

PEOPLES⁺

Peoples Jewellers
Limited

Annual Report
1986



Company Profile

Peoples Jewellers Limited is the second largest retail jeweller in Canada, and is one of the country's dominant specialty retail organizations. The Company has its headquarters in Don Mills, Ontario, employs 2,398 employees, and operates 296 retail stores located in every major population centre in Canada and in almost all major shopping centres.

Each of our two jewellery divisions serves a distinct segment of the Canadian jewellery market. 199 "Peoples" stores serve Canada's mid-market, with the "Mappins" stores serving the middle and upper-income segments.

Peoples also owns 15% of the outstanding shares of Zale Corporation, the world's largest retail jeweller.

Front Cover:

Photo-murals such as this appeal to Peoples Jewellers customers – youthful, positive shoppers who expect a wide selection of diamond and other jewellery combining high quality and value!

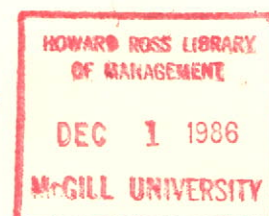
Financial Highlights

Year Ending August 31

<i>000's Omitted Except Per Share Data</i>	1986	1985	1984
Sales	\$ 184,837	\$ 177,736	\$ 175,130
Continuing Income excluding unusual items	12,932	7,738	6,580
Income from Canadian Operations	8,178	6,831	5,071
-per share	.93	.95	.73
Net Income	1,779	7,738	9,412
-per share	.20	1.08	1.35
Working Capital	66,598	43,282	41,580
Total Assets	260,626	255,476	227,221
Shareholders' Equity	130,466	112,199	92,420
Dividends	2,640	2,196	1,048
Book Value Per Share	13.53	13.39	13.22

Contents

Financial Highlights	1
Directors' Report to the Shareholders	2
Review of Canadian Operations	4
Financial Review	10
Consolidated Balance Sheet	12
Consolidated Statement of Income	14
Consolidated Statement of Changes in Financial Position	15
Notes to Consolidated Financial Statements	16
Store Locations	18
5 Year Statistical Summary	19
Directors and Officers	20



Directors' Report to the Shareholders

On behalf of your Directors, I am pleased to report that the results for 1986 reflect continued improvement in the Company's Canadian operations. Sales for the year ended August 31, 1986 were \$184,837,000, as compared with \$177,736,000 in fiscal 1985, an increase of 4%. Pre-tax income from Canadian operations was \$13,578,000, as compared with \$10,131,000 the previous year, an increase of 34%. Income from Canadian operations was \$8,178,000, or \$.93 per share, as compared with \$6,831,000 or \$.95 per share in 1985. On average, 22% more shares were outstanding than in fiscal 1985.

The Company's equity interest from our investment in Zale Corporation was affected by asset write-downs and restructuring provisions by Zale, which were reflected as unusual items in their quarter ended March 31, 1986.

Our share of these items was \$11,153,000; and while it has reduced the book value of our investment, it has not affected cash flow, and the market value of our holdings has increased.

Peoples' equity interest in the results of Zale for their four quarters ended June 30, 1986, net of related interest costs and unusual items, was a loss of \$7,399,000, as compared with income of \$907,000 in fiscal 1985. This reduced net income before an extraordinary item to \$779,000 or \$.09 per share, as compared with \$7,738,000 or \$1.08 per share in 1985. The recovery of income taxes through the utilization of losses carried-forward increased net income to \$1,779,000. Net earnings per share were \$.20 as compared with \$1.08 in 1985.

The results for the first half of the year, and the first four months in particular, reflected moderately improving growth in sales and profits, due to strengthened merchandising programs cou-

pled with continued expense control. This initial strength in sales was offset by a weaker third quarter in which sales decreased 4.3%. The fourth quarter reflected an improvement to a 1.5% increase.

Peoples Jewellers operated 296 stores as of August 31, 1986, as a result of opening 5 new stores during the fiscal year and closing 6 Peoples and 5 Mappins locations. During the year, 26 stores underwent renovations. One new store has been opened subsequent to the year end. The Company remains committed to the renovation and remerchandising of existing locations, while at the same time closing stores when shifts in population or shopping patterns occur.

The Zale write-downs relate to its restructuring plan put forward on March 23, 1986, which contemplated among other things the disposition of its Aeroplex and O.G. Wilson Catalogue Divisions, its European retailing operations, and the revaluation of inventory and certain other assets. At this date, the Aeroplex and O.G. Wilson Catalogue Divisions and both European operations have been sold, and the inventory has been written down.

