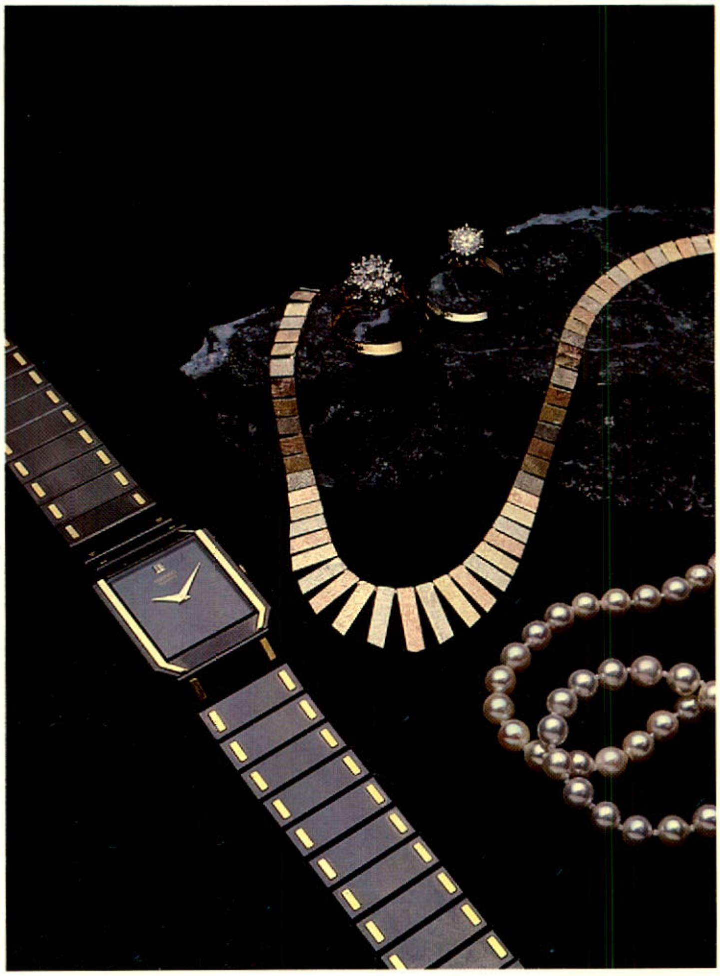
Consumers Distributing

Annual Report
1985



Consumers Distributing is a pioneer in catalogue showroom merchandising with a long record of growth and a leading position in many product lines. Its extensive range of quality merchandise includes jewellery, housewares, toys, home electronics and leisure goods. These products are available through more than 300 retail outlets. The patronage of millions of customers throughout North America is testimonial to the company's dedication to service, selection and value.

Cover photo

Over the last six years Consumers Distributing has renovated a large majority of its showrooms in order to better fulfill the needs and wants of our changing customer base. Most showrooms now have upscale jewellery departments with knowledgeable sales staff and custom-order merchandise programs. We are proud of our accomplishments in this area and are Canada's leading retailer of watches and a dominant force in jewellery. We fully expect to continue to improve our market share in this commodity in the years ahead.

Highlights

(Dollars in millions, except per share data)	*Fifty-two weeks ended February 1,* 1986	*Fifty-three weeks ended February 2,* 1985
Operations		
Sales	$ 876.6	$ 837.1
Income from continuing operations	2.0	16.1
Income (loss) before extraordinary item	(3.6)	13.3
Net income (loss)	(29.6)	12.5
Funds from operations	11.6	24.0
Capital expenditures	28.4	27.7
Per Class A or Class B Share		
Income (loss) before extraordinary item	$ (0.15)	$ 0.58
Net income	(1.26)	0.54
Book value	4.25	5.53
Market price range – Class A	7.75/5.25	7.88/5.13
– Class B	7.50/5.00	7.75/5.00
Financial Position		
Working capital	$ 45.0	$ 65.6
Total assets	422.0	393.7
Shareholders' equity	100.9	127.3
Stores		
Canada	218	212
United States East Coast	89	87

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Consumers Distributing is one of Canada's most successful retailers with a long record of growth and currently enjoys a leading position in many product lines. As a result of a number of aggressive decisions taken during the past year, the company is now poised for a positive future.

Results in fiscal 1986 were adversely affected by two key factors:

• United States West Coast operation — continuing failure to generate profits and deteriorating performance led to a decision to discontinue this division. Accordingly, in reporting for the past fiscal year, the results have been segmented into continuing and discontinued operations and prior years' results have been similarly restated. The Canadian division and the U.S. East Coast division comprise the continuing operations.

• Canadian distribution centre — a large volume of sales was lost in the important pre-Christmas period because of start-up problems with a new computer-controlled distribution system. Without this short-term problem, which has now been resolved, sales in Canada would have shown a significant increase.

