Consumers Distributing Company Limited

Annual Report 1986

Through innovation in distribution and advanced information technology in our 309 stores and warehouse locations, Consumers Distributing is continually improving its ability to provide quality products to millions of satisfied customers.

Our Corporate Mission is clear: "To be a leading distributor and retailer of semi-durable consumer goods offering the best overall value".

Annual Meeting
The Annual General Meeting of the shareholders will be held in the Toronto Stock Exchange Auditorium, The Exchange Tower, 2 First Canadian Place, Toronto, Ontario, on Wednesday, June 17, 1987 at 3 p.m.

Financial Highlights

(Dollars in millions, except per share data)	Fifty-two weeks ended January 31, 1987	Fifty-two weeks ended February 01, 1986
Operations		
Sales	$ 933.4	$ 876.6
Earnings (loss) before extraordinary item	5.6	(3.6)
Net earnings (loss)	5.6	(29.6)
Funds from operations	17.5	11.6
Capital expenditures	9.9	28.4
Per Class A or Class B Share		
Income (loss) before extraordinary item	$ 0.21	$ (0.15)
Net earnings	0.21	(1.26)
Shareholders' equity	4.36	4.29
Dividends — Class A	0.09	0.09
— Class B	0.12	0.12
Financial Position		
Working capital	$ 118.2	$ 45.9
Total assets	372.9	414.2
Total debt	251.4	312.5
Shareholders' equity	121.5	101.7
Ratios		
Return on average equity	5.0 %	(3.2%)
Debt: Equity	51:49	66:34
Stores		
Catalogue Showrooms — Canada	197	198
— United States East Coast	89	89
Toy City	23	20

Contents

Henri A. Roy, Chairman, Chief Executive Officer and President.

Chairman's Report

Fiscal 1987 was a year of recovery for Consumers Distributing during which we have re-established a new base level of profitability for the Company.

Total sales increased 6.5% to $933.4 million and net earnings from continuing operations rose to $5.6 million, or 21 cents a share, from $2.0 million, or 9 cents a share, in our preceding year. The elimination of the 3% inventory tax allowance and the imposition of surtaxes have reduced profits by some $4.2 million. The impact of these tax changes is important because they have permanently reduced the profitability potential of the Company.

The disappointing results of the last year have raised doubt as to the soundness of our basic market posture and business strategy. Accordingly, our management teams have expended considerable efforts to diagnose our situation, to develop programs to redirect our competitive position, and to assure acceptable financial performance. This review has yielded a realistic assessment. We are confident that implementation of the strategy outlined in this report will assure the long-term viability of the Company.

As a first step, we have clarified our Corporate Mission:

"TO BE A LEADING DISTRIBUTOR AND RETAILER OF SEMI-DURABLE CONSUMER GOODS OFFERING THE BEST OVERALL VALUE".

The catalogue showroom concept has largely reached maturity.

To assure a more focused approach in the redirection of the Company, we reorganized into three operating divisions: Canadian Catalogue Showrooms, U.S. Catalogue Showrooms, and Toy City. Each division will function as an autonomous business unit supported by a reduced corporate staff.

Because our main business remains the catalogue showrooms, we have concentrated our strategic efforts in this segment. This examination has led us to conclude that the catalogue showroom concept has largely reached maturity. Inherent in catalogue retailing is the negative customer perception associated with out-of-stock problems. This particularity of the Consumers' concept causes natural erosion of the customer base which has been further aggravated by the difficulties experienced in the distribution centre during the fall of 1985. In addition, changes to tax laws, gradual escalation of store lease costs, and competition from discounters and specialty retailers have affected the business economics and the competitiveness of our format.

More specifically, our Canadian Catalogue operation continues to face problems of unfilled demand, capacity constraints, and limited expansion opportunities for our traditional catalogue store format. Similarly, further to the closure of its West Coast Division, the U.S. operation is burdened with high fixed costs, low consumer awareness and, most importantly, has consistently been unable to generate profits.

This diagnosis calls for a redirection of the Company and major investment in people, technology and capital to rebuild a viable company with the potential to generate superior returns to shareholders. Our corporate objective demands the attainment of a return on capital of 15% within three years. From the current base return of 5%, the challenge to improve is considerable.

Consumers Distributing has developed a very powerful concept with dominant market positions in many product segments. The reduction of unfilled demand, improved inventory management and a repositioning of the format can dramatically and positively affect customer attitudes and corporate profitability.

These programs will improve the long-term viability of the Company

Thus we are embarking on a major long-term turnaround program that will materially transform the Company. The elements of this multi-year rebuilding program that relate principally to the catalogue business are based on the following:

- Development of a strong professional management team and the commitment of all employees.
- Redesign of the Canadian Catalogue showroom distribution network to a modified pull system to improve unfilled demand, rationalize inventory management and improve operating flexibility.
- Major investments in modernizing distribution, logistic and information technology in both the warehouse and stores.
- Expand the market reach of the Consumers concept into rural markets.
- Improve the shopping convenience of our catalogues.
- Redeploy capital assets by developing a network of agents, affiliates and franchises.

Overall, the challenge will be to integrate information and distribution technologies throughout the entire supply chain, from manufacturing and distribution through to the ultimate customer so that total costs are reduced and strategic advantages gained. This should strengthen our position and increase our ability to manage the supply chain efficiently. In addition, franchising and the general use of agents and affiliates at retail has potential to improve our responsiveness to consumer needs and materially improve the efficient use of capital resources.

Understandably, the coming year will be critical in that we will conduct important experiments to test customer acceptance and the feasibility of new market concepts. Also, we will study important design alternatives to change our distribution systems while maintaining our low cost structure. Although risks are always inherent in the development and implementation of new strategies, we are confident that these programs will improve the long-term viability of the Company.

