalogue marketing, Miles Kimball enjoyed another year of growth. Miles Kimball is a highly efficient and profitable marketer of gifts in the United States, with a mailing list of four million customers. Progress continued in the development of catalogue marketing of office products.

In July, 1986 Torstar redeemed all outstanding $2.68 Preference Shares issued in 1981. The total redemption cost of $15 million was largely offset by $11 million from the exercise of the Class B share purchase warrants which expired June 30, 1986.

In March, 1986 the annual dividend rate for Class A and Class B shares was increased from 80 cents to 96 cents and in May both share classes were split on a two-for-one basis. The resulting dividend rate of 48 cents per share was increased to 52 cents with the fourth quarter dividend.

Torstar enters 1987 with the prospect of continued growth. Our companies are the leaders in their respective fields and our senior management groups are largely unchanged from the leadership that was evident in the 1986 profit performance.

As a result of debt reduction and equity increases achieved in 1986, we are well-positioned to consider substantial capital investment to enhance the growth of our existing companies, as well as further diversification in publishing, direct marketing and communications.

Joint development programs with Southam will be actively considered, and three senior executives from each of Torstar and Southam form a newly established group to examine areas of mutual interest.

Paul Zimmerman, president of Torstar from 1980 to 1984 and a director since December, 1979, retires from the board in 1987. The directors record their appreciation for the splendid contribution he has made to the success of the company.

Consistent with the overall theme of this annual report, it is appropriate to recognize the 6,800 people throughout the Torstar family whose efforts were instrumental to our achievements in 1986.

**TORSTAR'S Office of the Chairman includes Beland H. Honderich (centre), chairman and chief executive officer; David R. Jolley (left), president and chief executive officer of the newspaper and printing division; and David A. Galloway, president and chief executive officer of the book publishing and direct marketing division.**

As chief executive officers of Torstar's two operating divisions, and as members of the Office of the Chairman, Jolley and Galloway participate directly in corporate affairs, with the specific assignment of developing and implementing strategies that will ensure Torstar's continuing growth.

Beland Honderich

David Jolley

David Galloway

## Review of continuing operations

Consolidated revenue in 1986 increased 14.4 per cent from $699.3 million to $799.7 million. Operating profit of $115.5 million was up 36.2 per cent from the 1985 total of $84.8 million. Operating profit was 14.4 per cent of revenue compared with 12.1 per cent in the previous year. All three business segments improved their margins.

## Newspapers and printing

Revenue rose by 11.1 per cent in 1986 with an 8.6 per cent increase in newspapers and a 27.4 per cent growth in printing revenues. This revenue increase was led by The Toronto Star's 7.2 per cent increase in linage and 4.2 per cent increase in advertising rates. These increases were complemented by higher circulation revenue in The Star.

Metroland's community newspapers achieved higher advertising volume, partially by increasing frequency of publication to two days and three days in several markets.

Printing revenue rose because of increased capacity in heatset printing and 19 per cent higher revenue in coldweb offset printing. Rotogravure revenue was flat and operating profit declined significantly.

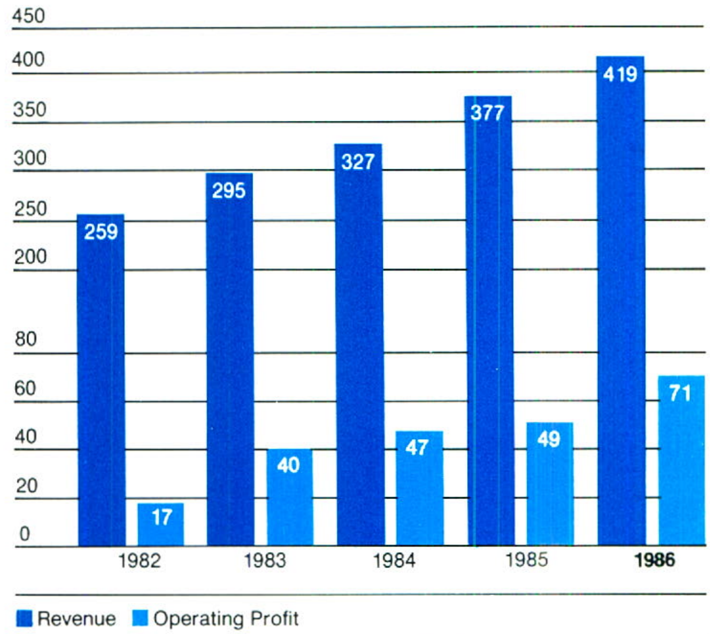
Operating profit for newspapers and printing rose 43.7 per cent to $70.9 million in 1986 from $49.3 million in 1985. Margins were 16.9 per cent of revenue, up from 13.1 per cent in the previous year. This increase reflected the higher advertising volume and stability in newsprint costs.

## Book publishing

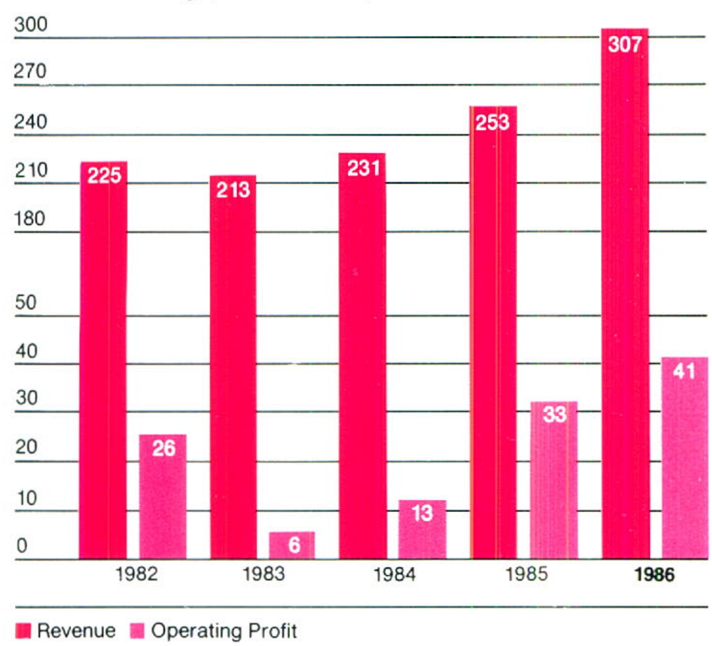
Revenue from book publishing increased 21.6 per cent from $252.7 million to $307.4 million. Operating profit, after depreciation and amortization, rose from $32.6 million to $41.5 million. Book publishing margins were 13.5 per cent of revenue, compared with 12.9 per cent in 1985.

These gains reflected much-improved overseas earnings, aided in part by the recovery of European currencies, and continuing strong performance in North America. Operating costs in 1986 included $7.4 million for Harlequin product development, an increase of $5.1 million over 1985, largely in North American direct mail book club projects

Revenue and Operating Profit
Newspapers and Printing (millions of dollars)




Revenue and Operating Profit
Book Publishing (millions of dollars)



## Catalogue marketing

Catalogue marketing revenue was $73.2 million, up 5.4 per cent from $69.4 million in 1985. Operating profit increased 7.1 per cent to $7.8 million. The main gift business was little changed, with growth coming from greeting cards and the office product development business which is approaching a break-even point.

## Income from continuing operations

Interest expense decreased from $22.5 million to $19.5 million, with a decline in interest rates accounting for most of the savings. Translation of foreign assets and debts resulted in a foreign exchange gain of $100,000 compared to a gain of $4.9 million in 1985. The company's tax rate increased from 31.7 per cent to 41.1 per cent, due to the increase in Canadian earnings and tax rates in 1986 and to non-recurring credits realized in 1985.

Income from continuing operations rose to $69.6 million, an increase of 34 per cent from 1985.Fully diluted earnings per share from continuing operations rose 10.8 per cent to $1.75 from $1.58 in 1985.

## Changes in financial position

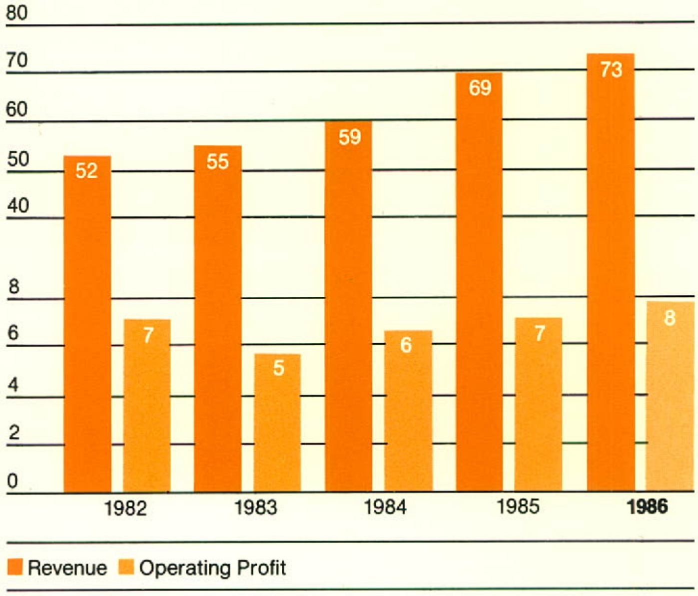
Net borrowings decreased by $39.2 million from $221.8 million to $182.6 million. Net cash provided by operations was $36.7 million, compared to $27.7 million in 1985. This improvement was the result of higher net income and lower fixed asset and working capital additions.

