GESCO

GESCO DISTRIBUTING LIMITED/ANNUAL REPORT 1980

GESCO DISTRIBUTING LIMITED

Directors

H.R. Bennett, Partner
Richardson Securities of Canada, Toronto
R.R. Hall, Q.C., Barrister and Solicitor, Toronto
Allan Shnier, Winnipeg
Cecil Shnier, Winnipeg
Irving Shnier, Toronto
Norman Shnier, Toronto
Philip Shnier, Toronto
N. Starr, C.A., President
Acklands Ltd., Toronto

Officers & National Managers

Irving Shnier,
Chairman of The Board
Norman Shnier, President
Allan Shnier, Vice President
Philip Shnier, Vice President
Cecil Shnier, Vice President
and Secretary
A.E. Rosenhek, Vice President
Ian H. Collinge, Vice President
David A. MacDonald,
Vice President
B. Neskar, Vice President
K.H. McManus, R.I.A., C.I.M.,
P. Mgr., Controller
Administration Manager
D.W. Pengelly, National
Credit Manager

Transfer Agent and Registrar

The Royal Trust Company,
Toronto, Winnipeg,
Calgary

Auditors

Touche Ross & Co., Toronto

Listed on

The Toronto Stock Exchange

Head Office

1965 Lawrence Avenue West,
Weston, Ontario M9N 1H5

Financial Highlights	1980	1979
Sales	$86,983,195	$82,030,152
Income from operations (before depreciation and interest)	$ 3,837,085	$ 3,155,154
Net Income	$ 836,977	$ 1,092,532
Earnings per share Number of shares outstanding	0.82 $ 1,025,000	1.07 $ 1,025,000
Working capital	$ 9,438,762	$ 8,709,157
Current ratio	1.43/1	1.46/1
Inventory	$14,558.931	$13,686,997
Receivables	$16,452,866	$13,758,636
Sinking Fund Debentures	$ 1,061,085	$ 675,000
Shareholder's Equity	$10,122,341	$ 9,285,344

To Our Shareholders

Our 1980 year, which ended September 26, was an eventful year for Gesco Distributing Limited.

Despite difficult times, the Company achieved a modest sales increase to $86,983,000, compared with sales of $82,030,000 in the previous year. Our profit, (after income taxes of $663,000) in the 1980 fiscal year was $837,000 or $0.82 per share compared with a profit, (after income taxes of $657,000), in the previous year, of $1,092,000 or $1.01 per share.

A certain amount of the profits of most Canadian companies, in our present environment, are illusionary. The costs of replacing inventories sold in the course of business, escalate, because of inflation. Some recognition of this fact is made by the Government of Canada through a provision in the current Income Tax regulations providing an "Inventory tax allowance" which is deducted from the base on which our income taxes are payable. In our opinion, this allowance is quite inadequate and should be increased in line with increases in the rate of inflation. Otherwise, expansion or even survival of many companies will be at stake, with resultant loss of growth and jobs for our country.

The decreased activity in construction generally, and home building and home improvements specifically, created difficulties for many of our dealers in 1980. Bad Debt write offs, and increases in our reserves for doubtful accounts resulted in increased expenses in 1980 vs 1979 of approximately $200,000; Depreciation expense increased by approximately $270,000, and bank interest cost increased by approximately $400,000. Inflation continues to be a major problem for Gesco Distributing Limited, as it is for all Canadians.

Despite the foregoing, the results from our usual operations were somewhat better than in our 1979 year. However, during the 1980 year Gesco took several steps aimed at exploiting our strengths and providing a more secure base for our business activities. Start up expenses on these new ventures, detailed in the following paragraphs, had a negative effect on our final consolidated results.

Early in the year, through a wholly owned subsidiary, we entered into an agreement to operate the Floor Covering Departments in a Junior Department Store Group in Ontario. This operation has provided us with insights into the needs of retailers and the public, which will enable us to improve the efficiency of our services, to our broad base of Floor Covering Dealers.