Canadian Operations

Canadian sales of $565.1 million were 1.9 percent below the previous year's $576.1 million. During the critical fourth quarter, which had one less operating week this year, sales of the Canadian division amounted to $221.5 million compared to $232.8 million in the previous year. Net operating income of $4.2 million was substantially less than the $17.9 million earned last year.

As previously reported, Canadian results suffered from computer problems at our Mississauga distribution centre. Repeated attempts to iron out the bugs in the new system proved unsuccessful. As a result stores were not properly replenished during the third and fourth quarters. The computerized distribution centre is once again moving goods efficiently to our stores although still not using the full capacity of the system. Canadian operations will continue to benefit as improvements are made in the distribution centre.

United States Operations

Disappointing and deteriorating results coupled with a thorough evaluation of our United States operations led to a major decision to discontinue our West Coast operations, located primarily in California.

East Coast sales increased to $312 million from $261 million. The net operating loss was $2.2 million compared to $1.8 million in the previous year.

A provision of $26 million, net of future income tax recoveries, has been established for the estimated non-recurring expenses associated with the discontinuance of the division. Financo Inc., a subsidiary of Shearson Lehman Brothers, Inc., has been retained to assist the company in divesting itself of these assets.

The West Coast stores, now designated as discontinued operations, had a loss of $5.6 million in fiscal 1986, compared with a loss of $2.8 million in fiscal 1985. Given their performance in the past, management believes East Coast stores have the potential to generate profits. By rationalizing our U.S. operations, the stage has been set for greatly improved performance in the remaining outlets.

Results For Fiscal 1986

The company incurred a pre-tax loss from continuing operations of $2.3 million on sales of $876.6 million in fiscal 1986 compared to a pre-tax profit from those same operations in 1985 of $24.5 million on sales of $837.1 million. After income tax recoveries for fiscal 1986, continuing operations produced income of $2.0 million or nine cents per share compared to after-tax income of $16.1 million or 70 cents per share in the previous year.

Taking the loss from discontinued operations into account, the company incurred a net after-tax loss of $3.6 million or 15 cents per share, compared to an after-tax income of $13.3 million, or 58 cents per share, in the prior 53 week year.

In another important move, the company has changed its accounting policy regarding pre-opening costs of new stores. Such costs, previously deferred in the accounts and amortized over periods of up to three years, will now be charged against earnings in the first full month of operation. This change in accounting policy resulted in a net income increase, after-tax, of $1.1 million in the current year and a reduction in retained earnings of $2.2 million reflecting the adjustment of prior years' earnings.

In summary, the operating results, the change in accounting policy and the special provision for West Coast discontinuance resulted in the company reporting a net loss for the 1986 fiscal year of $29.6 million or $1.26 per share compared, on a similar basis, with a profit of $12.5 million or 54 cents per share in the previous year.

Provigo Acquires Voting Control

In July, 1985, Provigo Inc. of Montreal purchased all the shares of the company held by the family of Jack Stupp, founder of Consumers Distributing, for $7 per share.

Provigo is one of Canada's leading distributors of food and drug products with sales of $4.7 billion in the latest fiscal year.

Provigo acquired 2,793,697 class A shares, 787,394 Subordinate Voting class B shares and 10 common shares from the Stupp family. These shares represented 33.6 percent of the voting rights attached to all outstanding shares at that time. The purchase gave Provigo a 15.5 percent equity interest in the company. Since that date, Provigo has increased its equity interest to 21.7 percent, representing 46.1 percent of the votes.

Founding Chairman Resigns

On February 7, 1986, Jack Stupp, who had remained as Chairman and Chief Executive Officer of Consumers Distributing following sale of his family shares to Provigo Inc., announced his retirement.

Mr. Stupp, a pioneer in the catalogue showroom business, built Consumers Distributing from a basement store in Toronto in 1959 to 369 stores in Canada and the United States with annual sales of more than $1 billion. Consumers today is the only catalogue showroom retailing business left in Canada.

Board of Directors

As a result of the change in ownership, a new board of directors was elected at our last shareholders' meeting. New directors named to the board at that time were Pierre Lortie, Chairman and Chief Executive Officer of Provigo Inc., Jean-Claude Merizzi, Vice-President, Development and Expansion, Provigo Inc., David F. Sobey, Deputy Chairman and Chief Executive Officer of Sobeys Stores Limited, Jean-Louis Lamontagne, retired Provigo executive, H. Paul Gobeil, President, Provigo (Distribution) Inc., and Executive Vice-President, Provigo Inc., Kenneth W. Quinn, President and Chief Executive Officer, Horne & Pitfield Foods Limited and Jacques Desmeules, Vice-Chairman of Raymond, Chabot, Martin, Pare of Montreal. Subsequently, Mr. Gobeil resigned. This vacancy was filled by Henri Roy, Executive Vice-President of Provigo, Inc.

