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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549**

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**FORM 10-Q**

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(Mark One)

☒ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d)  
OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended June 30, 2001

OR

☐ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d)  
OF THE SECURITIES EXCHANGE ACT OF 1934**

Commission File Number 1-4694

**R. R. DONNELLEY & SONS COMPANY**  
(Exact name of registrant as specified in its charter)

**Delaware**  
(State or other jurisdiction of  
incorporation or organization)

**36-1004130**  
(I.R.S. Employer  
Identification No.)

**77 West Wacker Drive,  
Chicago, Illinois**  
(Address of principal executive offices)

**60601**  
(Zip Code)

**Registrant's Telephone Number (312) 326-8000**

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to the filing requirements for the past 90 days.

Yes ☒

No ☐

**Number of shares of common stock outstanding  
as of July 31, 2001**

**116,038,823**

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**PART I**  
**FINANCIAL INFORMATION**

**Item 1. Financial Statements**

| <u>Index</u>   | <u>Page<br/>Number(s)</u> |
|--|---------------------------|
| Condensed Consolidated Statements of Income (Unaudited) for the<br>Three and Six Months Ended June 30, 2001 and 2000 . . . . . | 3                         |
| Condensed Consolidated Balance Sheets (Unaudited) as of June 30,<br>2001 and December 31, 2000 . . . . .                       | 4                         |
| Condensed Consolidated Statements of Cash Flows (Unaudited) for<br>the Six Months Ended June 30, 2001 and 2000 . . . . .       | 5                         |
| Notes to Condensed Consolidated Financial Statements<br>(Unaudited) . . . . .  | 6 - 12                    |
| <br><b>Item 2. Management's Discussion and Analysis of Financial Condition<br/>and Results of Operations</b>                   |                           |
| Company Overview . . . . .   | 13 - 16                   |
| Results of Operations—Second Quarter 2001 Compared with Second<br>Quarter 2000 . . . . .                                       | 16 - 19                   |
| Results of Operations—First Six Months of 2001 Compared with<br>First Six Months of 2000 . . . . .                             | 19 - 21                   |
| Changes in Financial Condition . . . . .   | 22 - 23                   |
| Other Information . . . . .  | 23 - 26                   |
| <br><b>Item 3. Quantitative and Qualitative Disclosures About Market Risk . . .</b>  | <br>26                    |

**PART II**  
**OTHER INFORMATION**

|   |           |
|---|-----------|
| <b>Item 1. Legal Proceedings . . . . .</b>                | <b>27</b> |
| <b>Item 5. Other Information . . . . .</b>                | <b>27</b> |
| <b>Item 6. Exhibits and Reports on Form 8-K . . . . .</b> | <b>27</b> |

**R.R. DONNELLEY & SONS COMPANY AND SUBSIDIARIES**

**CONDENSED CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)**

**(Thousands of dollars, except per-share data)**

|  | <b>Three Months Ended<br/>June 30</b> |                  | <b>Six Months Ended<br/>June 30</b> |                   |
|--|---------------------------------------|------------------|-------------------------------------|-------------------|
|  | <b>2001</b>                           | <b>2000</b>      | <b>2001</b>                         | <b>2000</b>       |
| Net sales .....                            | \$1,292,050                           | \$1,388,805      | \$2,594,700                         | \$2,731,775       |
| Cost of sales .....                        | 1,069,568                             | 1,121,085        | 2,172,845                           | 2,224,619         |
| Gross profit .....                         | 222,482                               | 267,720          | 421,855                             | 507,156           |
| Selling and administrative expenses .....  | 144,607                               | 155,073          | 282,388                             | 299,368           |
| Restructuring and impairment charges ..... | 52,333                                | —                | 74,075                              | —                 |
| Earnings from operations .....             | 25,542                                | 112,647          | 65,392                              | 207,788           |
| Other income (expense):                    |                                       |                  |                                     |                   |
| Interest expense .....                     | (18,676)                              | (24,960)         | (36,300)                            | (47,101)          |
| Other, net .....                           | 3,129                                 | 3,922            | 4,488                               | 6,859             |
| Earnings before income taxes .....         | 9,995                                 | 91,609           | 33,580                              | 167,546           |
| Provision for income taxes .....           | 3,848                                 | 35,269           | 12,928                              | 64,505            |
| Net income .....                           | <u>\$ 6,147</u>                       | <u>\$ 56,340</u> | <u>\$ 20,652</u>                    | <u>\$ 103,041</u> |
| Net income per share of common stock       |                                       |                  |                                     |                   |
| Basic .....                                | \$ 0.05                               | \$ 0.46          | \$ 0.17                             | \$ 0.84           |
| Diluted .....                              | 0.05                                  | 0.46             | 0.17                                | 0.84              |

See accompanying Notes to Condensed Consolidated Financial Statements.

# R.R. DONNELLEY & SONS COMPANY AND SUBSIDIARIES

## CONDENSED CONSOLIDATED BALANCE SHEETS (UNAUDITED)

**June 30, 2001 and December 31, 2000**  
**(Thousands of dollars, except share data)**

| <b>ASSETS</b>   |  | <b>2001</b>               | <b>2000</b>               |
|---|--|---------------------------|---------------------------|
| Cash and equivalents .....  |  | \$ 87,299                 | \$ 60,873                 |
| Receivables, less allowance for doubtful accounts of \$22,379<br>in 2001 and \$20,016 in 2000 .....                               |  | 716,098                   | 882,486                   |
| Inventories .....   |  | 172,886                   | 188,745                   |
| Prepaid expenses .....  |  | 105,011                   | 74,345                    |
| Total current assets .....  |  | <u>1,081,294</u>          | <u>1,206,449</u>          |
| Net property, plant and equipment, at cost, less accumulated depreciation of<br>\$2,916,254 in 2001 and \$3,040,871 in 2000 ..... |  | 1,525,523                 | 1,620,592                 |
| Goodwill and other intangibles, net of accumulated amortization<br>of \$285,162 in 2001 and \$266,014 in 2000 .....               |  | 495,584                   | 520,242                   |
| Other noncurrent assets .....   |  | <u>553,517</u>            | <u>566,919</u>            |
| Total assets .....  |  | <u><u>\$3,655,918</u></u> | <u><u>\$3,914,202</u></u> |
| <b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>   |  |                           |                           |
| Accounts payable .....  |  | \$ 277,322                | \$ 387,495                |
| Accrued compensation .....  |  | 158,661                   | 184,668                   |
| Short-term debt .....   |  | 370,986                   | 271,640                   |
| Current and deferred income taxes .....   |  | 16,279                    | 43,484                    |
| Other accrued liabilities .....   |  | <u>295,182</u>            | <u>303,274</u>            |
| Total current liabilities .....   |  | <u>1,118,430</u>          | <u>1,190,561</u>          |
| Long-term debt .....  |  | 740,307                   | 739,190                   |
| Deferred income taxes .....   |  | 234,085                   | 233,505                   |
| Other noncurrent liabilities .....  |  | <u>501,332</u>            | <u>518,398</u>            |
| Total noncurrent liabilities .....  |  | <u>1,475,724</u>          | <u>1,491,093</u>          |
| Shareholders' equity:   |  |                           |                           |
| Common stock at stated value (\$1.25 par value)   |  |                           |                           |
| Authorized shares: 500,000,000; Issued 140,889,050 in 2001 and 2000 ..  |  | 308,462                   | 308,462                   |
| Retained earnings .....   |  | 1,623,799                 | 1,666,936                 |
| Accumulated other comprehensive income .....  |  | (82,181)                  | (74,126)                  |
| Unearned compensation .....   |  | (4,750)                   | (6,752)                   |
| Reacquired common stock, at cost .....  |  | <u>(783,566)</u>          | <u>(661,972)</u>          |
| Total shareholders' equity .....  |  | <u>1,061,764</u>          | <u>1,232,548</u>          |
| Total liabilities and shareholders' equity .....  |  | <u><u>\$3,655,918</u></u> | <u><u>\$3,914,202</u></u> |

See accompanying Notes to Condensed Consolidated Financial Statements.

**R.R. DONNELLEY & SONS COMPANY AND SUBSIDIARIES**

**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)**

**For the Six Months Ended June 30  
(Thousands of dollars)**

|  | <u>2001</u>      | <u>2000</u>      |
|--|------------------|------------------|
| Cash flows provided by (used for) operating activities:                  |                  |                  |
| Net income . . . . .   | \$ 20,652        | \$ 103,041       |
| Restructuring and impairment charges . . . . .                           | 74,075           | —                |
| Depreciation . . . . .   | 162,278          | 161,660          |
| Amortization . . . . .   | 29,084           | 28,301           |
| Gain on sale of assets . . . . .   | (6,426)          | (6,045)          |
| Net change in operating working capital . . . . .                        | (29,174)         | (13,531)         |
| Net change in other assets and liabilities . . . . .                     | (37,166)         | 18,776           |
| Other . . . . .  | 7,197            | 5,791            |
| Net cash provided by operating activities . . . . .                      | <u>220,520</u>   | <u>297,993</u>   |
| Cash flows provided by (used for) investing activities:                  |                  |                  |
| Capital expenditures . . . . .   | (95,055)         | (122,535)        |
| Other investments including acquisitions, net of cash acquired . . . . . | (326)            | (211,529)        |
| Dispositions of assets including investments, net of tax . . . . .       | 7,349            | 22,289           |
| Net cash used for investing activities . . . . .                         | <u>(88,032)</u>  | <u>(311,775)</u> |
| Cash flows provided by (used for) financing activities:                  |                  |                  |
| Net increase in borrowings . . . . .                                     | 103,936          | 100,565          |
| Disposition of reacquired common stock . . . . .                         | 12,356           | 1,957            |
| Acquisition of common stock . . . . .                                    | (167,504)        | (21,878)         |
| Cash dividends paid . . . . .  | (54,639)         | (53,879)         |
| Net cash provided by (used for) financing activities . . . . .           | <u>(105,851)</u> | <u>26,765</u>    |
| Effect of exchange rate changes on cash and equivalents . . . . .        | (211)            | 1,407            |
| Net change in cash and equivalents . . . . .                             | 26,426           | 14,390           |
| Cash and equivalents at beginning of period . . . . .                    | 60,873           | 41,873           |
| Cash and equivalents at end of period . . . . .                          | <u>\$ 87,299</u> | <u>\$ 56,263</u> |

See accompanying Notes to Condensed Consolidated Financial Statements.

