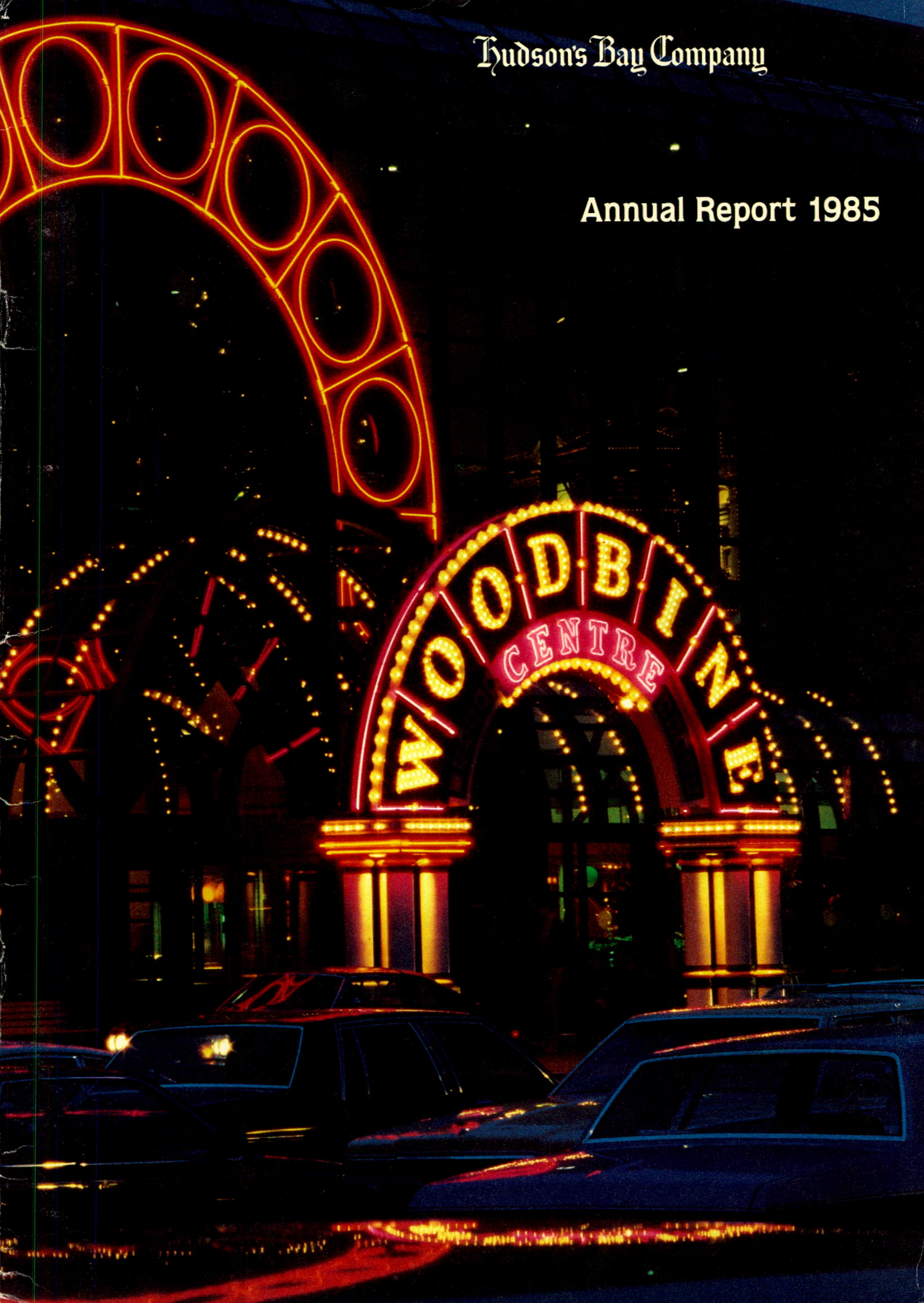
Hudson's Bay Company

Annual Report 1985



Hudson's Bay Company is Canada's oldest and one of its largest enterprises, with holdings in merchandising, real estate and natural resources. It owns, among other assets, three major retail companies, The Bay, Simpsons and Zellers; a large real estate subsidiary, Markborough Properties Inc.; and a 54.3% interest in Canadian Roxy Petroleum Ltd.

The Company aims to develop its human and material resources and capitalize on its experience in merchandising, real estate and natural resources, to anticipate and satisfy the needs of Canadians for the goods and services of these three industries at fair prices, and thereby earn a satisfactory return for its shareholders.

- The 317th Annual Meeting of Shareholders will be held at Commerce Hall, Commerce Court (King and Bay Streets), Toronto, on May 27, 1986 at 3.30 p.m.
- Annual Reports of Markborough Properties Inc. and Canadian Roxy Petroleum Ltd. are available from those companies.
- On peut obtenir ce rapport annuel en français sur demande.

