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Corporate Foods Limited

ANNUAL REPORT 1986



CORPORATE FOODS LIMITED

Financial Highlights

	1986	1985	1984	1983	1982
Sales	\$119,869,504	\$102,340,470	\$97,550,272	\$92,127,223	\$89,515,797
Earnings from operations	5,190,879	3,879,260	4,829,862	4,514,043	5,179,128
Equity in income of other bakery companies	3,346,000	3,667,000	2,094,300	1,775,000	1,216,023
Long-term debt	8,040,358	7,925,239	6,945,033	4,695,101	4,644,433
Interest on long-term debt	857,318	1,046,201	487,251	454,990	581,059
Net earnings	5,803,000	5,345,000	4,710,189	4,458,769	3,751,521
*Number of common shares outstanding	3,131,000	3,129,400	3,129,400	3,129,400	3,129,400
*Earnings per common share	\$1.83	\$1.69	\$1.48	\$1.40	\$1.18
*Dividends declared per common share70	.60	.47	.48	.34
Number of preferred shareholders	97	96	92	105	124
Number of common shareholders	348	354	298	244	275
Return on invested capital	15.2	16.0	15.4	17.6	17.2
Return on shareholders equity	19.7	20.7	21.0	23.2	22.9

Quarterly sales and net earnings (unaudited)
(dollars in thousands except per share)

	Sales			Net earnings			Net earnings per common share		
	1986	1985	1984	1986	1985	1984	1986	1985	1984
1st quarter	\$24,454	\$ 22,117	\$20,465	\$ 921	\$1,023	\$ 792	\$.29	\$.32	\$.25
2nd quarter	27,267	23,039	21,681	1,344	1,157	1,008	.42	.36	.31
3rd quarter	28,565	24,242	23,987	1,548	1,346	1,263	.49	.43	.40
4th quarter	39,583	32,942	31,417	1,990	1,819	1,647	.63	.58	.52
	<u>\$119,869</u>	<u>\$102,340</u>	<u>\$97,550</u>	<u>\$5,803</u>	<u>\$5,345</u>	<u>\$4,710</u>	<u>\$1.83</u>	<u>\$1.69</u>	<u>\$1.48</u>

* 1982 and 1983 restated for 1984 stock split (10 for 1)

Directors' Report

REPORT TO SHAREHOLDERS:



Norman T. Currie
President & Chief Executive Officer

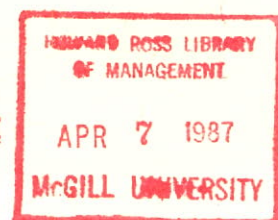
Net earnings for the 52 weeks which ended December 27, 1986 were \$5,803,000 or \$1.83 per share compared with \$5,345,000 or \$1.69 per share for the 52 weeks which ended December 28, 1985. This represents a 9% increase over last year and is our sixth consecutive record profit year.

Earnings from our wholly owned Ontario Operations, before income taxes and interest on long-term debt, were \$5,191,000 compared with \$3,879,000 for the previous year. Increased sales volume and resulting lower distribution costs were the main reasons for the profit improvement.

Equity in income of other bakery companies decreased to \$3,346,000 from \$3,667,000 in 1985. These earnings are derived from our 25% share of Multi-Marques Inc. and our 49% share of Dough Delight Ltd. The decline in earnings from these sources is attributable to start up costs at Dough Delight's new facility and their introduction of two new production lines.

Ontario Operations

Sales by our Ontario operations for the year were \$119,870,000 compared with \$102,340,000 for 1985 – an increase of 17%. Unit volume showed good growth in both the retail and food service markets.



Dempster's Bread Division Sales and Marketing –

The Dempster's brand name continued to strengthen in terms of public recognition and consumer acceptance. Vigorous marketing programs and innovative promotions and merchandising maintained Dempster's as the market leader in whole wheat and variety breads in Ontario.