## R.R. DONNELLEY & SONS COMPANY AND SUBSIDIARIES

### NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

**NOTE 1.** The condensed consolidated financial statements included herein are unaudited (although the balance sheet at December 31, 2000 is condensed from the audited balance sheet at that date) and have been prepared by the company to conform with the requirements applicable to this quarterly report on Form 10-Q. Certain information and disclosures, normally included in financial statements prepared in accordance with generally accepted accounting principles, have been omitted as permitted by such requirements. However, the company believes that the disclosures made are adequate to make the information presented not misleading. These condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and the related notes included in the company's 2000 Annual Report on Form 10-K.

The condensed consolidated financial statements included herein reflect, in the opinion of the company, all adjustments (which include only normal, recurring adjustments) necessary to present fairly the financial information for such periods. Certain prior year amounts have been reclassified to maintain comparability with current year classifications.

**NOTE 2.** Components of the company's inventories at June 30, 2001, and December 31, 2000, were as follows:

| <u>Thousands of dollars</u>                    | <u>2001</u>      | <u>2000</u>      |
|--|------------------|------------------|
| Raw materials and manufacturing supplies ..... | \$108,613        | \$131,803        |
| Work in process .....                          | 155,417          | 144,927          |
| Finished goods .....                           | 1,361            | 2,069            |
| Progress billings .....                        | (38,901)         | (39,450)         |
| LIFO reserve .....                             | (53,604)         | (50,604)         |
| Total .....                                    | <u>\$172,886</u> | <u>\$188,745</u> |

**NOTE 3.** The following provides supplemental cash flow information:

| <u>Thousands of dollars</u> | <u>Six Months Ended<br/>June 30</u> |             |
|-----------------------------|-------------------------------------|-------------|
|                             | <u>2001</u>                         | <u>2000</u> |
| Interest paid .....         | \$ 36,606                           | \$ 46,786   |
| Income taxes paid .....     | \$ 67,568                           | \$ 25,704   |

**NOTE 4.** On November 25, 1996, a class action was brought against the company in federal district court in Chicago, Illinois, on behalf of current and former African-American employees, alleging that the company racially discriminated against them in violation of the Civil Rights Act of 1871, as amended, and the U.S. Constitution (*Jones, et al. v. R.R. Donnelley & Sons Co.*). The complaint seeks declaratory and injunctive relief, and asks for actual, compensatory, consequential and punitive damages in an amount not less than \$500 million. Although plaintiffs sought nationwide class certification, most of the specific factual assertions of the complaint relate to the closing by the company of its Chicago catalog operations in 1993. Other general claims relate to other company locations.

On June 30, 1998, a class action was filed against the company in federal district court in Chicago on behalf of current and former African-American employees, alleging that the company racially discriminated against them in violation of Title VII of the Civil Rights Act of 1964 (*Adams, et al. v. R.R. Donnelley & Sons Co.*). While making many of the same general discrimination claims contained in the *Jones* complaint, the *Adams* plaintiffs are also claiming retaliation by the company for the filing of discrimination charges or otherwise complaining of race discrimination. The complaint seeks the same relief and damages as sought in the *Jones* case.

## R.R. DONNELLEY & SONS COMPANY AND SUBSIDIARIES

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### NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)—(Continued)

On April 6, 2001, in an amended opinion, the district court judge in the *Jones* and *Adams* cases certified three plaintiff classes in the actions: a class consisting of African-American employees discharged in connection with the shutdown of the Chicago catalog operations; a class consisting of African-American employees of the Chicago catalog operations after November 1992 who were other than permanent employees; and a class consisting of African-Americans subjected to an allegedly hostile working environment at the Chicago catalog operations, the Chicago Financial, Pontiac or Dwight, Illinois, manufacturing operations. The judge also consolidated the *Jones* and *Adams* cases for pretrial purposes. On May 1, 2001, the federal court of appeals denied plaintiffs' application for leave to appeal the certification of classes. On July 27, 2001, the district court judge certified for appeal to the court of appeals the issue of the appropriate statute of limitations to apply to the first and third plaintiff classes.

On December 18, 1995, a class action was filed against the company in federal district court in Chicago alleging that older workers were discriminated against in selection for termination upon the closing of the Chicago catalog operations (*Gerlib, et al. v. R.R. Donnelley & Sons Co.*). The suit also alleges that the company violated the Employee Retirement Income Security Act (ERISA) in determining benefits payable to retiring or terminated employees. On August 14, 1997, the court certified classes in both the age discrimination and ERISA claims limited to former employees of the Chicago catalog operations.

On December 28, 2000, a purported class action was brought against the company and certain of its benefit plans in federal district court in Chicago on behalf of certain former employees of the Chicago catalog operations (*Jefferson, et al. v. R.R. Donnelley & Sons Co., et al.*). The suit alleges that enhanced pension benefits were not paid to plaintiffs and that plaintiffs are being required to contribute to the costs of retiree medical coverage, both in violation of plan documents and ERISA. The complaint seeks recalculation of pension benefits due plaintiffs since their retirement dates, reimbursement of any amounts paid by plaintiffs for medical coverage, interest on the foregoing amounts, as well as a declaration as to the benefits due plaintiffs in the future.

The *Jones*, *Gerlib* and *Jefferson* cases relate primarily to the circumstances surrounding the closing of the Chicago catalog operations. The company believes that it acted properly in the closing of the operations, and that certain claims of the classes of former employees of the Chicago catalog operations are untimely. On December 20, 2000, in the *Jones* case the company filed a renewed motion for partial summary judgment on the basis of timeliness, which is pending. Further, with regard to all cases, the company believes it has a number of valid defenses to all of the claims made and will vigorously defend its actions. However, management is unable to make a meaningful estimate of any loss that could result from an unfavorable outcome of any of the pending cases.

In December 1999, the U.S. Environmental Protection Agency, Region 5 (U.S. EPA) issued a Notice of Violation against the company, pursuant to Section 113 of the Clean Air Act (the Act). The notice alleges that the company's facility in Willard, Ohio, violated the Act and Ohio's State Implementation Plan in installing and operating certain equipment without appropriate air permits. While the notice does not specify the remedy sought, upon final determination of a violation, the U.S. EPA may issue an administrative order requiring the installation of air pollution control equipment, assess penalties, or commence civil or criminal action against the company. The company responded to U.S. EPA on March 10, 2000. The company believes that the resolution of this matter, even if unfavorable to the company, will not materially impact its financial position or results of operations.

In addition, the company is a party to certain litigation arising in the ordinary course of business which, in the opinion of management, will not have a material adverse effect on the operations or financial condition of the company.

## R.R. DONNELLEY & SONS COMPANY AND SUBSIDIARIES

### NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)—(Continued)

**NOTE 5.** Under Statement of Financial Accounting Standards (SFAS) No. 130, *Reporting Comprehensive Income*, the company reports changes in shareholders' equity that result from either recognized transactions or other economic events, excluding capital stock transactions, which affect shareholders' equity. For the company, the differences between net income and comprehensive income were as follows:

| <u>Thousands of dollars</u>                              | <u>Three Months Ended<br/>June 30</u> |                  | <u>Six Months Ended<br/>June 30</u> |                  |
|--|---------------------------------------|------------------|-------------------------------------|------------------|
|  | <u>2001</u>                           | <u>2000</u>      | <u>2001</u>                         | <u>2000</u>      |
| Net income .....   | \$6,147                               | \$ 56,340        | \$20,652                            | \$103,041        |
| Net gains (losses) on cash flow hedging activities ..... | 5                                     | —                | (1)                                 | —                |
| Unrealized foreign currency gain (loss) .....            | 720                                   | (10,829)         | (8,054)                             | (5,856)          |
| Comprehensive income .....                               | <u>\$6,872</u>                        | <u>\$ 45,511</u> | <u>\$12,597</u>                     | <u>\$ 97,185</u> |

**NOTE 6.** The company operates primarily in the commercial print portion of the printing industry, with related service offerings designed to offer customers complete solutions for communicating their messages to target audiences. Substantially all revenues within commercial printing result from the sale of printed products and services to customers in the following end-markets: Long-run Magazines, Catalogs and Inserts; Telecommunications; Book Publishing Services; Financial Services; Specialized Publishing Services; RRD Direct; Premedia; and International, which provides similar products and services outside the United States. The company's management has aggregated its commercial print businesses as one reportable segment because of strong similarities in the economic characteristics, nature of products and services, production processes, classes of customers and distribution methods used.

R.R. Donnelley Logistics (Donnelley Logistics) represents the company's logistics and distribution services operation for its print customers and other mailers. Donnelley Logistics serves its customers by consolidating and delivering printed products and packages to the U.S. Postal Service closer to the final destination, resulting in reduced postage costs and improved delivery performance. Following the company's acquisition of certain net assets of CTC Distribution Services L.L.C. (CTC) in February 2000, the combined operations of Donnelley Logistics and CTC have been included within the reportable segment "Logistics Services." Refer to Note 9 of the condensed consolidated financial statements for more details regarding the acquisition of CTC.