With these additions, the board is in a position to provide strong leadership as the company seeks to strengthen its performance.

Outlook

My personal business philosophy is that when the problems facing a corporation can be identified they can be remedied. Consumers Distributing has successfully met many challenges in attaining its pre-eminent position in retailing. I have no doubt the challenges we currently face will also be overcome because our management team is committed to generating substantially improved results in the years ahead. We anticipate improved overall results from the changes we have instituted in the past year in the United States. In Canada, a return to normal profitable results is expected.

The retailing environment is changing. Your company is constantly monitoring these changes and is well positioned, willing and able to move in whatever direction is necessary to better serve our millions of customers. Consumers Distributing will continue to provide, as it has in the past, service, selection quality and value.

Appreciation

One of the strengths of Consumers Distributing is our people. They have been tested during a year of change and difficulties and shown their true mettle. On behalf of the Board of Directors I would like to extend our appreciation for their hard work and dedication. Thanks are also due to our suppliers, who provide us with merchandise of quality and value. Last but not least, we thank our customers who through their continued patronage of our stores, have given us a reassuring vote of confidence.

Michael Haberman
President and Chief Operating Officer

Housewares, both electric and non-electric, are another major commodity group for us. The Company originally built its reputation on providing name brand appliances at every-day low prices. We have continued this tradition and are proud to acknowledge that well respected brand names such as Black & Decker, Braun, Philips/Norelco, Proctor Silex, Remington and Sunbeam have helped us achieve today's leading market share position.


BAKE
CUISSON
FOUR

Our Shareholders know how important toys are to our success in the retailing marketplace. In Canada, Consumers Distributing and Toy City, combined, are the largest retailer of toys. From a unit point of view, toys represent an even greater proportionate share of our traffic. In addition, toys totally complement our strategy of catering to young married families, who are our primary target market.

Our vast assortment of electronic products includes typewriters, calculators, cameras and home entertainment products. These commodities have grown in importance over the years and today represent our largest portion of sales revenues. Falling prices in these product lines, due to changes in technology, have helped put virtually all products within the reach of the mass market. Our young, better educated customer is very conversant with the capabilities of these products and is forever demanding the best, the latest and the most innovative.


Duylin AM Radio/Cassette
AUTO STOP
SONY
WALKMAN
WM-11
OLYMPUS
skyline
RELOC

Summary of Significant Accounting Policies

February 1, 1986

Basis of accounting
The financial statements have been prepared on the historical cost basis in accordance with generally accepted accounting principles in Canada, and also conform in all material respects with International Accounting Standards.

Inventory
Inventory is valued at the lower of cost and net realizable value, cost being determined 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, representing the excess of cost over assigned values of net assets acquired, is being amortized over 40 years.

Favourable leases
The cost of favourable leases is amortized over the average remaining term of those leases.

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.

Deferred financing costs
Deferred financing costs are amortized over the terms of the related financing agreement.

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. Obligations recorded under capital leases are reduced by rental payments net of imputed interest. All other leases are accounted for as operating leases whereby rent payments are charged against earnings.

Income taxes
The company follows the deferral method of income tax allocation. Deferred income taxes result from the recognition of revenue and expense in different periods for tax and financial statement purposes.

Foreign currency translation
The financial statements of the U.S. Division are translated using the "current rate" method. Under this method, assets and liabilities are translated into Canadian dollars at the rate of exchange at the fiscal year end. Revenues and expenses are translated at the weighted average exchange rates prevailing during the year.

Transactions of the Canadian Division, whose terms are denominated in foreign currency, are recorded in Canadian dollars at the exchange rates in effect at the date of the transaction. Monetary assets and liabilities arising from those transactions which are outstanding at the balance sheet date are adjusted to reflect the exchange rate in effect at the balance sheet date.

Exchange gains or losses arising from the translation of the financial statements of the U.S. Division are deferred and included as a separate component of shareholders' equity. Exchange gains or losses arising from the translation of current monetary assets and liabilities resulting from transactions of the Canadian Division are included in operations when applicable to current monetary items, and are deferred and amortized on a straight-line basis over the remaining life of the related monetary items when applicable to long-term items.