Portions of the write-down which relate to assets in existence at the time that Peoples began to equity account for Zale in 1981 have not been reflected in our statements, since we originally purchased our shares of Zale at less than book value.

On February 14, 1986, Peoples Jewellers submitted an offer to the Board of Directors of Zale Corporation to acquire all of the outstanding common and preferred stock of Zale not owned by Peoples, in a merger transaction with a U.S. subsidiary of Peoples. Under the terms of the offer, Zale common shareholders would have

Sales results to date in the current fiscal year show a continued improvement over those for the comparable period of the previous year, and augur well for both sales and profits in fiscal 1987.

During the year, Robert A. Kingston, Q.C., a partner of Blake Cassels & Graydon, Barristers and Solicitors, retired from the Board of Directors, and we thank him for his many years of dedicated service. Bruce Lockwood Esq., also a partner of that firm, was appointed to the Board to replace Mr. Kingston.

In closing, I would like to note that the final results achieved in fiscal 1986 reflect the continued commitment and efforts of the Company's approximately 2,400 employees; and our thanks are due to each of them for their assistance in accomplishing these results.

Respectfully submitted on behalf of the Board.



Bertrand Gerstein
Chairman, Board of Directors
Toronto, Ontario,
October 30, 1986

received \$35 (U.S.) net per share in cash, plus \$5 (U.S.) per share liquidation and redemption amount of a new 14% Cumulative Exchangeable Senior Preferred stock of Zale, as the surviving corporation. Zale preferred shareholders would have received \$28 (U.S.) net per share in cash, plus \$4 (U.S.) per share liquidation and redemption amount of such Preferred stock. This offer and two revised offers, were turned down by the Zale board.

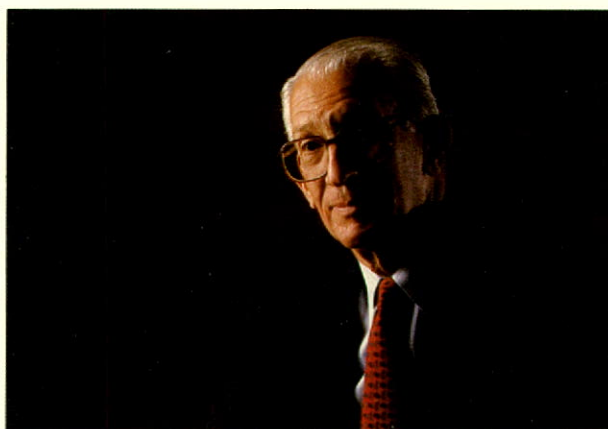
On October 29, 1986 Peoples and Swarovski International Holding A.G. made an offer to acquire by merger all of Zale's outstanding common and preferred stock not owned by Peoples, for \$50 (U.S.) net cash per share and, \$40 (U.S.) respectively.

Swarovski is a Zurich based diversified industrial holding company whose affiliates have major operations in the Tyrol region of Austria. Through its subsidiaries in approximately 40 countries, Swarovski manufactures and markets precious and synthetic jewellery stones, crystal, optical products, grinding wheels and abrasives.

On April 25, 1986, the Company received final payment on its U.S. dollar note receivable which was due in January, 1988. Additional funds came to the Company through the exercise of 1,255,700 warrants, which were exercisable at \$11.50 each prior to the end of June, 1986, for total proceeds of \$14,440,550. 96.6% of these warrants were exercised.

On July 16, 1986, the Company issued a private placement of \$25,000,000, 11% senior unsecured debentures; and the proceeds were used to pay off bank term debt.

During the year, the Company paid quarterly dividends of 7½ cents per share in each of the four quarters of fiscal 1986, resulting in total dividends for the year of \$0.30 per share.



*Sales Increases By Division:
1986 over 1985, by Quarter*

Quarter	Peoples Jewellers	Mappins
1st	+ 5%	+ 21%
2nd	+ 4%	+ 13%
3rd	- 5%	+ 2%
4th	- 4%	+ 17%
Year	+ 1%	+ 13%

Review of Canadian Operations

The first half of fiscal 1986 produced favourable operating results, reflecting higher profit margins, increased sales and effective continuing cost controls. While the third quarter was soft, the fourth quarter saw a return to a stronger market share and profit levels.

Implementation of a significant store renovation program, strengthened inventory levels, further improvements in the distribution system, and an upgrading of the information services area will all have a positive improvement on 1987 fiscal year results.

