# RR DONNELLEY & SONS CO

## FORM 10-Q
(Quarterly Report)

Filed 05/01/98 for the Period Ending 03/31/98

| | |
|---|---|
| Address | 111 SOUTH WACKER DRIVE<br>CHICAGO, IL 60606 |
| Telephone | 3123268000 |
| CIK | 0000029669 |
| Symbol | RRD |
| SIC Code | 2750 - Commercial Printing |
| Industry | Printing & Publishing |
| Sector | Services |
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# UNITED STATES
# SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

# FORM 10-Q

(MARK ONE)

**[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(D)**
**OF THE SECURITIES EXCHANGE ACT OF 1934**

**FOR THE QUARTERLY PERIOD ENDED MARCH 31, 1998**
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<br>(STATE OR OTHER JURISDICTION OF INCORPORATION OR ORGANIZATION) | 36-1004130<br>(I.R.S. EMPLOYER IDENTIFICATION NO.) |
| 77 WEST WACKER DRIVE, CHICAGO, ILLINOIS<br>(ADDRESS OF PRINCIPAL EXECUTIVE OFFICES) | 60601<br>(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.

**X**

Yes------- No -------

| | |
|---|---|
| NUMBER OF SHARES OF COMMON STOCK OUTSTANDING AS OF MARCH 31, 1998 | 141,899,978 |

# PART I

# FINANCIAL INFORMATION

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## CONDENSED CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)

(THOUSANDS OF DOLLARS, EXCEPT SHARE DATA)

| | THREE MONTHS ENDED MARCH 31 | |
|---|---|---|
| | 1998 | 1997 |
| Net sales | $ 1,161,396 | $ 1,102,647 |
| Cost of sales | 943,337 | 909,544 |
| Gross profit | 218,059 | 193,103 |
| Selling and administrative expenses | 130,220 | 120,778 |
| Earnings from operations | 87,839 | 72,325 |
| Other income (expense): | | |
| Interest expense | (19,947) | (22,561) |
| Other, net | 117 | 4,706 |
| Earnings before income taxes | 68,009 | 54,470 |
| Provision for income taxes | 23,803 | 19,392 |
| Income from continuing operations | $ 44,206 | $ 35,078 |
| Loss from discontinued operations, net of income taxes | -- | (5,737) |
| Net income | $ 44,206 | $ 29,341 |
| Income from continuing operations per share of common stock | | |
| Basic | $ 0.31 | $ 0.24 |
| Diluted | $ 0.30 | $ 0.24 |
| Net income per share of common stock | | |
| Basic | $ 0.31 | $ 0.20 |
| Diluted | $ 0.30 | $ 0.20 |
| Cash dividends per basic share | $ 0.20 | $ 0.19 |
| Average basic shares outstanding | 143,928,000 | 145,785,000 |
| Average diluted shares outstanding | 146,222,000 | 146,953,000 |

See accompanying Notes to Condensed Consolidated Financial Statements.