Statement of Income and Retained Earnings

Consumers Distributing Company Limited

(In Thousands of Dollars)	Notes	*Fifty-two weeks ended February 1,* 1986	*Fifty-three weeks ended February 2,* 1985
Sales		**$876,634**	$837,133
Costs and expenses			
Cost of sales and operating expenses		**853,111**	791,660
Interest expense, including interest on long-term debt and obligations under capital leases of $7,544,000 (1985 — $7,006,000)		**15,158**	12,678
Depreciation and amortization	10	**10,668**	8,260
		878,937	812,598
Income (loss) from continuing operations before income taxes		**(2,303)**	24,535
Income tax expense (recovery)	11	**(4,316)**	8,416
Income from continuing operations		**2,013**	16,119
Loss from discontinued operations	1	**5,630**	2,844
Income (loss) before extraordinary item		**(3,617)**	13,275
Provision for discontinuance expenses	1	**26,000**	—
Loss on debt guarantees of related company		**—**	795
Net income (loss)		**(29,617)**	12,480
Retained earnings, beginning of year, as restated	2	**74,683**	64,733
		45,066	77,213
Dividends		**2,585**	2,530
Retained earnings, end of year		**$ 42,481**	$ 74,683
Earnings (loss) per share	12		
From continuing operations		**$ .09**	$.70
From discontinued operations		**($ .24)**	($.12)
Before extraordinary item		**($ .15)**	$.58
Net		**($1.26)**	$.54

See accompanying notes.

Statement of Financial Position

Consumers Distributing Company Limited (Incorporated under the laws of Ontario)

(In Thousands of Dollars)	Notes	*February 1,* 1986	*February 2,* 1985
Current assets			
Cash		$ 473	$ 448
Amounts receivable		17,122	12,868
Income taxes recoverable		9,932	6,074
Inventory		256,312	239,412
Prepaid expenses, including catalogue costs		20,768	20,943
		304,607	279,745
Current liabilities			
Bank indebtedness	5	130,674	68,409
Accounts payable and accrued liabilities		115,696	131,474
Dividends payable		653	633
Current portion of obligations under capital leases		6,856	4,228
Current portion of long-term debt		121	3,748
Deferred income taxes		5,590	5,665
		259,590	214,157
Working capital		45,017	65,588
Net assets of discontinued operations	1	28,278	41,789
Fixed assets	3	83,024	66,849
Other assets	4	6,090	5,362
Total assets employed		$162,409	$179,588
Financed by:			
Obligations under capital leases	6	$ 40,535	$ 27,904
Long-term debt	7	20,964	24,390
Shareholders' equity			
Capital stock	8	50,678	47,255
Retained earnings		42,481	74,683
Foreign currency translation adjustment		7,751	5,356
		100,910	127,294
Total capital employed		$162,409	$179,588

See accompanying notes.

On behalf of the Board

Michael Haberman, Director

Henri A. Roy, Director

Statement of Changes in Financial Position

Consumers Distributing Company Limited

(In Thousands of Dollars)	*Fifty-two weeks ended February 1,* 1986	*Fifty-three weeks ended February 2,* 1985
Cash provided by (used in) operating activities:		
Income from continuing operations	$ 2,013	$ 16,119
Add (deduct) items not involving cash:		
Depreciation and amortization	10,668	8,260
Reduction in deferred income taxes	(2,676)	(474)
Loss on disposal of fixed assets	1,604	115
	11,609	24,020
Net changes in non-cash working capital balances related to operations	(39,657)	(26,769)
Cash used in operating activities	(28,048)	(2,749)
Cash provided by (used in) financing activities:		
Increase in obligations under capital leases	19,137	11,414
Payment of obligations under capital leases	(6,856)	(4,947)
Issue of shares	3,423	3,094
Repayments of long-term debt	(3,426)	(6,648)
Payments of dividends	(2,585)	(2,530)
Effect of foreign exchange rate changes on cash	(1,493)	783
Cash provided by financing activities	8,200	1,166
Cash provided by (used in) investment activities:		
Fixed asset acquisitions	(28,435)	(27,656)
Proceeds on disposal of assets	1,756	947
Cash used in investment activities	(26,679)	(28,603)
Cash used in discontinued operations	(15,713)	(5,844)
Net decrease in cash during the year	(62,240)	(36,030)
Cash position, beginning of year	(67,961)	(31,931)
Cash position, end of year	($130,201)	($ 67,961)

Cash position comprises bank indebtedness, less cash on hand.
See accompanying notes.

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 February 1, 1986 and the statements of income and retained earnings, and changes in financial position for the fifty-two weeks ended February 1, 1986. 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 February 1, 1986 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, after giving retroactive effect to the change in accounting for pre-opening costs of new stores as explained in Note 2 to the financial statements, on a basis consistent with that of the preceding year.

Toronto, Ontario
March 27, 1986

Laventhol & Horwath
Chartered Accountants.

(Tabular Figures in Thousands of Dollars)

1. Business rationalization

(a) Loss from discontinued operations

As a result of recurring losses, a decision has been taken to discontinue the West Coast operations of the company in the United States. These operations included 71 stores in the State of California, and 2 stores and a warehouse in Nevada. As at February 1, 1986, ten stores in California have closed. Management plans to discontinue the operations of the remaining 63 stores before August 31, 1986.