Based on the theme, "Nutritious and Delicious", Dempster's market communications continue to concentrate on the nutritional benefits of Dempster's breads. It is encouraging to note the increasing recognition of the benefits of bread in a well balanced diet.

During the year, two new loaves, Dempster's Milk Bread and Hi-Fibre Bread were successfully introduced.

Production

The increased market demand for Dempster's products required us to operate our plants at near capacity levels. This created inefficiencies at periods of peak demand and, as a result, we did not achieve our usual improvements in productivity.

We are investing \$2.5 million in our London plant which will increase throughput by 50%. This is scheduled to be completed by May 1987. This, together with increasing from two to three shifts in both our London and Toronto bread plants, will give us sufficient capacity to better meet peak demand requirements.

Following two years of research and development, new dough processing methods are being introduced in Dempster's Fraser Avenue plant in Toronto. This will

further enhance quality and consistency of product and allow greater ingredient control and increased automation.

Franchise Dealers

Dempster's distributes its products to retail stores through a network of over 225 independent Dealers. This route distribution system is unique in the baking industry and has contributed greatly to our increased sales. Independent Dealers are strongly motivated and are highly responsive to the needs of retailers and consumers.

Regular monthly Dealer Forum meetings and a bi-monthly publication featuring Dealers' activities are just two of the many ways the Dealers and the Company communicate and maintain their strong relationship.



Gainsborough Division

Gainsborough represents our line of frozen unbaked pastry products, including pie and tart shells, which are sold in retail stores across Canada. A new product, currently being introduced, is a European style flan shell. In addition to unbaked dough products, Gainsborough markets such other products as waffles and whipped toppings.

Gainsborough's sales and profits improved over last year and we expect 1987 will be a year of further growth.

Multi-Marques Inc.

Multi-Marques is Quebec's leading manufacturer of bread and rolls, operating 25 plants throughout the Province with more than 3,200 employees. As the name implies, Multi-Marques markets its products under various brand names by region. Its largest selling brands are Gailuron and Durivage.

1986 was a year of continuing growth in both sales and earnings and we expect this outstanding performance will continue in 1987.



Dough Delight Ltd.

It was an extraordinary year for Dough Delight. In January, 1986, the Company completed its move from an 18,000 square foot rented facility to a custom-designed, and owned, 75,000 square foot plant located near Steeles and Dufferin Street in Northwestern Toronto.

During the year a \$1,000,000 dough make-up line was installed. It is the largest and most automated line of its kind for making croissant, Danish and puff pastry products. Two new production lines were installed for making Danish coffee cakes and bagels together with a new high capacity pita bread line.

In total, over \$7.5 million has been invested during the past 18 months to make Dough Delight's production facility one of the finest in North America.

Although the expansion did affect earnings during the year under review, Dough Delight is now positioned to produce a wide range of high quality products most efficiently. Sales attained record levels during the year – including increased sales to the U.S. market.

With the expanding in-store bakery and food service market, Dough Delight is in an excellent position to benefit from its recent investment in new plant and equipment and we expect this to be reflected in 1987 earnings.



Working Capital and Fixed Asset Purchases

Working capital increased from \$1,069,000 to \$1,757,000 as at December 27, 1986. Fixed asset purchases increased from \$2.8 million to \$4.6 million.

The increase in expenditures over last year represents work-in-progress payments for the London plant up-grading referred to earlier, increased roll capacity at the Bartley Drive plant in Toronto and the acquisition of additional land adjacent to our Etobicoke plant. We expect fixed asset purchases will total approximately \$5.0 million for 1987.



Outlook

With the strong support of our Dealer and sales and marketing organizations, we are confident of continuing strong sales performance. In addition, increased plant capacities and continuing improvements in our distribution services should enable us to achieve still greater efficiencies in production and distribution. As a result, we anticipate further improvement in earnings from Ontario operations in 1987.