The company has disclosed earnings (loss) from operations as the primary measure of segment earnings (loss). This is the measure of profitability used by the company's chief operating decision-maker that is most consistent with the presentation of profitability reported within the consolidated financial statements. The accounting policies of the business segments reported are the same as those described in the "Summary of Significant Accounting Policies" footnote on page F-6 in the 2000 Annual Report on Form 10-K.

# R.R. DONNELLEY & SONS COMPANY AND SUBSIDIARIES

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)—(Continued)

### Industry Segment Information

| Thousands of dollars                       | Commercial<br>Print | Logistics<br>Services | Other (1) | Corporate | Consolidated<br>Total |
|--|---------------------|-----------------------|-----------|-----------|-----------------------|
| <b>Second Quarter Ended June 30, 2001</b>  |                     |                       |           |           |                       |
| Net sales .....                            | \$1,102,976         | \$186,118             | \$ 2,956  | \$ —      | \$1,292,050           |
| Restructuring and impairment charges ..... | 47,319              | 91                    | 1,334     | 3,589     | 52,333                |
| Earnings (loss) from operations .....      | 22,149              | (3,209)               | (7,885)   | 14,487    | 25,542                |
| Earnings (loss) before income taxes .....  | 27,547              | (3,222)               | (8,251)   | (6,079)   | 9,995                 |
| <b>Second Quarter Ended June 30, 2000</b>  |                     |                       |           |           |                       |
| Net sales .....                            | \$1,226,213         | \$157,524             | \$ 5,068  | \$ —      | \$1,388,805           |
| Restructuring and impairment charges ..... | —                   | —                     | —         | —         | —                     |
| Earnings (loss) from operations .....      | 111,816             | (467)                 | (8,938)   | 10,236    | 112,647               |
| Earnings (loss) before income taxes .....  | 114,981             | (500)                 | (9,998)   | (12,874)  | 91,609                |
| <b>Six Months Ended June 30, 2001</b>      |                     |                       |           |           |                       |
| Net sales .....                            | \$2,217,007         | \$372,336             | \$ 5,357  | \$ —      | \$2,594,700           |
| Restructuring and impairment charges ..... | 67,021              | 91                    | 1,334     | 5,629     | 74,075                |
| Earnings (loss) from operations .....      | 57,836              | (7,802)               | (15,151)  | 30,509    | 65,392                |
| Earnings (loss) before income taxes .....  | 68,279              | (7,832)               | (17,865)  | (9,002)   | 33,580                |
| Assets .....                               | 2,703,640           | 218,354               | 834       | 733,090   | 3,655,918             |
| <b>Six Months Ended June 30, 2000</b>      |                     |                       |           |           |                       |
| Net sales .....                            | \$2,414,888         | \$306,774             | \$ 10,113 | \$ —      | \$2,731,775           |
| Restructuring and impairment charges ..... | —                   | —                     | —         | —         | —                     |
| Earnings (loss) from operations .....      | 206,288             | (1,073)               | (12,755)  | 15,328    | 207,788               |
| Earnings (loss) before income taxes .....  | 211,338             | (1,149)               | (13,768)  | (28,875)  | 167,546               |
| Assets .....                               | 3,008,302           | 228,420               | 22,420    | 737,103   | 3,996,245             |

(1) Represents other operating segments of the company, including Red Rover Digital.

**NOTE 7.** The company has used corporate-owned life insurance (COLI) to fund employee benefits for several years. In 1996, the United States Health Care Reform Act was passed, eliminating the deduction for interest from loans borrowed against COLI programs. 1998 was the final year of the phase-out for deductions. In closing the Internal Revenue Service (IRS) audit of the company's 1990 to 1992 tax returns, the company paid during the first quarter of 2001 approximately \$62 million in taxes and interest for COLI interest deductions disallowed by the IRS. The company accrued for this payment as a current liability at December 31, 2000. The company may file a claim for refund of this payment and ultimately pursue litigation of this matter.

In three federal trial court decisions involving different corporate taxpayers, the courts disallowed deductions for loans against those taxpayers' COLI programs. Appeals from these decisions have been taken and in one, the appellate court upheld the tax court's ruling. While the company believes its COLI program differs from those involved in the earlier litigation, should the reasoning of these cases be upheld and applied to others, in addition to payments already made, the company could lose up to \$155 million in federal and state tax benefits for periods from 1993 through 1998 plus interest of approximately \$53 million after-tax through June 30, 2001.

The company will continue to examine its COLI position with respect to the final resolution of pending cases. The ultimate resolution of the company's COLI issues may have a material impact on the company's results of operations and financial condition.

## R.R. DONNELLEY & SONS COMPANY AND SUBSIDIARIES

### NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)—(Continued)

**NOTE 8.** The following summarizes share information as a basis for both the basic and diluted earnings per share computation in accordance with SFAS No. 128, *Earnings per Share*:

| In thousands                                 | Three Months<br>Ended June 30 |                | Six Months<br>Ended June 30 |                |
|--|-------------------------------|----------------|-----------------------------|----------------|
|  | 2001                          | 2000           | 2001                        | 2000           |
| Average shares outstanding—basic . . . . .   | 117,258                       | 121,907        | 118,466                     | 122,040        |
| Effect of dilutive securities . . . . .      | 1,871                         | 1,211          | 1,762                       | 980            |
| Average shares outstanding—diluted . . . . . | <u>119,129</u>                | <u>123,118</u> | <u>120,228</u>              | <u>123,020</u> |

**NOTE 9.** During February 2000, the company acquired certain net assets of CTC, one of the largest shippers of business-to-home packages in the United States, for approximately \$160 million, net of cash acquired. CTC, formerly headquartered in Minneapolis, Minnesota, has 21 facilities nationwide. The acquisition has been accounted for using the purchase method of accounting. The purchase price has been allocated based upon fair values at the date of the acquisition. Goodwill from this transaction of approximately \$153 million is being amortized over a 20-year period.

**NOTE 10.** The company has limited transactions that fall under the accounting rules of SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, as amended by SFAS No. 137 and SFAS No. 138. From time to time the company uses financial instruments, including forward exchange and option contracts, to manage exposure to movements in exchange rates. The company currently has one foreign currency fair value hedge. There are no outstanding cash flow hedges. During the three and six months ended June 30, 2001, the effects of derivative instruments as recorded in the accompanying financial statements were not material.

**NOTE 11.** The company regularly assesses its manufacturing platforms to assure that they are efficient, flexible and properly aligned with customer needs. During 2001, the company has approved various restructuring plans, which consist primarily of the consolidation of plant operations within the Commercial Print segment. In addition, in June 2001, the company announced a workforce reduction resulting in the elimination of approximately 250 general and administrative positions throughout the company.

First quarter 2001 restructuring plan:

The restructuring plan approved by management in the first quarter of 2001 (first quarter plan) resulted in a pretax charge of \$22 million (\$13 million after-tax, or \$0.11 per diluted share). This charge reduced earnings from operations in the Commercial Print segment by \$20 million and \$2 million within Corporate. As part of the first quarter plan, the company announced the closing of a directory-printing plant in St. Petersburg, Florida; a magazine-printing plant in South Daytona, Florida; and a financial-printing facility in Houston, Texas. In addition, the first quarter plan included workforce reductions at other facilities, primarily within Financial Services and Premedia. Simultaneously, in connection with the company's transition of directory-printing operations from a plant in York, England to a newly-constructed plant in Flaxby, England, the company incurred employee termination and relocation costs. The first quarter pre-tax charge consisted of the following:

- \$10 million of employee termination benefits, including severance and outplacement costs for planned personnel reductions. The actions approved under the first quarter plan were expected to result in the termination of 520 employees by June 30, 2001.

## **R. R. DONNELLEY & SONS COMPANY AND SUBSIDIARIES**

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### **NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)—(Continued)**

- \$2 million of exit costs which consist primarily of costs to maintain closed facilities until the estimated dates of sale.
- \$1 million of relocation costs incurred for employees to be transferred from closed facilities, as well as equipment transfers, both of which are being expensed on an as incurred basis.
- \$6 million for anticipated losses on the disposal of property and equipment in connection with the closing of facilities. This included the planned disposition of the two printing plants located in St. Petersburg, Florida and South Daytona, Florida; print production only was ceased at the Houston, Texas facility as the location remains open as a sales and service center. The asset impairment loss recognized was based on the difference between the estimated selling prices of the assets to be sold and the related carrying values. Selling prices were estimated based on third party appraisals for land and buildings and significant pieces of equipment, as well as the company's prior experience with comparable equipment disposals.
- \$2 million asset impairment charge to write down the carrying values of two Internet-related technology investments recorded using the cost method of accounting. Both investments related to entities that had experienced significant solvency issues during the first quarter of 2001, such that the company believed it was probable that the carrying values would not be recovered.