## CONDENSED CONSOLIDATED BALANCE SHEETS (UNAUDITED)

### MARCH 31, 1998 AND DECEMBER 31, 1997
(THOUSANDS OF DOLLARS)

| ASSETS | 1998 | 1997 |
|---|---|---|
| Cash and equivalents | $ 56,920 | $ 47,814 |
| Receivables, less allowance for doubtful accounts of $18,105 and $16,259 at March 31, 1998 and December 31, 1997, respectively | 754,155 | 814,664 |
| Inventories | 194,227 | 201,402 |
| Prepaid expenses | 125,160 | 82,691 |
| Total current assets | 1,130,462 | 1,146,571 |
| Property, plant and equipment, at cost | 4,216,860 | 4,214,765 |
| Accumulated depreciation | 2,456,704 | 2,426,649 |
| Net property, plant and equipment | 1,760,156 | 1,788,116 |
| Goodwill and other intangibles--net | 386,597 | 385,512 |
| Other noncurrent assets | 675,223 | 659,260 |
| Net assets of discontinued operations | 132,112 | 154,707 |
| Total assets | $4,084,550 | $ 4,134,166 |
| **LIABILITIES AND SHAREHOLDERS' EQUITY** | | |
| Accounts payable | $ 249,072 | $ 291,666 |
| Accrued compensation | 123,398 | 152,235 |
| Short-term debt | 45,000 | 45,000 |
| Current and deferred income taxes | 61,764 | 58,888 |
| Other accrued liabilities | 277,788 | 264,833 |
| Total current liabilities | 757,022 | 812,622 |
| Long-term debt | 1,274,874 | 1,153,226 |
| Deferred income taxes | 230,867 | 229,538 |
| Other noncurrent liabilities | 353,211 | 347,283 |
| Shareholders' equity: | | |
| Common stock, at stated value ($1.25 par value) | 320,962 | 320,962 |
| Retained earnings, net of cumulative translation adjustments of $50,753 and $45,782 at March 31, 1998 and December 31, 1997, respectively | 1,489,719 | 1,482,624 |
| Unearned compensation | (8,443) | (9,414) |
| Reacquired common stock, at cost | (333,662) | (202,675) |
| Total shareholders' equity | 1,468,576 | 1,591,497 |
| Total liabilities and shareholders' equity | $4,084,550 | $ 4,134,166 |

See accompanying Notes to Condensed Consolidated Financial Statements.

## CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

**FOR THE THREE MONTHS ENDED MARCH 31**
(THOUSANDS OF DOLLARS)

| | 1998 | 1997 |
|---|---|---|
| Cash flows provided by (used for) operating activities: | | |
| Net income | $ 44,206 | $ 29,341 |
| Loss from discontinued operations, net of income taxes. | -- | 5,737 |
| Depreciation | 81,375 | 72,469 |
| Amortization | 7,781 | 6,373 |
| Gain on sale of assets | (1,176) | (8,173) |
| Net change in operating working capital | (32,063) | 117,638 |
| Net change in other assets and liabilities | 2,872 | (33,980) |
| Other | (4,883) | 3,172 |
| Net cash provided by operating activities | 98,112 | 192,577 |
| Cash flows provided by (used for) investing activities: | | |
| Capital expenditures | (54,432) | (103,606) |
| Other investments including acquisitions, net of cash acquired | (17,567) | (24,768) |
| Dispositions of assets | 1,176 | 22,765 |
| Net cash used for investing activities | (70,823) | (105,609) |
| Cash flows provided by (used for) financing activities: | | |
| Net increase (decrease) in borrowings | 121,648 | (24,173) |
| Disposition of reacquired common stock | 17,539 | 12,735 |
| Acquisition of common stock | (150,732) | (1,144) |
| Cash dividends on common stock | (28,975) | (27,665) |
| Net cash used for financing activities | (40,520) | (40,247) |
| Effect of exchange rate changes on cash and equivalents | (258) | (15) |
| Net (decrease) increase in cash and equivalents from continuing operations | (13,489) | 46,706 |
| Net increase (decrease) in cash from discontinued operations | 22,595 | (26,966) |
| Cash and equivalents at beginning of period | 47,814 | 21,317 |
| Cash and equivalents at end of period | $ 56,920 | $ 41,057 |

See accompanying Notes to Condensed Consolidated Financial Statements.

## 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, 1997 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 1997 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 and to reflect the reclassification of operations discontinued in 1997.

**Note 2. Components of the company's inventories at March 31, 1998, and Dec.**
31, 1997, were as follows:

| | (THOUSANDS OF DOLLARS) | |
|---|---|---|
| | 1998 | 1997 |
| Raw materials and manufacturing supplies | $114,196 | $123,280 |
| Work in process | 169,361 | 153,142 |
| Finished goods | 889 | 1,047 |
| Progress billings | (44,840) | (31,715) |
| LIFO reserve | (45,379) | (44,352) |
| Total inventories | $194,227 | $201,402 |