Store Operations

Geographically, sales increases were strong in Ontario and Manitoba, relatively flat in Eastern Canada, and weak in the Western provinces, reflecting regional economic conditions. Overall, Mappins showed slightly more strength than Peoples.

*Sales Increases By Division:
1986 over 1985, Geographically*

Division	Peoples Jewellers	Mappins
British Columbia	+ 1%	- 6%
Alberta	- 6%	+ 13%
Saskatchewan	+ 2%	+ 7%
Manitoba	flat	+ 10%
Ontario	+ 5%	+ 24%
Quebec	flat	+ 17%
Atlantic	- 6%	+ 3%
National	+ 1%	+ 13%

Marketing

Inventory: Inventory levels at year end were higher than for the previous fiscal year, because the ordering of Fall and Christmas merchandise was completed in advance of previous years, giving important benefits in better prices and terms, and greatly improved delivery schedules.

Many of our customers "layaway" their Christmas gifts in the early fall; and with virtually all of this inventory in the stores, the Company is well positioned for the Fall Season. Inventory levels are planned to be lower at the end of the Christmas selling season than last year.



A major new Store Renovation Program instantly establishes our stores' feeling for fashion, style and selection. Here: Our newly renovated Peoples store in Toronto's Yorkdale Mall, featuring exciting diamond and other jewellery, supported by dramatic point-of-purchase displays.



Peoples and Mappins engage in friendly but strong competition with each other for cross-over customers; and by competing well against each other, sell more effectively against the competition.

Clearly Defined New Images for Each Division:
Our stores are the single most important point of communication with customers. Recognizing this fact, Peoples and Mappins are both implementing a major new Store Renovation program which gives shoppers an instant sense of each store's feeling for fashion, style and selection.

Peoples Jewellers attracts customers who are principally in their 20s to late 30s – youthful, positive shoppers who know what they want, and expect a wide selection of trendy, upbeat items combining quality and value.

In direct response to this market, the new store look for Peoples is exciting, dramatic, glittering – with show-type lighting, handsome new display cases, and merchandise segmented and strongly identified by clear acrylic hanging overhead signs for more convenient shopping.

Distribution: In a continuation of the improvements which were begun in the 1985 fiscal year, the Distribution Centre focused strongly on further reducing the turnaround time of merchandise to the stores. The aim is for the Distribution Centre not to “warehouse” the products, but through close co-operation with suppliers who ticket and package the product at their facilities, to receive the merchandise, and ship it to the stores in the shortest time possible.

A greater quantity of merchandise was handled this year since we have arranged for suppliers to use the Company's Distribution system to transship goods to the stores, benefitting both the customers and the Company with significant savings in both time and shipping costs.

Merchandising

Customers want and expect two things from their retail jeweller; a good balance of both basic and exciting new products, and the best possible service. Our Merchandising program is under constant examination and improvement to ensure that both these criteria are provided to shoppers, giving them unique and positive benefits from shopping the Company's stores over those of the competition.



This page: The Company has made an important investment to upgrade its on-line point-of-sale system. Far page: (above) we combine stones and settings into unique jewellery statements; (below) full-colour fashion photography adds to the in-store excitement.



Peoples to shop the world and to offer our customers a balanced selection of basic traditional items and unique new jewellery styles and values.

Antwerp, New York, Tel Aviv and Bombay among others, supply us with the finest diamonds and other precious stones, in both traditional and fancy shapes and cuts. We source the world's leading jewellery designers for styles and fashions; and combine stones and settings into unique jewellery statements.

Information Services

Peoples has made an important investment to upgrade its on-line point-of-sale system, and is developing a new Database system which will give users access to more information in a more accessible manner, and allow accessing of information not previously available.

Adding to the excitement are displays of fashion jewellery that customers can touch, feel and try, to make their shopping experience more accessible and fun.

Mappins customers are predominantly in their 30s through 40s and on into mature years; upscale, sophisticated shoppers who give high priority to quality and tradition.

Mappins stores are being re-designed to emphasize their customers' sense of style, craftsmanship and quality. Large windows show the breadth of selection, and an attractive new fashion look and colours are featured throughout the stores.

Under the carefully planned new Store Renovation program, the past fiscal year saw about 10% of all stores being renovated, with another 15% planned for renovation in fiscal 1987. This program is having an immediate, strong and positive impact on customer response and sales.

Unique Jewellery and Fashion Offerings: Supporting the new stores look is an exciting new look to the merchandise. Years of experience enables



Mappins customers are upscale, sophisticated shoppers who give high priority to quality and tradition. Here: the Mappins store in The Promenade in northwest Toronto offers the finest in jewellery craftsmanship, supported by attractive high-fashion displays.