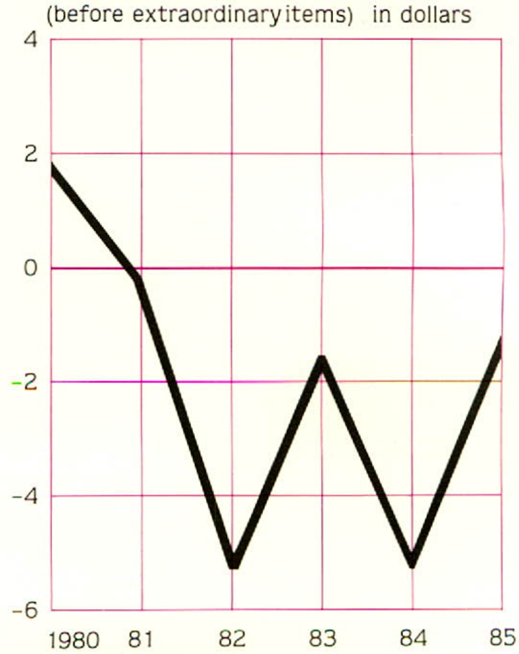
Financial Highlights

	This Year 1985	Last Year 1984
	$ millions	$ millions
Sales and Revenue	**5,271.5**	4,829.3
Operating Profit	**252.9**	111.9
Loss Before Extraordinary Items	**(9.1)**	(107.4)
Extraordinary Items	**3.5**	–
Loss	**(5.6)**	(107.4)
Capital Expenditures	**146.9**	153.0
Shareholders' Equity	**1,114.0**	1,035.1

Per Ordinary Share:	$	$
Loss Before Extraordinary Items	**(1.23)**	(5.40)
Loss	**(1.09)**	(5.40)
Dividends	**.60**	.60
Equity	**30.49**	33.29

Sales and Revenue
in billions of dollars

Earnings (Loss) per Share
(before extraordinary items) in dollars



Directors' Report to Shareholders

T. Iain Ronald, Executive Vice-President, Donald S. McGiverin, Governor and George J. Kosich, Executive Vice-President.

Summary

Your Company achieved an encouraging recovery in 1985 from the substantial loss position of the year before. The loss before extraordinary items was reduced to $1.23 per share from $5.40 per share in 1984.

The Company recorded an increase of $141.0 million in operating profit, principally from improved retail operations. This was partially offset by an increase of $51.1 million in interest costs, primarily due to higher borrowings related to the additional assets employed in the business in 1985.

Last year at this time, the Company decided to focus management attention on financial objectives. Three specific objectives were identified for 1985 and we are pleased to report substantial progress toward all of them.

They were:

1. To turn Simpsons around and increase profitability of other retail operations;
   Result: the operating loss at Simpsons of $52.5 million in 1984 was transformed into a $7.4 million profit in 1985 and the operating profit of other retail operations increased to $104.0 million from $56.3 million.
2. To maintain the momentum of real estate operations;
   Result: operating profit from real estate increased to $126.4 million from $87.8 million.
3. To disengage from marginal activities;
   Result: the company disposed of six non-strategic investments for proceeds of approximately $66 million and non-recurring after-tax gains of $3.5 million.

Given a continuation of a reasonably strong Canadian economy, we expect to achieve significant improvements in operating profit and cash flow and to strengthen further the financial condition of the Company during 1986.

Retail Rationalization

During the year, the Company re-examined the strategies and objectives of its retail groups to refine, focus and strengthen the market thrust of each. The new integrated positioning policy identifies a designated market for each store group and covers the full spectrum of Canadian department store shopping.

Simpsons will be the high fashion premium quality store in the two largest markets. It will serve medium income and upscale customers with distinctive assortments of fine merchandise.

The Bay Department Stores will cover the broad mid-range urban and suburban markets offering fashionable, good quality merchandise at popular prices with a high level of service, integrity and good taste.

The Bay Northern Stores will serve northern, rural and resource based communities with assortments of food and dry goods tailored to their requirements.

Zellers will continue its promotional department store business in large and medium size retail markets from coast to coast. Zellers will strive to maintain its value leadership, enhance its quality image and improve its high level of efficiency.

As a result of this rationalization, the Bay Northern Stores has now been included, for reporting purposes, in the Zellers Group and last year's figures have been adjusted to reflect this change. Also, during the year, nine stores were transferred to Zellers from The Bay Department Stores and a further six stores were transferred to Zellers from The Bay Northern Stores.

Subsequent to the year-end, and as a further result of the rationalization process, it was announced that all of the Simpsons stores outside Montreal and Toronto will be transferred to The Bay Department Stores effective August 1, 1986. This will allow Simpsons to concentrate on its newly defined target markets in Canada's two largest metropolitan areas.