Note 3. The following provides supplemental cash flow information:

| | (THOUSANDS OF DOLLARS) | |
|---|---|---|
| | THREE MONTHS ENDED MARCH 31 | |
| | 1998 | 1997 |
| Interest paid, net of capitalized interest | $ 8,521 | $ 7,130 |
| Income taxes paid | $ 19,908 | $ 21,947 |

**Note 4. On Nov. 25, 1996, a purported class action was brought against the**
company in federal district court in Chicago, Ill., on behalf of all current and former African-American employees, alleging that the company racially discriminated against them. 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 seek nationwide class certification, most of the specific factual assertions of the complaint relate to the closing by the company of its Chicago catalog production operations in 1993. Other general claims relate to other company locations. The company has filed a motion for partial summary judgment as to all claims relating to its Chicago catalog operations on the grounds that those claims are untimely and plaintiffs have filed a motion for class certification. Both motions are pending.

On Dec. 18, 1995, a purported 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. 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 Oct. 8, 1996, plaintiffs filed a motion to maintain the ERISA claims as a class action on behalf of all company retirement plan participants who were eligible for early retirement benefits at the time of their termination. On Aug. 14, 1997, the court denied plaintiffs' motion and certified classes in both the age discrimination and ERISA claims limited to former employees of the Chicago catalog operations.

Both pending cases relate at least in part to the circumstances surrounding the closure of the Chicago catalog operations. The company believes that it acted properly in the closing of the operations, has a number of valid defenses to all of the claims made and is vigorously defending its actions. However, management is unable to make a meaningful estimate of any loss that could result from an unfavorable outcome of either pending case.

**Note 5. The company adopted Statement of Financial Accounting Standard No.**
130, Comprehensive Income, effective for its quarter ended March 31, 1998. This statement is intended to report a measure of all changes in shareholders' equity that result from either recognized transactions or other economic events, excluding capital stock transactions, which impact shareholders' equity. For the company, the only difference between net income and comprehensive income is the effect of the increase in unrealized foreign currency translation losses of $5 million and $7 million for the quarters ended March 31, 1998 and 1997, respectively. Comprehensive income equaled $39 million and $22 million for the quarters ended March 31, 1998 and 1997, respectively.

**Note 6. Metromail Corporation, formerly a wholly-owned subsidiary of the**
company, completed an initial public offering of its common stock in June 1996, reducing the company's ownership to approximately 38%. In March 1988, Metromail entered into a merger agreement with The Great Universal Stores, P.L.C. (GUS), pursuant to which GUS initiated a tender offer for the outstanding shares of Metromail. In conjunction with the merger agreement, the company committed to sell its interest in Metromail to GUS. On April 13, 1998, the company received $297 million, or approximately $238 million after-tax, for its entire interest in Metromail. The accounting for the transaction will be reflected in the company's results for the quarter ending June 30, 1998.

**ITEM 2**

## MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

## COMPARISON OF FIRST QUARTER 1998 TO FIRST QUARTER 1997

### ABOUT THE COMPANY

R. R. Donnelley & Sons Company operates in a single industry segment as the largest commercial printer in North America. The company is a leading provider of printing and related services to the merchandising, magazine, book, directory and financial markets. The company applies its superior skills, scale and technology to deliver solutions that efficiently meet customers' strategic business needs. The company has approximately 26,000 employees in 19 countries on four continents.

The commercial print industry is a large, fragmented industry consisting of more than 52,000 firms and over 1 million employees in the United States and generating approximately $140 billion in revenue. The company has market- leading positions in five categories of the market served by its business units: Merchandise Media, which serves the catalog, retail insert and direct- mail markets; Magazine Publishing Services, which serves the consumer and the trade and specialty magazine markets; Book Publishing Services, which serves the trade and educational book markets; Telecommunications, which serves the domestic and international directory markets; and Financial Services, which serves the communication needs of the capital markets and the mutual fund and healthcare industries. In addition to its domestic operations, the company has operations in Europe, Latin America and Asia.

For most of 1997, the company owned approximately 80% of Stream International Holdings Inc. (SIH), which included three business units: Modus Media International (software replication, documentation, and kitting and assembly), Corporate Software & Technology (licensing and fulfillment, customized documentation, license administration and user training) and Stream International (technical and help-line support). SIH was formed in April 1995 by a merger of the company's Global Software Services business with Corporate Software Inc.