Losses incurred in the U.S. West Coast operations are summarized as follows

	Fifty-two weeks ended February 1, 1986	*Fifty-three weeks ended February 2,* 1985
Sales	$207,142	$189,521
Costs of sales and operating expenses	213,837	191,489
Interest expense	3,963	3,299
Depreciation and amortization	2,406	2,316
	220,206	197,104
Loss from operations	13,064	7,583
Income tax recovery	7,434	4,739
Loss from discontinued operations	$ 5,630	$ 2,844

(b) Provision for discontinuance expenses

The company has made provisions for estimated expenses in connection with the decision to discontinue U.S. West Coast operations as follows

Estimated expenses	$50,000
Less income tax recovery	24,000
Provision for discontinuance expenses	$26,000

Estimated expenses include, amongst other items, anticipated losses on disposal of inventory and fixed assets, operating losses during the discontinuance period, and other discontinuance expenses such as lease termination and severance.

This provision represents management's best estimate of the expenses to be incurred. However, due to complexities associated with such a discontinuance program, it is not possible to make a precise determination of the eventual total expenses, which may be more or less than the amount provided.

(c) Net assets of discontinued operations

The net assets of the U.S. West Coast operations, which are to be sold or discontinued, are carried at estimated realizable values. The 1985 figures are shown for comparative purposes only.

	February 1, 1986	February 2, 1985
Assets		
Inventory and fixed assets	$78,293	$97,711
Liabilities		
Accounts payable, including obligations under capital leases	46,587	55,922
Provision for 1987 operating loss and cash discontinuance expenses	27,428	—
	74,015	55,922
Net assets	4,278	41,789
Add income tax recovery as a result of asset write-downs and other discontinuance expenses	24,000	—
Net assets of discontinued operations	$28,278	$41,789

2. Statement changes

(a) Changes in presentation

The accompanying financial statements reflect the following changes in presentation:

- The company's decision to discontinue the West Coast operations in the United States (see Note 1) has resulted in these financial statements being prepared on a basis so as to distinguish between operating results from continuing and discontinued business segments. The comparative 1985 figures have been reclassified on a consistent basis.

- The company has reformatted the statement of financial position to highlight assets and capital employed.

- The statement of changes in financial position has been reformatted to emphasize cash flows resulting from operating, financing and investing activities.

- Certain of the 1985 figures have been reclassified to conform with the presentation adopted in 1986.

(b) Change in accounting policy

During the year, the company changed its accounting policy regarding pre-opening costs of new stores. Such costs, previously deferred in the accounts and amortized over periods of up to three years, are now charged against earnings in the first full month of operations.

(c) Income taxes of prior years

As a result of income tax reassessments applicable to fiscal years 1979 to 1983, the balance of retained earnings at the beginning of the current year has been adjusted for the cumulative increase in income taxes and interest.

The changes set out in (b) and (c) above, which have been applied retroactively, have resulted in the following revisions to retained earnings and net income:

	Fifty-two weeks ended February 1, 1986	Fifty-three weeks ended February 2, 1985
Retained earnings, beginning of year:		
As previously reported	$77,723	$68,152
Cumulative adjustment for store pre-opening costs, net of tax	(2,199)	(2,578)
Adjustment of prior years' income taxes	(841)	(841)
As restated	$74,683	$64,733
Net income increase:		
Adjustment for store pre-opening costs, net of tax	$ 1,144	$ 379

3. Fixed assets

	Cost	*Accumulated depreciation and amortization*	*Net* 1986	1985
Leasehold improvements	$ 36,070	$12,636	**$23,434**	$21,380
Office, warehouse and showroom equipment	32,302	17,193	**15,109**	15,733
Automotive equipment	2,705	2,201	**504**	710
Assets under capital leases	61,134	17,157	**43,977**	29,026
	$132,211	$ 49,187	**$83,024**	$66,849

4. Other assets

	Cost	*Accumulated amortization*	*Net* 1986	1985
Goodwill	$ 2,972	$ 594	**$ 2,378**	$ 2,452
Favourable leases	1,840	1,017	**823**	962
Deferred financing costs	1,125	236	**889**	964
Sundry	2,000	—	**2,000**	984
	$ 7,937	$ 1,847	**$ 6,090**	$ 5,362

5. Collateral assigned to bank

A collateral floating charge on all the assets of the company has been given to the bankers as security for $120,275,000 of the bank indebtedness.