Cash dividends, less dividends received from Southam Inc., increased by $5.2 million. The rise reflected a higher average dividend rate in 1986 for Class A and B shares (49 cents compared with 28.75 cents in 1985).

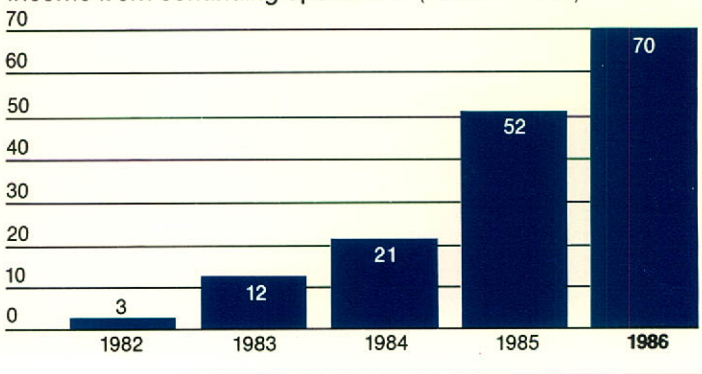
Investment transactions included $26.1 million in proceeds from the sale of Southam Inc. shares pursuant to the 1985 share exchange agreement. Payments of $7.2 million were made to Simon & Schuster by Harlequin under the 1984 Silhouette acquisition agreement. Investment spending on the discontinued Torstar Books operation amounted to $22.3 million in 1986.

Financing activities included the $15.1 million redemption of all $2.68 First Preference Shares. This was funded mainly by the $11.4 million received on the exercise of the Class B share purchase warrants.

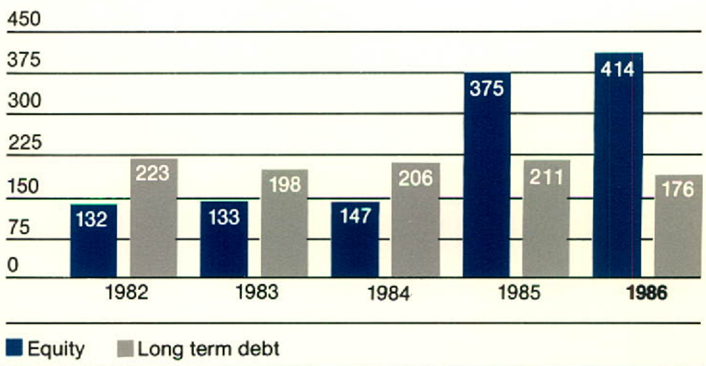
Revenue and Operating Profit
Catalogue Marketing (millions of dollars)




Torstar Corporation
Income from continuing operations (millions of dollars)




Capitalization (millions of dollars)



# Newspaper and Printing Division
# The Toronto Star

The Toronto Star, Canada's largest daily newspaper and the dominant print medium in Metropolitan Toronto, recorded its most successful year since the paper was founded in 1892. New readership, circulation, advertising and profit levels were achieved in 1986.

The performance was consistent with The Star's three primary objectives: to maintain a steady increase in circulation, to continue to carry at least 50 per cent of advertising linage among the three Toronto daily papers, and to remain highly competitive through profitability and investment in growth

The increase in readership and circulation is attributed to quality editorial content; to the substantial investment in prior years to introduce a Sunday edition and new sections, including Business Today; and to the publication of daily morning editions that began in 1981 for newsstand sales and in 1983 for home delivery.

Not only did advertising linage grow in 1986, but The Star also strengthened its position as the preferred choice for merchants in Canada's most competitive market. The Star carried more advertising lines than the other Toronto papers combined. Share of linage increased to average 51.6 per cent for the year. And an independent survey of daily newspapers placed The Star as the leading source of advertising information in greater Toronto.

| Newspaper and Printing Division | | | |
|---|---|---|---|
| (thousands) | 1986 | 1985 | 1984 |
| Revenue | $419,116 | $377,158 | $327,205 |
| Operating Profit* | 78,342 | 55,850 | 52,967 |
| Rate of Return on Revenue | 18.7% | 14.8% | 16.2% |

* Before depreciation and amortization

TORONTO STAR photographer Erin Combs poses model Krista Hatton in The Star's photo studio. In 1986, The Star's 22 photographers travelled an estimated 150,000 miles to all parts of the world and took about 100,000 pictures. Most pictures are now shot with color film as the capacity to process and print color continues to expand.

Star president David Jolley regards 1986 as a milestone year for The Star.

"We experienced a year in which all the elements of success clicked together," says Jolley. "We had good newspapers, record demand from readers and advertisers, a strong economy in our circulation areas, increased productivity and outstanding employee dedication.

"The Star's leadership position in the competitive Toronto market was strengthened even further in 1986 and with our excellent results we have the resources to make the kind of investments in our future that will sustain our leadership position."

## Circulation

Total circulation of The Star grew in 1986 to more than 205 million copies, or almost four million copies every week, with an increasing number of subscribers in the greater Metropolitan Toronto area (known statistically as the Census Metropolitan Area, or CMA).

Outside the CMA, most subscriber copies are delivered in the morning. Within the CMA, Saturday and Sunday deliveries are in the morning and almost 30 per cent of weekday deliveries are on doorsteps before breakfast.

Despite the high cost of maintaining morning and afternoon delivery systems, The Star is committed to meeting the needs of traditional afternoon subscribers and the increasing number of readers who prefer the paper in the morning.

The average Monday-to-Friday circulation was a record 525,255, up 6,541 copies from the previous high reached in 1985. All of the gain came in the CMA, with marginal declines in other parts of Ontario. The shift reflects a Star objective of strengthening its position of leadership in the primary trading area in order to provide Metro advertisers with assured access to their important markets.

Of equal importance was a growth of 5,400 home-delivered copies of the weekday Star in the CMA, compared with a daily increase of 1,800 copies sold at newsstands and boxes. Development of a loyal and growing subscriber base is a key to The Star's continued leadership in the Metro Toronto newspaper market.


**TORONTO STAR circulation employee Joe Martinec.**

Every day except Christmas and Good Friday, The Star's distribution staff of 550 and fleet of 225 delivery vehicles transport up to 900,000 copies of the paper to 7,500 newsstands, 10,000 Star boxes and 12,000 adult and youth carriers throughout southern and central Ontario.

The average circulation of The Sunday Star, launched in 1977, reached a record 531,540 copies in 1986, up 6,193 copies from the previous high set in 1985. As with the weekday editions, most of the growth came through home-delivered copies in the CMA.

The price of The Sunday Star delivered to homes in the CMA rose from 50 cents to 60 cents in September, 1986, following a similar increase implemented in May for home delivery elsewhere and for all single-copy sales. These increases slowed the growth rate of Sunday sales but did not prevent the year-to-year pattern of gain that has not been broken since The Sunday Star was introduced.


TORONTO STAR compositor Ray Lauze.
At one of The Star's 10 new advertising makeup units, the compositor moves a stylus over a work table to create an ad on the image screen, guided by information on the control screen (top). The system processes all text and graphic requirements, including photographs.

While total average circulation of The Saturday Star slipped from last year's all-time record of 813,949 to 805,255, home delivery in the CMA increased by 2,700 copies. A major factor for the decrease in sales of The Saturday Star was the pricing change from 85 cents to $1, completed early in 1986. Another factor was the introduction by another newspaper of a street-sale edition on Saturdays.

## Advertising

Advertising linage in The Star, including inserts, soared in 1986 to a record 48.2 million modular agate lines, up 7.2 per cent from the previous record set in 1985 and 11.5 per cent above the 1984 level. (Note: The Star has changed from the 2,772-line advertising page to conform to the new industry standard of an 1,848-line page. All pre-1986 advertising linage numbers have been restated to conform to the 1,848-line page).

The greatest linage growth came in classified, up 10.7 per cent from 1985 to a total of 20.3 million lines. The gain was led by employment opportunities, with help wanted up 37.9 per cent and careers up 21.1 per cent. By the end of 1986, The Star's share of careers linage in the three Toronto papers had grown to 64.6 per cent; five years ago, The Star's share was less than 14 per cent.

In a year in which the substantial growth in job-related advertising reflected the generally healthy economic conditions in southern Ontario, The Star continued to carry more employment linage than the other Toronto papers combined.

TORONTO STAR mailers (top to bottom) Gil Giroux, Frances Floroff, Beth Galvez and Flo Canizares process advertising inserts.
While machines handle a substantial volume of advertising and other inserts, many are still inserted by hand in the mailing room as papers move from the presses to the truck loading platform. In 1986, The Star carried a total of 323 million inserts, with a record-setting 18 separate pieces on a single day in November.

Real estate advertising, while still accounting for about one-fifth of all classified linage, was down 6.6 per cent from 1985. Buoyant sales of a limited supply of new homes in the Metro area reduced the volume of linage placed by developers in more normal market conditions.

In the highly competitive display advertising area, linage in 1986 was one per cent above the 1985 level. Gains in linage from national advertisers and smaller retail accounts only slightly more than offset a 14.4 per cent drop in linage from major department stores and food chains and a minor decline in travel linage. A portion of advertising from department stores and food chains was transferred to inserts.