Financial Review

Sales/Merchandise

Sales in fiscal 1986 increased 4% over 1985 versus a 1.5% increase last year over 1984. Particular strength was reflected in the first two quarters (8.8% and 7.1% respectively) with a decline of 4.3% in the third quarter and a modest 1.5% increase in the final quarter. The last two quarters of the previous year had reflected substantial increases of 12% and 4.5% respectively. In addition, these quarters reflect the operation of fewer stores and the closing of several stores during their two to three week renovation period.

Merchandise levels are 13% higher this year-end than last year due to the early implementation of the Fall program in order to maximize the sales impact for the Christmas season. Many customers "layaway" gifts for Christmas starting in August and September. Inventory levels are planned to be lower than last year starting after Christmas and through the Spring 1987 season.

Expenses/Prepaid Expenses/Other Assets

The cost of merchandise sold and all other expenses except depreciation and interest increased by only 2.8% notwithstanding the 4% sales increase. This yields a pre-tax, interest and depreciation margin of 12.7% versus 11.7% last year. Gross margins were comparable to last year.

Prepaid expenses were comparable to last year. Other assets increased over last year primarily due to the incurrence of costs related to a financing completed on July 16, 1986. Financing costs are amortized over the retractable life of the debentures (five years).

Depreciation/Fixed Assets

Depreciation for the year was \$5,240,000 and includes the amortization of other assets other than financing costs which are reflected as part of Zale related interest costs. The 11% increase over last year results primarily from increases in capital expenditures over the last two years for new stores and renovations.

Fixed assets relating to stores that are closed or undergoing significant renovation that do not continue to be used are written off and expensed to the "cost of goods sold and all other expenses" category. The cash registers which are being depreciated over eight years are being upgraded, which will extend their useful lives well beyond the previously estimated useful lives.

Interest/Financing/Receivables

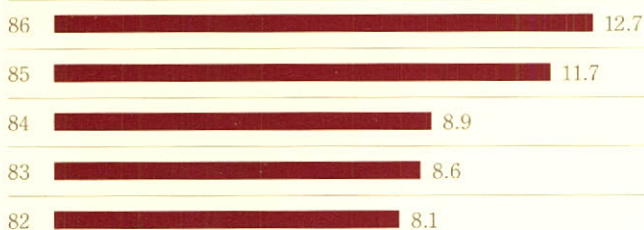
Long-term interest costs (including Zale related interest costs) rose slightly during the year as the result of fixing these costs for at least five years through the placement of ten year retractable debentures. The private placement of \$25,000,000 of 11% debentures on July 16, 1986 now fixes the interest rate on all long-term debt.

Short-term interest costs declined during the year due to lower interest rates and lower operating loans. Operating loans are at floating interest rates, but are fixed over short periods by the use of bankers' acceptances. The U.S. dollar loan was paid off during the year due to the early receipt of payment on the U.S. dollar receivable, portions of which were not due until January 1987 and 1988.

Upon completion of the July 16, 1986 private placement, the bank released security on the fixed assets and the Zale shares owned by the Company. As a result, the debentures placed on July 11, 1985 became unsecured due to a previous agreement between the bank, the Company and the trustee for the debentureholders.

As a result of increased equity from the exercise of warrants and earnings and lower debt due to the receipt of the long-term receivable, the Company's debt/equity ratio has improved to 1.00 from 1.28.

Margin before tax, interest and depreciation



Provision For Income Tax/Income Taxes Payable

This year's provision for income taxes is less than a normalized percentage of income, due to the application of the 3% inventory allowance for the first half of the year, together with the fact that portions of the income earned are the result of capital gains and the drawdown of the discount on the note receivable.

Income and other taxes payable include: federal sales and excise taxes; provincial sales taxes; withholding taxes; and payroll taxes payable for the month of August, 1986. This amount also includes \$250,000 for capital tax payable, relating to the fiscal year ended August 31, 1986.

As indicated in the notes to the Consolidated Financial Statements, losses carried-forward and available at this time total \$17,000,000; and a further \$2,500,000 of expenses re shares issues charged to retained earnings may also be applied against taxable income. In addition, the Company has available to it allowable capital losses of approximately \$1,000,000 which can be applied indefinitely against future capital gains.

Equity in the Earnings of Zale Corporation/Investment in Zale Corporation

Peoples Jewellers owns a 14.4% share of the outstanding Common shares of Zale Corporation. Three members of the Board of Directors of Peoples Jewellers are members of the Board of Directors of Zale Corporation.