In December 1997, SIH was reorganized into three separate businesses, and the company's interest was restructured such that the company now owns 87% of the common stock of Stream International Inc., 86% of the common stock of Corporate Software & Technology Holdings, Inc. (CS&T) and non-voting preferred stock of Modus Media International Holdings, Inc. (MMI). As a result of the restructuring and the company's intention to dispose of its interest in CS&T, the company has reported its interests in CS&T and MMI as discontinued operations and reclassified the prior years' consolidated financial results. The financial results of Stream International are reported in the consolidated results of the company's continuing operations.

Sales results by business unit for the first quarter of 1998 and 1997 are presented below:

### NET SALES BY BUSINESS UNIT

| FIRST QUARTER ENDED MARCH 31, (THOUSANDS OF DOLLARS) | 1998 | % OF TOTAL | 1997 | % OF TOTAL |
|---|---|---|---|---|
| Merchandise Media | $ 290,851 | 25% | $ 286,111 | 26% |
| Magazine Publishing Services | 331,002 | 29% | 299,575 | 27% |
| Book Publishing Services | 168,357 | 14% | 171,049 | 16% |
| Telecommunications | 190,013 | 16% | 173,311 | 16% |
| Financial Services | 123,551 | 11% | 115,279 | 10% |
| Other | 57,622 | 5% | 57,322 | 5% |
| | $1,161,396 | 100% | $1,102,647 | 100% |

## CONSOLIDATED RESULTS OF OPERATIONS

The company reported first quarter 1998 income from continuing operations and net income of $44 million, or $0.30 per diluted share. In the previous year's first quarter, the company reported income from continuing operations and net income of $35 million, or $0.24 per diluted share, and $29 million or $0.20 per diluted share, respectively.

## CONSOLIDATED NET SALES

Net sales increased by $59 million, or 5%, to $1.2 billion, reflecting volume growth in most business units. Merchandise Media and Magazine increased due to growth across most product categories and the impact of increases in paper prices. Telecommunications increased as a result of a significant customer's change in production cycle to move work previously done in the fourth quarter into the first quarter and continued growth in international directories. Financial Services increased due to the strength of the capital markets. Book declined due to weakness in the four-color trade market and a decline in computer titles pending a major software release.

## CONSOLIDATED EXPENSES

Gross profit in the first quarter of 1998 increased 13% to $218 million due to lower costs driven by the benefit of recent restructuring activities and the company's focus on continuous productivity improvement, as well as to increased revenues. In addition, in the previous year's first quarter the company incurred higher expenses associated with the development of the company's logistics and fulfillment businesses and the start-up of the Roanoke book facility.

Selling and administrative expenses for the first quarter of 1998 increased 8% to $130 million, due to volume increases in most business units and increases in system-related expenditures. The ratio of selling and administrative expenses to net sales was 11% in both the first quarters of 1998 and 1997. Earnings from operations increased by 21% to $88 million, corresponding to an improvement in operating margins from 6.6% to 7.6% of net sales.

## SUMMARY OF EXPENSE TRENDS

| FIRST QUARTER ENDED MARCH 31, (THOUSANDS OF DOLLARS) | 1998 | 1997 | % INCREASE (DECREASE) |
|---|---|---|---|
| Cost of materials..... | $ 455,142 | $ 426,841 | 6.6% |
| Cost of manufacturing... | 399,039 | 403,861 | (1.2%) |
| Depreciation..... | 81,375 | 72,469 | 12.3% |
| Amortization..... | 7,781 | 6,373 | 22.1% |
| Selling and administrative..... | 130,220 | 120,778 | 7.8% |
| Net interest expense.... | 19,947 | 22,561 | (11.6%) |

## NONOPERATING ITEMS

Interest expense decreased approximately $3 million due to lower average debt balances associated with improved balance sheet management, resulting in lower working capital and capital expenditures. Other income declined approximately $5 million due primarily to a non-recurring gain in the first quarter of 1997 on the sale of the company's interest in a magazine distribution venture in the United Kingdom.