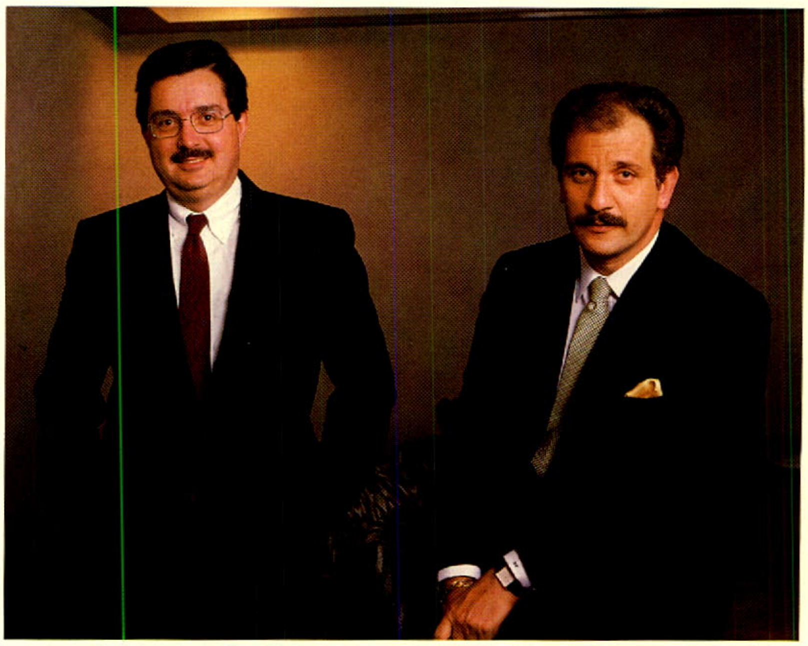
With a view to strengthening the capital structure of the Company, we proceeded with the redemption of the 11-7/8% subordinated convertible debentures with the effect of increasing the number of shares outstanding by 4.1 million shares or 17%.

Rebuilding a strong and dynamic management team.

The rebuilding of a strong and dynamic management team is well underway. We were particularly pleased when Mr. Maurice Tousson joined the team as Executive Vice-President of the Company. We also strengthened the Board of Directors with the addition of experienced executives. We welcomed Messrs. George Mann, Joseph Segal, Robert Despres and Mrs. Ruth MacDonald. It is with regret that we note the recent death of Mrs. MacDonald, as her contribution was particularly appreciated. Subsequent to year-end, Michael Haberman left the Company and we wish to note our appreciation for his contribution.

We are grateful for the dedicated support and loyalty of our staff during this transition period. It is our firm intention to solidify harmonious relationships with all employees by developing the necessary confidence and trust. It is also a pleasure to acknowledge the continued patronage of our customers and the active support of our many suppliers.

Henri A. Roy
Chairman, Chief Executive Officer and President



(Left) Henri A. Roy, Chairman, Chief Executive Officer and President, (Right) Maurice Tousson Executive Vice-President.

Canadian Catalogue Division

Operating Results

Sales during the first half of fiscal 1987 were flat but showed a strong turnaround in the second half. Lower prices in key merchandise categories and out-of-stocks resulting from the Fall, 1985 problems in the distribution centre were the principal causes of the Division's poor first-half results.

Despite a relatively flat November, our sales jumped 11.5% during the second half of the year. Major sales gains were achieved in appliances, personal care, baby goods, toys and home entertainment products. Jewellery sales were disappointing as customers "traded down" from higher-priced to costume-type jewellery.

Recuperating from a difficult year, the distribution centre was made operational by mid-year. Nevertheless, the originally planned systems improvements were only partially implemented.

Strategic Review

The strategic review for our Canadian Catalogue Division began by more clearly articulating its mission:

"TO BE THE LEADING NATIONAL DISTRIBUTOR/RETAILER OF SEMI-DURABLE GOODS, POSITIONED AS A PRICE LEADER, AND UTILIZING CATALOGUES AS A PRIMARY MARKETING VEHICLE".

The Canadian marketplace is evolving, especially as it affects our particular segments. Although overall population growth is slowing, the growth in household formation and the maturing baby boom generation are expected to stimulate consumer demand for household and recreation-related products. Furthermore, buying habits are changing as value and convenience are growing in importance for shoppers. Better informed, more affluent and self-confident shoppers are paying more attention to value for money, but won't compromise on quality. These buyers are attracted to different retail formats, depending on their buying patterns and particular convenience/value requirements.

Although Consumers' Canadian Catalogue Division is well positioned as a price leader, this factor alone is no longer enough to attract shoppers and preserve their loyalty. Competition is intensifying as "power retailers", who offer broader product mixes, attract customers with aggressive marketing and reduced price differentials between Consumers and traditional retailers. The catalogue is a promise of product availability, yet Consumers stores have a poor image of frequent stockouts.

The implications of changes for our catalogue showrooms in both the external and internal environments are significant:

- Consumers is very well positioned as a low-price retailer, however the growing importance of the convenience factor in shopper buying decisions, the frequently-out-of-stock image, combined with more aggressive "power retailers" and narrowing price differentials threaten our position in the marketplace.

- The efficiency of the Consumers system which until now was a major success factor, does not allow it the flexibility needed to respond to today's market conditions: the inventory push system impedes our ability to respond to individual store needs, and our annual catalogue, which establishes product mix and prices for one year, makes it a static target for competitors.

- The technological advances which are providing Consumers with tremendous opportunities for improved forms of retailing and distribution may also be adopted by current competitors and could lead to the emergence of new forms of competition.

The Consumers system, in its current format, has not been able to achieve the corporate financial objective of a 15% return on net assets. Achieving this stated objective with the same format and strategies appears highly unlikely. Radical changes to Consumers' current strategic direction are required.