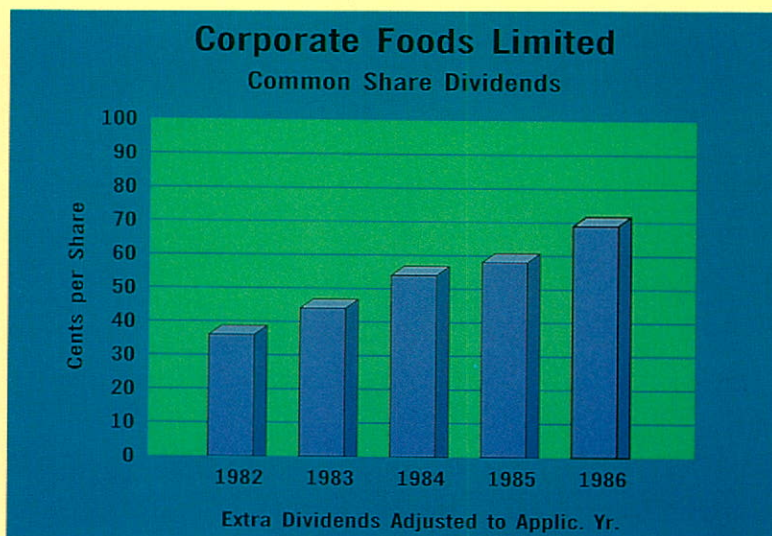
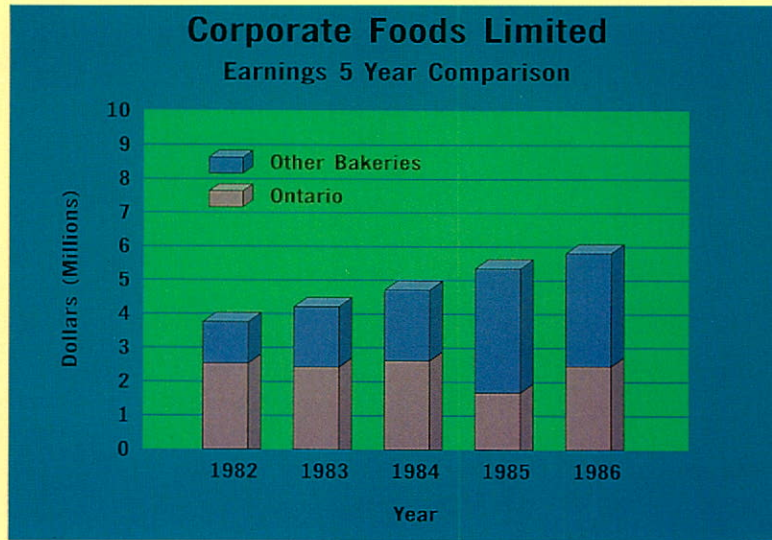
Earnings from our interest in other Bakery Companies are expected to increase as Dough Delight has now completed a major part of its expansion program.

We are very proud of our Employees and Dealers and wish to record our gratitude for their continuing dedication and support. The important contributions of our Management Group should also be acknowledged with appreciation. These 30 Key Managers provide the leadership and the professional teamwork which are essential to ensure that dependable, high quality service is provided to our customers through every facet of our operations, every day.

On behalf of the Board

President and Chief Executive Officer
February 1987





CORPORATE FOODS LIMITED

(Incorporated under the laws of Ontario)

Balance Sheet

December 27, 1986

(with comparative figures as at December 28, 1985)

Assets

	1986	1985
Current:		
Income taxes recoverable		\$ 148,090
Accounts receivable (note 8)	\$12,077,914	10,311,041
Inventories	3,552,935	2,756,185
Prepaid expenses	571,347	244,136
	<hr/> 16,202,196	<hr/> 13,459,452
Investments:		
Shares in other bakery companies (note 2)	21,792,200	20,274,946
Note receivable	118,012	239,989
	<hr/> 21,910,212	<hr/> 20,514,935
Fixed assets (note 3)	<hr/> 16,718,451	<hr/> 14,475,072
Goodwill	<hr/> 908,643	<hr/> 978,544
	<hr/> \$55,739,502	<hr/> \$49,428,003