Our ongoing investment in Zale provides Peoples Jewellers with a significant involvement in the international jewellery market.

The investment in Zale Corporation reflects the equity accounting for the earnings of Zale Corporation; and also includes the foreign currency translation adjustment. The equity investment in Zale Corporation reflects the cost of investment, plus our share of Zale's earnings, adjusted as indicated below, and less dividends received. The detailed calculation of the equity pick-up is as follows:

	(000's)
Zale earnings before unusual items for the year ended March 31, 1986 (U.S.\$)	\$27,875
Zale earnings before unusual items as calculated for year ended June 30, 1986	\$26,889
Depreciation and other adjustments	14,352
Lifo adjustments	(631)
Adjusted Zale earnings (U.S.\$)	\$40,610
Adjusted Zale earnings (Canadian\$)	56,107
Peoples' share 14.72%	8,259
Less Provision for withholding tax	547
	\$ 7,712
Our share of unusual items	\$(11,153)

The related interest cost on long-term debt reflects interest costs on the \$64,000,000 borrowed for the investment in Zale Corporation, offset by the reduction of applicable income taxes. The tax impact which is reflected is the maximum amount possible, because income tax on income other than Zale-related interest is less than the amount of tax which could have been recovered in the Zale-related interest in fiscal 1985 and 1986.

Earnings Per Share

Earnings per share reflect the average number of outstanding shares for fiscal 1986; 8,762,000 shares. This compares to a figure of 7,181,000 shares in the previous year. These numbers include Common, Class A non-voting, and First Preferred Series B Shares.

700,000 warrants to purchase Class A non-voting shares at \$9.00 per share prior to July 11, 1987 are outstanding. These warrants do not have a dilutive effect on earnings per share.

Dividends

The Company paid quarterly dividends in fiscal 1986 of 7½ cents in each of the four quarters per Common, Class A non-voting, and First Preferred Series B shares.

Working Capital

At the end of the year, working capital was \$66,598,000, an increase of \$23,316,000 over the previous year.

Consolidated Balance Sheet*(000's)*Peoples Jewellers Limited
*(Incorporated under the laws
of Canada)*

<i>As at August 31,</i>	1986	1985
Assets		
Current Assets:		
Cash	\$ 73	\$ 79
Accounts receivable	1,483	1,923
Merchandise	128,397	113,885
Prepaid expenses	2,341	2,293
Current portion of long-term receivables	-	3,870
Total current assets	132,294	122,050
Long-term receivables (notes 3 and 6a)	2,336	10,437
Investment in Zale Corporation (note 2)	88,044	87,754
Investment in Torcred Developments Limited	911	742
Fixed Assets:		
Buildings	11,830	11,570
Furniture, fixtures and equipment	34,279	29,484
	46,109	41,054
Less accumulated depreciation	21,212	18,015
	24,897	23,039
Land	2,264	2,514
Leasehold interests and improvements	6,356	5,994
Total fixed assets	33,517	31,547
Other assets	3,524	2,946
	\$ 260,626	\$ 255,476

(The accompanying notes are an integral part of these statements)

On behalf of the Board:


Irving R. Gerstein
Director

Sydney M. Hermant
Director

	1986	1985
Liabilities		
Current Liabilities:		
Bank indebtedness (note 4)	\$ 34,353	\$ 45,170
Accounts payable	28,716	24,996
Income and other taxes payable	2,549	2,837
Current portion of long-term debt	78	5,765
Total current liabilities	65,696	78,768
Long-term debt (note 5)	64,464	64,509
Shareholders' Equity		
Capital stock (note 6)		
Authorized—		
First Preferred shares		
Junior Preferred shares		
Class A non-voting shares		
Common shares		
	Shares	
Issued—		
First Preferred shares, Series B	205,900	1,916
Class A non-voting shares	8,564,451	77,687
Common shares	868,950	82
	79,685	65,139
Retained earnings	37,860	38,721
Foreign currency translation adjustment	12,921	8,339
Total shareholders' equity	130,466	112,199
	\$ 260,626	\$ 255,476

Consolidated Statement of Income

(000's)