Given this situation, the Company intends to pursue a prudent turnaround strategy based on the following three elements:

Operational Systems Improvements

This strategy involves improvements which will increase the efficiency of operations: increasing inventory turns; reducing out-of-stocks; instituting various catalogues to increase demand; improving the customer store experience; and improving information on customer needs and habits.

The major operational improvements are largely dependant on the redesign of our distribution system. A major study is currently underway to define the optimum system for Consumers taking into account our changing needs and requirements. We remain hopeful that a new system can be designed and implemented within the next three years to yield the additional flexibility of a pull-type system while maintaining a low cost of distribution.

The focus of this strategy is to broaden the reach of the concept in areas that are currently not addressed or where the traditional store format is not viable. We intend to expand into major urban markets by establishing home shopping systems that will provide added convenience to our customers. In addition, with the marketing success of the Provigo supermarket agent test, we intend to pursue our expansion into rural markets too small to be served economically by the traditional Consumers format. Thus, we will further test the regional expansion of our network of service counters using agents, principally in food stores. To increase shopper frequency in the stores we will introduce consumable items with small space requirements, high frequency of purchase and long shelf life. We intend to expand our product range through electronic shopping systems using kiosks within the store.

Asset Redeployment

Many stores in urban areas may not be viable in the long term in the traditional format, due to escalating rents. Reducing store sizes and converting them to specialty formats which have higher gross margins would increase operating profits.

More importantly, franchising has proven successful in numerous retailing concepts. We are confident that the use of franchising can materially improve the efficiency of the system by becoming more responsive to the consumer and more efficient in the use of capital. The benefits will be increased sales throughout and the release of capital.

A detailed action program has been developed. But equally important, the Canadian Catalogue Showroom Division is developing a strong and dedicated team committed to its implementation.

We intend to be flexible and to adapt as our program evolves over the next few years. We remain confident that improved results will be attained.

U.S. Catalogue Division Operating Results

Expanding our product range with the introduction of electronic shopping systems using kiosks principally in food stores.

Our U.S. West Coast operations, declared discontinued at the end of fiscal 1986, have ceased and we are continuing to dispose of the remaining leases. We expect to complete this program within the reserves provided. This exit from the West Coast was effected in a timely and professional manner and, as a collateral gain, we obtained useful retailing experience in the operation of warehouse stores.

East Coast operations have been transformed substantially to decrease overhead charges to a level more appropriate to our reduced operations. Additional management was drawn from both our former West Coast operations and the Canadian Catalogue Division.

The financial results reflect a poor first half but were buoyed by a sales gain of 6% in the second half. This sales upturn, coupled with higher gross profits and reduced advertising expenses, produced results which exceeded our stated objective of a breakeven at the operating profit level for the year.

The consolidation of our U.S. business into our East Coast operations allows us to initiate new strategies.

Strategic Review

The catalogue showroom industry in the U.S. has undergone significant consolidation in recent years. The industry has fallen on hard times and major cataloguers are now working to solve their problems by de-emphasizing the catalogue and making more effective use of retail space through self-service. This move could present an excellent opportunity for Consumers Distributing.

Consumers' U.S. Division now has a trimmed-down operation concentrated in the New York/New Jersey area. Our small-store concept is a well adapted vehicle for urban markets with a low-cost format and broad middle income appeal. Nevertheless, despite our best efforts over a number of years, we have been unable to develop a viable, profitable business.

The Corporate Mission has been and continues to be:

"TO PROVIDE NEEDED SEMI-DURABLE MERCHANDISE TO THE PUBLIC AT DISCOUNT PRICES THROUGH CATALOGUE MARKETING".

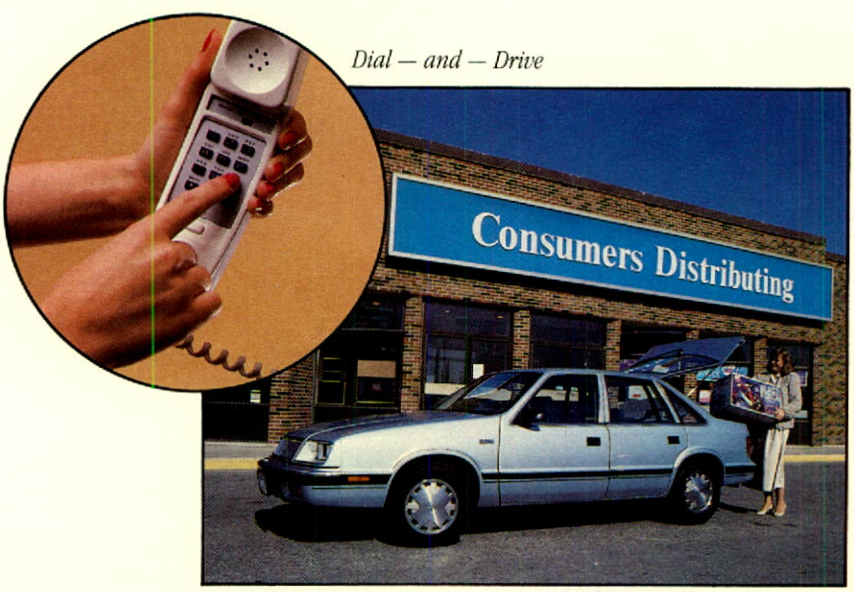
The major elements of our strategy include the extension of Consumers Distributing's presence into new markets without major investments in stores, equipment, furniture and fixtures. These will include the development of an agent network and the implementation of home delivery and dial-and-drive programs.

Additional follow up efforts are being made to improve operating efficiency and reduce the costs of operation. We are introducing a multi-catalogue approach while decreasing the number of items in each catalogue as well as increasing the frequency of delivery to our stores. These combined actions will reduce our unfilled demand, improve our inventory turnover and decrease our requirement for warehouse space. Further programs will be implemented to assure more efficient store operations by investing in training and information technology. The program to rationalize and reduce corporate overhead will be completed.