#### **Second quarter 2001 restructuring plan:**

During the second quarter of 2001, the company recognized a pretax restructuring charge of \$52 million (\$32 million after-tax, or \$0.27 per diluted share). This charge reduced earnings from operations in the company's business segments as follows: Commercial Print segment—\$47 million; Other—\$1 million (related to Red Rover) and Corporate—\$4 million. As part of the restructuring plan approved by management in the second quarter (the second quarter plan), the company announced the closing of a magazine-printing plant in Des Moines, Iowa and a catalog-printing plant in Old Saybrook, Connecticut, and plans to exit a leased Financial Services' sales and service center in Austin, Texas. In addition, the second quarter plan included workforce reductions and consolidations at other facilities, including a company-wide workforce reduction announced in June 2001 of approximately 250 general and administrative positions. The second quarter pretax charge consisted of the following:

- \$34 million of employee termination benefits, including severance, outplacement costs and early retirement benefit costs associated with planned personnel reductions. There were also adjustments of \$1 million as 30 employees who were originally anticipated to be terminated transferred to other company facilities. The actions approved under the second quarter plan will result in the termination of 1,690 employees by June 30, 2002.
- \$7 million of exit costs which consist of \$3 million of costs to maintain closed facilities until the estimated dates of sale, and \$4 million related to the termination of non-cancelable lease obligations and other contractual obligations.
- \$5 million of relocation costs incurred for employees to be transferred from closed facilities, as well as equipment transfers, both of which are being expensed on an as incurred basis. The majority of these costs relate to plant closures announced in the first quarter.
- \$7 million for anticipated losses on the disposal of property and equipment in connection with the closing of facilities. This included the planned disposition of the Des Moines, Iowa and Old Saybrook, Connecticut facilities. The asset impairment loss recognized was based on the difference between the estimated selling prices of the assets to be sold and the related

## R.R. DONNELLEY & SONS COMPANY AND SUBSIDIARIES

### NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)—(Continued)

carrying values. Selling prices were estimated based on third party appraisals for land and buildings and significant pieces of equipment, as well as the company's prior experience with comparable equipment disposals.

| Thousands of dollars                           | Employee<br>termination<br>benefits | Exit<br>costs | Relocation<br>costs | Asset<br>impairment<br>(non-cash) | Total     |
|--|-------------------------------------|---------------|---------------------|-----------------------------------|-----------|
| Restructuring and impairment charges . . . . . | \$10,242                            | \$2,299       | \$ 985              | \$ 8,216                          | \$ 21,742 |
| Cash payments . . . . .                        | (2,971)                             | —             | (985)               | —                                 | (3,956)   |
| Non-cash items . . . . .                       | —                                   | —             | —                   | (8,216)                           | (8,216)   |
| Reserve balance March 31, 2001 . . . . .       | \$ 7,271                            | \$2,299       | \$ —                | \$ —                              | \$ 9,570  |
| Restructuring and impairment charges . . . . . | 34,179                              | 6,914         | 4,619               | 7,446                             | 53,158    |
| Cash payments . . . . .                        | (9,616)                             | (515)         | (4,619)             | —                                 | (14,750)  |
| Non-cash items . . . . .                       | —                                   | —             | —                   | (7,446)                           | (7,446)   |
| Currency translation . . . . .                 | (19)                                | (10)          | —                   | —                                 | (29)      |
| Adjustments . . . . .                          | (724)                               | (101)         | —                   | —                                 | (825)     |
| Reserve balance June 30, 2001 . . . . .        | \$31,091                            | \$8,587       | \$ —                | \$ —                              | \$ 39,678 |

Status of the restructuring plans:

As of June 30, 2001, the company has ceased print production at its St. Petersburg, Florida, South Daytona, Florida and Houston, Texas plants, and all customer work has been transferred to existing company facilities. Of a total of 490 planned employee terminations related to the first quarter 2001 restructuring plan, all have been completed as of June 30, 2001. Both Florida printing facilities are being currently held for sale.

In connection with the second quarter 2001 restructuring plan, the company has begun to transition certain customers' work to other company facilities. Planned production will gradually be transferred to other company facilities once necessary expansions in those facilities to accommodate the transfer of work are complete. The company expects to complete the closures of the Des Moines, Iowa, and the Old Saybrook, Connecticut, plants by June 30, 2002. Additional charges related to the second quarter 2001 restructuring plan are expected to be approximately \$25 million, half of which are anticipated to be recognized by the end of 2001, and relate primarily to employee and equipment relocation. The workforce reduction of approximately 250 general and administrative personnel was completed by June 30, 2001. Of a total of 1,690 planned employee terminations related to the second quarter 2001 restructuring plan, 460 have been completed as of June 30, 2001.

The net book value of assets to be disposed as of June 30, 2001 was \$53 million. Annual depreciation on facilities held for disposal is approximately \$1 million.

**NOTE 12.** In July 2001, the Financial Accounting Standards Board issued SFAS No. 141, *Business Combinations*, and SFAS No. 142, *Goodwill and Other Intangible Assets*. SFAS No. 141 requires that all business combinations initiated after June 30, 2001 be accounted for by the purchase method of accounting. SFAS No. 142, which must be implemented in January 2002, will require that goodwill no longer be subject to amortization over its estimated useful life. Instead, goodwill must be assessed for impairment at least annually by applying a fair-value-based test. The company anticipates that future earnings will increase without amortization expense; however, the company must assess its existing goodwill for impairment under the new standard. In accordance with the transition provisions of the new standard, the company may record a change in accounting principle for any impairment of goodwill. For the second quarter and first six months of 2001, the company recognized goodwill amortization of \$4 million and \$9 million, respectively.

## Item 2

### Management's Discussion and Analysis of Financial Condition and Results of Operations

#### Company Overview

R.R. Donnelley & Sons Company (NYSE:DNY) provides comprehensive, integrated communications services that efficiently and effectively produce, manage and deliver our customers' content, regardless of the communications medium. While our superior print capabilities remain the foundation of the company, our recent focus on expanding our range of offerings with value-added services allows us to create additional value.

We provide solutions designed to enhance the effectiveness of our customers' communications. Our services include:

- *Content creation*—to provide creative design services to maximize the impact of communications and improve response rates. In addition to in-house capabilities, alliances with best-in-class providers complement our service offerings.
- *Digital asset management*—to help our customers leverage their content to reach end-users through multiple marketing channels. Through our premedia services, we digitally capture content, convert it to the appropriate format and channel it to multiple communications media, including print and the Internet.
- *Production*—to drive results for our customers cost-effectively through print or the Internet. Our manufacturing operations around the world offer a full range of capabilities and are networked to produce quickly large printing jobs with identical specifications. We also are able to version printed content to reach targeted audiences. Our Internet services include website production to extend our customers' brands to the Internet by delivering content and commerce online through our Red Rover Digital (Red Rover) subsidiary.
- *Distribution*—to deliver our customers' words and images efficiently and reliably through print or the Internet. R.R. Donnelley Logistics (Donnelley Logistics) delivers printed products and packages to the U.S. Postal Service (USPS), saving our customers significant time and money. Red Rover offers a full range of services to deliver value, maximize content effectiveness, enhance our clients' businesses and build their customer relationships via the Internet.

Our 137-year history as a printing industry leader positions us well for the future. The printing industry is projected to grow along with the communications industry. Print advertising is expected to remain among the most cost-effective ways for our customers to deliver their messages and generate revenue as they use words and images to inform, educate, entertain and sell to their audiences.

We are confident that print will remain integral to successful marketing given its unique capabilities, such as portability and high-quality graphics that cannot be duplicated by other communications methods. We also believe that the nature of print will evolve. The ability of print to be targeted, timely, flexible and integrated with other communications media will become more critical.

#### End-Market Descriptions

We operate primarily in the commercial print portion of the printing industry, with related service offerings designed to offer customers complete solutions for communicating their messages to targeted audiences. While our manufacturing plants, financial service centers and sales offices are located throughout the United States and selected international markets, the supporting technologies and

knowledge base are common. Our locations have a range of production capabilities to serve our customers and end-markets. We manufacture products with the operational goal of optimizing the efficiency of the common manufacturing and distribution platform. As a result, most plants produce work for customers in two or three of our end-markets.

The following describes the end-markets we serve:

*Long-run Magazines, Catalogs and Inserts* R.R. Donnelley is a leader in the North American magazine, catalog and advertising insert markets. These markets are characterized by demand for large, cost-effective print runs with excellent opportunity for differentiation among competitors through services such as premedia and Donnelley Logistics. Our U.S. customers include seven of the top 10 magazine titles, eight of the top 10 consumer catalog companies and seven of the top 10 retailers. Contracts typically span from three to five years.

*Telecommunications* R.R. Donnelley is the worldwide leader in the directory market. We serve the global directory needs of telecommunications providers, including three of the four U.S. Regional Bell Operating Companies, independent telephone companies such as Sprint, independent directory publishers such as McCleod and Yellow Book, and leading international telecommunications providers such as British Telecom, Dutch KPN and Shanghai Telephone.

Directory contracts typically span five to 10 years, with our current major contracts expiring between 2004 and 2009. Deregulation and substantial investment in the global telecommunications industry provide growth opportunities. In addition, growth opportunities arise as we work with directory publishers to introduce innovations such as targeted printed directories, website development for small businesses, content for online directories and solutions for the technology and government markets, and as we extend our capabilities worldwide.

*Book Publishing Services* R.R. Donnelley, the leader in the North American book market, serves the consumer, religious and educational book segments. We are a key supplier for all of the top 10 U.S. book publishers and we print more than 50% of *The New York Times*' adult best-seller titles. We also print one-third of all textbooks used in classrooms in the United States.

We are one of the leading converters of book publishers' content to electronic format for electronic books, or e-books, providing services for all major e-book formats. We have converted approximately 1,500 titles to date, including Stephen King's novella *Riding the Bullet*, which was distributed only online.

*Financial Services* R.R. Donnelley Financial, a leader in the U.S. and international financial services markets, supports the communications needs of corporations and their investment banks as they access the global capital markets. We also are a leading provider of customized communications solutions for investment management, banking, insurance, managed care and pharmaceutical companies.

Our global service network, manufacturing platform and distribution system give us unique advantages in servicing the capital markets, particularly for large financial deals. For example, the four largest transactions of the 1990s used R.R. Donnelley Financial to communicate their deals. Additionally, we are a leading provider of mutual fund compliance communications. To meet our clients' needs for accuracy, speed, confidentiality and convenience, we have developed technology for virtual deal management and Internet-enabled inventory management, are experts in EDGAR HTML filings and have integrated database management with content assembly, digital output and multiple-media delivery.

Our customized communications solutions provide an integrated suite of information management, content assembly and delivery solutions designed to give our clients closer and longer-lasting relationships with their customers. In markets that increasingly see demand for more precise communication with individuals, we believe customized communications solutions are and will continue to be a significant growth opportunity for the company.