In addition, in August 1980, Gesco announced a new division, Clairville Carpet Mills, which manufactures a limited range of carpets, in a suburb of Toronto. These carpets will be sold to independent wholesalers, and major retailers, and through Gesco's marketing divisions, Eagle Distributing Co., and G.E. Shnier Co. Clairville Carpets is expected to add to our profitability late in our current (1981) fiscal year.

A third new investment is represented by the acquisition of a 50% interest in United Fibre-Bond Inc. United Fibre-Bond is a new venture, located in Winnipeg, Manitoba. Its products are padding and decking for use in the mattress and upholstery trades. These trades are similar to those serviced by our General Foam and Cushion Division. The manufacturing facility is capable of diversification into industrial and other consumer products and the Company will be actively exploring these fields during the current year.

During 1980, Gesco for the first time, achieved significant export sales. While development of export business is a slow and complex process, and involves uncertainties with regard to transportation, exchange rates, customs tariffs and international regulations, Gesco expects to continue, on a careful basis, to investigate and exploit export opportunities.

We are pleased that once again we were able, after our fiscal year end, to distribute approximately $103,000 to eligible employees under the Gesco Employee Profit Participation Plan.

We want to again, on behalf of the officers and shareholders of Gesco Distributing Limited, thank all our employees for their continuing efforts and we particularly want to welcome those new employees who have joined Gesco through our acquisitions and new ventures.

N Shnier

Norman Shnier
President
JANUARY 1981

Consolidated Statement of Income
for the year ended September 26, 1980

	1980	1979
Sales	$86,983,195	$82,030,152
Income from operations before the following	$ 3,837,085	$ 3,155,154
Depreciation and amortization of fixed assets	677,270	417,611
Amortization of other assets	73,032	71,856
Interest, including interest on long-term debt of $215,783 (1979 - $151,490)	1,550,040	1,051,867
Interest income	(20,364)	(77,712)
	2,279,978	1,463,622
Income before income taxes	1,557,107	1,691,532
Provision for income taxes	663,000	657,000
Income from operations	894,107	1,034,532
Loss in associated company	57,110	—
Income before extraordinary items	836,997	1,034,532
Extraordinary items		
Recovery of income taxes (Note 7)	—	58,000
Net income for the year	$ 836,997	$ 1,092,532
Earnings per share, based on 1,025,000 shares outstanding		
Income before extraordinary item	$0.82	$1.01
Extraordinary item	—	0.06
Net income for the year	$0.82	$1.07

Consolidated Statement of Changes in Financial Position
for the year ended September 26, 1980

	1980	1979
Source of funds		
From operations		
Income for the year before extraordinary item	$ 894,107	$1,034,532
Add non-cash charges		
Depreciation and amortization of fixed assets	677,270	417,611
Amortization of other assets	73,032	71,856
Increase in deferred income taxes	266,300	370,700
Extraordinary item - recovery of income taxes	—	58,000
	1,910,709	1,952,699
Proceeds on disposal of investment and other assets, net	944	—
Disposal of fixed assets, net	—	1,131
Increase in long term debt	450,168	—
	2,361,821	1,953,830
Application of funds		
Additions to fixed assets (net)	1,595,609	1,753,823
Less increase in related obligations under leases	243,894	1,176,159
	1,351,715	577,664
Redemption of 8% sinking-fund debentures Series A	135,000	135,000
Investment in associated company	145,501	—
	1,632,216	712,664
Increase in working capital	729,605	1,241,166
Working capital at beginning of year	8,709,157	7,467,991
Working capital at end of year	$9,438,762	$8,709,157

See accompanying notes to consolidated financial statements

(Incorporated under The Business Corporations Act - Ontario)
Consolidated Balance Sheet as at September 26, 1980