Insert linage increased by more than 19 per cent and linage in Star special sections was almost 50 per cent greater than in 1985. Advertising in Starweek and the color comics remained at 1985 levels.

A corporate decision taken early in 1987 will remove about 90,000 lines from overall advertising volume in the year, at a cost of about $1 million. The Star no longer accepts brand advertising for cigarettes.

## Editorial

In editorial, a combination of constant improvement in all sections of The Star, together with superior coverage of major news events around the world, was instrumental to the readership gains recorded in 1986.

Additional editorial space was created in three highly competitive areas — world and national news, sports and business — and more color was added throughout the paper.

The Star's expanded coverage of world news recognized the importance of staff writers based in London, Tokyo and South Africa.

Reporting in the areas of science and the environment was strengthened.

The paper has been made more appealing to younger readers through improved entertainment coverage, including the Friday What's On section; through expanded sports content, including high school sports and the addition of popular columnist John Robertson; and through the addition of Wheels, a Saturday section devoted to news and advertising of motor vehicles.

The Life section was revamped, also, to maintain The Star's historic appeal to female readers. The section was expanded to include more feature stories and columns which cover a wide range of topics in which readers are interested.

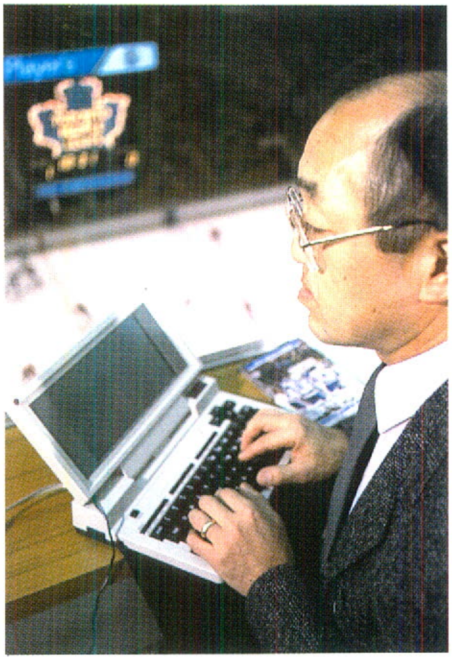

TORONTO STAR pressman Ron Monk.

The Star's six huge presses printed well over 200 million daily newspapers in 1986, consuming 126,000 tonnes of newsprint and 2.4 million kilograms of ink. All surplus newspapers are sold for shredding for packaging or for recycling as newsprint. Since 1978, surplus inks have been reclaimed by a powerful vacuum system in the pressroom, eliminating the need to dispose of a liquid waste.

The major news stories of 1986 included the Challenger space shuttle disaster; continued racial tension in South Africa; provincial elections in Prince Edward Island, Alberta, Saskatchewan and British Columbia; the Ontario doctors strike; approval of Metro's domed stadium; arms sales to Iran; and the series of troubles besetting the federal goverment in Canada.

The quality of The Star's editorial content was recognized by several national and international awards, including a share of the prestigious Michener Award for meritorious public service in journalism, two National Newspaper Awards and the Stephen Leacock Medal for Humor.

As the author of an eight-part series on Metro's ethnic minorities, Sunday Star writer Olivia Ward accepted the Michener Award from Governor-General Jeanne Sauve. The series required three months of research and 1,400 interviews. Ward also won the Washington-based Population Institute's Global Media Award for a separate series on urban population problems.




TORONTO STAR reporter Rick Matsumoto.
The Star has an editorial staff of 400 and about 70 portable computers are now used by reporters to transmit copy over telephone lines, at 300 words a minute and from almost anywhere in the world, to the central editing system in Toronto. Previously, reporters working away from the office dictated every word to a rewrite desk.

National Newspaper Awards winners for 1985 were book columnist Ken Adachi and sports columnist Wayne Parrish.

The Leacock award went to Star columnist Joey Slinger for his book, *No Axe Too Small To Grind.* The annual award recognizes Canadian authors judged most in keeping with standards set by the late humorist.

Other Star recipients of awards in 1986 included: columnists Milt Dunnell, Judy Nyman and John Power; retired columnist Lotta Dempsey; reporters Kathy English, Jonathan Ferguson, Rick Fraser, Jim Foster, Cal Millar, Nicholas Pron, Bill Schiller, Walter Stefaniuk and David Vienneau; reporter-photographers Dale Brazao, Don Dutton and Jim Wilkes; and correspondent Phil Johnson.

As well, The Star won the Canadian fashion industry's highest award, The Judy, for an unprecedented seventh time.

## Community participation

The Star's participation in the community passed an important milestone in 1986. Public contributions to the Fresh Air Fund and Santa Claus Fund topped $1 million for the first time since the funds were established by publisher Joseph E. Atkinson in 1902 and 1906, respectively. The money is

TORONTO STAR switchboard supervisor Eva Cavan (standing) with operators (clockwise from lower left) Glenna Lee, Linda Turner, Mary-Louise Ross, Helen Jones and Cathy Garnett.
While most incoming calls flow directly to Star personnel through a new computerized telephone system, Star operators still handle up to 3,000 incoming calls daily and place about 500 long-distance calls to all parts of the world.

used to make life happier for needy children in Metro, in 1986 by giving 20,000 a summer camp holiday and 25,000 a Christmas gift.

The Star's Great Salmon Hunt attracted a record 17,300 fishing enthusiasts to Lake Ontario during its eight-week period in 1986. From accumulated proceeds, a $100,000 patrol boat has been ordered for delivery this spring to the Peel Regional Police Force; this raises to more than $250,000 the amount that has been returned to the community from Salmon Hunt revenue for sport, conservation and safety projects.

Corporate donations from The Star to community and charitable ventures in 1986 totalled $408,600. The largest single contribution went to the United Way of Metropolitan Toronto. The United Way received an additional $121,000 in pledges from Star employees.

## Capital investment

Capital investments during 1986 included almost $3 million for the acquisition of 10 computerized advertising makeup units for The Star's composing room. Capable of processing both text and photographs, the units are the forerunner to the day when pages of The Star, including editorial and advertising content, will be assembled by operators working with computer systems.

## Other

Collective agreements with The Star's various unions expired at the end of 1986 and negotiation of new contracts began early in the current year.

**TORONTO STAR Santa Claus Fund boxes and gift certificates are delivered by hundreds of volunteers to 25,000 needy children.**

The 1986 volunteers included the 125th Scout Group (from left): Leader Dave Wochenmarkt, Tom McKeown, Chris Lewis, Ann Veyvara, Edwin Ho, Jason O'Born, James Wood, Greg Filzmaier and Colin Green; and North York firefighters (from left): Doug Browne, Darryl Thompson and Captain Dan Antle.

With the implementation of aggressive expansion plans, weekly distribution of Metroland's community newspaper editions soared close to the 1.3 million level by the end of 1986.

Community newspapers are the core business of Metroland Printing, Publishing & Distributing. The company also prints and distributes a broad range of advertising material in and around Metro Toronto.

The papers strengthened their leadership in community newspaper readership in an area from Oshawa/Whitby in the east to Burlington in the west and to Newmarket in the north.

Total advertising in 1986 was 57 million lines, compared with 47 million in 1985. The growth came in part from the introduction of new editions.

In printing, the volume of advertising inserts and flyers produced by Metroland's four production facilities continued to grow. Total commercial printing revenue increased by 27 per cent.

The Metroland carrier force distributed more than 307 million advertising pieces in 1986, compared with 299 million in 1985. Distribution revenue grew by seven per cent.

Revenue from all operations increased by 22 per cent in 1986 from 1985.

## Newspapers

Metroland now publishes a total of 40 regular editions each week in 22 markets, as well as the Today and Community supplements in five markets. A monthly tabloid is produced for business people in 11 communities and the company now has three special-interest publications.


METROLAND president John Baxter and apprentice film stripper Kevin Higginbottom.

Production of The Toronto Star's Saturday color comics was moved during 1986 from an outside printer to Metroland's Scarborough plant and then to the plant adjacent to company headquarters in Mississauga. Depending on the volume of advertising inserts, the 900,000-copy press run can be completed in as few as 13 hours.


METROLAND'S George W. Coyle (left) is publisher of three special-interest newspapers. With him are Jane McPhee, advertising and marketing director, and editor Don Atanasoff.

Displays at consumer shows in the Toronto area are used by Metroland as promotional platforms for Today's Seniors and the recently acquired Canadian Coin News and Canadian Stamp News.

The community newspapers are Acton Free Press, Ajax/Pickering News Advertiser, Aurora Banner, Brampton Guardian, Burlington Post, Erin/Hillsburgh Echo, Etobicoke Advertiser/Guardian, Georgetown Independent, Markham Economist & Sun, Milton Canadian Champion, Mississauga News, Newmarket Era, Oakville Beaver, Oshawa/Whitby This Week, Richmond Hill Liberal, Scarborough Mirror, Stouffville Tribune, Thornhill Liberal, Vaughan Liberal and Willowdale Mirror.

With the exception of the Erin/Hillsburgh Echos, all are published at least twice weekly. Six of the papers are published three times weekly.

A section of the Wednesday editions of the Brampton, Etobicoke, Georgetown, Acton and Mississauga papers is overprinted and delivered to non-newspaper households. This section allows advertisers to reach the entire market at a premium price.