## DISCONTINUED OPERATIONS

The operations of MMI and CS&T are reported as discontinued operations in conjunction with the restructuring of the company's ownership interest in SIH, as discussed above. After-tax losses for discontinued operations were $6 million, or $0.04 per diluted share, in the first quarter of 1997.

## CHANGES IN FINANCIAL CONDITION

### LIQUIDITY AND CAPITAL RESOURCES

For the first quarter of 1998, net cash flow provided by operating activities was $98 million, down $94 million from last year's first quarter. Increased net income was offset by a decline in cash provided from operating working capital (defined as inventories, accounts receivable and prepaid expenses, minus accounts payable, accrued compensation and other accrued liabilities) predominantly due to a smaller decline in receivables and the payment of incentive compensation. Capital expenditures totaled $54 million for the first quarter of 1998. Spending was directed principally to projects that are expected to further enhance productivity. Full-year capital spending is expected to total between $325 million and $350 million. Management believes that the company's cash flow and borrowing capacity are sufficient to fund current operations and growth.

At March 31, 1998, the company had an unused revolving credit facility of $550 million with a number of banks. This credit facility provides support for the issuance of commercial paper and other credit needs.

## SUBSEQUENT EVENT

Metromail Corporation, formerly a wholly-owned subsidiary of the company, completed an initial public offering of its common stock in June 1996, reducing the company's ownership to approximately 38%. In March 1998, Metromail entered into a merger agreement with The Great Universal Stores P.L.C. (GUS), pursuant to which GUS initiated a tender offer for the outstanding shares of Metromail. In conjunction with the merger agreement, the company committed to sell its interest in Metromail to GUS. On April 13, 1998, the company received $297 million, or approximately $238 million after tax, for its entire interest in Metromail. The accounting for the transaction will be reflected in the company's results for the quarter ending June 30, 1998.

## OTHER INFORMATION

Share repurchase--In January 1998, the board of directors authorized a program to repurchase up to $500 million of the company's common stock in privately negotiated or open-market transactions over an 18-month period. The program will include shares purchased for issuance under various stock option plans.

The company will utilize the Metromail proceeds to support the $500 million share buyback, which was accelerated during the first quarter of 1998 in anticipation of the receipt of such proceeds. During the quarter, the company purchased approximately 3.7 million shares, at an average price of $39.40 per share.

Technology--The company remains a technology leader, investing not only in print-related technologies, such as computer-to-plate and digital printing, but also in areas such as distribution of content and images over the Internet. Technology is applied to enhance customers' products across the entire manufacturing process. The company's recent investments have been focused on a digital infrastructure to support the movement of work from customers' desktops across the company's manufacturing process, enabling output in multiple media. The company is focused on investing in technologies that contribute to its financial performance and help it deliver products, services and solutions its competitors cannot easily duplicate.

Process control and information systems are becoming increasingly important to the effective management of the company. Increased spending on new systems and updating of existing systems

will be necessary. In the near term, these efforts will be focused on ensuring that processes and systems are Year 2000 compliant, and the company will defer other infrastructure and systems initiatives that would support continuous productivity improvements and enhanced service capabilities until after the company is Year 2000 compliant.

The Year 2000 compliance issues stem from the computer industry's practice of conserving data storage by using two digits to represent a year. Systems and hardware using this format may process data incorrectly or fail with the use of dates in the next century. These types of failures can influence applications that rely on dates to perform calculations (such as an accounts receivable aging report), as well as systems such as building security and heating.

The company's effort to address Year 2000 compliance issues continues. The effort consists of evaluating internal computing infrastructure, business applications and shop-floor systems for Year 2000 compliance and replacing or renovating systems and applications as necessary to assure such compliance. This effort will be completed by mid-1999. In addition, the company will evaluate compliance by external companies and systems that interact with those of the company, and test to ensure all systems work together. Company employees, assisted by the expertise of external consultants where necessary, staff the Year 2000 compliance effort.