(See accompanying notes)

On behalf of the Board:

Norman T. Currie, Director

William T. Murchie, Director

Auditors' Report

To the Shareholders of Corporate Foods Limited:

We have examined the balance sheet of Corporate Foods Limited as at December 27, 1986 and the statement of earnings and retained earnings and changes in financial position for the fifty-two week period 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, these financial statements present fairly the financial position of the company as at December 27, 1986 and the results of its operations and the changes in its financial position for the fifty-two week period then ended in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding period.

Toronto, Canada,
February 11, 1987.

Clarkson Gordon
Chartered Accountants

Liabilities and Shareholders' Equity

	1986	1985
Current:		
Bank indebtedness	\$ 2,538,250	\$ 1,436,135
Accounts payable and accruals	8,275,532	8,114,051
Payable to parent company	820,722	487,670
Dividends payable	486,718	392,716
Long-term debt – current portion (note 4)	1,003,897	1,081,044
Income taxes payable	206,241	
Deferred income taxes	1,113,746	878,969
	14,445,106	12,390,585
Long-term liabilities:		
Long-term debt (note 4)	8,040,358	7,925,239
Deferred income taxes	3,857,566	3,317,748
	11,897,924	11,242,987
Shareholders' equity:		
Share capital (note 5)	1,386,388	1,358,748
Retained earnings	28,010,084	24,435,683
	29,396,472	25,794,431
	\$55,739,502	\$49,428,003

(See accompanying notes)

CORPORATE FOODS LIMITED

Statement of Earnings and Retained Earnings

For the fifty-two weeks ended December 27, 1986
(with comparative figures for the fifty-two weeks ended December 28, 1985)

	1986	1985
Revenues:		
Sales	\$119,869,504	\$102,340,470
Other income	381,206	202,305
	<u>120,250,710</u>	<u>102,542,775</u>
Expenses:		
Cost of sales	99,581,137	84,816,818
Selling and administrative expenses	13,071,626	11,483,525
Depreciation and amortization	2,407,068	2,363,172
	<u>115,059,831</u>	<u>98,663,515</u>
Earnings from operations	5,190,879	3,879,260
Earnings from other bakery companies (note 2)	3,346,000	3,667,000
Interest income	126,439	207,181
Interest on long-term debt and on capital lease obligations	(857,318)	(1,046,201)
Income taxes (note 6)	(2,003,000)	(1,362,240)
Net earnings for the period	5,803,000	5,345,000
Retained earnings, beginning of period	24,435,683	21,034,474
	<u>30,238,683</u>	<u>26,379,474</u>
Dividends – preference shares	68,750	68,750
– common shares	2,159,849	1,875,041
	<u>2,228,599</u>	<u>1,943,791</u>
Retained earnings, end of period	<u>\$ 28,010,084</u>	<u>\$ 24,435,683</u>
Earnings per common share	<u>\$1.83</u>	<u>\$1.69</u>

(See accompanying notes)

CORPORATE FOODS LIMITED

Statement of Changes in Financial Position

For the fifty-two weeks ended December 27, 1986
(with comparative figures for the fifty-two weeks ended December 28, 1985)