Metroland moved in 1986 into the new field of business news coverage. Monthly tabloid papers with a focus on local business-oriented advertising and editorial content were introduced in 11 markets. They are distributed only to businesses in their respective communities.

Another expansion last year came in the area of special-interest newspapers.

In mid-1985, Metroland launched Today's Seniors, a monthly 44,000-circulation tabloid aimed at people over 50 and distributed to community centres, hospitals, libraries and nursing and retirement homes from Oshawa to Hamilton and north to Newmarket.

At the beginning of 1987, Metroland acquired Canadian Coin News and Canadian Stamp News, both bi-weekly tabloids, with respective circulation of 15,000 and 11,000 across Canada. Efforts will be directed this year to raising the readership of both papers and further purchases of special-interest publications will be pursued.

## Distribution

Metroland's finely tuned distribution system offers advertisers total coverage of any of the 22 communities on any day of the week. Computerized information allows advertisers to select from a broad range of demographic data and thus pinpoint residential areas in which their advertising material is to be distributed.

## Printing

Metroland's four production plants are located in Mississauga, Scarborough, Willowdale and Vaughan Township. A third heatset offset press will be installed in 1987 in the Scarborough plant to meet the demand for advertising products.

In 1986, coldweb printing revenue increased by 19 per cent and heatset revenue grew by 113 per cent, due largely to the installation of a second heatset press. Revenue from rotogravure printing was flat.

Overall operating income from printing rose 10 per cent and was adversely affected by a large drop in contribution from rotogravure printing.

Revenue from Torstar's book publishing and direct marketing division, which includes Harlequin Enterprises and Miles Kimball, was a record $380.5 million in 1986, up 13.5 per cent from 1985. Operating profit, excluding amortization and depreciation, increased by 26 per cent from $50.8 million to $64 million in 1986.

| Book Publishing and Direct Marketing Division (thousands) | 1986 | 1985 | 1984 |
|---|---|---|---|
| Revenue | **$380,548** | $322,138 | $290,358 |
| Operating Profit* | **64,024** | 53,506 | 30,976 |
| Rate of Return on Revenue | **16.8%** | 16.6% | 10.7% |

* Before depreciation and amortization

HARLEQUIN'S senior management group includes Brian E. Hickey (centre), president, book publishing. Horst K.W. Bausch (right) is vice-president and editor-in-chief and Robert J. Massie (left) is executive vice-president, overseas.

Harlequin books are published in 17 languages and distributed in more than 100 countries. The North American market remains the leader, but volumes are showing significant increases in Australia, West Germany and the United Kingdom. Earnings from overseas operations reached record levels in 1986.

## Harlequin

Harlequin books are published in 17 languages, distributed in more than 100 countries and were purchased at an average rate of 392 copies every minute during 1986.

The total of more than 206 million books gave Harlequin record revenue of $307.4 million and record operating profit, before depreciation and amortization, of $52.4 million. Compared with 1985, revenue was up 21.6 per cent and profit gained 23.3 per cent.

Most of the profit increase came in overseas countries, with the balance in more moderately expanding markets in Canada and the United States.

Harlequin, the world's largest publisher of romance fiction, is based in Toronto but operates offices in the following countries, listed in descending order by sales volume: United States, West Germany, France, United Kingdom, Italy, Canada, Japan, Australia, The Netherlands, the Scandinavian countries, Spain, Greece and Switzerland.

Field offices are maintained in Finland, New Zealand and the Philippines.

As well, books are distributed in 90 other countries, with South Korea being added to the list early in 1987. The move into South Korea represents a step toward more aggressive development of the Asian markets.

Historically, Harlequin has been organized on a geographic basis with two operating units, Harlequin North America and Harlequin Overseas.

A reorganization completed during 1986 has focussed Harlequin's efforts around its two strategic thrusts – publishing and direct marketing – and will facilitate the company's growth and expansion.

The new alignment is on market segments.

| Harlequin Enterprises (thousands) | 1986 | 1985 | 1984 |
|---|---|---|---|
| Revenue | **$307,381** | $252,697 | $231,232 |
| Operating Profit* | **52,420** | 42,517 | 21,094 |
| Rate of Return on Revenue | **17.1%** | 16.8% | 9.1% |

* Before depreciation and amortization

Harlequin's publishing division handles editorial development and worldwide retail marketing.

Harlequin's direct marketing division has responsibility for maintaining and developing book club membership in North America and Harlequin's direct marketing diversification efforts.

Of Harlequin's unit sales in North America, about half are sold in stores and about half by mail order to readers who subscribe for a specified number of titles.

"The reorganization was an important step at the right time for Harlequin," says President David Galloway. "This allows us to expand and diversify in publishing and direct marketing – possibly outside of publishing.

"The marketing and administrative process is quite different in the two segments and we are now better able to plan and manage Harlequin's growth in both parts of the market. We have the books and the people – and now the right focus."

## Publishing

Harlequin continues to be the world's most prolific publisher of paperback novels. More than 600 new titles were published for the North American market during 1986 and more than 4,000 foreign language editions were produced for sale in overseas countries.

Harlequin's book publishing operations include editorial, North American retail, overseas and motion pictures.

**HARLEQUIN art buyer Shelley Cinnamon with Toronto illustrator Will Davies RCA.**
Like most of the 56 independent artists Harlequin uses for book cover designs, Davies receives a summary of a book's story, selects appropriate models and takes their picture. He works from a black and white print to complete a water color illustration. Davies has done more than 300 Harlequin covers.

### Editorial

Harlequin titles are grouped in various segments and published under different product lines. The imprints include Harlequin, Silhouette, World Wide Library and Gold Eagle.

Editorial developments in 1986 include:

☐ Editorial administration of Harlequin romance novels was strengthened by consolidating editorial activities in Toronto, New York and London. Editor-in-chief Horst Bausch moved from the U.K. to Toronto to provide more effective management of the editorial functions.


HARLEQUIN authors Vicki Lewis Thompson (second from left) of Tucson, Arizona and Sally Garrett (second from right) of Dillon, Montana with Harlequin fans at a reader party in Tucson.

Eight or nine times a year in cities in Canada and the United States, up to 300 Harlequin readers are invited to lunch with and meet Harlequin authors. Anyone celebrating a birthday or anniversary is asked to help cut a cake. Some readers have as many as 5,000 Harlequin titles in their collections.

☐ Promotion of a romance series entitled *Janet Dailey Americana* was launched early in the year. Janet Dailey is a best-selling author with more than 90 million books in print. Each novel in the 50-volume reprint series uses one of the American states as the editorial setting.

☐ Major commitments outside of traditional romance fiction continued under the new imprint, World Wide Library. Seventeen titles were published in 1986 compared with eight in 1985. More than 40 titles are scheduled for release in 1987. Included in this sharply expanded category of more general women's fiction are such top-name authors as Patricia Mathews, William Kennedy and John Ralston Saul.

☐ Plans were finalized for the introduction of a new imprint, Crosswinds, directed at the young adult market. Replacing the First Love series, Crosswinds will be launched in June, 1987. The imprint will feature two romance titles and two general fiction titles a month for younger readers.

Several other editorial topics have been identified for development of new series, including historical romance, mystery and science fiction. New single-title products will attract male readers of adventure and espionage stories.

## North America retail

Harlequin and Silhouette romance titles remained dominant in the retail segment in Canada and the United States, enjoying the largest share of the the market in both countries.

While book club sales continued to grow dramatically in North America, Harlequin's retail markets continued to decline, although less so in 1986 than in previous years.

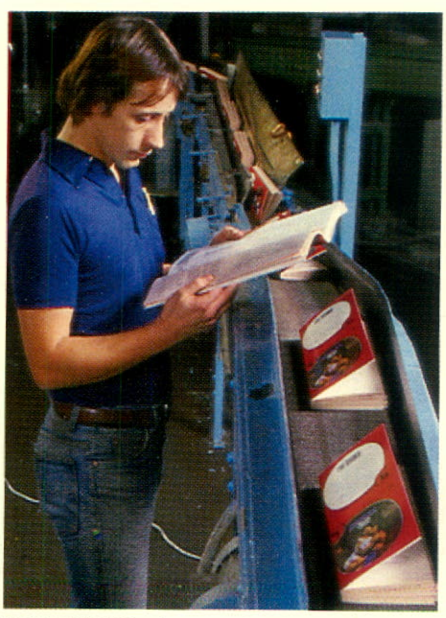
The company's profit in 1986 was helped by better distribution control of unsold books. As well, savings were realized over the full year from investments made prior to 1986 in typesetting capacity, computer procedures and the processing of orders.

## Overseas

The 11 companies that make up the Harlequin overseas group enjoyed record revenues and operating profits in 1986. While a portion of the growth is attributable to favorable foreign exchange rates, the companies themselves implemented several product and marketing improvements:

**HARLEQUIN mail opener Cheryl Jendrasik in the Buffalo distribution centre.**

New equipment acquired in 1986 allows 1,500 book club orders to be processed every hour. Mail openers handle about 125,000 orders every week from all parts of Canada and the United States.



**HARLEQUIN books are printed in large part at Arcata Graphics in Buffalo.**

Bindery employee Robert Chowaniec checks books after covers have been glued to text pages and before the books are trimmed. Arcata processes 500,000 books through the bindery area every 24 hours.