6. Leases

Future minimum lease payments (exclusive of taxes, insurance, and certain other occupancy charges) for property and equipment under capital leases and long-term operating leases, are as follows:

	Capital leases	Operating leases
Fiscal year ending:		
1987	$13,598	$ 32,089
1988	12,762	31,798
1989	11,065	29,030
1990	9,898	26,323
1991	8,849	24,760
1992 and thereafter	23,532	121,351
Total minimum lease payments	79,704	$265,351(a)
Less imputed interest at an average rate of 11.6% per annum	28,092	
Present value of net minimum lease payments	$51,612	
Shown as:		
Obligations under capital leases	$40,535	
Current portion of obligations under capital leases	6,856	
Included in net assets of discontinued operations (Note 1)	4,221	
	$51,612	

(a) Of the total future minimum payments under operating leases, $60,036,000 relates to discontinued operations. The provision for discontinuance expenses includes an amount which, in the opinion of management, will be sufficient to settle these future obligations.

Aggregate rental expense under operating leases for property and equipment for the fifty-two weeks ended February 1, 1986 amounted to $36,438,000 of which $8,490,000 relates to discontinued operations.

The company has issued a Series B bond to indemnify the Oshawa Group Limited, an original guarantor under certain of its leases. The maximum amount for which the company could be held liable under this indemnification is $7,500,000. The Series B bond has been issued under a trust deed which includes a floating charge over all the assets of the company ranking second only to the security provided to the bankers.

7. Long-term debt

	February 1, 1986	*February 2,* 1985
Subordinated debentures (a)	**$20,670**	$23,975
First promissory unsecured note repayable in equal monthly payments without interest to February 1, 1989. This note has been recorded at a discounted value based on an imputed interest rate of 13%	**415**	521
Second promissory unsecured note bearing interest at 1% over the bank prime lending rate and maturing February 1, 1986	**—**	3,642
	21,085	28,138
Less current portion (b)	**121**	3,748
	$20,964	$24,390

(a) Pursuant to a Trust Indenture dated December 10, 1982, the company issued $27.5 million 11⅞% subordinated debentures with a maturity date of December 14, 1997. The debentures are redeemable at the company's option for a premium of 11⅞%, commencing December 15, 1985. The premium declines by 1% per year until par value is reached.

The debentures are convertible at any time up to the close of business on December 14, 1997 into one Class A share and two Class B shares at a combined rate of $15. The Trust Indenture contains anti-dilution provisions whereby the conversion price could be changed. The Trust Indenture further provides for mandatory sinking fund requirements commencing December 15, 1992 and contains restrictions against payment of dividends if interest payments on the debentures are in default.

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

Fiscal year ending:	
1987	$ 121
1988	137
1989	157
1990	—
1991	—
1992 and thereafter	20,670
	$21,085

8. Capital stock

Authorized:
10 Common shares
12,000,000 Class A shares
50,000,000 Class B subordinate voting shares

Stated capital:	Class A shares		Class B shares		Total
Balance, beginning of year	7,642,009	$16,371	15,384,536	$30,883	$47,254
Issued during the year:					
For cash — Employees Stock Option Plan	14,550	40	29,100	77	117
Debenture conversion	220,330	1,139	440,662	2,167	3,306
Conversion of Class A shares into Class B shares	(50,450)	(381)	50,450	381	—
	7,826,439	$17,169	15,904,748	$33,508	50,677
10 Common shares					1
					$50,678

(a) Voting rights
Class A shares:
20 votes for each share held.
Class B shares:
1 vote for each share held (same as common shares).

(b) Preferences
Class A shares:
the first five cents on liquidation, dissolution, or winding up of the corporation.
Class B shares:
a non-cumulative dividend of one-quarter of one cent in each fiscal quarter year of the corporation.

The Class B shares carry the right to receive not less than 115% of the amount of all cash dividends declared in any fiscal year on the Class A and the common shares, to a limit of twenty cents of dividends on the Class B shares. Dividends on all classes of shares are at the discretion of the directors.

(c) Convertibility
Class A shares:
convertible at any time, at the option of the holder, into Class B shares on a share-for-share basis.
Class B shares:
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, 1,025,000 Class B shares have been reserved. At February 1, 1986 there were options outstanding to purchase 672,000 Class B shares over the next five years, exercisable at prices from $5.00 to $6.88.

Subordinated debentures:
The company has reserved 1,378,000 Class A shares and 2,756,000 Class B shares for issuance upon conversion of the 11⅞% subordinated debentures.

9. 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 218 stores the company operated in Canada from Newfoundland to British Columbia.

2. United States segmented information relates to the 90 stores the company operated in the States of Connecticut, Maryland, Massachusetts, New Hampshire, New Jersey, New York, and Pennsylvania.