Business Dispositions

Substantial progress was made during the year toward the announced goal of disposing of non-strategic assets. The company sold its interests in six businesses for proceeds of approximately $66 million and a net extraordinary gain of $3.5 million.

These dispositions were:

- a 100% interest in Marshall Wells Limited, a hardware distributor
- a 39% interest in Eaton Bay Financial Services
- a 100% interest in HBC Travel Travel Limited
- a 50% interest in Hudson's Bay Distillers Limited
- a 70% interest in Toronto Credits Limited
- a 22% interest in Computer Innovations Distribution Corporation

The purchasers of all but one of these business interests will continue their relationships with the Company through supply, royalty or licence agreements.

1985 Results

The Company incurred a loss before extraordinary items of $9.1 million in 1985, compared with a loss of $107.4 million the year before. After deducting preferred share dividends of $20.6 million in both years, there was a loss of $1.23 per ordinary share in 1985, compared with a loss of $5.40 per share the year before.

In addition, there was an extraordinary gain in 1985 of $3.5 million or 14¢ per share which reduced the net loss for the year to $5.6 million or $1.09 per share.

Sales and Revenue were $5.27 billion in 1985, up by 9.2% from the previous year. Retail sales were ahead by 8.9%.

Total operating profit in 1985 was $252.9 million, an increase of $141.0 million from the year before.

Retail operating profit was ahead substantially at $111.4 million from $3.8 million in 1984, with The Bay contributing $22.6 million, Simpsons $59.9 million and the Zellers Group $16.7 million to the improvement. Strong sales increases, including for the first time in some years stores in B.C. and Alberta, were the principal reasons for the profit increase at The Bay. Simpsons' recovery was fuelled by sales increases together with a reduction in expenses from the unusually high level of the previous year. Simpsons' operating profit in 1985 includes approximately $15 million arising from a one-time reversal of a pension provision no longer required. The effect of higher sales in the Zellers Group more than offset the costs of the transfer of 15 stores from The Bay.

Wholesale operating profit increased to $10.0 million from $5.3 million in 1984 because of higher sales and better control of expenses.

In contrast, Fur results deteriorated to $2.0 million from $8.0 million the year before as the result of a sharp decline in mink prices.

In Real Estate, operating profit of Markborough, at $98.8 million, was up by $7.2 million from the prior year. Profit from non-Markborough real estate amounted to $27.6 million in 1985 and included $35.2 million arising from the sale of surplus merchandising properties.

Normal operating profit from Natural Resources in 1985 was substantially higher than a year ago because of increased oil production by Canadian Roxy Petroleum. However, a one time write-off by Roxy of East Coast exploration expenses reduced operating profit to $3.1 million compared with $6.9 million in 1984.

Interest costs rose substantially to $250.4 million from $199.3 million the year before, primarily due to the higher borrowings required to finance the additional assets employed in the business in 1985. The average cost of borrowing was 11.5%, down from 12.1% the year before.

Income taxes at $12.9 million were $6.4 million less than a year ago and relate in both years mainly to Markborough's real estate operations.

Financial

Despite substantial growth in operating profit, the Company had a net cash outflow from operating activities of $132.7 million in 1985, the principal cause of which was an increase of $186.4 million in receivables – the result of substantial credit sales growth. In addition, there was a net cash outflow from investing activities of $135.4 million relating principally to real estate.

Control of debt has been identified as a high priority of the Company and a five-part program has been developed to deal with it.

Non-Recurring Items

In addition to the extraordinary items shown "below the line" in this year's financial statements, there were in 1985 a number of non-recurring items which, because they relate to ongoing operations, were included in the year's operating results. The net effect of including such items was to marginally decrease the operating profit as shown below:

		$ millions
Positive Items		
Profit on sale of surplus merchandising properties	35.2	
Net effect of pension provision adjustments	12.1	47.3
Negative Items		
Termination and reorganization costs	27.7	
Store transfer and other costs	13.4	
Roxy East Coast write-off	7.6	48.7
Excess of negative over positive items		1.4

Three operating divisions of the Company have important interests in the Woodbine Centre, a 610,000 sq. ft. regional centre in Toronto, also shown on the cover of this report. The Bay and Simpsons operate the two anchor department stores and Markborough is a 40% owner of the centre.

The first part is growth in operating profit. The second is continued restraint in capital expenditures in the merchandising sector. The third is further dispositions of non-strategic assets. The fourth is improved management of inventories now that the appropriate deeper assortments required to sustain accelerated sales growth have been put in place.

The fifth part is the injection of new equity into the Company. The first successful step in this direction was taken in December 1985 when $109.6 million in new ordinary equity was raised through a Rights Issue. Shareholders were offered one new share at $23.00 for each five shares held. The offering was 96.1% subscribed in its first phase and the remaining shares were taken under an additional subscription privilege and under a commitment by the principal shareholder. A dividend reinvestment plan was introduced in 1985 and a further $5.2 million in new equity was raised through this plan.