**HARLEQUIN order filler Helen Polanski.**

Equipment known as a banded prepack collator at Harlequin's Buffalo distribution centre can assemble and shrink-wrap up to 12 paperbacks at a time and process a total of 576 books a minute. The plant's one billionth Harlequin book was shipped during 1986.

☐ The Silhouette franchise, acquired in 1984, was successfully integrated into several key markets, most notably Australia, Japan and the U.K.

☐ A new company was established in West Berlin with Harlequin's West German partner of 10 years, Axel Springer, to oversee printing and distribution of books. This consolidation of activities has resulted in production and distribution efficiencies.

☐ Titles aimed at young adults were introduced in a number of European markets.

☐ A wholly owned distribution company was created by Harlequin in New Zealand to provide better service, particularly in more sparsely settled areas.

☐ An administrative change in Spanish-language operations that took place in 1985 generated earnings improvement in 1986. This entailed Harlequin taking full ownership of the company in Spain and establishing licensing arrangements rather than equity for publishing activities in Mexico and all of Latin America.

☐ Management of the U.K. company was strengthened and its earnings were the highest in six years.

## Motion pictures and video

Harlequin's development of movies and videos based on romance novels achieved a major goal in October, 1986 when *Love with a Perfect Stranger*, starring Marilu Henner and David Massey, made its debut on Showtime, the American pay television channel.

Under an agreement with Atlantic Television Inc. of Los Angeles and Video Ventures Ltd. of London, England, both production companies and distribution companies, Harlequin is participating in the development of five more such films.

Distribution of the films in North America will be initiated by Showtime for pay TV, by Paramount Home Video Inc. for video cassettes and by CBS Inc. for commercial television.

Overseas distribution for commercial television will be handled by Yorkshire Television Enterprises Ltd. of London and its agent, International Television Enterprises Ltd. Video cassettes will be administered by Paramount Home Video.

HARLEQUIN premium buyer Dollina MacMillan (left) with Dianne Kingston, product manager for direct marketing membership development in the United States.
As many as 45 different premiums are used by Harlequin's direct marketing group over a year as incentives to recruit and retain book club memberships. Premiums are measured and weighed to ensure correct packaging prior to shipment from the company's distribution centre in Buffalo.

## Direct Marketing

Operating profit for Harlequin's direct marketing group increased only slightly in 1986 due to substantial promotional spending during the year.

Expenditures to retain and acquire members of romance book clubs were at an all-time high in 1986. Increased response rates and operating efficiencies have reduced the cost of acquiring new members by more than 20 per cent. These savings, together with membership growth and an increase of almost 100 per cent in book orders, will create earnings growth in 1987 and 1988.

Based on extensive research conducted in 1985 and 1986, Harlequin is continuing to invest in the development of three new product lines:

☐ The Select Reader is a non-fiction continuity subscription series of condensed books, with four or five titles in each hardcover volume. Titles are selected on the basis of the popularity of the original hardcover volumes. This program is still in the development stage.

☐ General Books is a direct marketing program designed to sell hardcover, single-title, non-fiction books. Early test results are positive. Some of the titles in this program will be contributed by Marshall Editions, Harlequin's subsidiary book packager in the U.K.

☐ As well, Choice for Bestsellers, a continuity subscription series of paperback fiction for women, is being launched in 1987 on the basis of positive response to research tests.

Other investment spending in 1986 included better control of book club membership lists and overall customer service.

Additional testing and development is planned in 1987 of non-book direct marketing activities.

## Marshall Editions

Marshall Editions is a London-based specialized packager of books published in multiple languages for international markets. The broad subject range includes home design, gardening, fitness, photography, cooking, embroidery, encyclopedia and atlases.

## Other

In September, Harlequin joined with Global TV and CBS Records to establish Global Playhouse Childcare, a daycare centre located in Don Mills Junior High School. Staffed by professional and licensed teachers, the centre provides economical day care for children of employees of the three companies.

**HARLEQUIN joined with Global TV and CBS Records in 1986 to open the non-profit Global Playhouse Childcare in Don Mills Junior High School.**

The daycare centre is for children of employees of the three companies. Teacher Joanne Bosley supervises (clockwise from lower left) Derreck Ivey, Laura Grubb, Andrew Buzny, Cameron Black, Michael Buzny and Elysia Caprara.

An average of 9,300 mail orders a day arrived in 1986 at the offices and plant of The Miles Kimball Co. in Oshkosh, a city of 50,000 on the shores of Lake Winnebago in eastern Wisconsin.

The average order was worth $21 and asked for five of the 2,100 household items listed in the company's catalogues.

About 93 per cent of the orders were filled and shipped – largely by United Parcel Service – within 48 hours by 275 permanent and, in peak periods, an additional 1,200 seasonal employees.

The best-selling items in 1986 were personalized pencils and calendars incorporating a photograph sent in by the purchaser. Even the cover of the catalogue sells as a separate item – 18,000 of them in the year.

President Ted Leyhe says product variety, price, quality and fast service are why Miles Kimball is one of the largest catalogue mail-order companies in the United States for home products.


MILES KIMBALL driver Jerry Roberts.
Driver Roberts is retiring after 33 years of delivering up to 24,000 orders a day from the post office in Oshkosh. A mail room staff of 45 processes all orders on the day they're received. In the peak September-December period, a fully loaded tractor-trailer leaves the plant every two hours for the courier's distribution centre in Milwaukee..

"We can maintain our strengths because our people know their business," says Leyhe. "Our turnover rate in permanent staff is only one per cent a year and many of our permanent and seasonal people have been with us for 30 years."

Miles Kimball marked its 51st anniversary in 1986 by a record $73.2 million (expressed in Canadian dollars) in revenue and operating profit of $7.8 million. Compared with 1985, revenue was up $3.7 million or 5.4 per cent and profit grew by $513,000 or 7.1 per cent.

In a catalogue business, marketing is the largest expense. Miles Kimball distributed 35 million catalogues in 1986, using computerized mailing lists developed and owned by the company, as well as rented lists covering prime prospects for the catalogue items.

Because of close computer control, Miles Kimball customers rarely receive duplicate catalogues. The same controls allow concentration on known prospects.

"We know from research that our largest customer group is the suburbanite with median or higher education and income," says Leyhe. "We reach those people accurately and efficiently."

In fact, Miles Kimball's coverage of its most responsive buying audience is now so complete in the United States that the company's growth requires expansion into new market segments.

While new household formations will still be tapped for home products, efforts will continue to strengthen penetration of the office product market.


MILES KIMBALL artist Shelia Noffke.
Personalized mail boxes are a popular Christmas tree ornament and among the dozens of Christmas items in the 210-page Miles Kimball catalogue.

A catalogue entitled The Business Book was launched in 1982 and is now distributed to 150,000 customers annually.

The Business Book accounts for nine per cent of Miles Kimball revenues. After contribution to fixed costs and with added list rental income, this division broke even in 1986 while adding 30,000 new businesses to the customer base.

The accompanying financial statements are prepared in accordance with accounting principles generally accepted in Canada and conform in all material respects with International Accounting Standards. The following is a summary of significant accounting policies:

(a) Principles of consolidation
The consolidated financial statements include the accounts of the company and all its subsidiaries.

(b) Foreign exchange
Assets and liabilities denominated in foreign currencies have been translated to Canadian dollars primarily at exchange rates prevailing at the year end. Revenues and expenses are translated at average rates for the year.
Exchange adjustments relating to self-sustaining foreign operations are included in shareholders' equity as unrealized exchange adjustments. These adjustments will be recognized in income in proportion to any reduction in the company's net investment in the foreign operation.
The accounting policy recognizes that the long-term U.S. dollar denominated debt is designated as a hedge against U.S. dollar assets and future U.S. dollar cash flows. Adjustments arising from this hedge are deferred and amortized over the remaining life of the long-term debt.

(c) Receivables
Receivables are reduced by provisions for anticipated book returns which are determined by reference to past experience and expectations.

(d) Inventories
Inventories are valued at the lower of cost and net realizable value.

(e) Investment in Southam Inc.
The investment in Southam Inc. ("Southam") is accounted for by the equity method. Since Torstar owns 14,290,000 (22.4%) of the common shares of Southam and Southam owns 12,700,000 (approximately 30%) of Torstar's Class A and Class B shares (fully diluted), Torstar has a pro rata interest in its own Class A and Class B shares of 6.7%. Accordingly, the investment in Southam and shareholders' equity are reduced by the cost to Torstar of its interest in its own shares.

The carrying value of the investment in Southam exceeds the underlying book value by $134.9 million. This excess has been attributed to Southam's newspaper circulation, interest in broadcast licences, land and goodwill. Circulation will not be written down or amortized unless circulation of the Southam newspapers falls below the levels prevailing at the acquisition date. Broadcast licenses will be written down if and when there has been a diminution in value. Goodwill is amortized over forty years.

(f) Depreciation
Fixed assets are depreciated using various rates and methods depending on the estimated useful lives of the assets. The rates and methods used for the major depreciable assets are as follows:

(i) Machinery and equipment — straight line over 10 to 15 years or 20% diminishing balance;

(ii) Buildings — straight line over 25 years or 5% diminishing balance;

(iii) Leasehold interests — straight line over the life of the lease.

(g) Mailing lists
Purchased direct mail marketing lists are amortized on a straight line basis over 5 to 10 years.