We intend to adapt the structure of the organization to meet the requirements of the strategic plan. The organization will be stabilized by instituting training programs, improving our benefits, and selective recruiting.

A critical element of the turnaround strategy will be the testing of new forms of retailing; principally the use of agents and telephone shopping for customer order taking, the trial self-service warehouse stores and the development of a franchise program for the U.S. The success of these new retailing programs will determine the long-term viability of our presence in the U.S.

Clearly, there are risks in such undertakings but the U.S. strategy is based on developing market penetration with retailing concepts that require minimum investments. We will continue to assess our business position in the U.S. as the success of this year's efforts and programs unfold.



Dial — and — Drive

Toy City continued to expand across Canada this year with the opening of 4 stores, and significant sales gains on the existing store base. These results were achieved despite a toy market that did not grow and that was characterized by aggressive competition.

Toy City is Canada's largest chain of toy stores with outlets in every major market coast-to-coast. Current plans call for continued expansion during the year to complete the development program. Further expansion will come principally from in-filling existing markets to capitalize on potential economies of scale and synergy of operations.

Toy City Operating Results

Our specialty chain of toy supermarkets was launched some six years ago to diversify and complement Consumers Distributing's toy business. Toy City has expanded rapidly since its inception and its success has attracted competition. The concept of Toy City is still in a growth stage and is now Consumers major format in maintaining a dominant position in Canadian toy retailing.

Strategic Review

Toy City's Corporate Mission has been defined as:

"A SPECIALTY CHAIN OF TOY SUPERMARKETS DEDICATED TO PROVIDING A SUPERIOR SELECTION OF TOYS AND RELATED JUVENILE PRODUCTS SUPPORTED BY A STRONG SHOPPING EXPERIENCE, AND OVERALL GOOD VALUE".

The basic long-term growth trends for toy retailing are very positive, due principally to favourable demographics. Increased disposable income, growth in numbers of first born and multi-parent children are all trends favouring increased spending on toys and related juvenile products.

The changing competitive situation has resulted in aggressive pricing practices. All major competitors have increased product selection and advertising frequency. In addition, many retailers now discount toys during the all-important pre-Christmas season.

The main elements of our strategic program are to increase market penetration by adding new stores, expand our advertising, and improve our customer service.

Store profitability will be improved by investing in point-of-sale systems, and improving shrink control and decision-making support systems.

Toy City is a proven, powerful specialty retailing concept which holds substantial potential for increased profitability. In addition, franchising and the development of a small-size store format will further enhance its long-term viability.

Statement of Earnings

(In Thousands of Dollars)	Notes	Fifty-two weeks ended January 31, 1987	Fifty-two weeks ended February 1, 1986
Sales		**$933,382**	$876,634
Costs and expenses:			
Cost of sales and operating expenses		**897,439**	853,111
Interest expense, including interest on long-term debt and obligations under capital leases of $6,290,000 (1986 — $7,544,000)		**13,031**	15,158
Depreciation and amortization		**11,970**	10,668
		922,440	878,937
Earnings (loss) from continuing operations before income taxes		**10,942**	(2,303)
Income tax expense (recovery)	8	**5,376**	(4,316)
Earnings from continuing operations		**5,566**	2,013
Loss from discontinued operations	1	**—**	(5,630)
Earnings (loss) before extraordinary item		**5,566**	(3,617)
Provision for discontinuance expenses	1	**—**	26,000
Net earnings (loss)		**$ 5,566**	$(29,617)
Earnings (loss) per share:			
From continuing operations		**$ .21**	$ .09
From discontinued operations		**—**	$ (.24)
Before extraordinary item		**$ .21**	$ (.15)
Net		**$ .21**	$(1.26)

See accompanying notes

Statement of Retained Earnings

(In Thousands of Dollars)	Notes	Fifty-two weeks ended January 31, 1987	Fifty-two weeks ended February 1, 1986
Balance, beginning of year:			
As previously reported		**$42,481**	$74,683
Adjustment of 1979-1983 income taxes		**841**	841
As restated		**43,322**	75,524
Net earnings (loss)		**5,566**	(29,617)
		48,888	45,907
Dividends		**(2,953)**	(2,585)
Deferred financing costs	5	**(460)**	—
Balance, end of year		**$45,475**	$43,322

See accompanying notes

Statement of Financial Position

(In Thousands of Dollars)	Notes	**Fifty-two weeks ended January 31, 1987**	Fifty-two weeks ended February 1, 1986
Current assets:			
Cash		**$ 384**	$ 473
Amounts receivable		**10,877**	9,366
Income taxes recoverable		**—**	9,932
Inventory		**250,913**	256,312
Prepaid expenses, including catalogue costs		**17,317**	20,768
Deferred income taxes		**2,800**	—
		282,291	296,851
Current liabilities:			
Bank indebtedness	3	**33,858**	130,674
Accounts payable and accrued liabilities		**122,224**	107,099
Dividends payable		**770**	653
Current portion of obligations under capital leases		**7,109**	6,856
Current portion of long-term debt		**137**	121
Deferred income taxes		**—**	5,590
		164,098	250,993
Working capital		**118,193**	45,858
Net assets of discontinued operations	1	**7,569**	28,278
Fixed assets	2	**78,911**	83,024
Other assets		**4,144**	6,090
Total assets employed		**$208,817**	$163,250
Financed by:			
Obligations under capital leases	4	**$ 37,167**	$ 40,535
Long-term debt	5	**50,157**	20,964
Shareholders' equity:			
Capital stock	6	**71,381**	50,678
Retained earnings		**45,475**	43,322
Foreign currency translation adjustment	1	**4,637**	7,751
		121,493	101,751
Total capital employed		**$208,817**	$163,250

See accompanying notes.