Excessive debt does not melt away quickly or without effort. However, by the diligent application of the five-part program, just described, we are aiming over the next three years to significantly reduce your Company's debt/equity ratio.

Debt, once incurred, must be well managed and your Company is acknowledged to be an innovator in this area. During the past year interest rate swaps and caps were used to convert variable to fixed rate debt and to provide insurance against future increases in interest rates.

Economic Conditions

The Canadian economy grew by 4.5% in 1985, the third consecutive year of impressive expansion. Unlike the previous two years where growth was export led, the economy in 1985 was powered by domestic demand, including housing and consumer spending.

Strength in business capital spending and in residential construction is expected to provide the momentum for another sound performance by the Canadian economy in 1986, provided government policy allows Canadian interest rates to follow U.S. rates downward. The indicators for consumer spending, however, are mixed. Inflation is at the lowest level in many years and may decline further if lower oil prices are passed on to the consumer, employment is on a modest upturn and the personal savings rate appears to be declining. It is to be hoped these positive components will be strong enough to overcome the negative effects of higher taxes imposed in the Federal budgets of 1985 and 1986 and in the most recent Ontario budget.

1986 Plans

All three retail groups have prepared specific plans to improve profit in 1986, through a combination of sales development, margin improvement and expense control.

Real Estate activities will continue at about the same level as 1985 excluding the one-time profit from sales of surplus merchandising properties.

Capital expenditures on retailing will continue to be restrained. Neither The Bay nor Simpsons will open any new stores in 1986, although funds will continue to be spent on productive modernization programs with short payback periods.

We expect to raise additional equity in 1986 and thereby strengthen the financial position of the Company. This, of course, will depend on favourable conditions in the financial markets.

Board

Five members of the board will retire at the Annual Meeting in May. They are Alexander J. MacIntosh, Sir Martin Jacomb, Graham R. Dawson, J. Michael G. Scott, and Pierre Laurin. Mr. MacIntosh joined the board in 1969 and served with distinction as Deputy Governor from 1970 to 1985. He participated in all the key decisions of that eventful period during which his counsel was always forthright, sound and highly valued.

Sir Martin Jacomb has been a director since 1971 and was a member of the Executive Committee from 1973 to 1985. For fifteen years he has given generously of his outstanding talents in the financial field to the benefit of the Company. Messrs Dawson, Scott and Laurin have all been associated with the Company as members of the board or as directors of subsidiary companies for many years. We extend to each of the retiring directors our grateful appreciation for their many contributions to the welfare of the Company.

Appreciation

Our employees endured the uncertainties of reorganizations and rationalizations in the early part of 1985, but they ended the year in a very positive frame of mind as members of a confident rejuvenated winning team. The improvement in results during the past year is due in large part to their dedication and hard work and we thank them sincerely. We also thank our customers, our suppliers and our shareholders for their continuing support.

On behalf of the Board

D. S. McGIVERIN, Governor

G. J. KOSICH, Executive Vice-President

T. I. RONALD, Executive Vice-President

March 14, 1986

Summary of Operations

Results in thousands of dollars		This Year	Last Year
Hudson's Bay Company	Sales and revenue	**5,271,548**	4,829,325
	Operating profit	**252,913**	111,883
	Interest	**(250,393)**	(199,275)
	Income taxes	**(12,895)**	(19,292)
	Loss before extraordinary items	**(9,055)**	(107,434)
The Bay Department Stores	Sales and revenue	**1,452,476**	1,307,242
	Operating profit	**31,070**	8,491
	Assets employed	**622,673**	570,898
Simpsons	Sales and revenue	**787,648**	737,254
	Operating profit (loss)	**7,438**	(52,466)
	Assets employed	**455,126**	397,090
Zellers Group	Sales and revenue	**2,020,791**	1,806,201
	Operating profit	**68,184**	51,532
	Assets employed	**716,832**	696,351
Hudson's Bay Wholesale	Sales and revenue	**637,659**	581,813
	Operating profit	**10,032**	5,319
	Assets employed	**123,984**	133,433
Hudson's Bay Company Fur Sales	Consignments	**348,393**	357,139
	Operating profit	**1,975**	8,029
	Assets employed	**107,580**	75,253
Real estate – principally **Markborough**	Sales and revenue	**276,112**	243,452
	Operating profit	**126,434**	87,844
	Assets employed	**1,014,154**	872,571
Natural resources – principally **Canadian Roxy**	Operating profit	**3,057**	6,912
	Assets employed	**243,678**	179,123