(h) Subscription list
The newspaper subscription list is amortized on a straight line basis over a 30-year period to 2001.

(i) Goodwill
Goodwill is amortized on a straight line basis over periods of 20 to 40 years from the dates of acquisition.

(j) Past service pension costs
The costs relating to improved pension benefits granted for employment in prior periods, to the extent they are not covered by pension plan surplus, are amortized over periods not exceeding 15 years from the dates at which such benefits become effective.

# Torstar Corporation

(Incorporated under the laws of Ontario)

## Consolidated Balance Sheet

December 31, 1986 (with comparative figures at December 31, 1985 (note 7))

| Assets | 1986 | 1985 |
|---|---|---|
| | (thousands of dollars) | |
| **Current:** | | |
| Cash and short-term investments | **$22,823** | $30,606 |
| Receivables (note 1) | **121,885** | 100,080 |
| Inventories | **35,636** | 31,465 |
| Prepaid expenses | **50,266** | 39,981 |
| Prepaid and recoverable income taxes | **29,644** | 34,797 |
| **Total current assets** | **260,254** | 236,929 |
| **Investment in Southam Inc.** (note 2) | **202,615** | 216,256 |
| **Fixed assets at cost:** | | |
| Land | **4,598** | 4,599 |
| Buildings and leasehold interests | **28,121** | 25,654 |
| Machinery and equipment | **118,222** | 106,705 |
| | **150,941** | 136,958 |
| Less accumulated depreciation | **(72,476)** | (62,070) |
| **Net fixed assets** | **78,465** | 74,888 |
| **Mailing lists at amortized cost** | **11,037** | 14,651 |
| **Subscription list at amortized cost** | **4,917** | 5,250 |
| **Goodwill at amortized cost** | **202,860** | 197,963 |
| **Other assets** | **22,972** | 25,375 |
| **Total assets** | **$783,120** | $771,312 |

(See accompanying notes)

On behalf of the Board

Beland Honderich

Director

Burnett M. Thall

Director

| Liabilities and Shareholders' Equity | 1986 | 1985 |
|---|---|---|
| | (thousands of dollars) | |
| **Current:** | | |
| Bank indebtedness | $29,779 | $41,076 |
| Accounts payable and accrued liabilities | 117,764 | 113,420 |
| Income taxes payable | 21,487 | 15,668 |
| **Total current liabilities** | 169,030 | 170,164 |
| **Long-term debt** (note 3) | 175,607 | 211,301 |
| **Deferred income taxes** | 15,827 | 10,896 |
| **Employees' shares subscribed** (note 4) | 8,519 | 3,625 |
| **Shareholders' equity:** | | |
| Share capital (note 4) | 284,087 | 285,141 |
| Contributed surplus (note 4) | 2,389 | 3,114 |
| Retained earnings | 175,641 | 141,463 |
| Foreign currency translation adjustment | 382 | (266) |
| | 462,499 | 429,452 |
| Less cost of Torstar's interest in its own Class B shares (note 2) | (48,362) | (54,126) |
| | 414,137 | 375,326 |
| **Total liabilities and shareholders' equity** | $783,120 | $771,312 |

(See accompanying notes)

## AUDITORS' REPORT

**To the Shareholders of Torstar Corporation**

We have examined the consolidated balance sheet of Torstar Corporation as at December 31, 1986 and the consolidated statements of income, retained earnings and changes in net borrowings for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, the consolidated financial statements present fairly the financial position of the company as at December 31, 1986 and the results of its operations and the changes in its financial position for the year then ended in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

**Clarkson Gordon**
Chartered Accountants

February 23, 1987
Toronto, Ontario

# Consolidated Statement of Income

Year ended December 31, 1986 (with comparative figures for 1985 (note 6))

| | 1986 | 1985 |
|---|---|---|
| | (thousands of dollars) | |
| **Operating revenue** | **$799,664** | $699,296 |
| **Operating profit** | | |
| Newspapers and printing | **$70,874** | $49,326 |
| Book publishing | **41,452** | 32,621 |
| Catalogue marketing | **7,757** | 7,244 |
| Corporate administration | **(4,590)** | (4,411) |
| | **115,493** | 84,780 |
| Interest — non-current | **(19,856)** | (22,201) |
| — other (net) | **307** | (258) |
| Foreign exchange gain (net) | **116** | 4,934 |
| Income before taxes | **96,060** | 67,255 |
| Income taxes (note 5) | **39,500** | 21,300 |
| Income before equity in earnings of Southam Inc. | **56,560** | 45,955 |
| Equity in earnings of Southam Inc. (note 2) | **12,994** | 5,939 |
| Income from continuing operations | **69,554** | 51,894 |
| Net loss from discontinued operations (note 6) | **(4,314)** | (1,747) |
| Income before extraordinary items | **65,240** | 50,147 |
| Extraordinary items (note 7) | **(9,818)** | |
| **Net income** | **$55,422** | $50,147 |
| **Fully diluted earnings per Class A and Class B share** (note 8) | | |
| From continuing operations | **$1.75** | $1.58 |
| Before extraordinary items | **$1.64** | $1.53 |
| Net income | **$1.39** | $1.53 |

(See accompanying notes)

# Consolidated Statement of Retained Earnings

Year ended December 31, 1986 (with comparative figures for 1985)

| | 1986 | 1985 |
|---|---|---|
| | (thousands of dollars) | |
| **Retained earnings, beginning of year** | **$141,463** | $109,530 |
| Net income | **55,422** | 50,147 |
| | **196,885** | 159,677 |
| **Deduct:** | | |
| Dividends on First Preference shares | **2,967** | 4,144 |
| Dividends Class A and B shares | **19,347** | 9,269 |
| Interest in own dividends paid to Southam Inc. (note 2) | **(1,471)** | (638) |
| | **20,843** | 12,775 |
| Share issue expenses (net of taxes) | | 893 |
| Excess of cost of shares purchased and cancelled over book value | **401** | 4,546 |
| | **21,244** | 18,214 |
| **Retained earnings, end of year** | **$175,641** | $141,463 |

(See accompanying notes)

## Consolidated Statement of Changes in Net Borrowings

Year ended December 31, 1986 (with comparative figures for 1985 (note 7))



| | 1986 | 1985 |
|---|---|---|
| | (thousands of dollars) | |
| **Operating activities:** | | |
| Cash provided by continuing operations: | | |
| Income before equity in earnings of Southam Inc. | $56,560 | $45,955 |
| Depreciation | 11,555 | 10,107 |
| Amortization | 10,801 | 10,109 |
| Deferred and recoverable income taxes | 4,931 | 19,751 |
| Dividends from Southam Inc. | 6,923 | 3,176 |
| | 90,770 | 89,098 |
| Increase in non-cash working capital | (14,920) | (24,827) |
| Fixed asset additions | (17,186) | (23,634) |
| Cash dividends paid | (21,941) | (12,983) |
| Net cash provided by continuing operations | 36,723 | 27,654 |
| **Investment and other activities:** | | |
| Investment in Southam Inc. | | (266,981) |
| Shares issued for investment in Southam Inc. | | 215,900 |
| Sale of shares of Southam Inc. (note 2) | 26,081 | |
| Payment under Silhouette acquisition agreement (note 10) | (7,185) | |
| Investment in discontinued operations (notes 6 & 7) | (22,293) | (13,106) |
| Shares purchased for cancellation | (425) | (4,854) |
| Other | 8,240 | 15,685 |
| Cash provided by (used in) investment activities | 4,418 | (53,356) |
| **Financing activities:** | | |
| Issue of $1.70 Preference Shares | | 30,400 |
| Redemption of $2.68 Preference Shares | (15,124) | |
| Cash from exercise of warrants | 11,412 | |
| Cash (used in) provided by financing activities | (3,712) | 30,400 |
| Cash used to reduce net borrowings | 37,429 | 4,698 |
| Effects of exchange rate changes | 1,779 | (8,021) |
| Net borrowings, beginning of year | (221,771) | (218,448) |
| **Net borrowings, end of year** | ($182,563) | ($221,771) |
| **Net borrowings represented by:** | | |
| Bank indebtedness net of cash and short-term investments | $6,956 | $10,470 |
| Long-term debt | 175,607 | 211,301 |
| | $182,563 | $221,771 |

(See accompanying notes)

## 1. Receivables

The provisions for anticipated book returns deducted from receivables at December 31, 1986 amounted to $57 million (December 31, 1985 — $58 million).

## 2. Investment in Southam Inc.

(a) Details of the investment in Southam for the years ended December 31, 1986 and 1985 are as follows:

| | 1986 | 1985 |
|---|---|---|
| | (thousands of dollars) | |
| **Cost of original investment** | **$266,981** | $266,981 |
| Cumulative equity in earnings of Southam | **18,405** | 5,939 |
| Company's pro rata cumulative interest in its own dividends paid to Southam | **2,109** | 638 |
| | **287,495** | 273,558 |
| Less cumulative dividends received from Southam | **(10,099)** | (3,176) |
| Less carrying value of investment sold | **(26,419)** | |
| Less cost of the company's pro rata interest in its own Class B (non-voting) shares held by Southam | **(48,362)** | (54,126) |
| **Carrying value of investment at end of year** | **$202,615** | $216,256 |

(b) On August 15 pursuant to the 1985 share exchange agreement with Southam Inc., the Southam group exercised its option to purchase 1,590,000 Southam shares from Torstar. Proceeds from the disposal amounted to $26.1 million.