Peoples Jewellers Limited

<i>Year ended August 31,</i>	1986	1985
Sales	\$ 184,837	\$ 177,736
Deduct:		
Cost of merchandise sold and all other expenses except those listed below	161,355	157,034
Depreciation and amortization	5,240	4,719
Interest on long-term debt	550	728
Interest on bank indebtedness	4,114	5,124
	171,259	167,605
Income from Canadian Operations before provision for income taxes	13,578	10,131
Provision for income taxes (note 7)	5,400	3,300
Income from Canadian Operations	8,178	6,831
Equity in Zale Corporation earnings (note 2)	7,712	5,526
Less share of unusual items	(11,153)	-
Less related interest on long-term debt (net of income taxes: 1986 - \$4,150; 1985 - \$2,850)	(3,958)	(4,619)
	(7,399)	907
Net income before extraordinary item	779	7,738
Recovery of income taxes through utilization of losses carried-forward	1,000	-
Net income for the year	\$ 1,779	\$ 7,738
Earnings per Common, Class A non-voting and First Preferred, Series B share		
Net income for the year	\$ 0.20	\$ 1.08
Net income before extraordinary item	\$ 0.09	\$ 1.08
Income from Canadian Operations	\$ 0.93	\$ 0.95

(The accompanying notes are an integral part of these statements)

Consolidated Statement of Retained Earnings

(000's)

<i>Year ended August 31,</i>	1986	1985
Retained earnings, beginning of year	\$ 38,721	\$ 34,275
Net income for the year	1,779	7,738
	40,500	42,013
Dividends		
First Preferred shares, Series B	65	67
Class A non-voting shares	2,314	1,868
Common shares	261	261
	2,640	2,196
Commission and other expenses on issue of Class A non-voting shares	-	1,096
	2,640	3,292
Retained earnings, end of year	\$ 37,860	\$ 38,721

(The accompanying notes are an integral part of these statements)

Consolidated Statement of Changes in Financial Position

Peoples Jewellers Limited

(000's)

Year ended August 31,	1986	1985
Cash provided from (applied to):		
Operating activities—		
Income from Canadian Operations	\$ 8,178	\$ 6,831
Add (deduct) items not involving a flow of cash:		
Depreciation and amortization	5,240	4,719
Extraordinary item – recovery of income taxes	1,000	–
Other (net)	(989)	(201)
	<u>13,429</u>	<u>11,349</u>
Changes in non-cash operational working capital balances –		
Merchandise	(14,512)	(20,422)
Accounts payable	3,720	10,167
Other	104	4
	<u>(10,688)</u>	<u>(10,251)</u>
Cash provided from Canadian Operations	2,741	1,098
Interest on long-term debt related to acquisition of Zale Corporation shares	(3,958)	(4,619)
Dividends received from Zale Corporation	3,040	2,936
	<u>1,823</u>	<u>(585)</u>
Financing activities—		
Issue of capital stock (net of expenses)	14,746	12,000
Redemption of capital stock	(200)	(911)
Issue of retractable debentures	25,000	35,000
Repayment of long-term bank debt	(30,732)	(40,924)
Dividend payments	(2,640)	(2,196)
	<u>6,174</u>	<u>2,969</u>
Investment activities—		
Net expenditures on fixed assets, investments and other assets	(8,317)	(8,767)
Receipt of long-term receivables	11,131	2,246
	<u>2,814</u>	<u>(6,521)</u>
Decrease (increase) in bank indebtedness for the year	10,811	(4,137)
Cash and bank indebtedness, beginning of year	(45,091)	(40,954)
Cash and bank indebtedness, end of year	<u>\$ (34,280)</u>	<u>\$ (45,091)</u>

(The accompanying notes are an integral part of these statements)

Auditors' Report

To the Shareholders of
Peoples Jewellers Limited:

We have examined the consolidated balance sheet of Peoples Jewellers Limited as at August 31, 1986 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.

In our opinion, these consolidated financial statements present fairly the financial position of the company as at August 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.

Toronto, Ontario
October 3, 1986

Clarkson Gordon
Chartered Accountants

August 31, 1986

1. Summary of significant accounting policies

a) Principles of consolidation –

The accompanying consolidated financial statements include the accounts of Peoples Jewellers Limited and its subsidiaries. The investments in Zale Corporation and Torcred Developments Limited are accounted for on the equity basis.

b) Merchandise –

Merchandise is stated at the lower of cost determined on a first-in, first-out basis or net realizable value.

c) Fixed assets –

Fixed assets are stated at cost and depreciated based on estimated useful lives as follows:

Buildings	– 5% declining balance
Furniture and fixtures	– 10% straight-line
Electronic data equipment	– 12½-20% straight-line

Leasehold improvements are stated at cost, less amortization on a straight-line basis over the term of the lease plus one renewal period with the total term not exceeding fifteen years.

d) Other assets –

Other assets are stated at cost less amortization calculated on a straight-line basis over three to five years.

e) Foreign currency translation –

Amounts relating to the investment in Zale Corporation are translated into Canadian dollars on the following basis: carrying cost at year-end rates of exchange and equity in earnings at average exchange rates throughout the year. Unrealized translation adjustments are reflected in shareholders' equity. Translation gains and losses on U.S. dollar denominated debt and long-term receivables outstanding during the year were included in income.