*International* We have extended our core competencies for high quality print and related services into non-U.S. geographic markets with no pre-existing local solution. These markets tend to be emerging, with favorable demographic trends such as rising education levels and increasing disposable income. Our international operations in Poland, Mexico and South America, where we produce magazines, books and telephone directories, are reported as “International.” Financial Services’ international revenue is included in Financial Services. Directory revenues from China and England are included in Telecommunications.

*Specialized Publishing Services* R.R. Donnelley is a leader in providing short-run publishers, catalogers and associations with comprehensive communications solutions. We serve customers with highly targeted audiences and typical production runs from 10,000 to 200,000 copies. We offer full-service and cost-effective solutions for business-to-business and consumer magazine and catalog publishers, as well as journal, association and academic publishers.

*RRD Direct* R.R. Donnelley is a leader in the U.S. direct-mail market, offering expertise and a range of services to guide customers smoothly and cost-effectively through direct-marketing projects. Our full-service solutions include content creation, database management, premedia, printing, personalization, finishing and distribution. We produce highly personalized and sophisticated direct mail pieces that generate results for our customers.

*Premedia* In our premedia services, we leverage digital technologies to effectively create, manage and prepare customer content and distribute it via various communications media, including print and the Internet. We have developed technology that allows customers to securely access their digital content in an Internet-enabled database and repurpose it for multiple uses. These technologies include our ImageMerchant® ASP (Application Service Provider) service for merchandisers, AdSpring™ ASP and PubSpring™ services for magazine publishers, and Photo-Flow™ for photography customers.

*R.R. Donnelley Logistics* R.R. Donnelley is one of the largest users of the USPS, handling approximately 25% of the ground packages and 15% of the magazines delivered by the USPS. No other business partner of the USPS approaches our volume levels in these combined categories. Distribution costs are a significant component of our customers’ cost structures, and our ability to deliver mail and packages more predictably and cost-effectively is a key differentiator for us.

Our February 2000 acquisition of CTC Distribution Services L.L.C. (CTC) extended our services by adding package delivery to our established business of delivering printed material (freight services). By leveraging the USPS infrastructure to make the final delivery to households and businesses, we are able to provide more economical logistics services. Through “zone skipping” we are able to obtain greater postal discounts and provide more timely, reliable delivery for our customers. As we complete the integration of CTC and further develop our processes for zone skipping, we are able to bring together our scale, systems and expertise to create logistics services that are valuable to our customers.

In addition to delivering packages and printed material, we also provide returns management and expedited distribution of time-sensitive and secure material (expedited services). Together, these services help merchandisers and other businesses manage their supply chains more effectively and at a lower cost.

*Red Rover Digital* This subsidiary (included in the operating segment “Other”) can meet our customers’ Internet needs using a range of services including a full suite of scalable communications and e-commerce solutions. Red Rover implements solutions that deliver value, maximize content effectiveness, enhance our clients’ businesses and build their customer relationships. Services such as strategy, design, editorial, development and production populate sites with content, and provide the end-to-end solutions necessary for businesses to survive on the Internet today. Our partnerships and investments in this arena strengthen our online services offering, expand our solutions and help our customers leverage the power of the Internet to communicate with their audiences.

## **Results of Operations**

### **Consolidated Results—Second Quarter 2001 Compared with Second Quarter 2000**

Consolidated net sales decreased \$97 million, or 7.0%, to \$1,292 million compared with \$1,389 million in the second quarter of 2000, driven by the decline in net sales of the Commercial Print segment of 10.1%. Second quarter net sales for the Logistics Services segment increased 18.2% between years, driven by increased sales from package logistics.

For our Commercial Print segment, value-added revenue represents net sales less the cost of materials. For some customers, we purchase paper used in the printing process and pass through this cost (referred to as “pass through material sales”) at a margin that is lower than print and related services; other customers furnish their own paper. Customer-furnished paper is not reflected in our financial results. For our Logistics Services segment, value-added revenue represents net sales less the cost of transportation. By measuring value-added revenue, we eliminate the effects of material prices and transportation costs that are largely beyond our control.

Consolidated value-added revenue decreased \$74 million, or 9.0%, to \$748 million compared with \$822 million in the second quarter of 2000. Second quarter value-added revenue within the Commercial Print segment decreased 9.9% between years. Value-added revenue is affected by the price of scrap (by-product) paper we sell. Income from the sale of by-products is recorded as a reduction in our cost of materials. During the second quarter of 2001, we recognized a reduction in our cost of materials of \$9 million from the sale of by-products, compared with \$17 million for the year ago period.

Gross profit as a percentage of net sales was 17.2% in the second quarter of 2001 compared with 19.3% a year ago, primarily due to lower margins within the Commercial Print segment. Commercial Print’s gross profit margin was affected negatively in 2001 by lower volumes across most of the segment, primarily within Financial Services and Long-run Magazines, Catalogs and Inserts. Our Logistics Services segment, which has a lower gross profit margin than our Commercial Print segment, also represented a higher proportion of second quarter net sales in 2001 (14.4% versus 11.3% in 2000).

Selling and administrative expenses decreased \$10 million, or 6.7%, to \$145 million in the second quarter of 2001, due to cost reduction initiatives. Selling and administrative expenses as a percentage of net sales for the second quarter was consistent between years at 11.2%. In June 2001, we announced the elimination of approximately 250 administrative positions during the second quarter of 2001 from across the company (see Note 11 to the condensed consolidated financial statements). Pretax savings from this action are expected to be \$10 million for the second half of 2001.

Excluding restructuring and impairment charges (discussed in Note 11 to the condensed consolidated financial statements), earnings from operations decreased \$35 million, or 30.9%, to \$78 million in the second quarter of 2001. Lower earnings from operations were driven principally by the decline in net sales and lower gross profit margins within the Commercial Print segment. Including restructuring and impairment charges, earnings from operations decreased 77.3% versus the second quarter of 2000.

Net interest expense decreased 25.2% to \$19 million in the second quarter of 2001 due to lower debt levels, lower interest rates on commercial paper and the benefit for having refinanced \$200 million of matured long-term bonds in December 2000 with commercial paper at lower rates. Other income, net, decreased \$1 million between years primarily due to lower earnings from unconsolidated investments (\$3 million), partially offset by additional miscellaneous income (\$2 million).

Excluding restructuring and impairment charges (discussed in Note 11 to the condensed consolidated financial statements), net income of \$38 million in the second quarter of 2001 decreased \$18 million, or 32.0%, from the second quarter of 2000, while diluted earnings per share decreased 30.4% to \$0.32. Including restructuring and impairment charges, both second quarter net income and earnings per diluted share decreased 89.1% between years. The effective tax rate for the second quarter in both years was 38.5%.

The following table shows the trends in net sales and value-added revenue by end-market:

### Second Quarter Ended June 30

| Thousands of dollars              | Net Sales          |                    |                | Value-Added Revenue |                  |               |
|-----------------------------------|--------------------|--------------------|----------------|---------------------|------------------|---------------|
|                                   | 2001               | 2000               | % Change       | 2001                | 2000             | % Change      |
| Long-run Magazines,               |                    |                    |                |                     |                  |               |
| Catalogs and Inserts . . . .      | \$ 362,160         | \$ 423,722         | (14.5%)        | \$ 229,807          | \$ 265,769       | (13.5%)       |
| Book Publishing Services . .      | 179,061            | 195,523            | (8.4%)         | 126,575             | 132,281          | (4.3%)        |
| Financial Services . . . . .      | 173,562            | 204,301            | (15.0%)        | 144,443             | 173,665          | (16.8%)       |
| Telecommunications . . . . .      | 192,464            | 192,598            | (0.1%)         | 90,140              | 91,228           | (1.2%)        |
| International (1) . . . . .       | 72,279             | 74,948             | (3.6%)         | 33,856              | 33,223           | 1.9%          |
| Specialized Publishing            |                    |                    |                |                     |                  |               |
| Services . . . . .                | 59,293             | 65,474             | (9.4%)         | 37,306              | 40,250           | (7.3%)        |
| RRD Direct . . . . .              | 40,113             | 43,809             | (8.4%)         | 21,238              | 23,769           | (10.7%)       |
| Premedia . . . . .                | 24,044             | 25,838             | (6.9%)         | 24,043              | 25,263           | (4.8%)        |
| <b>Commercial Print . . . . .</b> | <b>\$1,102,976</b> | <b>\$1,226,213</b> | <b>(10.1%)</b> | <b>\$707,408</b>    | <b>\$785,448</b> | <b>(9.9%)</b> |
| Logistics Services . . . . .      | 186,118            | 157,524            | 18.2%          | 38,817              | 32,491           | 19.5%         |
| Other (2) . . . . .               | 2,956              | 5,068              | (41.7%)        | 1,702               | 4,238            | (59.8%)       |
| <b>Total . . . . .</b>            | <b>\$1,292,050</b> | <b>\$1,388,805</b> | <b>(7.0%)</b>  | <b>\$747,927</b>    | <b>\$822,177</b> | <b>(9.0%)</b> |

(1) Includes South America, Poland and Mexico.

(2) Includes Red Rover, Louisville Distribution (sold in June 2000) and Other.

### Operating Results by Business Segment—Second Quarter 2001 Compared with Second Quarter 2000

As discussed more fully in Note 6 to the condensed consolidated financial statements, we have two reportable segments: Commercial Print and Logistics Services. Following our acquisition of CTC in February 2000, we report results from our logistics businesses segment within Logistics Services.

Net sales of our Commercial Print segment decreased \$123 million in the second quarter of 2001, or 10.1%, from a year ago. Second quarter net sales for Long-run Magazines, Catalogs and Inserts decreased 14.5% between years, which reflected volume decreases across all major markets. The continued U.S. economic slowdown during the second quarter of 2001 resulted in volume decreases between years driven by lower magazine and retail insert advertising spending, as well as lower catalog page counts. Retail bankruptcies since late in 2000 hurt the second quarter of 2001 on a year over year basis. Paper prices for major grades of paper employed within Long-run Magazines, Catalogs and Inserts declined 2.3% from a year ago.