(c) A condensed balance sheet and statement of income for Southam Inc. appear below.

| | 1986 | 1985 |
|---|---|---|
| | (thousands of dollars) | |
| At December 31 | | |
| Current assets | **$288,855** | $264,157 |
| Fixed assets | **335,826** | 325,653 |
| Other assets | **184,767** | 175,564 |
| Investment in Torstar | **156,359** | 140,981 |
| **Total assets** | **$965,807** | $906,355 |
| Current liabilities | **$233,029** | $247,931 |
| Long-term debt and deferred taxes | **284,254** | 254,899 |
| Shareholders' equity | **448,524** | 403,525 |
| **Total liabilities and shareholders' equity** | **$965,807** | $906,355 |

| **Statement of Income** | 1986 | 1985 |
|---|---|---|
| **Revenue** | **$1,279,370** | $1,184,431 |
| **Operating income** | **$52,688** | $43,560 |
| Equity in income of associated businesses | **19,241** | 5,830 |
| Extraordinary loss | **(5,017)** | (12,064) |
| **Net income** | **$66,912** | $37,326 |

## 3. Long-term debt

(a) Term Loan Agreement: The company has a $300 million line of credit with two Canadian banks. The borrowing limit reduces by $30 million per year commencing in 1990 or later if mutually acceptable.
Amounts borrowed under the line of credit are primarily in the form of bankers' acceptances which are issued at varying interest rates normally slightly below prime and maturing over periods ranging from 30 days to one year. Borrowings may be made in Canadian dollars or U.S. dollars.

(b) Interest rates: As of December 31, 1986 interest on all long-term debt was at floating rates, which averaged 8.4%. Subsequent to December 31, 1986, arrangements were made to ensure that the interest rate on $100 million of U.S dollar debt will not exceed 7.2% for the period July 1, 1987 to March 31, 1988.

(c) No long-term debt repayments are required in the next five years.

(d) Long-term debt at December 31, 1986 includes U.S. $105 million.

## 4. Share capital

(a) The following is a summary of changes in the company's share capital during the year:

| | Authorized Shares | Outstanding Shares | Amount |
|---|---|---|---|
| | | | (thousands of dollars) |
| **First preference shares, non-voting** | | | |
| Balance at beginning of year | 8,575,609 | | |
| **$2.68 — 1981 Series** | | | |
| Balance at beginning of year | | 577,635 | $14,441 |
| Redeemed during year | (577,635) | (577,635) | (14,441) |
| Balance at end of year | | Nil | Nil |

| | Authorized Shares | Outstanding Shares | Outstanding Amount |
|---|---|---|---|
| | | | (thousand of dollars) |
| **$1.00 — Second Series** | | | |
| Balance at beginning of year | | 49,529 | 1,238 |
| Issued during year | | 2,000 | 50 |
| Redeemed during year | (2,000) | (2,000) | (50) |
| Converted to Class B shares | (8,537) | (8,537) | (213) |
| Balance at end of year | | 40,992 | 1,025 |
| **$1.70 — Third Series** | | | |
| Balance at beginning of year | | 1,400,000 | 31,500 |
| Converted to Class B shares | (246,049) | (246,049) | (5,536) |
| Balance at end of year | | 1,153,951 | 25,964 |
| **Total First Preference Shares** | 7,741,388 | 1,194,943 | $26,989 |
| **Class A (voting) and Class B (non-voting)** | Unlimited | | |
| **Class A shares** | | | |
| Balance at beginning of year (reflecting 2 for 1 stock split in May 1986) | | 5,128,354 | $ 2,788 |
| Converted to Class B | | (27,525) | (16) |
| Balance at end of year | | 5,100,829 | 2,772 |
| **Class B shares** | | | |
| Balance at beginning of year (reflecting 2 for 1 stock split in May 1986) | | 33,140,402 | 235,174 |
| Exercise of warrants | | 1,113,310 | 11,412 |
| Issued under employees' share purchase plan | | 281,706 | 1,612 |
| Converted from Third Series preference shares | | 492,098 | 5,536 |
| Converted from Second Series preference shares | | 37,642 | 213 |
| Converted from Class A shares | | 27,525 | 16 |
| Issued as stock dividends | | 15,574 | 373 |
| Acquired for cancellation | | (25,000) | (24) |
| Other | | 550 | 14 |
| Balance at end of year | | 35,083,807 | 254,326 |
| **Total Class A and B shares** | | 40,184,636 | $257,098 |

| | Authorized Shares | Outstanding Shares | Outstanding Amount |
|---|---|---|---|
| | | | (thousands of dollars) |
| **Class C (non-voting) shares** | | | |
| Balance at beginning of year | 44,898,450 | | |
| Issued during the year as stock dividends on Class A and B shares | | 153,465 | 21 |
| Redeemed for cash within 15 days of the dates of issue | (153,465) | (153,465) | (21) |
| Balance at end of year | 44,744,985 | Nil | Nil |
| **Total Share Capital** | | | $284,087 |

(b) During the year the shareholders passed a special resolution subdividing the issued and outstanding Class A and Class B shares of the company on a 2 for 1 basis.

(c) Details with respect to rights attaching to the company's share capital are as follows:

(i) $1.00 Cumulative Convertible, Redeemable First Preference Shares, Second Series ("the Second series")

Subject to certain employment conditions and achievement of earnings objectives, the Second series, which has been set aside for stock purchase loans to executives, may be eligible for conversion in 1987 and future years into 166,392 Class B shares. The Second series shares are redeemable at any time at a price of $25 per share at the option of either the holder or the company.

(ii) $1.70 Cumulative Redeemable Convertible First Preference Shares, Third Series ("the Third series")

Third series shares are convertible at the option of the holder into Class B shares until April 1990 on a basis of two Class B shares for each Third series share. The shares are redeemable at the option of the company after March 31, 1990 and, in certain circumstances between March 31, 1988 and April 1, 1990, at predetermined prices varying from $23.50 to $22.50 plus accrued and unpaid dividends, if any.

(iii) Class A (voting) and Class B (non-voting) shares

Class A and Class B shareholders may elect to receive dividends in cash or stock dividends in the form of Class B or Class C shares.

Class A shares are convertible at any time at the option of the holder into Class B shares.

(iv) Voting provisions

First Preference Shares and Class B shares are non-voting unless eight quarterly dividends have not been paid.

(v) Restrictions on transfer

Registration of the transfer of any of the company's shares may be refused if such transfer could jeopardize either the ability of the company to engage in broadcasting or its status as a Canadian newspaper.

(d) Under the company's employees' share purchase plan, employees may subscribe for Class B shares to be paid for through payroll deductions over two-year periods at a purchase price which is the lower of:

(i) market price on the entry date;

or

(ii) the market price at the end of the payment period.

As at December 31, 1986, outstanding employee subscriptions were as follows:

| Number of shares | Subscription rate per share | Maturing |
|---|---|---|
| 211,216 | $9.64 | May 1987 |
| 247,054 | $26.24 | May 1988 |

(e) During the year, the redemption of the $2.68 Cumulative Redeemable First Preference Shares at a cost in excess of par value resulted in a $725,000 reduction in contributed surplus.

## 5. Income taxes

The financial statement tax rate differs from the Canadian statutory rate. A reconciliation of the difference is as follows:

| | 1986 | 1985 |
|---|---|---|
| Canadian statutory rate | **53.0%** | 52.0% |
| Amortization of goodwill and other outlays not deductible for tax purposes | **4.4** | 6.5 |
| Foreign income taxed at lower rates | **(9.8)** | (15.0) |
| Non-taxable foreign exchange | **(4.1)** | (6.7) |
| Manufacturing and processing profits allowance | **(2.4)** | (2.1) |
| Other non-recurring credits | | (3.0) |
| Financial statement tax rate | **41.1%** | 31.7% |

## 6. Loss from discontinued operations

In 1986 the company announced that it would discontinue Torstar Books, a development project to market non-fiction series books by direct mail. The operating losses from this operation in 1986 and 1985 have been reclassified as loss from discontinued operations and are summarized below. In addition, the investment in the business has been written down to the net realizable value (note 7).

| | 1986 | 1985 |
|---|---|---|
| | (thousands of dollars) | |
| Loss before tax | **$7,414** | $3,047 |
| Income tax recovery | **(3,100)** | (1,300) |
| Net loss from discontinued operations | **$4,314** | $1,747 |

## 7. Extraordinary items

Extraordinary items in 1986 are summarized as follows:

| | (thousands of dollars) |
|---|---|
| Extraordinary loss on discontinued operations of Torstar Books (net of income tax recovery of $6,400) | **$8,952** |
| Equity in extraordinary losses of Southam Inc. | **528** |
| Other | **338** |
| Net loss | **$9,818** |

There were no extraordinary items in 1985.

The comparative figures in the consolidated balance sheet for 1985 have been restated to facilitate meaningful comparison with the 1986 accounts. The company's net investment in discontinued operations of $11.3 million in 1986 ($11.9 million in 1985) has been recorded on the balance sheet in other assets.