2. Investment in Zale Corporation

The Company's investment in Zale includes certain costs associated with the Company's continuing efforts to acquire a significant additional interest in Zale.

3. Long-term receivables

In 1986, full repayment was received of the long-term note receivable relating to the 1982 sale of the net assets of the Company's U.S. subsidiary. Interest income on this note of approximately (000's) \$896 (1985 – \$2,216) is included in "Cost of merchandise sold and all other expenses."

4. Bank indebtedness

As collateral for bank indebtedness there is a floating charge on the Company's inventory.

5. Long-term debt

The Company's long-term debt consists of the following:

	(000's)	
	1986	1985
12¼% Senior Unsecured Retractable Debentures due July 2, 1995	\$35,000	\$35,000
11% Senior Unsecured Retractable Debentures due July 2, 1996	25,000	–
Bank term loan due December 31, 1991	–	19,000
Bank loans due January 31, 1988	–	11,654
12% Mortgage due December 15, 1988	4,542	4,620
	<u>64,542</u>	<u>70,274</u>
Less current portion	78	5,765
	<u>\$64,464</u>	<u>\$64,509</u>

In 1986, the Company issued \$25,000,000 of 11% Senior Unsecured Retractable Debentures which are retractable at the option of the holder on July 2, 1991. The proceeds were used to repay the bank term loan.

The 12¼% Debentures are retractable at the option of the holder on July 2, 1990.

The mortgage is repayable by monthly principal instalments of \$6,500 plus interest to the date of maturity when the outstanding principal balance becomes payable. The head office land and building are pledged as collateral.

6. Capital stock

a) Capital stock changes

	First Preferred Series B		Class A non-voting	
	Shares	Amount	Shares	Amount
		(000's)		(000's)
Balance, August 31, 1985	230,000	\$2,040	7,282,751	\$63,017
Redeemed during year	(21,600)	(200)	—	—
Converted in year	(26,000)	(229)	26,000	229
Issued during year	23,500	305	1,255,700	14,441
Balance, August 31, 1986	205,900	\$1,916	8,564,451	\$77,687

Of the First Preferred, Series B shares redeemed and converted during the year, 14,400 shares and 9,600 shares, respectively, were from or by officers other than directors. The 23,500 First Preferred, Series B shares issued were issued under the employee stock purchase plan. Amounts due from employees under this plan are included in long-term receivables and are repayable over ten years from dividends paid on the shares issued after which time the balance is payable.

The Class A non-voting shares were issued upon exercise of outstanding warrants. Warrants remain outstanding to purchase up to 700,000 Class A non-voting shares at \$9.00 per share up to July 11, 1987.

b) Capital stock provisions

Holder of First Preferred, Series B, Class A non-voting and Common shares may elect to receive stock dividends in lieu of cash, subject to the directors declaring such dividends. Such dividends may be declared in either Class A non-voting or redeemable Junior Preferred shares. First Preferred shares, Series B are convertible up to a cumulative maximum of 20% in each of the next five years into Class A non-voting shares on a one-for-one basis or at the holder's option are redeemable for an amount equal to the issue price of \$8.60 for those shares issued on May 1, 1983, \$10.00 for those shares issued on May 2, 1984, \$9.00 for those shares issued on April 29, 1985, and \$13.00 for those shares issued on April 10, 1986. These shares rank above the Junior Preferred shares as to dividends and claims against the Company's property at dissolution. Junior Preferred shares are redeemable at \$0.01 and rank above Class A non-voting shares and Common shares as to claims against the Company's property at dissolution. Class A non-voting shares are participating and have a preference over Common shares for dividends to the extent of \$0.15 per share. After the Common shares also receive \$0.15 per share, the two classes participate equally.

7. Income taxes

Income taxes provided are lower than statutory rates due to the 3% inventory allowance and the effect of the non-taxable portion of gains on disposition of property. The Company has losses available to offset future taxable income of approximately \$17,000,000, which expire as follows (000's): 1987 - \$2,000; 1990 - \$7,000; 1991 - \$2,000; 1992 - \$1,000; 1993 - \$5,000. In addition, the Company has available allowable capital losses of approximately \$1,000,000 which can be applied indefinitely against future capital gains. Any benefit realized through the reduction of future years' income taxes will be recognized as an extraordinary gain in the year of realization.