	1986	1985
Cash was generated from:		
Operating activities –		
Net earnings for the period	\$ 5,803,000	\$ 5,345,000
Depreciation and other non-cash items	2,375,962	2,331,926
Investment income from other bakeries net of dividends received and goodwill	(1,986,210)	(2,691,693)
Deferred income taxes	774,595	338,302
Changes in non-cash working capital	(30,940)	1,320,683
Cash from operations	6,936,407	6,644,218
Cash was applied to:		
Financing activities –		
Issuance of long-term debt	2,036,061	5,197,382
Repayment of long-term debt	(2,004,205)	(4,092,931)
	31,856	1,104,451
Dividends	(2,228,599)	(1,943,791)
Investing activities –		
Additions to fixed assets	(4,611,690)	(2,855,306)
Additions to investments	(1,329,177)	(4,849,412)
Proceeds on disposal of fixed assets	71,448	79,389
Issuance of share capital	27,640	
	(5,841,779)	(7,625,329)
Increase (decrease) in cash during the period	(1,102,115)	(1,820,451)
Cash (bank indebtedness), beginning of period	(1,436,135)	384,316
Bank indebtedness, end of period	\$(2,538,250)	\$(1,436,135)

In prior periods this statement was presented on a working capital basis. The 1985 comparative balances have been restated on a cash basis to conform with the 1986 presentation.

(See accompanying notes)

CORPORATE FOODS LIMITED

Notes to Financial Statements

December 27, 1986

1. Accounting policies

- (a) Accounting for other bakery companies –
The company accounts for its investment in other bakery companies in which ownership is 50% or less on the equity basis, whereby it recognizes in the accounts its proportionate share of those companies' earnings since acquisition rather than when realized through dividends.
- (b) Inventories –
Inventories, consisting primarily of ingredients and supplies are valued at the lower of cost, as determined using the first-in, first-out (FIFO) method, and replacement cost.
- (c) Goodwill –
Goodwill, representing the excess cost of the company's investment over the underlying value of its interest in the net assets acquired, is amortized over periods ranging from twenty to forty years.
- (d) Fixed assets –
Fixed assets are initially recorded at cost and include certain leases, which in substance are purchases of fixed assets capitalized at the present value of their net minimum lease payments (note 4). Depreciation of owned and leased fixed assets is calculated on the straight-line basis at rates designed to amortize the cost over their estimated useful lives as follows:
- | | | |
|----------------------------|---|----------|
| Buildings | - | 2% |
| Automotive equipment | - | 20% |
| Bakery and other equipment | - | 7½%-33⅓% |
- (e) Income taxes –
The company follows the tax allocation method of accounting for income taxes to take into account timing differences which occur when revenues and expenses are recognized in the accounts in one period but are taxed or claimed for tax purposes in another period. The tax effect of these timing differences results in the recording of deferred income taxes.
- (f) Foreign currency translation –
Amounts which are receivable in foreign currencies are translated at the rate of exchange in effect at the balance sheet date. Revenues and expenses denominated in foreign currencies are translated at the rate of exchange in effect on the transaction date. Gains and losses on translation, which are not material, are included in earnings for the period.
- (g) Pension plans –
The company has voluntary pension plans providing retirement benefits to its employees. Current service costs of pension benefits are expensed as incurred. Unfunded past service costs arising from changes in the pension plan are expensed over periods not exceeding 15 years.

2. Investment in other bakery companies

The company owns a 25% interest in Multi-Marques Inc. of Montreal and a 49% interest in the Dough Delight Ltd. of Toronto. Goodwill amortization of \$163,500 (\$113,500 in 1985) is deducted in arriving at "earnings from other bakery companies".

3. Fixed assets

Fixed assets, including those owned and those recorded under capital leases, are comprised as follows:

	Cost	Accumulated depreciation and amortization	Net book value	
			1986	1985
Owned –				
Land	\$ 1,966,383		\$ 1,966,383	\$ 1,085,198
Buildings	5,715,816	\$ 2,104,391	3,611,425	3,417,405
Automotive equipment	209,423	120,363	89,060	110,815
Bakery and other equipment	20,501,275	10,625,080	9,876,195	7,941,693
	<u>28,392,897</u>	<u>12,849,834</u>	<u>15,543,063</u>	<u>12,555,111</u>
Leased –				
Automotive equipment	686,818	570,276	116,542	154,983
Bakery and other equipment	3,775,986	2,717,140	1,058,846	1,764,978
	<u>4,462,804</u>	<u>3,287,416</u>	<u>1,175,388</u>	<u>1,919,961</u>
	<u>\$32,855,701</u>	<u>\$16,137,250</u>	<u>\$16,718,451</u>	<u>\$14,475,072</u>

Depreciation and amortization expense includes goodwill amortization of \$69,901 (\$69,901 in 1985).