## 8. Earnings Per Class A and B Share

Basic earnings per share are calculated on the actual weighted average number of shares outstanding during the year. Net income for purposes of this calculation has been reduced by dividends paid on all preference shares.

| | 1986 | 1985 |
|---|---|---|
| Basic earnings per share | | |
| From continuing operations | **$1.83** | $1.69 |
| Before extraordinary items | **$1.72** | $1.63 |
| Net income | **$1.45** | $1.63 |

Fully diluted earnings per share are calculated using the weighted average number of shares that would have been outstanding assuming full conversion of the convertible First

Preference shares (Second and Third Series) and exercise of Class B share purchase warrants at the beginning of the year. In making this calculation, net income was increased by the imputed after tax earnings from the proceeds from exercise of the warrants less the dividends paid on the non-convertible First Preference shares (1981 Series).

All earnings per share figures are after eliminating the company's pro rata interest in its own Class B shares.

## 9. Pension plans

Unamortized past service costs for pension benefits in effect at December 31, 1986 approximate $12.2 million.

## 10. Commitments

In connection with the 1984 acquisition of Silhouette Books, Harlequin Enterprises Limited agreed to pay Simon & Schuster Inc. up to U.S. $25 million in the period 1986 through 1992 if Harlequin's romance fiction book business earnings increased above an agreed base. Payments to date amount to U.S. $5.2 million and an estimated 1987 payment of $9 million (U.S. $6.5 million) has been accounted for as an increase in goodwill.

## 11. Segmented information

The company's operations are classified into three business segments

Newspapers and Printing — Publishing of The Toronto Star, a daily newspaper, community newspapers and commercial printing;

Book Publishing — Publishing of romance fiction, distributed through retail outlets and by direct mail, and other books distributed primarily through direct mail;

Catalogue Marketing — Distribution of gifts and business supplies through direct mail catalogues.

**The following is a summary of business and geographic segments of the company:** (thousands of dollars)

| **Business Segments** | Operating Revenue | | Operating Profit before Depreciation and Amortization | | Operating Profit | |
|---|---|---|---|---|---|---|
| | **1986** | 1985 | **1986** | 1985 | **1986** | 1985 |
| Newspapers and printing | **$419,116** | $377,158 | **$78,342** | $55,850 | **$70,874** | $49,326 |
| Book publishing | **307,381** | 252,697 | **52,420** | 42,517 | **41,452** | 32,621 |
| Catalogue marketing | **73,167** | 69,441 | **11,604** | 10,989 | **7,757** | 7,244 |
| Corporate administration | | | **(4,517)** | (4,360) | **(4,590)** | (4,411) |
| Consolidated | **$799,664** | $699,296 | **$137,849** | $104,996 | **$115,493** | $84,780 |

| | Identifiable Assets | | Additions to fixed assets | | Depreciation and Amortization | |
|---|---|---|---|---|---|---|
| | **1986** | 1985 | **1986** | 1985 | **1986** | 1985 |
| Newspapers and printing | **$157,385** | $148,659 | **$11,127** | $16,378 | **$7,468** | $6,524 |
| Book publishing | **346,842** | 305,056 | **5,337** | 6,378 | **10,968** | 9,896 |
| Catalogue marketing | **36,913** | 40,665 | **570** | 832 | **3,847** | 3,745 |
| Corporate | **39,365** | 60,676 | **152** | 46 | **73** | 51 |
| | **580,505** | 555,056 | **17,186** | 23,634 | **22,356** | 20,216 |
| Investment in Southam Inc. | **202,615** | 216,256 | | | | |
| Consolidated | **$783,120** | $771,312 | **$17,186** | $23,634 | **$22,356** | $20,216 |

| **Geographic Segments** | Operating Revenue | | Operating Profit | | Identifiable Assets | |
|---|---|---|---|---|---|---|
| | **1986** | 1985 | **1986** | 1985 | **1986** | 1985 |
| Canada | **$435,793** | $394,100 | **$70,013** | $49,532 | **$231,152** | $203,200 |
| United States | **240,086** | 215,084 | **34,138** | 34,572 | **200,457** | 199,744 |
| Other (a) | **123,785** | 90,112 | **15,932** | 5,087 | **109,531** | 91,436 |
| Corporate administration | | | **(4,590)** | (4,411) | **39,365** | 60,676 |
| | **799,664** | 699,296 | **115,493** | 84,780 | **580,505** | 555,056 |
| Investment in Southam Inc. | | | | | **202,615** | 216,256 |
| Consolidated | **$799,664** | $699,296 | **$115,493** | $84,780 | **$783,120** | $771,312 |

(a) Principally United Kingdom, Australia, Germany, Japan, Italy and France.

# Ten-Year Operating Highlights — Continuing Operations

| | 1986 | 1985 | 1984 | 1983 |
|---|---|---|---|---|
| **Operating Revenue** | | | | |
| (thousands of dollars) | | | | |
| Newspapers and printing | **$419,116** | $377,158 | $327,205 | $294,579 |
| Book publishing | **307,381** | 252,697 | 231,232 | 212,914 |
| Catalogue marketing | **73,167** | 69,441 | 59,126 | 55,027 |
| Operating revenue | **$799,664** | $699,296 | $617,563 | $562,520 |
| **Operating Profit & Income from continuing operations** | | | | |
| (thousands of dollars) | | | | |
| Newspapers and printing | **$70,874** | $49,326 | $47,202 | $39,999 |
| Book publishing | **41,452** | 32,621 | 13,069 | 6,354 |
| Catalogue marketing | **7,757** | 7,244 | 6,395 | 5,454 |
| Corporate Administration | **(4,590)** | (4,411) | (3,915) | (3,251) |
| Operating profit | **115,493** | 84,780 | 62,751 | 48,556 |
| Interest (expense) income | **(19,549)** | (22,459) | (27,621) | (26,846) |
| Foreign exchange gain (loss) | **116** | 4,934 | 1,406 | (612) |
| Income before taxes | **96,060** | 67,255 | 36,536 | 21,098 |
| Income taxes | **39,500** | 21,300 | 15,100 | 9,000 |
| Income before minority interest and equity in earnings of Southam Inc. | **56,560** | 45,955 | 21,436 | 12,098 |
| Minority interest in earnings of subsidiary | | | | |
| Income before equity in earnings of Southam Inc. | **56,560** | 45,955 | 21,436 | 12,098 |
| Equity in earnings of Southam Inc. | **12,994** | 5,939 | | |
| Income from continuing operations | **$69,554** | $51,894 | $21,436 | $12,098 |
| **Per Share Data** (adjusted for 3 for 2 stock split in 1980 and 2 for 1 split in 1986) | | | | |
| Income from continuing operations | **$1.75** | $1.58 | 77¢ | 42¢ |
| Dividends — Class A and Class B shares | **49¢** | 28.75¢ | 20¢ | 20¢ |
| **Rate of Return on Revenue** | | | | |
| Operating profit | **14.4%** | 12.1% | 10.2% | 8.6% |
| Income before minority interest and equity in earnings of Southam Inc. | **7.1%** | 6.6% | 3.5% | 2.2% |
| **Return on Equity** | | | | |
| Income from continuing operations as a percentage of average shareholders' equity | **17.6%** | 19.9% | 15.3% | 9.1% |

*Years ended Sept. 30

| 1982 | 1981 | 1980 | 1979 | 1978* | 1977* |
|---|---|---|---|---|---|
| $258,697 | $242,048 | $191,440 | $172,058 | $150,791 | $139,651 |
| 225,395 | 194,543 | 184,402 | 146,317 | 88,263 | 59,454 |
| 52,195 | 52,357 | 38,639 | | | |
| $536,287 | $488,948 | $414,481 | $318,375 | $239,054 | $199,105 |
| $17,382 | $25,256 | $19,002 | $17,383 | $15,344 | $14,918 |
| 25,823 | 22,264 | 44,685 | 41,614 | 28,144 | 17,892 |
| 6,570 | 5,757 | 7,477 | | | |
| (2,673) | (2,376) | (2,700) | (2,620) | (1,742) | (1,507) |
| 47,102 | 50,901 | 68,464 | 56,377 | 41,746 | 31,303 |
| (37,930) | (33,925) | (5,742) | 616 | 877 | 108 |
| (463) | 24 | (668) | (181) | (87) | 131 |
| 8,709 | 17,000 | 62,054 | 56,812 | 42,536 | 31,542 |
| 6,000 | 5,702 | 25,900 | 26,696 | 21,054 | 14,959 |
| 2,709 | 11,298 | 36,154 | 30,116 | 21,482 | 16,583 |
| | 725 | 10,538 | 9,583 | 6,720 | 4,626 |
| 2,709 | 10,573 | 25,616 | 20,533 | 14,762 | 11,957 |
| $2,709 | $10,573 | $25,616 | $20,533 | $14,762 | $11,957 |
| 5¢ | 39¢ | $1.05 | 84¢ | 61¢ | 49¢ |
| 29¢ | 38¢ | 27.5¢ | 20¢ | 12.5¢ | 10.5¢ |
| 8.8% | 10.4% | 16.5% | 17.7% | 17.5% | 15.7% |
| 0.5% | 2.3% | 8.7% | 9.5% | 9.0% | 8.3% |
| 2.0% | 8.1% | 22.0% | 20.8% | 18.0% | 16.9% |

# Torstar Corporation Directors and Senior Management

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Director since 1967

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Torstar Corp.
Director since 1978

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Director since 1985

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David A. Galloway
President, Book Publishing and Direct Marketing Division

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Before Toronto Shops
For Fashion,
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