ASSETS	1980	1979
Current		
Accounts receivable (Note 5)	$16,452,866	$13,758,636
Inventory	14,558,931	13,686,997
Prepaid expenses and sundry assets	408,201	346,148
	31,419,998	27,791,781
Investments (Note 2 (b))	88,391	—
Fixed assets (Note 3)	1,851,365	1,177,176
Equipment under capital leases (Note 4)	1,757,316	1,609,908
Other assets	7,856	80,888
	$35,124,926	$30,659,753
LIABILITIES		
Current		
Bank indebtedness, secured (Note 5)	$ 9,572,185	$ 8,990,764
Accounts payable and accrued liabilities	11,517,688	9,520,988
Income taxes payable	355,597	181,175
Obligation under capitalized leases - current	329,849	254,697
Current portion of long-term debt	205,917	135,000
	21,981,236	19,082,624
Obligation under capitalized leases - non-current	1,529,181	1,381,085
Long term debt (Note 6)	855,168	540,000
	2,384,349	1,921,085
Deferred income taxes	637,000	370,700
SHAREHOLDERS' EQUITY		
Capital stock		
Authorized 1,500,000 shares without par value		
Issued 1,025,000 shares	2,493,750	2,493,750
Retained earnings	7,628,591	6,791,594
	10,122,341	9,285,344
	$35,124,926	$30,659,753

On behalf of the Board

.... Director

.... Director

Consolidated Statement of Retained Earnings for the year ended September 26, 1980

	1980	1979
Retained earnings at beginning of year	$6,791,594	$5,699,062
Net income for the year	836,997	1,092,532
Retained earnings at end of year	$7,628,591	$6,791,594

See accompanying notes to consolidated financial statements

Notes to Consolidated Financial Statements
September 28, 1980

1. Summary of significant accounting policies

a. Principles of consolidation

The consolidated financial statements include the accounts of Cardinal Furniture Products Limited, a wholly-owned subsidiary company from the date of acquisition. An investment in a 50% - owned associated company is accounted for on the equity basis reflecting the original capital investment and the Company's share of losses since acquisition.

An investment in a subsidiary company (51% - owned) is carried at a nominal value of $1 since increases in equity are unlikely to accrue to the Company.

b. Inventory

Inventory is stated at the lower of cost and net realizable value, cost being determined substantially on a first-in, first-out basis.

c. Fixed assets

Fixed assets are stated at acquisition cost, less accumulated depreciation and amortization.

Depreciation and amortization are provided on a straight-line basis at the following rates:

Machinery and equipment	10%
Office equipment	10%
Motor vehicles and fork lift trucks	30%
Leasehold improvements	Remaining life of the lease

d. Other assets

Other assets are valued at cost less amortization.

e. Foreign currency translation

Current assets and current liabilities in foreign currencies are translated into Canadian dollars at exchange rates prevailing at the balance sheet date. Transactions during the year are recorded at exchange rates in effect on the transaction date. All gains or losses on exchange are charged to operations.

f. Income taxes

Income taxes are based on accounting income which differs from taxable income. Differences generally arise because items of income and expense, such as depreciation, are reflected in different time periods for financial accounting purposes than for tax purposes. The result of this policy is to defer income taxes otherwise payable.

g. Leases

Leases are classified as capital or operating leases. A lease that transfers substantially all of the benefits and risks incidental to the ownership of property is classified as a capital lease. All other leases are accounted for as operating leases wherein rental payments are expensed as incurred. At the inception of a capital lease, an asset and an obligation are recorded at an amount equal to the lesser of the present value of the minimum lease payments and the property's fair value at the beginning of such lease. Assets recorded under capital leases are amortized on a straight-line basis over the lease term.

2. Acquisitions

a. During the year the Company acquired for $500 100% of the outstanding common shares of Cardinal Furniture Products Limited. The acquisition has been accounted for by the purchase method and the results of operations have been included in the consolidated financial statements since January 10, 1980.

b. Effective January 1, 1980 the Company acquired a 50% interest in United Fibre Bond Inc., an associated company.