Book Publishing Services' second quarter net sales decreased 8.4% between years primarily due to volume shortfalls within the consumer market and less favorable price/mix within the religious market, partially offset by the strength of the education market. Book publishers continue to work through excess inventories from 2000 and have reduced their orders for reprints. Net sales of Telecommunications were flat between years as timing shifts of directories to the second half of 2001 were offset by more non-directory work. Financial Services' second quarter 2001 net sales decreased 15.0% from their record second quarter net sales in 2000, driven by the slowdown in both the U.S. and international capital markets. During the second quarter of 2001, we derived 13.5% of our capital markets net sales from international, compared with 22.8% in 2000. For the second quarter, U.S. capital markets volume was down 12.2% between years; international capital markets volume was down 53.4%. Within Financial Services, second quarter net sales from customized communications solutions increased 6.5% between years.

Second quarter net sales of our Logistics Services segment increased \$29 million, or 18.2%, from a year ago. Second quarter net sales of our package logistics business were up 25.3% between years driven by higher unit volume and price increases. Package logistics unit volume was up 16% for the second quarter between years. Within print logistics, freight services unit volume for the second quarter was down 14% between years, partially offset by price increases and fuel surcharges. Lower expedited services volume as a result of the slowed capital markets was more than offset during the second quarter of 2001 by delivery services provided for banks as well as international mail.

Second quarter value-added revenue for the Commercial Print segment decreased \$78 million, or 9.9% from a year ago, primarily due to volume declines in Long-run Magazines, Catalogs and Inserts, as well as Financial Services. Second quarter value-added revenue for the Logistics Services segment increased \$6 million, or 19.5%, from a year ago. Package logistics contributed an incremental \$3 million in value-added revenue between years, driven by higher prices, higher unit volume and increased penetration of the postal system (delivery closer to the final destination, which reduces postage costs), partially offset by higher transportation costs. Second quarter value-added revenue for print logistics was up \$3 million, or 17.2%, based primarily on higher prices for freight services despite increased transportation costs.

Excluding restructuring and impairment charges (discussed in Note 11 to the condensed consolidated financial statements), second quarter earnings from operations for the Commercial Print segment decreased \$42 million, or 37.9%, between years. The majority of the decline was due to lower volumes within our traditional print businesses (long-run and book) and Financial Services. Most of our print-related businesses were also impacted negatively in the second quarter of 2001 by higher energy and healthcare costs, and lower by-products revenues.

The second quarter loss from operations for the Logistics Services segment was \$3 million, compared with a loss of \$0.5 million a year ago. The second quarter loss from operations from package logistics was \$1.5 million unfavorable to the prior year second quarter. The second quarter of 2001 reflected both a higher volume of packages and deeper penetration of the postal system (closer to final destination) for package logistics. Higher initial warehousing and transportation costs associated with this increased level of postal penetration achieved more than offset the volume-related gains. The second quarter loss from print logistics was \$1.2 million higher than the year ago period primarily due to consolidation center expansion costs, and increased selling and administrative expenses.

The second quarter loss from operations within the "Other" operating segment includes losses of \$8 million in both years to grow complementary businesses, including Red Rover. Second quarter 2000 also includes an additional loss of \$1 million related to a distribution center that was sold during the quarter.

A summary analysis of expense trends is presented below:

## Second Quarter Ended June 30

| Thousands of dollars                           | 2001    | % of Sales | 2000    | % of Sales | % Change |
|--|---------|------------|---------|------------|----------|
| Cost of materials . . . . .                    | 396,822 | 30.7%      | 441,596 | 31.8%      | (10.1%)  |
| Cost of transportation . . . . .               | 147,301 | 11.4%      | 125,032 | 9.0%       | 17.8%    |
| Cost of manufacturing . . . . .                | 444,087 | 34.4%      | 472,481 | 34.0%      | (6.0%)   |
| Depreciation . . . . .                         | 80,576  | 6.2%       | 81,151  | 5.8%       | (0.7%)   |
| Amortization . . . . .                         | 12,874  | 1.0%       | 13,923  | 1.0%       | (7.5%)   |
| Selling and administrative expenses . . . . .  | 132,515 | 10.3%      | 141,975 | 10.2%      | (6.7%)   |
| Restructuring and impairment charges . . . . . | 52,333  | 4.1%       | —       | 0.0%       | N/A      |
| Net interest expense . . . . .                 | 18,676  | 1.4%       | 24,960  | 1.8%       | (25.2%)  |

## Consolidated Results—First Six Months of 2001 Compared with First Six Months of 2000

Consolidated net sales decreased \$137 million, or 5.0%, to \$2,595 million compared with \$2,732 million in the first half of 2000. Acquisitions contributed an increase of \$77 million in net sales for the first half between years, offset by lower organic sales within both the Commercial Print and Logistics Services segments.

Consolidated value-added revenue decreased \$103 million, or 6.6%, to \$1,476 million compared with \$1,580 million in the first half of 2000. Acquisitions contributed an increase of \$23 million in value-added revenue between years. Value-added revenue is affected by the price of scrap (by-product) paper we sell. Income from the sale of by-products is recorded as a reduction in our cost of materials. During the first half of 2001, we recognized a reduction in our cost of materials of \$22 million from the sale of by-products, compared with \$33 million for the year ago period.

Gross profit as a percentage of net sales was 16.3% in the first half of 2001 compared with 18.6% in the first half of 2000, primarily due to lower margins within the Commercial Print segment. Commercial Print's gross profit margin was affected negatively in the first half of 2001 by lower volumes across most of the segment, primarily within Financial Services and Long-run Magazines, Catalogs and Inserts. Our Logistics Services segment, which has a lower gross profit margin than our Commercial Print segment, also represented a higher proportion of first half net sales in 2001 (14.3% versus 11.2% in 2000).

Selling and administrative expenses decreased \$17 million, or 5.7%, to \$282 million in the first half of 2001, due to cost reduction initiatives. Selling and administrative expenses as a percentage of net sales for the first half was 10.9% in 2001 compared with 11.0% for the year ago period.

Excluding restructuring and impairment charges (discussed in Note 11 to the condensed consolidated financial statements), earnings from operations decreased \$68 million, or 32.9%, to \$139 million in the first half of 2001. Lower earnings from operations were driven principally by the decline in net sales and lower gross profit margins within the Commercial Print segment. Including restructuring and impairment charges, earnings from operations decreased 68.5% versus the first half of 2000.

Net interest expense decreased 22.9% to \$36 million in the first half of 2001 due to lower debt levels, lower interest rates on commercial paper, and the benefit for having refinanced \$200 million of matured long-term bonds in December 2000 with commercial paper at lower rates. Other income, net, decreased \$2 million between years primarily due to non-recurring gains on the sale of assets in 2000 (\$5 million) and lower earnings from unconsolidated investments (\$2 million), partially offset by additional miscellaneous income (\$5 million).

Excluding restructuring and impairment charges (discussed in Note 11 to the condensed consolidated financial statements), net income of \$66 million in the first half of 2001 decreased \$37 million, or 35.7%, from the first half of 2000, while diluted earnings per share decreased 34.5% to \$0.55. Including restructuring and impairment charges, first half net income and earnings per diluted share decreased 80.0% and 79.8%, respectively, between years. The effective tax rate for the first half in both years was 38.5%.

The following table shows the trends in net sales and value-added revenue by end-market:

#### Six Months Ended June 30

| Thousands of dollars                          | Net Sales          |                    |               | Value-Added Revenue |                    |               |
|---|--------------------|--------------------|---------------|---------------------|--------------------|---------------|
|   | 2001               | 2000               | % Change      | 2001                | 2000               | % Change      |
| Long-run Magazines,<br>Catalogs and Inserts . | \$ 804,763         | \$ 874,730         | (8.0%)        | \$ 505,519          | \$ 544,324         | (7.1%)        |
| Book Publishing                               |                    |                    |               |                     |                    |               |
| Services . . . . .                            | 342,714            | 377,555            | (9.2%)        | 244,162             | 257,914            | (5.3%)        |
| Financial Services . . . . .                  | 274,401            | 337,611            | (18.7%)       | 228,597             | 278,288            | (17.9%)       |
| Telecommunications . . . . .                  | 382,958            | 399,921            | (4.2%)        | 174,564             | 187,492            | (6.9%)        |
| International (1) . . . . .                   | 149,878            | 157,041            | (4.6%)        | 69,684              | 69,092             | 0.9%          |
| Specialized Publishing                        |                    |                    |               |                     |                    |               |
| Services . . . . .                            | 124,251            | 128,461            | (3.3%)        | 76,261              | 77,459             | (1.5%)        |
| RRD Direct . . . . .                          | 86,247             | 91,970             | (6.2%)        | 46,719              | 49,857             | (6.3%)        |
| Premedia . . . . .                            | 51,794             | 47,599             | 8.8%          | 51,793              | 46,786             | 10.7%         |
| <b>Commercial Print . . . .</b>               | <b>\$2,217,006</b> | <b>\$2,414,888</b> | <b>(8.2%)</b> | <b>\$1,397,299</b>  | <b>\$1,511,211</b> | <b>(7.5%)</b> |
| Logistics Services . . . . .                  | 372,336            | 306,775            | 21.4%         | 75,771              | 59,664             | 27.0%         |
| Other (2) . . . . .                           | 5,358              | 10,112             | (47.0%)       | 3,139               | 8,809              | (64.4%)       |
| <b>Total . . . . .</b>                        | <b>\$2,594,700</b> | <b>\$2,731,775</b> | <b>(5.0%)</b> | <b>\$1,476,209</b>  | <b>\$1,579,685</b> | <b>(6.6%)</b> |

(1) Includes South America, Poland and Mexico.