On behalf of the Board:

(Director) (Director)

Statement of Changes in Financial Position

(In Thousands of Dollars)	**Fifty-two weeks ended January 31, 1987**	Fifty-two weeks ended February 1, 1986
Cash provided by (used in) operating activities:		
Earnings from continuing operations	**$ 5,566**	$ 2,013
Add (deduct) items not involving cash:		
Depreciation and amortization	**11,970**	10,668
Increase (reduction) in deferred income taxes	**664**	(2,676)
Loss (gain) on disposal of fixed assets	**(744)**	1,604
	17,456	11,609
Net changes in non-cash working capital balances related to operations	**24,392**	(39,657)
Cash provided by (used in) operating activities	**41,848**	(28,048)
Cash provided by (used in) financing activities:		
Increase in obligations under long-term leases	**3,741**	19,137
Payment of obligations under long-term leases	**(7,109)**	(6,856)
Issue of long-term debt	**50,000**	—
Repayments of long-term debt	**(20,807)**	(3,426)
Issue of shares	**20,704**	3,423
Payments of dividends	**(2,953)**	(2,585)
Effect of foreign exchange rate changes on cash	**4,305**	(1,493)
Cash provided by financing activities	**47,881**	8,200
Cash provided by (used in) investment activities:		
Fixed asset acquisitions	**(9,892)**	(28,435)
Proceeds on disposal of assets	**1,171**	1,756
Cash used in investment activities	**(8,721)**	(26,679)
Cash provided by (used in) discontinued operations	**15,719**	(15,713)
Net increase (decrease) in cash during the year	**96,727**	(62,240)
Cash position, beginning of year	**(130,201)**	(67,961)
Cash position, end of year	**$ (33,474)**	$(130,201)

Cash position comprises current bank indebtedness, less cash on hand.

See accompanying notes.

Responsibility for Financial Reporting

The management of Consumers Distributing Company Limited is responsible to the Board of Directors for the preparation and integrity of the financial statements and related information of the Company. This responsibility includes the selection of appropriate accounting policies and, where necessary, management's best estimates and judgements, applied within the framework of generally accepted accounting principles.

Management has developed and maintains accounting systems and internal controls designed to provide reasonable assurance that assets are safeguarded from loss or unauthorized use and that the financial records are reliable for preparing the financial statements.

Ultimate responsibility for financial statements to shareholders rests with the Board of Directors. An Audit Committee of non-management directors is appointed by the Board to oversee the fulfillment by management of its responsibilities in the preparation of financial statements and financial control of operations. The Audit Committee reviews financial statements with management, and reports to the Board prior to the approval of the audited financial statements for publication.

These financial statements have been examined by Clarkson Gordon and Doane Raymond, independent auditors appointed by the shareholders, whose report also appears on this page.

Maurice Tousson
Executive Vice-President

C. L. Judson

Craig L. Judson
Vice-President, Finance

Auditors' Report

To the Shareholders of
Consumers Distributing Company Limited

We have examined the statement of financial position of Consumers Distributing Company Limited as at January 31, 1987 and the statements of earnings, retained earnings, and changes in financial position for the fifty-two weeks ended January 31, 1987. 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 January 31, 1987 and the results of its operations and the changes in its financial position for the fifty-two weeks then ended in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

The financial statements for the preceding year were examined by other chartered accountants.

Doane Raymond
Clarkson Gordon

Chartered Accountants
March 6, 1987
Toronto, Canada

Summary of Significant Accounting Policies

January 31, 1987

The financial statements have been prepared in accordance with generally accepted accounting principles in Canada, consistently applied, and conform in all material respects with International Accounting Standards with regard to the presentation of financial information at historical cost. They include the following policies:

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

Catalogue costs:
The cost of the Company's annual catalogue is charged to earnings over its one year life based upon seasonal sales patterns. Similarly, the costs of supplementary catalogues and promotional material are charged to earnings over the period during which they are in effect.

Fixed assets:
Equipment and leasehold improvements are recorded at cost. Depreciation and amortization are provided on a straight-line basis at rates which are designed to write off the assets over their estimated useful lives as follows:

Leasehold improvements	— Term of lease plus one renewal period, to a maximum of 10 years
Office, warehouse and showroom equipment	— 5% and 10%
Automotive equipment	— 10% and 20%
Assets under capital leases:	
Building	— 2½% or term of lease
Equipment	— 5%, 10% and 20%

Goodwill:
Goodwill is being amortized over 40 years.

Pre-opening costs:
Costs associated with the opening of new stores are expensed during the first full month of operations. The costs are carried as prepaid expenses prior to the store opening.

Lease obligations:
Leases transferring substantially all of the benefits and risks incident to ownership of property ("capital leases") are accounted for as the acquisition of assets financed by long-term liabilities. All other leases are accounted for as operating leases whereby rent payments are charged against earnings.

Foreign currency translation:
The financial statements of the U.S. business unit are translated into Canadian dollars as follows: assets and liabilities, at the year-end exchange rate; revenues and expenses, at the average exchange rate for the year. Foreign exchange gains or losses arising from translation are deferred and included in a separate component of shareholders' equity as foreign currency translation adjustment.

Notes to Financial Statements

January 31, 1987

1. Business rationalization:

(a) Discontinued operations:
At the close of the prior fiscal year, February 1, 1986, the Company decided to discontinue its West Coast operations in the United States. Accordingly, the Company made provision at that time for discontinuance expenses in the amount of $26,000,000 net of income tax recovery.