3. Summary of fixed assets

	1980 Cost	1980 Accumulated depreciation and amortization	1980 Net	1979
Leasehold improvements	$ 924,731	$ 420,043	$ 504,688	$ 377,724
Machinery and equipment	1,804,843	672,033	1,132,810	612,933
Office equipment	331,996	192,642	139,354	126,631
Motor vehicles	122,408	108,595	13,813	38,850
Fork lift trucks	515,335	454,635	60,700	21,038
	$3,699,313	$1,847,948	$1,851,365	$1,177,176

4. Summary of equipment under capital lease

	1980 Cost	1980 Accumulated amortization	1980 Net	1979
Computer equipment	$1,075,367	$120,818	$ 954,549	$948,886
Office equipment	33,410	7,693	25,717	32,698
Motor vehicles	1,078,016	310,730	767,286	608,120
Fork lift trucks	19,836	10,072	9,764	20,204
	$2,206,629	$449,313	$1,757,316	$1,609,908

The computer equipment is amortized on a straight-line basis over its economic life of seven years commencing in 1980. The remaining equipment is amortized on a straight-line basis over the lease terms, ranging from 2 to 5 years.

The amount of amortization charged to expense in 1980 is $384,461 (1979 - $159,484).

5. Bank indebtedness

Bank indebtedness is secured by a general assignment of accounts receivable.

6. Long term debt

8% sinking-fund debentures series A	$405,000
13-1/2% chattel mortgage, due January 15, 1985	206,168
13-1/2% debenture, due October 23, 1986	244,000
	$855,168

8% sinking-fund debentures are secured by a first floating charge on all the assets and property of the Company and mature on February 1, 1984. Annual sinking-fund payments of $135,000 are required on February 1, to 1984.

The terms of the trust deed securing the debentures allow dividends to be paid as long as the working capital of the Company after payment of such dividends exceeds the greater of $5,000,000 and the funded indebtedness of the Company.

In addition, the amounts that can be paid out in the form of redemption of debenture principal, repurchase of capital stock and dividends cannot exceed 80% of net income since September 30, 1968.

The 13-1/2% chattel mortgage is secured by a charge on production equipment of a division of the Company.

The 13-1/2% debenture is secured by a first fixed charge on fixed assets of a division of the Company.

7. Recovery of income taxes

Recovery of income taxes reflects the realization of income tax loss carryovers from 1978. The benefit of these losses had not been reflected in the 1978 accounts.

8. Commitments

a. Lease obligations

Annual rentals payable under long-term leases of premises are approximately $1,160,000 (1979 - $938,000) during each of the years 1980 to 1995 inclusive.

The following is a schedule of future minimum lease payments under the capital leases expiring through October 1, 1986 together with the balance of the obligation under capital lease.

Year ending September	
1981	$ 732,653
1982	$ 569,979
1983	$ 514,016
1984	$ 535,907
1985 and subsequent	$ 864,126
Total minimum lease payments	$3,216,681
Less: Amount representing interest	$1,357,651
Balance of the obligation	$1,859,030

b. Executive pension plan

The unfunded liability with respect to past service amounts to $263,753 of which $112,572 is payable in instalments on December 15 each year as follows:

1981 to 1984 inclusive	$17,271
1985 to 1987 inclusive	8,739

The balance of $151,181 may be paid in full or in part at any time prior to December 15, 1984 at the discretion of the Company.

c. The Company has guaranteed the bank indebtedness of a subsidiary company and an associated company amounting to approximately $500,000.

9. Remuneration of directors and senior officers

Remuneration of directors and senior officers, as defined by The Business Corporation Act-Ontario, of the Company included in the statement of income amounts to approximately $430,000 (1979 - $375,000).

10. Industry segmentation

The Company has substantially all of its operations in the floorcovering industry. The Company is a distributor of a product line that includes carpeting, floor tiles, ceramic tiles, cushioned flooring, under-cushion and supplies.