	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	$230,444	$163,277	$393,721
Net assets from discontinued operations			28,278
			$421,999

	Fifty-three weeks ended February 2, 1985		
	Canada	United States	Combined
Sales	$576,101	$261,032	$837,133
Operating profit (loss)	$ 42,533	($ 1,330)	$ 41,203
Interest expense			12,678
General corporate expense			3,990
			16,668
Income before taxes			24,535
Income taxes			(8,416)
Loss from discontinued operations			(2,844)
Loss on debt guarantee			(795)
Net income			$ 12,480
Total assets from continuing operations	$208,281	$143,675	$351,956
Net assets from discontinued operations			41,789
			$393,745

10. Depreciation and amortization

	Fifty-two weeks ended February 1, 1986	*Fifty-three weeks ended February 2,* 1985
Depreciation and amortization of fixed assets	$10,380	$7,977
Amortization of goodwill	74	74
Amortization of favourable leases	139	132
Amortization of deferred financing costs	75	77
	$10,668	$8,260

11. 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 48% (1985 — 50%) for the following reasons:

	Fifty-two weeks ended February 1, 1986	*Fifty-three weeks ended February 2,* 1985
Income tax expense (recovery) at the combined corporate tax rate	($ 7,376)	$8,287
Add (deduct) effect of:		
3% inventory allowance	(4,547)	(3,694)
Investment tax credit	—	(300)
Other	173	(616)
Actual income tax expense (recovery)	($11,750)	$3,677
Shown as:		
Income tax expense (recovery):		
Continuing operations	($ 4,316)	$8,416
Discontinued operations (Note 1)	(7,434)	(4,739)
	($11,750)	$3,677

The extraordinary item 'Provision for discontinuance expenses' as reported in the income statement is net of the related tax recovery of $24,000,000, (see Note 1).

12. Earnings per share

The earnings per share figures are calculated using the weighted monthly average number of shares outstanding during the respective fiscal years.

If all outstanding subordinated debentures and stock options were converted or exercised, the result would be anti-dilutive in the current year.

13. Dividend restrictions

The company is restricted from declaring or paying dividends under the terms of the trust deed securing the Series B bond if, after deduction of the dividend, the working capital is less than $10 million or the shareholders' equity is less than $20 million. See also Note 7(a).

14. Related party transactions

The company obtains legal services from the firm in which two directors of the company are partners. Payment for such services in the fifty-two weeks ended February 1, 1986 amounted to $147,000 (fifty-three weeks ended February 2, 1985 — $138,000).

Current assets include loans due from senior officers of $657,000 (February 2, 1985 — $480,000). These amounts are secured by mortgages and shares of the company.

(In Thousands of Dollars)	*52 Weeks February 1,* 1986	*52 Weeks February 2,* 1985	*52 Weeks January 28* 1984	*52 Weeks January 29* 1983	*52 Weeks January 30* 1982
Operations					
Sales					
Canada	**$565,085**	576,101	529,255	478,750	408,278
United States East Coast	**311,549**	261,032	203,718	154,289	121,323
	$876,634	837,133	732,973	633,039	529,601
Income before the undernoted	**$ 23,523**	45,473	47,314	40,266	23,901
Depreciation and amortization	**10,668**	8,260	6,287	5,484	5,103
Interest expense					
Bank	**7,614**	5,672	3,743	6,007	7,591
Long-term debt, including capital leases	**7,544**	7,006	6,619	3,931	3,758
Pre-tax operating income (loss)	**(2,303)**	24,535	30,665	24,844	7,449
Income taxes (recovery)	**(4,316)**	8,416	12,650	11,224	2,542
Income from continuing operations	**2,013**	16,119	18,015	13,620	4,907
Income (loss) from discontinued operations	**(5,630)**	(2,844)	(4,370)	(699)	12
Net operating income (loss)	**(3,617)**	13,275	13,645	12,921	4,919
Extraordinary item	**26,000**	795	—	—	—
Net income (loss)	**$(29,617)**	12,480	13,645	12,921	4,919
Financial Position					
Working capital	**$ 45,017**	65,588	71,638	83,435	50,841
Total assets	**421,999**	393,745	324,364	259,576	220,244
Shareholders' equity	**100,910**	127,294	111,355	99,599	87,243
Changes in Financial Position					
Funds provided from continuing operations	**$ 11,609**	24,020	27,031	19,187	9,956
Capital expenditures	**28,435**	27,656	27,520	9,209	5,592
Dividends	**2,585**	2,530	2,359	1,613	1,456
Financial Analysis					
Working capital ratio	**1.2**	1.3	1.5	1.7	1.5
Return on average equity — percent	**(3.2)**	11.1	12.9	13.8	5.8
Number of Stores					
Canada	**218**	212	205	198	200
United States East Coast	**89**	87	69	53	45
	307	299	274	251	245

Catalogue Showrooms (287)

307 Stores in North America (May 3, 1986)

Canada (198)

Alberta (18)
Calgary (7)
Edmonton (8)
Lethbridge
Medicine Hat
Red Deer

British Columbia (8)
Kamloops
Kelowna
Vancouver (6)
Victoria

Manitoba (10)
Brandon (1)
Winnipeg (9)