1985 Principal Operating Factors	1986 Action Plan
• Strong consumer spending and refocused merchandising strategies produced substantial increases in retail sales and operating profit. • Real estate profit was supplemented by gains on sale of surplus merchandising properties. • Six non-strategic business investments were sold. • Additional borrowings to finance increased investment in the business raised interest costs. • New equity of $117.5 million was raised.	• Achieve further substantial increases in retail profit. • Maintain momentum of real estate operations. • Achieve positive cash flow from overall activities. • Raise additional equity.
• Intensified inventories, better in-stock position, powerful promotions and improved customer service combined with strong consumer spending to produce substantial sales gains. • Centralization of procurement and sales promotion led to operating efficiencies. • Modernization of downtown Vancouver store was completed in time for Expo.	• Accelerate growth in soft goods through deeper assortments and more store space. • Maintain higher in-stock position of basic merchandise. • Intensify sales promotion activity. • Emphasize in-store marketing and customer service standards. • Integrate eight former Simpsons stores.
• Sales were up particularly in priority soft goods areas. • Expense rate was lowered dramatically. • Promotional campaign raised awareness of Simpsons' fashion leadership. • First phase of Toronto flagship store modernization captured public interest. • Reversal of pension provision increased profit.	• Consolidate position in Toronto and Montreal as a quality fashion merchandiser. • Increase blend of soft goods. • Refine advertising campaign to include both product and positioning. • Continue modernization of Toronto flagship store.
• Substantial sales increase was achieved without growth in inventories. • Fashion blend was improved. • Costs were incurred in conversion of 15 Bay stores. • Higher than planned markdowns were taken to balance inventories. • Bay Northern Stores improved profit by transferring and closing stores and reducing expenses.	• Maintain better in-stock inventory position. • Support three distinct Zellers store profiles with appropriate advertising. • Open five new Zellers stores. • Improve store level control of markdowns. • Expand four Bay Northern Stores and close two.
• Sales increased in all major product lines. • Significant reduction in expense rate was achieved. • Five small branches were closed.	• Accelerate growth in sales of non-tobacco commodities. • Maintain market share in tobacco. • Expand imports to include new merchandise classifications.
• Sharp decline in mink prices reduced profit. • Wild fur prices remained stable. • Market share improved.	• Increase sales of U.S. ranched and Canadian wild furs. • Reduce operating expenses and overhead.
• Expansions, acquisitions and active leasing produced improved income property results. • Land sales were up in Canada but down in U.S. from exceptional 1984 level. • Sales resulting from rationalization of income property portfolio increased profit. • Major land inventory was purchased to replace land sold in 1984. • Sale of surplus merchandising properties supplemented profit.	• Increase level of United States land sales. • Expedite development approvals for new land inventories. • Acquire additional lands. • Improve returns on existing properties through expansion and re-leasing. • Expand income property portfolio.
• Revenues and cash flow improved substantially as a result of successful exploration and development. • Important reserves were added in Elswick field. • Costs of East Coast program were written off.	• Restrict capital investments to discretionary cash flow generated.

Merchandising

The Bay Department Stores

Operating profit for The Bay Department Stores improved to $31.1 million in 1985 from $8.5 million in 1984. An 11.1% increase in Sales and Revenue, to $1.45 billion, was the major factor contributing to the profit improvement.

Sales and revenue accelerated each quarter and were especially strong in the fourth quarter with an increase of 16.8%. All Regions achieved significant sales increases and it was particularly encouraging to see the sales turnaround in Western Canada.

Larger inventories and higher in-stock positions of basic merchandise were major factors in the sales increase. Increased sales promotion and stronger in-store marketing programs together with a concentrated effort to improve customer service also contributed to the sales increase.

In line with our marketing strategy, there was a significant increase in the blend of soft good sales, especially in the Fall season.

The gross profit rate decreased in 1985. Higher initial margins were offset by increased markdowns and the provision requirements of higher inventory levels. Expenses were well managed and the expense rate decreased.

The modernization program for the Vancouver Downtown Store was completed in advance of the opening of Expo '86. Direct access is now available from the store to the new Advanced Light Rapid Transit System. Our business has increased as a result.

The Woodbine Store opened in August in Northwest Toronto and results in the Fall season were above plan.

During the year, The Bay Department Stores transferred nine stores to Zellers. These stores were in smaller communities where Zellers' merchandising and distribution will better meet customer requirements.

A successful "Italian Fair" promotion was held in six of the Downtown Stores in October, 1985 as part of a continuing program to bring vitality and excitement to these major units.

The new Bay store at Woodbine in Toronto, set the tone for the division; deeper assortments of popular priced soft goods and a strong emphasis on staff training and customer service.

Procurement and Sales Promotion functions were fully centralized during the year. This freed regional and store management to concentrate on upgrading sales development, sales management and customer service. In addition, a number of support functions were revised and consolidated. Delivery operations in most regions are now contracted out. These changes will result in substantial expense savings in 1986.