As at January 31, 1987, all stores included in discontinued operations have been closed and all inventory and fixed assets have been sold. As a result of this disposition, the proportionate foreign exchange gain of $2,341,000, accumulated as a separate component of shareholders' equity, has been brought into earnings as an extraordinary item net of income taxes of $1,171,000. Offsetting this gain, an additional provision for discontinuance expenses of $1,170,000 (net of income taxes) has been made, based on management's best estimate of costs yet to be incurred. Although a final adjustment of discontinuance expenses is not determinable at this time, management believes that no further provision will be required.

(b) Net assets of discontinued operations:
The net assets of the U.S. West Coast operations are carried at estimated realizable values.

(In Thousands of Dollars)	**January 31, 1987**	February 1, 1986
Assets:		
Inventory and fixed assets	**$ —**	$78,293
Liabilities:		
Accounts payable, including obligations under capital leases	**2,893**	46,587
Allowance for discontinuance expenses	**2,509**	27,428
	5,402	74,015
Net assets (liabilities) before income tax recovery	**(5,402)**	4,278
Add income tax recovery as a result of asset write-down and other discontinuance expenses	**24,000**	24,000
Net Assets	**18,598**	28,278
Less income tax recovery applied to income taxes otherwise payable	**3,529**	—
Less current portion of deferred income taxes	**7,500**	—
Net assets of discontinued operations	**$ 7,569**	$28,278

2. Fixed assets:

	Cost	Accumulated depreciation and amortization	Net **1987**	1986
Leasehold improvements	$ 38,590	$ 16,764	**$ 21,826**	$ 23,434
Office, warehouse and showroom equipment	37,290	21,197	**16,093**	15,109
Automotive equipment	3,409	2,889	**520**	504
Assets under capital leases	61,895	21,423	**40,472**	43,977
	$141,184	$ 62,273	**$ 78,911**	$ 83,024

3. Collateral assigned to banks:

A collateral floating charge on all the assets of the Company has been given to the bankers as security for current and long-term bank indebtedness.

4. Leases:

Future minimum lease payments for property and equipment under capital leases and long-term operating leases, are as follows:

	Capital leases	Operating leases
Fiscal year ending:		
1988	$ 11,726	$ 24,230
1989	10,424	23,105
1990	9,714	21,548
1991	8,981	20,575
1992	5,408	19,163
1993 and thereafter	20,684	88,800
Total minimum lease payments	66,937	197,421 (a)
Less imputed interest at an average rate of 11.8% per annum	22,661	
Present value of net minimum lease payments	44,276	
Less current portion	7,109	
Obligations under capital leases	$ 37,167	

(a) Aggregate rental expense under operating leases for property and equipment for the fifty-two weeks ended January 31, 1987 amounted to $30,511,000 (February 1, 1986 — $27,948,000).

The Company has guaranteed the payments of certain of its operating leases to a maximum of $7,500,000 by providing a second charge on all the assets of the Company.

5. Long-term debt:

	January 31, 1987	February 1, 1986
Bank revolving line of credit (a)	$50,000	—
Subordinated debentures (b)	—	$20,670
Other	294	415
	50,294	21,085
Less current portion (c)	137	121
	$50,157	$20,964

(a) The bank revolving line of credit is convertible in December 1988 into a three year term loan which calls for equal monthly payments on account of principal. Interest is related to the bank prime rate and security is as outlined in Note 3.

(b) During the year, all subordinated debentures outstanding at February 1, 1986 were converted into 1,377,990 Class A shares and 2,755,987 Class B shares of the Company. In relation to this conversion, previously deferred issue costs of $460,000 net of income tax were charged to retained earnings.

(c) The aggregate amounts of principal repayment of long-term debt are as follows:

Fiscal year ending:	
1988	$ 137
1989	1,546
1990	16,667
1991	16,667
1992	15,277
	$50,294

Notes
(Continued)

6. Capital stock:

Authorized:

10 Common shares (1 vote per share)
12,000,000 Class A shares (20 votes per share)
50,000,000 Class B shares (1 vote per share)

Stated capital:	Class A shares		Class B shares		Total
Balance, beginning of year	7,826,439	$17,169	15,904,748	$33,508	$50,677
Issued during the year:					
For cash — Employees' Stock Option Plan			250	1	1
For cash — Employees' Share Purchase Plan			5,871	32	32
Debenture conversion	1,377,990	6,881	2,755,987	13,789	20,670
Conversion of Class A shares into Class B shares	(366,276)	(2,490)	366,276	2,490	—
	8,838,153	$21,560	19,033,132	$49,820	71,380
10 Common shares					1
					$71,381

(a) Dividends:

Each Class B share has a preference of a non-cumulative dividend of one-quarter of one cent in each fiscal quarter year of the Corporation. In addition, each Class B share carries the right to receive not less than 115% of the cash dividend declared on each Class A and Common share in any fiscal year, to a limit of twenty cents per share.

(b) Convertibility:

Class A shares are convertible at any time, at the option of the holder, into Class B shares on a share-for-share basis.

Class B shares are convertible into Class A shares on a share-for-share basis solely for the purpose of accepting any tender offer or Stock Exchange Take-Over Bid for the Class A shares, under specified circumstances.

Stock options:

In connection with the Company's Employees' Stock Option Plan, 425,000 Class B shares have been reserved. At January 31, 1987 there were options outstanding to purchase 390,500 Class B shares over the next five years, exercisable at prices from $5.00 to $7.20.

Employees' share purchase plan:

All permanent full time salaried employees of the Company in Canada are eligible to participate in the Share Purchase Plan. Employees may contribute up to six per cent of their annual base salary through payroll deductions during the first ten months of each calendar year. Accumulated contributions are used to purchase Class B shares of the Company at their weighted average price on the Toronto Stock Exchange during the last 5 trading days of October, less 10 per cent.

7. Segmented information:

The Company operates in what is considered to be a single business, namely the sale of general merchandise through retail stores supported by the distribution of catalogues featuring such merchandise.