The Company has also incurred approximately \$2,500,000 of expenses on issues of share capital which have been charged to retained earnings. These expenses are also available to reduce future taxable income and any benefit realized will be included in retained earnings.

8. Commitments and contingent liability

A number of the Company's store locations are leased under operating leases for periods from four to twenty years. Most of these leases are for minimum rentals and many contain percentage of sales clauses, and require the Company to pay certain occupancy costs. The minimum rentals payable under all such leases currently in force for subsequent fiscal years are as follows (000's): 1987 - \$9,229; 1988 - \$8,504; 1989 - \$7,408; 1990 - \$5,932; 1991 - \$5,077; subsequent years - \$14,368.

The actual rental payments in the year amounted to (000's): 1986 - \$15,460; 1985 - \$14,393.

9. Comparative figures

Certain of the prior year's figures have been reclassified to conform with the presentation adopted in the current year.

Two hundred and ninety-six stores

As at August 31, 1986



● Peoples stores
● Mappins/Mackenzies stores

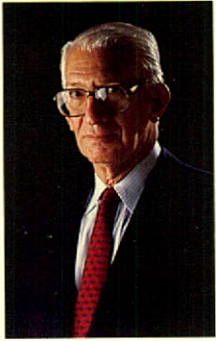
	Peoples Stores	Mappins/Mackenzies Stores	Total
British Columbia	34	15	49
Alberta	24	22	46
Saskatchewan	16	8	24
Manitoba	9	7	16
Ontario	77	35	112
Quebec	16	4	20
New Brunswick	9	2	11
Nova Scotia	11	4	15
Prince Edward Island	1	—	1
Newfoundland	2	—	2
Total	199	97	296

5 Year Statistical Summary

August 31

<i>(000's omitted)</i>	1986	1985	1984	1983	1982
Sales	\$ 184,837	177,736	175,130	145,014	127,220
Sales increase %	4%	2%	21%	14%	3%
Continuing income before taxes, unusual items, and Zale equity	13,578	10,131	7,171	3,995	2,016
Continuing income/(loss)	779	7,738	9,412	(144)	1,518
EPS—Quarter 1	(.25)	(.70)	(.21)	(1.25)	(.21)
2	1.93	2.05	2.12	2.76	2.42
3	(1.67)*	(.24)	(.33)	(1.56)	(1.13)
4	0.08	(.03)	(.23)	.02	(.72)
Total	0.09	1.08	1.35	(0.03)	0.36
Net income/(loss)	1,779	7,738	9,412	(144)	(6,196)
EPS—Quarter 1	(.25)	(.70)	(.21)	(1.25)	(.51)
2	2.43	2.05	2.12	2.76	2.74
3	(2.06)*	(.24)	(.33)	(1.56)	(2.97)
4	0.08	(.03)	(.23)	.02	(.72)
Total	0.20	1.08	1.35	(0.03)	(1.46)
Inventory	128,397	113,885	94,213	90,229	64,582
Total assets	260,626	255,476	227,221	202,320	171,529
Working Capital	66,598	43,282	41,580	41,008	38,671
Shareholders' equity	130,466	112,199	94,420	78,793	52,012
Dividends	2,640	2,196	1,048	1,048	2,548
Number of shares outstanding					
—year end	9,639	8,382	6,994	6,988	4,189
—average balance	8,762	7,181	6,984	4,730	4,251
Book Value per share	13.53	13.39	13.21	11.28	12.42
Number of stores	296	302	309	299	282
Number of employees	2,398	2,405	2,507	2,654	2,508

*Includes our share of unusual items.



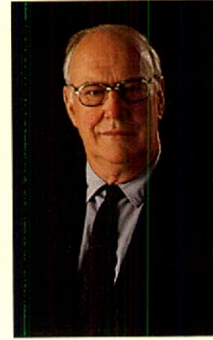
Bertrand Gerstein
Chairman



Marvin Gerstein
Vice-Chairman



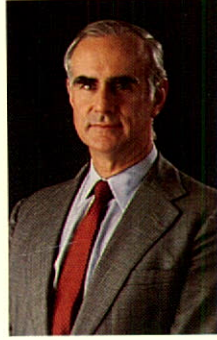
Irving R. Gerstein
President



James M. Gillies



Sydney M. Hermant



Henry N.R. Jackman



Bruce Lockwood



Phyllis M. McAllister

PEOPLES⁺