As a further rationalization within the Company's three retail organizations, eight Simpsons Stores will be transferred to The Bay in August of 1986. It is expected the The Bay's merchandising, sales promotion and in-store marketing will have an immediate positive effect on the transferred stores.

The results for 1986 should be much improved because of the favourable impact of the new organization.

The exterior of Zellers' new store at Heritage Place in Ottawa is an historic facade dating from 1872. The interior is as modern as tomorrow.

Zellers Group

Operating profit of the Zellers Group increased by 32% to $68.2 million in 1985 from $51.5 million the year before. 1985 was a good year for retailing and the sales and market share of the Zellers Group kept pace with the industry despite heightened promotional activity by many traditional competitors, and the aggressive new store expansion of discount speciality stores into some of its markets. Consolidated sales and revenue, including Zellers, Fields, Bay Northern Stores and Just Kids, increased by 11.9% to $2.02 billion during 1985.

Zellers' sales rose 16.0% to $1.56 billion, including sales of three new stores and 15 stores transferred during the year from The Bay's Northern and Department Stores Divisions. Two stores were closed during the year. Zellers achieved significant sales gains in several key departments related to new merchandise strategies. This resulted in an improvement in fashion goods blend and partly offset the continuing aggressive competitive pressure on margins, particularly in the hardlines area.

Higher than planned markdowns were experienced as Zellers took strong action to balance its inventories. One-time costs associated with the transfer of Bay Stores further reduced operating profit.

After starting the year significantly over-inventoried, Zellers made major strides to gain a better balance in its inventories and to improve its turnover. On the negative side, Zellers' staple replenishment system had problems in the second half of 1985 which resulted in lost sales. An aggressive action plan is in place for 1986 to achieve further inventory management improvements.

The newly designed prototype store has proven successful in both new and redeveloped locations and Zellers will

The expanded Men's Wear area at Simpsons Downtown Toronto features upscale fashions by world famous designers. The modernization program continues in 1986 on the lower level and the women's fashion floors.

introduce its new store design in additional markets. The three stores opened in 1985 were at Heritage Place in downtown Ottawa, at Cloverdale Mall in Toronto and in Sherbrooke, Quebec. Another, at Dartmouth, N.S., was substantially expanded and upgraded.

Sales of Fields increased by 5.0% as two stores were opened and one store was closed during the year.

The Bay Northern Stores Division improved its earnings substantially in 1985 by narrowing its focus to its traditional markets, cutting back and centralizing its administrative structure and closing, transferring or disposing of stores in markets where the division's merchandising concepts were not viable.

Northern Stores strengthened its ability to service the unique requirements of its customers in the North by centralizing its management group and by assuming full responsibility for its own buying. As a result, operating efficiencies were achieved while costs were reduced substantially. Capital spending has been directed to upgrading stores, equipment and support facilities in the North. Sales, on a comparable store basis, advanced 8.5% in 1985 despite the difficult economic conditions experienced in many resource-based communities and the cut-backs in government sponsored social and job creation programs.

During the last two years, 21 stores have been transferred to Zellers, one store was transferred to The Bay Department Stores and 18 stores were closed. All stores transferred were in communities which could be better serviced by Zellers. Others were unprofitable and did not fit within the Northern Stores long-term strategy.

Results are expected to continue to improve in 1986 as the full benefits of the changes made during 1985 are realized.

The first phase of the modernization program at Simpsons Downtown Toronto opened in the fall of 1985 to enthusiastic customer acclaim. The Women's Accessories area on the main floor includes one of the most impressive and extensive cosmetics departments in North America.

Simpsons

The operating profit in 1985 of $7.4 million is a $59.9 million improvement on the 1984 loss of $52.5 million. However, approximately $15 million of the increase resulted from a one-time reversal of a pension provision that is no longer required.

Sales increased overall by 6.8% to $787.6 million in 1985. Soft goods sales were up 12.7% and the blend of soft goods improved by 3.4% to 59.5% of total retail sales.

In spite of expanded inventories and more promotional activities, margins improved on a year-to-year basis while expenses were down significantly from 1984, as every operating component was analyzed and revised where appropriate.

As part of its repositioning strategy to capitalize on the potential of the fashion markets in Toronto and Montreal, Simpsons increased the physical space for and devoted more resources to the soft goods divisions in 1985.

Elements of the new strategy were evident in the Pointe Claire renovation and the new Woodbine Store. However, the best expression of the Company's intention to concentrate on an upscale fashion profile is the transformation of the Fashion Accessory and Men's Wear departments in the Downtown Toronto Store. This program will continue in 1986 and beyond and will reinforce the position of Simpsons as a world-class, high-fashion retailer. These changes were strongly promoted in the Company's successful "Simpsons Spirit" advertising campaign.

In 1986 Simpsons will concentrate its efforts in Canada's two major upscale markets, Toronto and Montreal, and will transfer its existing eight stores outside these two markets to The Bay.