The Company operates in two distinct geographic regions:

1. Canadian segmented information relates to the 220 stores the Company operates throughout Canada.
2. United States segmented information relates to the 89 stores the Company operates in the States of Connecticut, Maryland, Massachusetts, New Hampshire, New Jersey, New York, and Pennsylvania.

Fifty-two weeks ended January 31, 1987	Canada	United States	Combined
Sales	$605,606	$327,776	$933,382
Operating profit	$ 28,322	$ 780	$ 29,102
Interest expense			13,031
General corporate expense			5,129
			18,160
Earnings before taxes			10,942
Income taxes			5,376
Net Earnings			$ 5,566
Total assets from continuing operations	$226,501	$138,845	$365,346
Net assets from discontinued operations			7,569
			$372,915

Fifty-two weeks ended February 1, 1986	Canada	United States	Combined
Sales	$565,085	$311,549	$876,634
Operating profit (loss)	$ 20,531	($ 2,006)	$ 18,525
Interest expense			15,158
General corporate expense			5,670
			20,828
Loss before tax recovery			(2,303)
Income taxes recoverable			4,316
Loss from discontinued operations			(5,630)
Provision for discontinuance expenses			(26,000)
Net loss			$(29,617)
Total assets from continuing operations	$224,171	$161,794	$385,965
Net assets from discontinued operations			28,278
			$414,243

8. Income tax expense:

The provision for income taxes in the statement of income reflects an effective tax rate which differs from the combined Canadian federal and provincial corporate tax rate of 50% (1986 — 48%) for the following reasons:

	Fifty-two weeks ended January 31, 1987	Fifty-two weeks ended February 1, 1986
Income tax expense (recovery) at the combined corporate tax rate	**$5,471**	$(1,105)
Add (deduct) effect of:		
3% inventory allowance	**(288)**	(3,399)
Other	**193**	188
Actual income tax expense (recovery)	**$5,376**	$(4,316)

9. Related party transactions:

The Company was charged fees of $564,000 for fiscal 1987 (nil in 1986) for services rendered by its principal shareholder, Provigo, Inc.

Amounts receivable include loans due from senior officers of $643,000 (February 1, 1986 — $657,000). These amounts are secured by mortgages and shares of the Company.

10. Comparative figures:

Certain of the 1986 figures have been reclassified to conform with the presentation adopted in 1987.

Consumers Distributing Company Limited Historical Review

(In Thousands of Dollars)	**52 Weeks January 31, 1987**	52 Weeks February 1, 1986	53 Weeks February 2, 1985	52 Weeks January 28, 1984	52 Weeks January 29 1983
CONTINUING OPERATIONS					
Sales					
Canada	**$605,606**	$565,085	$576,101	$529,255	$478,750
United States East Coast	**327,776**	311,549	261,032	203,718	154,289
	$933,382	$876,634	$837,133	$732,973	$633,039
Earnings before the undernoted	**$ 35,943**	$ 23,523	$ 45,473	$ 47,314	$ 40,266
Depreciation and amortization	**11,970**	10,668	8,260	6,287	5,484
Interest expense					
Bank	**6,741**	7,614	5,672	3,743	6,007
Long-term debt, including capital leases	**6,290**	7,544	7,006	6,619	3,931
Pre-tax earnings (loss)	**10,942**	(2,303)	24,535	30,665	24,844
Income tax expense (recovery)	**5,376**	(4,316)	8,416	12,650	11,224
Earnings from continuing operations	**5,566**	2,013	16,119	18,015	13,620
Earnings (loss) from discontinued operations	**—**	(5,630)	(2,844)	(4,370)	(699)
Earnings (loss) before extraordinary item	**5,566**	(3,617)	13,275	13,645	12,921
Extraordinary item	**—**	26,000	795	—	—
Net earnings (loss)	**$ 5,566**	($ 29,617)	$ 12,480	$ 13,645	$ 12,921
Financial Position					
Working Capital	**$118,193**	$ 45,858	$ 65,588	$ 71,638	$ 83,435
Total assets	**372,915**	414,243	393,745	324,364	259,576
Shareholders' equity	**121,493**	101,751	127,294	111,355	99,599
Changes in Financial Position					
Funds provided from continuing operations	**$ 17,456**	$ 11,609	$ 24,020	$ 27,031	$ 19,187
Capital expenditures	**9,892**	28,435	27,656	27,520	9,209
Dividends	**2,953**	2,585	2,530	2,359	1,613
Financial Ratios					
Current ratio	**1.7**	1.2	1.3	1.5	1.7
Return on average equity	**5.0%**	(3.2)%	11.1%	12.9%	13.8%
Debt:Equity	**51:49**	66:34	50:50	45:55	36:67
Number of stores					
Catalogue showrooms — Canada	**197**	198	197	194	193
— United States	**89**	89	87	69	53
Toy City	**23**	20	15	11	5
	309	307	299	274	251

Corporate Information

Directors

Robert Desprès (2)
Management Consultant
Quebec City, Quebec

Lloyd S.D. Fogler (2)
Barrister and Solicitor
Toronto, Ontario

Michael Haberman
Toronto, Ontario

Jean-Louis Lamontagne (1) (3)
Montreal, Quebec

Pierre Lortie (1)
Chairman, Chief Executive Officer
and President
Provigo, Inc.
Montreal, Quebec

George S. Mann
Chairman of the Board
Unicorp Canada Corporation
Toronto, Ontario

Jean-Claude Merizzi (1)
Executive Vice-President
Provigo, Inc.
Montreal, Quebec

Bertin F. Nadeau (1) (3)
Chairman of the Board,
President and Chief
Executive Officer
Unigesco Inc.
Montreal, Quebec

Kenneth W. Quinn (2)
President and
Chief Executive Officer
Horne & Pitfield Foods Ltd.
Edmonton, Alberta

Henri A. Roy (1) (3)
Chairman, Chief Executive
Officer and President
Consumers Distributing
Company Limited
Executive Vice-President
Provigo, Inc.
Montreal, Quebec

Joseph Segal
President,
Kingswood Capital Corp.
Vancouver, B.C.