Management believes currently that the cost of the Year 2000 initiative is not a material issue that would cause reported financial information not to be indicative of future operating results or financial condition.

Litigation--On November 25, 1996, a purported class action was brought against the company in federal district court in Chicago, Ill., on behalf of current and former African-American employees, alleging that the company racially discriminated against them. 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 seek nationwide class certification, most of the specific factual assertions of the complaint relate to the closing by the company of its Chicago catalog production operations begun in 1993. Other general claims relate to other company locations. The company has filed a motion for partial summary judgment as to all claims relating to its Chicago catalog operations on the grounds that those claims are untimely and plaintiffs have filed a motion for class certification. Both motions are pending.

On December 18, 1995, a purported 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 closing of the Chicago catalog operations. The suit also alleges that the company violated the Employee Retirement Income Security Act (ERISA) in determining benefits payable to retiring or terminating employees. On October 8, 1996, plaintiffs filed a motion to maintain the ERISA claims as a class action on behalf of all company retirement plan participants who were eligible for early retirement benefits at the time of their termination. On August 14, 1997, the court denied plaintiffs' motion and certified classes in both the age discrimination and ERISA claims limited to former employees of the Chicago catalog operations.

Both pending cases relate at least in part to the circumstances surrounding the closing of the Chicago catalog operations. The company believes that it acted properly in the closing of the operations, has a number of valid defenses to all of the claims made and is vigorously defending its actions. However, management is unable to make a meaningful estimate of any loss that could result from an unfavorable outcome of either pending case.

Environmental Regulations--The company is subject to various laws and regulations relating to employee health and safety and to environmental protection. The company's policy is to be in compliance with all such laws and regulations that govern protection of the environment and employee

health and safety. The company does not anticipate that compliance with such environmental, safety and health laws and regulations will have a material adverse effect upon the company's competitive or consolidated financial position.

Outlook--The commercial printing business in North America (the company's primary geographic market) is highly competitive in most product categories and geographic regions. Industry analysts consider most of the commercial printing markets to suffer from overcapacity, and competition, therefore, is fierce. Competition is based largely on price, quality and servicing the special needs of customers.

The company is a large consumer of paper, acquired for customers and by customers. The cost and supply of certain paper grades consumed in the manufacturing process will continue to affect the company's financial results. Although prices were slightly higher in the first quarter, management currently does not foresee any disruptive conditions affecting prices and supply of paper in 1998.

Postal costs are a significant component of the cost structure of the customers of the company. Changes anticipated in postal rates in 1998, however, are expected to be manageable for most key customer segments, and favorable U.S. Postal Service financial performance could possibly delay the implementation of any new rates beyond 1998.

Additionally, proposed changes to the Postal Service's legislative charter also could affect the postal communication and commerce environment. While the proposed legislative changes are controversial, aspects of the proposal could strengthen the company's position as a postal intermediary. Even in the absence of legislative reform, the company's ability to improve the cost efficiency of mail processing and distribution will enhance its positioning in the postal business marketplace.

In addition to paper and postage costs, consumer confidence and economic growth are key drivers of print demand. Most experts expect continued strength in the domestic economy; however, a significant change in the economic outlook could affect demand for the company's products, particularly in the financial printing market.

Management believes the company's competitive strengths--including its comprehensive service offerings, depth of customer relationships, technology leadership, management experience and economies of scale--should result in profitable growth throughout 1998 and well into the future.

**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, since approximately 70% of the company's debt is at fixed interest rates, the company's exposure to 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 is also immaterial to the consolidated financial statements of the company as a whole, although the company occasionally uses financial instruments to hedge what exposure to foreign exchange rate changes it may have. The company does not use financial instruments for trading purposes and is not a party to any leveraged derivatives. Further disclosure relating to financial instruments is included in the Debt Financing and Interest Expense note in the Notes to Consolidated Financial Statements included in the company's 1997 annual report on Form 10-K.