The newly directed Simpsons has made good progress in one year. Market concentration in Toronto and Montreal and merchandise repositioning will provide Simpsons with further strategic advantages.

With continued emphasis on training and better merchandise information, provided through the introduction of the parent company's "BASICS" system, the outlook for 1986 is for significant further profit improvement.

Hudson's Bay Wholesale

Sales of Hudson's Bay Wholesale, excluding inter-company transfers, increased 9.6% in 1985 to $637.7 million. Operating profit rose to $10.0 million from $5.3 million the year before as a result of the sales increase and effective cost controls. Better terms from a major supplier improved margins in the latter part of the year. Results improved in all regions with the largest gains in Alberta and Ontario.

Tobacco distribution is still a major segment of the wholesale business. Growth of this extremely competitive market has been limited by rising prices, largely the result of increased Federal and Provincial taxation. However, Hudson's Bay Wholesale has maintained its market share.

Confectionery and food sales for the year showed encouraging growth with the addition of new domestic product lines and the increasing acceptance of exclusive imported candy lines.

A well-defined assortment of popular health and beauty aid products has been developed in the past two years. The program is expected to provide a base for substantial growth in the non-tobacco segment of the business.

Upgrading of existing branch computer information systems continued in 1985. Accommodation of customer service requirements was the primary objective of changes to the systems.

As part of a program to improve the productivity of assets employed, and to increase the efficiency of larger branches, five branches in smaller centres have been closed. Wholesale is committed to providing a superior level of service and its customers in these locations will have the benefits of the greater assortments carried by the larger branches.

Vending profits rose over last year despite substantial declines in cigarette sales. Growth in full-line vending, Red Carpet Coffee Service and Customer Controlled Vending, a sales and leasing program, was most encouraging. These major vending programs all focus on meeting the consumers' need for increased convenience.

A new debit card system has been developed as an alternative to coin systems for use in photocopiers, vending machines, computers and word processors. This system is being used primarily in Customer Controlled Vending.

Hudson's Bay Wholesale anticipates further increases in sales and earnings in 1986.

Fur Sales

Operating profit from Fur Sales declined to $2.0 million in 1985 from $8.0 million the year before. Consignment sales also declined from $357 million to $348 million.

The principal reason for lower profits was the decline in mink prices which began in the Spring of 1985 and is still continuing. In U.S. dollars most mink prices are now some 25% lower than a year ago. Wild fur prices, on the other hand, have been reasonably stable and some have risen.

The New York operation, which is almost 100% mink and which has a selling pattern under which its major sales fall towards the end of the fiscal year, has suffered more than either Toronto or London, although all three operations were affected.

Although the company increased its market share in all areas, the additional volume did not offset the price declines.

Overall, the fur market suffers from a sluggish retail market – with the notable exception of the United States – and an over-production of mink, particularly in the Scandinavian countries. There is some evidence that the present price structure is stimulating activity in traditional markets such as West Germany and the present level of mink prices will undoubtedly mean that there will be a cutback in mink production, although such a reduction would not be likely to affect the market until 1987.

For 1986, there are three factors which will improve our performance. The first is an increased share of U.S. ranched

The fur garments are from Simpsons, the building is Heritage Place, Markborough's new office retail complex in downtown Ottawa.

mink arising from our new premises in New Jersey and a strengthened management team. The second factor is an increased share in the wild fur market in Canada following the setting up of Trappers International Marketing Services which has exclusive selling arrangements through our Toronto operation. The third factor will be continued expense reduction by eliminating overlapping costs and sharing various activities and facilities.

Real Estate

Markborough

Independent appraisals of the properties of Markborough in 1985 set the appreciated equity of Markborough, as at January 31, 1986, on an after tax basis, at approximately $750 million compared to Hudson's Bay Company's book equity of $289 million. If estimated taxes on the appraisal increment were excluded, the value would increase by a further $198 million.

Operating profit of Markborough increased to $98.8 million in 1985 from $91.6 million the year before as higher profit from income properties more than offset reduced profit from land development.

In land development, an anticipated decline in land sales in Texas and Arizona from the exceptional levels of 1984 reduced profits by 43.1%. In California, construction of a dam and 34.7-acre lake on the Sunnymead Ranch site were completed and significant sales of serviced lands are anticipated in 1986. Substantially increased sales and higher margins were recorded in the Alberta land operations.

Major land purchases of 1,980 acres in Tampa, Florida and 965 acres in two locations in Houston, Texas were completed in 1985 and a further 3,100 acres in Austin, Texas are under option.

In 1986, Markborough's priorities for land development are to increase land sales in the United States, to expedite development approvals on recently acquired land tracts and to acquire additional lands in Arizona and Ontario.

Profit from income properties increased by 14.1% in 1985 including one-time gains from disposals of interests in six shopping centres and two office buildings.