4. Long-term debt

	1986	1985
Floating rate term notes, due March 31, 1992	\$6,222,978	\$5,071,472
8½% Series "A" sinking fund debentures, due December 15, 1988	1,643,762	1,937,646
Capital lease obligations	<u>1,177,515</u>	<u>1,997,165</u>
	9,044,255	9,006,283
Less current portion included in current liabilities	<u>1,003,897</u>	<u>1,081,044</u>
	<u>\$8,040,358</u>	<u>\$7,925,239</u>

The company has credit facilities with Canadian chartered banks which include a \$10,000,000 operating line and a \$13,000,000 seven-year revolving term loan. The revolving period and term expiry may be extended annually. Currently the company is borrowing under the operating line using bankers' acceptances which may be converted to a term loan at any time at the company's option. The average interest rate paid on these loans over the year was 9.1%.

Under the terms of a trust indenture, the sinking fund debentures are secured by a floating charge on the assets of the company, and the company is restricted from declaring common share dividends if net current assets fall below \$400,000 after such declaration or if net assets are less than twice the amount of all long-term debt excluding capital lease obligations and deferred income taxes. Net assets are defined to include shareholders' equity plus deferred income taxes.

Long-term debt repayments are as follows:

1987	-	\$ 299,000
1988	-	2,589,357
1989	-	1,244,595
1990	-	1,244,595
1991	-	1,244,595
Thereafter	-	<u>1,244,598</u>
		<u>\$7,866,740</u>

Payments under capital leases (including both principal and interest) are as follows:

1987	-	\$ 771,474
1988	-	407,844
1989	-	81,276
1990	-	12,407
1991	-	8,879
Subsequent years	-	<u>7,728</u>
		<u>1,289,608</u>
Less interest component		<u>112,093</u>
		<u>1,177,515</u>
Less amount due currently		<u>704,897</u>
		<u>\$ 472,618</u>

The weighted average interest rate on capital leases is 9.4%.

The company also leases property and equipment under agreements which are classified as operating leases. Annual rentals under these leases are as follows:

1987	-	\$ 1,264,502
1988	-	1,217,349
1989	-	941,276
1990	-	680,442
1991	-	478,211
Thereafter	-	<u>1,544,840</u>
		<u>\$6,126,620</u>

5. Share capital

Authorized	Issued and outstanding	Value of consideration received	
		1986	1985
Preferred shares: 50,000 shares issuable in series - 25,000 Series A, \$2.75 cumulative, non-voting, redeemable at \$52.75	25,000	\$1,225,000	\$1,225,000
Common shares: Unlimited shares	3,131,000 (1985 - 3,129,400)	<u>161,388</u>	<u>133,748</u>
		<u>\$1,386,388</u>	<u>\$1,358,748</u>

The Board of Directors has approved the issue of stock options to certain members of the company's management under the Incentive Stock Option Plan.

To date, of the 100,000 options available, 48,400 options have been granted. Of those options granted, 3,000 options have been cancelled and 1,600 options exercised during the year for cash of \$27,640. 43,800 options are outstanding at a weighted average issue price of \$21.71 and expire during the period 1990 to 1992.