(2) Includes Red Rover, Louisville Distribution (sold in June 2000) and Other.

#### Operating Results by Business Segment—First Six Months of 2001 Compared with First Six Months of 2000

Net sales of our Commercial Print segment decreased \$198 million in the first half of 2001, or 8.2%, from a year ago. First half net sales for Long-run Magazines, Catalogs and Inserts decreased 8.0% between years, which reflected volume decreases across all major markets. Increased retail bankruptcies, as well as lower magazine and retail insert advertising spending, and lower catalog page counts drove the majority of volume declines. The impact on net sales from the economic slowdown was more severe in the second quarter of 2001. Paper prices for major grades of paper employed during the first half within Long-run Magazines, Catalogs and Inserts increased 1.2% from a year ago.

Book Publishing Services' first half net sales decreased 9.2% between years primarily due to volume shortfalls within the consumer market. Net sales of Telecommunications were down 4.2% between years due to timing shifts of directories to the second half. Financial Services' first half net sales decreased 18.7% between years, driven by the slowdown in both U.S. and international capital markets. During the first half of 2001, we derived 14.0% of our capital markets net sales from international, compared with 23.6% in 2000. For the first half, U.S. capital markets volume was down 20.1% between years; international capital markets volume was down 57.7%. Within Financial Services, first half net sales from customized communications solutions increased 11.7% between years. First half net sales of RRD Direct were down 6.2% between years, as work performed in 2000 for the U.S. census was only partially offset by improved price/work mix in 2001.

First half net sales of our Logistics Services segment increased \$66 million, or 21.4%, from a year ago. CTC (package logistics) was acquired in February 2000 and contributed an increase of \$68 million in net sales between years. First half net sales of our package logistics business were up 44.8% between years driven by an additional five weeks of activity in 2001, higher volume and higher prices. First half net sales of our print logistics business decreased \$2 million, or 1.2%, between years. Within print logistics, freight services unit volume for the first half was down 10% between years, partially offset by price increases and fuel surcharges. Lower expedited services volume as a result of the slowed capital markets was more than offset in the first half of 2001 by delivery services provided for banks as well as international mail.

First half value-added revenue for the Commercial Print segment decreased \$114 million, or 7.5% from a year ago, primarily due to volume declines in Long-run Magazines, Catalogs and Inserts, as well as Financial Services. First half value-added revenue for the Logistics Services segment increased \$16 million, or 27.0%, from a year ago. CTC (package logistics) contributed an increase of \$15 million in value-added revenue between years. This increase was driven by an additional five weeks of activity in 2001, higher prices, higher unit volume and increased penetration of the postal system (delivery closer to the final destination), despite higher transportation costs. First half value-added revenue for print logistics was up \$1 million, or 4.6%.

Excluding restructuring and impairment charges (discussed in Note 11 to the condensed consolidated financial statements), first half earnings from operations for the Commercial Print segment decreased \$81 million, or 39.5%, between years. The majority of the decline was due to lower volumes within our traditional print businesses (long-run and book) and Financial Services. Most of our print-related businesses were also negatively impacted in the first half of 2001 by higher energy and healthcare costs, and lower by-products revenues.

First half loss from operations for the Logistics Services segment was \$8 million, compared with a loss of \$1 million a year ago. The first half loss from operations for package logistics was flat compared with the year ago period. The first half of 2001 reflected both a higher volume of packages and deeper penetration of the postal system (closer to final destination, which reduces postage costs), offset by higher transportation, processing and administrative costs. The first half loss from operations for print logistics was \$7 million unfavorable to the year ago period primarily due to higher transportation costs related to prior consolidation center start-up problems from the fourth quarter of 2000, facility expansion costs and increased selling and administrative expenses.

First half loss from operations within the "Other" operating segment includes losses of \$15 million and \$11 million in 2001 and 2000, respectively, to grow complementary businesses, including Red Rover. First half 2000 also includes an additional loss of \$2 million related to a distribution center that was sold during the second quarter of 2000.

A summary analysis of expense trends is presented below:

#### **Six Months Ended June 30**

| <b>Thousands of dollars</b>                    | <b>2001</b> | <b>% of Sales</b> | <b>2000</b> | <b>% of Sales</b> | <b>% Change</b> |
|--|-------------|-------------------|-------------|-------------------|-----------------|
| Cost of materials . . . . .                    | 821,926     | 31.7%             | 904,980     | 33.1%             | (9.2%)          |
| Cost of transportation . . . . .               | 296,565     | 11.4%             | 247,110     | 9.0%              | 20.0%           |
| Cost of manufacturing . . . . .                | 890,301     | 34.3%             | 909,987     | 33.3%             | (2.2%)          |
| Depreciation . . . . .                         | 162,278     | 6.3%              | 161,660     | 5.9%              | 0.4%            |
| Amortization . . . . .                         | 29,084      | 1.1%              | 28,301      | 1.0%              | 2.8%            |
| Selling and administrative expenses . . . . .  | 255,142     | 9.8%              | 271,903     | 10.0%             | (6.2%)          |
| Restructuring and impairment charges . . . . . | 74,075      | 2.9%              | —           | 0.0%              | 0.0%            |
| Net interest expense . . . . .                 | 36,300      | 1.4%              | 47,101      | 1.7%              | (22.9%)         |

## **Changes in Financial Condition**

### **Cash Provided by Operating Activities**

Cash provided by operating activities totaled \$225 million in 2001, compared with \$298 million in 2000. The decrease was primarily due to the 2001 COLI tax payment of \$62 million as a result of the settlement of a federal income tax audit for the years 1990 through 1992.

Our cash conversion cycle (days' sales outstanding plus days' inventory on hand minus days' payable outstanding) was consistent year over year at 48 days. The ratio of operating working capital to sales has continued to improve to 6.1% in 2001 from 6.5% in 2000.

### **Cash Used for Investing Activities**

Our principal recurring investing activities are capital expenditures to improve the productivity of operations. In the first six months of 2001, capital expenditures totaled \$95 million, a \$27 million decrease from a year ago. We expect full year capital spending to be between \$300 million and \$350 million in 2001, compared with capital spending of \$237 million in 2000. This higher planned level of investment in 2001 is driven by our intent to create a more efficient print platform to serve our magazine, catalog and advertising insert customers. As discussed in the first quarter of 2001, over the next two years, we expect to invest up to \$300 million in this print platform, a third of which relates to restructuring activities, to create fewer, larger and more efficient facilities focused on very specific capabilities.

### **Acquisitions**

In 2000, we made acquisitions and investments to extend our geographic reach and expand our range of capabilities. We have had no acquisitions to date in 2001.

Acquisitions completed during 2000 included:

- Omega Studios-Southwest, Inc. (January 2000)—This dedicated photography studio expanded our premedia offerings in digital photography and creative services, and extended our geographic reach to the Southwest.
- Iridio, Inc. (February 2000)—This full-service premedia company, which provides digital photography, prepress, digital asset management and digital print services, brought us a significant presence in the Pacific Northwest.
- Evaco, Inc. (February 2000)—This financial printer based in Florida expanded our Financial Services operations in the Southeast, one of our fastest-growing geographic regions.
- CTC (February 2000)—This mailer of business-to-home packages in the United States more than doubled the revenue of our Logistics Services segment, enhanced our scale and expanded our service offerings to include the delivery of packages in addition to printed products.
- Circulo do Livro (July 2000)—This Brazilian book printer expanded our capabilities to serve the book publishing market and, together with expansion of our Hamburg Gráfica Editora division, made us the largest book printer in South America.
- Interactive Dataflow Technology, Inc. (December 2000)—This application service provider based in Lanham, Maryland, provides the federal government with secure, customized Internet-based solutions that can help automate print procurement processes.

## **Cash Provided by Financing Activities**

Financing activities include net borrowings, dividend payments and share repurchases. Our net borrowings increased by \$3 million year over year.

Commercial Paper is our primary source of short-term financing. On June 30, 2001, we had \$297 million outstanding in commercial paper borrowings. In addition, at June 30, 2001, we had a \$438 million unused revolving credit facility with a number of banks. This facility provides support for issuing commercial paper and other credit needs. Management believes our cash flow and borrowing capability are sufficient to fund operations.

## **Share Repurchase**

We purchased 1.9 million shares of our stock in the second quarter of 2001 for \$53 million in privately negotiated or open-market transactions. For the year to date, we have purchased 5.1 million and 0.9 million shares of our stock in 2001 and 2000, respectively, for \$141 million and \$21 million, respectively.

In January 2001, the board of directors authorized a share repurchase program for up to \$300 million of the company's common stock in privately negotiated or open-market transactions. Since February 1, under this program we have purchased approximately 4.1 million shares at an aggregate cost of approximately \$113 million through June 30, 2001. We expect to complete this program by the end of 2001.

Net cash used to repurchase common stock for the year, defined as cash used for share repurchases net of proceeds from stock options exercised, was \$155 million and \$20 million in 2001 and 2000, respectively.

## **Other Information**

### **Technology**

We remain a technology leader and have held 265 patents in print-related technology since 1953, of which 180 have been issued since 1980. We are a leader in technologies such as computer-to-plate, customer connectivity and digital imaging capabilities, as well as Internet-based services. In addition, we are a pioneer in managing digitized images and text, and hold more than 25 issued and pending patents for these emerging technologies. For more than 23 years, we have been first with every significant technological advancement in the printing industry.

Public recognition from *eWeek* and *Information Week* for our technology efforts in 2000 include the following rankings among all U.S. companies:

- #3 of the most innovative media and entertainment company users of information technology (*Information Week*, September 11, 2000);
- #82 of the top 500 leading IT innovators (*Information Week*, September 11, 2000); and
- #19 of the top 100 innovators in e-business networking (*eWeek*, May 8, 2000).