## PART II

## OTHER INFORMATION

### ITEM 1. LEGAL PROCEEDINGS

On November 25, 1996, a purported class action was 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 purported class action was brought against the company alleging age discrimination in connection with the 1993 closing of the company's Chicago, Ill., catalog operations, and violation of the Employee Retirement Income Security Act. These actions are described in part I of this quarterly report on Form 10-Q.

### ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

(a) The company held its Annual Meeting of Stockholders on March 26, 1998.

(b) The following matters were voted upon at the Annual Meeting of Stockholders:

1. The election of the nominees for Directors of the First Class, who will serve for a term to expire at the Annual Meeting of Stockholders to be held in 2001, was voted on by the stockholders. The nominees, all of whom were elected, were Martha Layne Collins, William L. Davis, Oliver R. Sockwell and Stephen M. Wolf. The Inspectors of Election certified the following vote tabulations:

| | FOR | WITHHELD | NON-VOTES |
|---|---|---|---|
| Martha Layne Collins | 129,635,103 | 1,342,868 | 0 |
| William L. Davis | 129,625,373 | 1,352,598 | 0 |
| Oliver R. Sockwell | 129,310,311 | 1,667,660 | 0 |
| Stephen M. Wolf | 129,650,043 | 1,327,928 | 0 |

2. A proposal to amend the 1995 Stock Incentive Plan was approved by the stockholders. The Inspectors of Election certified the following vote tabulations:

| FOR | AGAINST | ABSTAIN | NON-VOTE |
|---|---|---|---|
| 106,906,224 | 23,218,429 | 853,318 | 0 |

3. A stockholder proposal relating to executive compensation was rejected by the stockholders. The Inspectors of Election certified the following vote tabulations:

| FOR | AGAINST | ABSTAIN | NON-VOTE |
|---|---|---|---|
| 4,756,339 | 119,623,003 | 1,307,207 | 5,291,422 |

### ITEM 5. OTHER INFORMATION

Certain statements in this filing, including the discussions of management expectations for 1998, 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 1997 Annual Report on Form 10-K for a description of such factors.

### ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K.

(a) EXHIBITS

27 Financial Data Schedule

(b) A Report on Form 8-KA was filed on February 18, 1998 and included Item 5 "Other Events" and Item 7 "Financial Statements, Pro Forma Financial Information and Exhibits."

**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/ Peter F. Murphy*
*Corporate Controller*
*(Authorized Officer and*
*Chief Accounting Officer)*

Date *May 1, 1998*

**ARTICLE 5**

MULTIPLIER: 1,000

| | |
|---|---|
| PERIOD TYPE | 3 MOS |
| FISCAL YEAR END | DEC 31 1998 |
| PERIOD START | JAN 01 1998 |
| PERIOD END | MAR 31 1998 |
| CASH | 56,920 |
| SECURITIES | 0 |
| RECEIVABLES | 772,260 |
| ALLOWANCES | 18,105 |
| INVENTORY | 194,227 |
| CURRENT ASSETS | 1,130,462 |
| PP&E | 4,216,860 |
| DEPRECIATION | 2,456,704 |
| TOTAL ASSETS | 4,084,550 |
| CURRENT LIABILITIES | 757,022 |
| BONDS | 1,274,874 |
| PREFERRED MANDATORY | 320,962 |
| PREFERRED | 0 |
| COMMON | 0 |
| OTHER SE | 1,147,614 |
| TOTAL LIABILITY AND EQUITY | 4,084,550 |
| SALES | 1,161,396 |
| TOTAL REVENUES | 1,161,396 |
| CGS | 943,337 |
| TOTAL COSTS | 1,073,557 |
| OTHER EXPENSES | (117) |
| LOSS PROVISION | 0 |
| INTEREST EXPENSE | 19,947 |
| INCOME PRETAX | 68,009 |
| INCOME TAX | 23,803 |
| INCOME CONTINUING | 44,206 |
| DISCONTINUED | 0 |
| EXTRAORDINARY | 0 |
| CHANGES | 0 |
| NET INCOME | 44,206 |
| EPS PRIMARY | 0.31 |
| EPS DILUTED | 0.30 |

**End of Filing**

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