6. Income taxes

A reconciliation comparing income taxes (on income excluding earnings from other bakery companies) calculated at the Canadian statutory rate to the amount provided in the accompanying financial statements is as follows:

	1986	%	1985	%
Income taxes at Canadian statutory rate (including provincial income taxes)	\$2,377,000	53.3	\$1,580,240	52.0
Decrease in taxes applicable to -				
Manufacturing and processing profits deduction	245,000	5.5	149,000	4.9
Inventory allowance	4,000	0.1	27,000	0.9
Other	<u>125,000</u>	<u>2.8</u>	<u>42,000</u>	<u>1.4</u>
Total income tax provision	<u>\$2,003,000</u>	<u>44.9</u>	<u>\$1,362,240</u>	<u>44.8</u>
Represented by:				
Current income taxes	\$1,228,405		\$1,024,240	
Deferred income taxes	<u>774,595</u>		<u>338,000</u>	
	<u>\$2,003,000</u>		<u>\$1,362,240</u>	

7. Segmented information

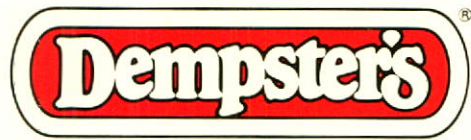
The company operates primarily in a single industry consisting of the manufacture and sale of bakery products.

8. Related party transactions

A significant portion of cost of sales represents flour purchases, substantially all of which are purchased from the parent company. Purchases from equity accounted affiliates totalled \$225,000 in 1986. Accounts receivable includes \$415,000 due from affiliates.

9. Pension plan

An actuarial valuation of the company's pension plan as at January 1, 1986 indicates an unfunded past service pension liability of \$275,000. This amount is being charged to operations and funded over periods not exceeding 15 years.



Nutritious and Delicious.



BREAD FOR ALL SEASONS.

Corporate Directory

Directors

Norman T. Currie
R. G. Dale
R. S. DeMone
A. H. James
W. T. Murchie
J. A. Schollar

Senior Management

Norman T. Currie
President and Chief Executive Officer
R. H. Bonus
Senior Vice-President
J. L. Chizick
Vice-President, Sales and Marketing
J. G. Foy
Vice-President, Employee Relations
L. D. Irwin
Vice-President and Secretary
P. A. Nelson
Vice-President, Technical Services
and Manufacturing

Financial Management

T. A. Burns
Manager, Internal Audit
E. K. Kunz
Manager, Information Systems
L. J. Palko
Corporate Controller

Purchasing

M. J. MacIsaac, Manager, Purchasing

Sales and Marketing

W. D. Benson
Marketing Manager, Frozen Division
J. D. Henderson
Area Sales Manager, Western Ontario
F. J. MacEachern
General Sales Manager
R. J. Maddalena
Sales Manager, National Accounts
T. Maddison
Manager, Equipment Control
R. P. Martineau
Sales Manager, Eastern Ontario
E. E. Quigley
Manager, Franchising
J. W. Slauenwhite
Marketing Manager, Fresh Division
W. F. Stubbs
Manager, Frozen Division
W. R. Sudeyko
Area Sales Manager, Central West
R. F. Tessier
Area Sales Manager, Central East

Production

C. J. Czerny, Manager, Distribution
J. N. Hennessy, Plant Manager, Ottawa
G. B. Hicks, Plant Manager, Toronto
F. Leithinger
Manager, Equipment Repair Centre
W. J. Lewicki, Manager, Production
Y. G. Maksym, Plant Manager, Toronto
M. Ng, Manager, Engineering
A. Stroczyk, Plant Manager, Etobicoke
A. A. Vesely, Production Controller
W. J. Worotny, Plant Manager, London

Auditors

Clarkson Gordon, Toronto

Registrars and Transfer Agents

The Canada Trust Company,
Toronto, Montreal, Winnipeg

Debenture Trustee

The Canada Trust Company,
Toronto

Head Office

10 Four Seasons Place, Etobicoke, Ontario
M9B 6H7

Annual Meeting

The Annual and Special Meeting of the Shareholders of Corporate Foods Limited will be held at the Royal York Hotel, Confederation Rooms 4 and 5, 100 Front Street West, Toronto, Ontario, on Friday, April 24, 1987 at 10:00 o'clock in the forenoon.



Corporate Foods Limited
10 Four Seasons Place
Etobicoke, Ontario M9B 6H7