## **Litigation and Contingent Liabilities**

In 1996, a class action was brought against us in federal district court in Chicago, Illinois, on behalf of all current and former African-American employees, alleging that we racially discriminated against them in violation of the Civil Rights Act of 1871, as amended, and the U.S. Constitution (*Jones, et al.*

*v. R.R. Donnelley & Sons Co.*). The complaint seeks declaratory and injunctive relief, and asks for actual, compensatory, consequential and punitive damages in an amount not less than \$500 million. Although plaintiffs sought nationwide class certification, most of the specific factual assertions of the complaint relate to the closing of our Chicago catalog operations in 1993. Other general claims relate to other company locations.

In 1998, a class action was filed against us in federal district court in Chicago on behalf of current and former African-American employees, alleging that the company racially discriminated against them in violation of Title VII of the Civil Rights Act of 1964 (*Adams, et al. v. R.R. Donnelley & Sons Co.*). While making many of the same general discrimination claims contained in the 1996 case, the plaintiffs in this case also claim retaliation by the company for the filing of discrimination charges or otherwise complaining of race discrimination. The complaint seeks the same relief and damages as sought in the 1996 case.

On April 6, 2001 in an amended opinion, the district court judge in the *Jones* and *Adams* cases certified three plaintiff classes in the actions: a class consisting of African-American employees discharged in connection with the shutdown of the Chicago catalog operations; a class consisting of African-American employees of the Chicago catalog operations after November 1992 who were other than permanent employees; and a class consisting of African-Americans subjected to an allegedly hostile working environment at the Chicago catalog operations, the Chicago Financial, Pontiac or Dwight, Illinois, manufacturing operations. The judge also consolidated the *Jones* and *Adams* cases for pretrial purposes. On May 1, 2001, the federal court of appeals denied plaintiff's application for leave to appeal the certification of classes. On July 27, 2001, the district court judge certified for appeal to the court of appeals the issue of the appropriate statute of limitations to apply to the first and third plaintiff classes.

In 1995, a class action was filed against us in federal district court in Chicago alleging that older workers were discriminated against in selection for termination upon the closing of the Chicago catalog operations (*Gerlib, et al. v. R.R. Donnelley & Sons Co.*). The suit also alleges that we violated the Employee Retirement Income Security Act (ERISA) in determining benefits payable to retiring or terminated employees. In August 1997, the court certified classes in both the age discrimination and ERISA claims limited to former employees of the Chicago catalog operations.

On December 28, 2000, a purported class action was brought against the company and certain of its benefit plans in federal district court in Chicago on behalf of certain former employees of the Chicago catalog operations (*Jefferson, et al. v. R.R. Donnelley & Sons Co., et al.*). The suit alleges that enhanced pension benefits were not paid to plaintiffs and that plaintiffs are being required to contribute to the costs of retiree medical coverage, both in violation of plan documents and ERISA. The complaint seeks recalculation of pension benefits due plaintiffs since their retirement dates, reimbursement of any amounts paid by plaintiffs for medical coverage, interest on the foregoing amounts, as well as a declaration as to the benefits due plaintiffs in the future.

The *Jones*, *Gerlib* and *Jefferson* cases relate primarily to the circumstances surrounding the closing of the Chicago catalog operations. The company believes that it acted properly in the closing of the operations, and that certain claims of the classes of former employees of the Chicago catalog operations are untimely. On December 20, 2000, in the *Jones* case the company filed a renewed motion for partial summary judgment on the basis of timeliness, which is pending. Further, with regard to all cases, the company believes it has a number of valid defenses to all of the claims made and will vigorously defend its actions. However, management is unable to make a meaningful estimate of any loss that could result from an unfavorable outcome of any of the pending cases.

In December 1999, the U.S. Environmental Protection Agency, Region 5 (U.S. EPA) issued a Notice of Violation against us, pursuant to section 113 of the Clean Air Act (the Act). The notice

alleges that our facility in Willard, Ohio, violated the Act and Ohio's State Implementation Plan in installing and operating certain equipment without appropriate air permits. While the notice does not specify the remedy sought, upon final determination of a violation, the U.S. EPA may issue an administrative order requiring the installation of air pollution control equipment, assess penalties, or commence civil or criminal action against us. We responded to U.S. EPA on March 10, 2000. We believe that the resolution of this matter, even if unfavorable to us, will not materially impact our financial position or results of operations.

In addition, we are a party to certain litigation arising in the ordinary course of business which, in the opinion of management, will not have a material adverse effect on the operations or financial condition of the company.

Refer to Note 7 of the condensed consolidated financial statements for the status at June 30, 2001 of our COLI programs.

*Environmental Health and Safety*—Our business is subject to various laws and regulations governing employee health and safety and environmental protection. Our policy is to comply with all laws and regulations. Our overriding principles are to create sustainable compliance and an injury-free workplace. We do not anticipate that compliance will have a material adverse effect on our competitive or consolidated financial position.

*Outlook*—The environment is highly competitive in most of our product categories and geographic regions. Competition is based largely on price, quality and servicing the special needs of customers. Industry analysts believe that there is overcapacity in most commercial printing markets. Therefore, competition is intense. Our intent is to differentiate our service offerings so that we are viewed by our customers as a partner who can help them deliver effective and targeted communications in the right format to the right audience at the right time.

We are a large user of paper, supplied to us by our customers or bought by us. The cost and supply of certain paper grades used in the manufacturing process will continue to affect our financial results. However, management currently does not see any disruptive conditions affecting prices and supply of paper in 2001.

Postal costs are a significant component of our customers' cost structures. Changes in postal rates went into effect in January 2001 and increased again in July 2001. These increases are not expected to negatively affect the company. In fact, postal rate increases enhance the value of Donnelley Logistics to our customers, as we are able to improve the cost efficiency of mail processing and distribution. This ability to deliver mail on a more precise schedule and at a lower relative cost should enhance our position in the marketplace.

The cost of energy affects our operating costs in the Commercial Print segment and transportation costs in Logistics Services. In Logistics Services, increases in fuel costs can be offset by fuel surcharges passed on to customers, but continuing increases in other energy costs could affect our consolidated financial results.

In addition, consumer confidence and economic growth are key drivers of demand for our services. The slowdown experienced in the U.S. economy is affecting demand across most of our businesses. We do not expect demand to return to 2000 levels during the second half of 2001. The slowdown experienced in U.S. capital markets in the fourth quarter of 2000 has continued into 2001 and spread to the international capital markets, negatively affecting our Financial Services business. However, growth in demand for customized communications solutions for investment management, banking, insurance, managed care and pharmaceutical companies provides opportunities for our Financial Services business to partially offset the capital markets slowdown.

In the longer term, technological changes, including the electronic distribution of information, present both risks and opportunities for the company. Many of our new business initiatives are designed to leverage our distinctive capabilities to participate in the rapid growth in electronic communications. Our goal remains to help our customers succeed by delivering effective and targeted communications in the right format to the right audience at the right time. We believe that with our competitive strengths, including our comprehensive service offerings, technology leadership, depth of management experience, customer relationships and economies of scale, we can develop the most valuable solutions for our customers, which should result in increased shareholder value.

Refer to Note 12 of the condensed consolidated financial statements for a discussion of recently issued accounting pronouncements related to business combinations and goodwill.

### **Item 3**

#### **Quantitative and Qualitative Disclosures About Market Risk**

The company is exposed to market risk from changes in interest rates and foreign exchange rates. However, the company generally maintains more than half of its debt at fixed rates (approximately 65% at June 30, 2001), and therefore its exposure to short-term interest rate fluctuations is immaterial to the consolidated financial statements of the company as a whole. The company's exposure to adverse changes in foreign exchange rates also is immaterial to the consolidated financial statements of the company as a whole, and the company occasionally uses financial instruments to hedge exposures to foreign exchange rate changes. The company does not use financial instruments for trading purposes and is not a party to any leveraged derivatives. For further disclosure relating to financial instruments see the "Debt Financing and Interest Expense" footnote to the consolidated financial statements included in the company's 2000 Annual Report on Form 10-K.

## **PART II**

### **OTHER INFORMATION**

#### **Item 1. Legal Proceedings**

On each of November 25, 1996, and June 30, 1998, class actions were brought against the company alleging racial discrimination and seeking actual, compensatory, consequential and punitive damages in an amount not less than \$500 million. On December 18, 1995, a class action was brought against the company alleging age discrimination in connection with the 1993 closing of the company's Chicago catalog operations, and violation of the Employee Retirement Income Security Act (ERISA). On December 28, 2000, a purported class action was brought against the company alleging failure to calculate pension benefits for former employees of the company's Chicago catalog operations in accordance with plan documents and ERISA. These actions are described in Part I of this quarterly report on Form 10-Q.

#### **Item 5. Other Information**

Certain statements in this filing, including the discussions of management expectations for 2001, constitute "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. Such forward-looking statements involve known and unknown risks, uncertainties and other factors that may cause actual results to differ materially from the future results expressed or implied by those statements. Refer to Part I, Item 1 of the company's 2000 Annual Report on Form 10-K for a description of such factors.

#### **Item 6. Exhibits and Reports on Form 8-K.**

##### **(a) Exhibits**

- 10 Retirement, Consulting and Release Agreement between the Company and Michael W. Winkel
- 12 Ratio of Earnings to Fixed Charges

(b) No current report on Form 8-K was filed during the second quarter of 2001.

**SIGNATURE**

**Pursuant to the requirements of the Securities and Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.**

R.R. DONNELLEY & SONS COMPANY

By /s/ VIRGINIA L. SEGGERMAN  
Corporate Controller  
(Authorized Officer and  
Chief Accounting Officer)

Date August 13, 2001