11. Related party transactions

The Company leases approximately 93 vehicles for use in its business from Cardinal Leasing Limited, a wholly-owned subsidiary of Metropolitan Equities Limited. Metropolitan Equities Limited and the Company are both controlled by the five Shnier Family Trusts. The cost of these leases amounted to approximately $337,000 in 1980.

The Company leases premises for ten of its distribution centres and its manufacturing facility from Sarah Investments Ltd., a company wholly-owned by the five Shnier Family Trusts. The lease terms are based on the appraisals of two independent real estate agents. Lease payments on these premises amounted to approximately $913,000 in 1980.

12. Income Taxes

A subsidiary company has incurred a tax loss of approximately $194,000, which may be carried forward and applied against future taxable incomes expiring in 1985. The potential tax saving resulting from the application of this loss against future earnings has not been reflected in these financial statements.

AUDITORS' REPORT

**The Shareholders,
Gesco Distributing Limited**

We have examined the consolidated balance sheet of Gesco Distributing Limited as at September 26, 1980 and the consolidated statements of income, retained earnings and changes in financial position 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. We have relied on the report of the auditors who have examined the financial statements of the subsidiary company.

In our opinion, these consolidated financial statements present fairly the financial position of the Company as at September 26, 1980 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.

Touche Ross & Co

Toronto, Ontario,
December 2, 1980.

Touche Ross and Co.
Chartered Accountants

Products

Floor coverings, carpets, carpet cushion, tiles, vinyl sheet flooring, cushioned flooring, rubber and vinyl cove base, ceramic floor and wall tile, hardware and specialty products, rubber and vinyl mats, stair treads, stair nosing, adhesives, installation and handling equipment, foam fabrications for furniture, bedding and toy manufacturers, custom packaging and fabricated head pillows and throw cushions, custom foam diecutting, moulded foam products, vinyl runner, synthetic turf.

- **WATERVILLE** sponge rubber-carpet cushion.
- **ARMSTRONG** tiles, vinyl sheet flooring, cushioned flooring.
- **CELANESE** carpets.
- **CONGOLEUM** fine floors.
- **CLAIRVILLE** carpets.
- **EZY-FIT** do-it-yourself carpets.
- **GFC** polyurethane, neocor, polyester fibre, foam and cushionings.
- **ILLINGWORTH** carpet tiles.
- **OZITE** carpets.
- **007** adhesives.
- **PHOENIX** ceramic tiles, floor mats, matting.
- **POLYSTAR** urethane carpet cushion.
- **RICHMOND** carpets.
- **ROBERTS** floorcovering accessories and installation tools.
- **WESTON** carpets.

GESCO DISTRIBUTING LIMITED

G.E. SHNIER CO.
Co-Managers I. Collinge, E. Adams
Head Office 1965 Lawrence Ave. W.,
Weston Ontario

BRANCHES
Vancouver
Edmonton
Calgary
Regina
Winnipeg
Thunder Bay
London
Ottawa/Hull
Montreal
Dartmouth

EAGLE DISTRIBUTING CO.
Co-Managers D. MacDonald, R. Watson
Head Office 1975 Lawrence Ave. W.,
Weston, Ontario

BRANCHES
Vancouver
Winnipeg
Calgary
Edmonton
Regina
Winnipeg
Thunder Bay
London
Ottawa/Hull
Montreal

GENERAL FOAM AND CUSHION
Manager B. Neskar
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BRANCHES
Montreal
Winnipeg

PHOENIX FLOOR AND WALL PRODUCTS
Manager B. Palansky
Head Office 111 Westmore Drive,
Rexdale, Ontario

CLAIRVILLE CARPET MILLS
Manager B. MacNeil
Head Office 25 Clairville Drive
Rexdale, Ontario

GESCO WAREHOUSING & DISTRIBUTING
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