New Brunswick (5)
Bathurst
Fredericton
Moncton (2)
Saint John

Newfoundland (2)
St. John's (2)

Nova Scotia (5)
Bedford
Dartmouth
Halifax
New Glasgow
Sydney

Prince Edward Island (1)
Charlottetown

Quebec (58)
Montreal (32)
Charlesbourg (2)
Chateauguay
Chicoutimi
Drummondville
Gatineau
Granby
Hull
Jonquiere
Levis
Quebec City (5)
Rosemere
St-Bruno
St. Eustache
St. Hyacinthe
St. Jean
St. Jerome
Sept Iles
Shawinigan
Sherbrooke
Trois Rivieres
Valleyfield

Saskatchewan (6)
Regina (2)
Moose Jaw
Prince Albert
Saskatoon (2)

Ontario (85)
Toronto (19)
Barrie
Belleville
Bramalea
Brampton
Brantford
Brockville
Burlington (2)
Cambridge
Chatham
Cornwall
Georgetown
Guelph (2)
Hamilton (6)
Kingston
Kitchener
London (5)
Markham
Mississauga (3)
Newmarket
Niagara Falls
North Bay
Oakville
Orangeville
Orillia
Oshawa (2)
Ottawa (6)
Owen Sound
Peterborough
Pickering
Richmond Hill
St. Catharines (2)
St. Thomas
Sarnia
Sault Ste. Marie
Stratford
Sudbury (2)
Thunder Bay
Timmins
Waterloo
Welland
Whitby
Windsor (3)
Woodstock

United States (89)

Connecticut (5)
Hamden
Norwalk
Stamford
Torrington
Waterbury

Maryland (4)
Eastpoint
Glen Burnie
Hyattsville
Pikesville

Massachusetts (5)
Boston
Dedham
Medford
Natick
Peabody

New Hampshire (1)
Portsmouth

New Jersey (22)
Bricktown
Eatontown
Florham Park
Hazlet
Jersey City
Kearny
Kinnelon
Montclair
North Plainfield
Paramus
Ramsey
Roselle
South Orange
South Plainfield
Tenafly
Toms River
Totawa
Union
Wayne
West New York
Westwood
Woodbridge

New York (47)
Bronx (2)
Brooklyn (8)
Carle Place
Centereach
Central Islip
Clifton Park
Commack
Coram
East Meadow
Eastchester
Great Neck
Hicksville
Holbrook
Kingston
Kissena
Massapequa
Melville
Merrick
Middletown
New Hyde Park
Niskayuna
Oceanside
Pearl River
Pelham
Portchester
Poughkeepsie
Queens (6)
Shirley
Staten Island
Valley Stream
West Babylon
West Islip
White Plains
Yonkers

Pennsylvania (5)
Philadelphia (4)
Willow Grove

Toy Stores (20)

Canada (20)

Toy City (15)

Alberta (4)
Calgary (2)
Edmonton (2)

British Columbia (2)
Vancouver (2)

Manitoba (2)
Winnipeg (2)

Ontario (7)
Brampton
Hamilton
Toronto (3)
Mississauga
Ottawa

Toyville (5)

Quebec (5)
Montreal (4)
Quebec City

Corporate Directory

Directors

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Chairman of the Board
Managing Partner and
Vice Chairman of the
Board of Directors
Groupe Raymond, Chabot,
Martin, Pare & Cie

Richard Bain, Q.C.
Barrister and Solicitor
Toronto

L.S.D. Fogler, Q.C.
Barrister and Solicitor
Toronto

Michael Haberman
President and
Chief Operating Officer
Consumers Distributing
Company Limited
Toronto

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Director
Provigo, Inc.
Montreal

Pierre Lortie
Chairman of the Board
& Chief Executive
Officer and President
Provigo, Inc.
Montreal

Jean-Claude Merizzi
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President, Convenience
Group
President, Development
Group
Provigo, Inc.
Montreal

Kenneth W. Quinn
President and
Chief Executive
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Horne & Pitfield Foods
Limited
Edmonton

Henri Roy
Executive Vice-President
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President, Health and
Pharmaceutical Group
President, USA Group
Provigo, Inc.
Montreal

Robert I. Scolnick
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Chief Executive Officer
United Tire and Rubber
Company Limited
Toronto

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

Harry Solomon
Chairman of the Board
Ronto Development
Corporation
Toronto

Jack Stupp
Toronto

Corporate Officers

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Chief Operating
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Fred Delsey
Vice-President and
General Manager
Toy City

John Gray
Vice-President
Store Operations

Margaret Grimes
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Craig L. Judson, C.A.
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Controller

Gary McCabe
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