David F. Sobey
Chairman of the Board &
Chief Executive Officer
Sobeys Stores Limited
New Glasgow, N.S.

Harry Solomon (3)
Chairman of the Board
Ronto Development Corp.
Toronto, Ontario

(1) Member of Executive Committee
(2) Member of Audit Committee
(3) Member of Human Resources Committee

Corporate Officers

Henri A. Roy
Chairman,
Chief Executive Officer
and President

Maurice Tousson
Executive Vice-President

Craig L. Judson
Vice-President, Finance

Reginald J. Robertson
Vice-President
Development

L.S.D. Fogler
Secretary

Canadian Catalogue Division Officers

Maurice Tousson
President

John Gray
Vice-President
Store Operations

Margaret Grimes
Vice-President
Merchandising

Maxwell Seymour
Vice-President, Financial
Planning and Control

U.S. Catalogue Division Officers

Gary McCabe
Senior Vice-President
Administration

Sanford Boroff
Vice-President
Advertising and Marketing

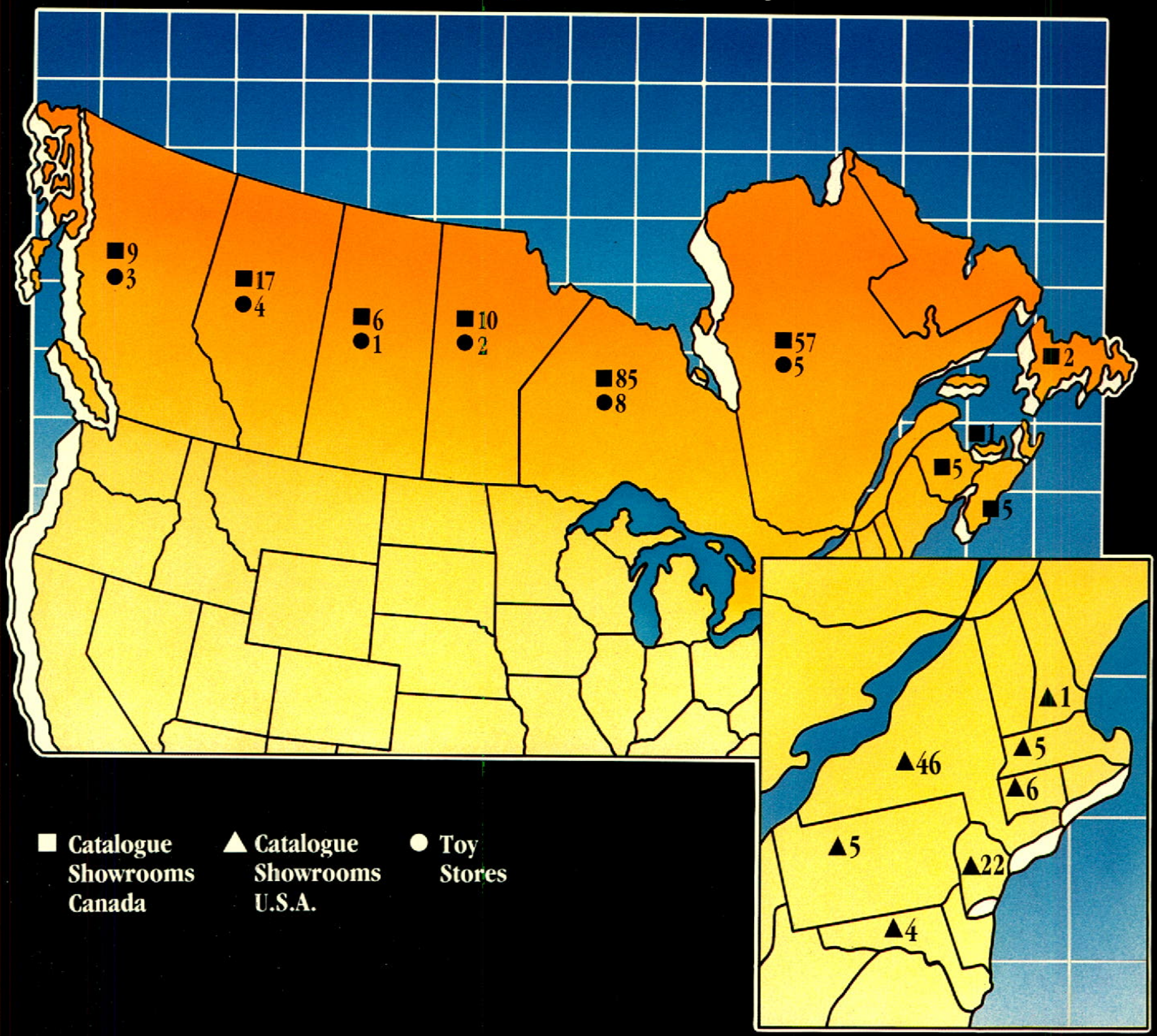
Douglas Newman
Vice-President
Operations

John Pflug
Vice-President
Merchandising

Toy City Division Officer

Fred Delsey
Vice-President and
General Manager

Consumers Distributing and Toy City Stores



Shareholders and Investors Information

Listed on
The Toronto Stock Exchange
The Montreal Exchange
Stock symbol: CDistb

Auditors
Clarkson Gordon
Toronto

Doane Raymond
Toronto

Principal Bankers
National Bank of Canada
Bank of Montreal
The Bank of Nova Scotia
The Harris Trust and
Savings Bank, Chicago

Tranfer Agent and Registrar
Guaranty Trust Company of Canada

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