During the year, Markborough's income-producing portfolio was enlarged and upgraded. The principal acquisitions were an interest in Market Mall, an existing regional shopping centre in Calgary with a total of 761,000 square feet of gross leasable area, and Greystone Park, a 13-acre site on which additional office space is being built in the prime business section of Las Vegas, Nevada. In addition, Woodbine Centre, the 610,000 square foot regional centre in the north-west section of Toronto in which Markborough has a 40% equity interest, opened in August.

The quality of Markborough's shopping centre portfolio was improved with the completion of expansions, renovations and remerchandising programs at centres in Montreal, Toronto, Vancouver, Winnipeg, Vernon and Calgary and with the sale of six community or neighbourhood centres.

The Heritage Place office-retail complex in Ottawa was officially opened in October, 1985 and the 150,000 square-foot office-retail project at 20th and L Streets in Washington, D.C. will be available for occupancy in May, 1986. The Beaver House project in The City of London, which is fully leased to The Royal Bank of Canada, is proceeding on schedule with completion expected in June 1987.

Priorities in 1986 for income producing properties will be to increase returns on existing assets through planned expansion and re-leasing programs and to expand the portfolio as opportunities arise.

Natural Resources

Canadian Roxy

Canadian Roxy experienced an outstanding year in 1985, achieving all corporate objectives. Crude oil production averaged 1,945 barrels per day, up 22%, and natural gas production averaged 13.7 million cubic feet per day, up 20%. Crude oil reserves at year end were 77% higher than a year ago.

Revenue and cash flow improved substantially as the result of successful exploration and development. Oil and gas revenue, less royalties, amounted to $28.2 million, an increase of 26%. Cash flow from operations increased to $20.5 million from $14.3 million in 1984, an increase of 43%.

Earnings before unusual items were $2.5 million, virtually unchanged from the year before. As a result of the termination of "PIP" grants and lack of success in finding reserves, Canadian Roxy decided to write off the entire costs, amounting to $5.4 million, of its East Coast drilling program at the end of 1985. This created a net loss for the year of $2.9 million.

Canadian Roxy maintained its emphasis on exploration for crude oil in Western Canada during 1985, concentrating on the search for light to medium crude in north-central Alberta and for natural gas and heavy oil in Saskatchewan and Alberta. Capital expenditures during 1985, net of "PIP" grants, were $27 million, an increase of 10% over 1984. Oil discoveries were made at Elswick and Pinto in Saskatchewan and at Seal, Spirit River and Chauvin in Alberta and follow-up drilling at Elswick has been notably successful.

Canadian Roxy aggressively pursues tertiary recovery as a medium to long-term means of adding reserves and production. Ownership increased in Vikor Resources Ltd. to 93.5% in 1985 and Canadian Roxy believes full-scale commercial operations are possible by 1988.

Reserves of crude oil and natural gas liquids at year-end were nine million barrels, an increase of 77% after the production of 710,000 barrels. Exploration and development drilling at Elswick added most of the new crude oil reserves. Natural gas reserves decreased to 145 billion cubic feet from 158 billion cubic feet in 1984.

The current lower level of crude oil and natural gas prices, together with the uncertainty created in the market, will lead to significantly decreased levels of capital investment in 1986.

Market forces appear likely to more than offset the gains achieved by the industry through federal and provincial fiscal initiatives in 1985.

Canadian Roxy's policy during this period will be to restrict the level of capital investment to discretionary cash flow generated. The Company's current financial position provides the degree of flexibility necessary for it to adapt to the current severe economic conditions while maintaining the ability to take advantage of any improvement in the current situation.

Consolidated Statement of Earnings

Year Ended January 31, 1986

	This Year $ 000's	Last Year $ 000's
Sales and Revenue (Note 2)		
Merchandising:		
Retail	**4,312,682**	3,958,422
Wholesale	**637,659**	581,813
Fur	**41,372**	38,338
	4,991,713	4,578,573
Real estate	**276,112**	243,452
Natural resources	**3,723**	7,300
	5,271,548	4,829,325
Source of Earnings (Note 2)		
Merchandising:		
Retail	**111,415**	3,779
Wholesale	**10,032**	5,319
Fur	**1,975**	8,029
	123,422	17,127
Real estate	**126,434**	87,844
Natural resources	**3,057**	6,912
Operating Profit	**252,913**	111,883
Interest on long-term debt	**(180,575)**	(163,372)
Net short-term interest	**(69,818)**	(35,903)
Earnings (Loss) Before Income Taxes, Minority Interest and Extraordinary Items	**2,520**	(87,392)
Income Taxes (Note 3)	**(12,895)**	(19,292)
Loss Before Minority Interest and Extraordinary Items	**(10,375)**	(106,684)
Minority Interest	**1,320**	(750)
Loss Before Extraordinary Items	**(9,055)**	(107,434)
Gain on Disposition of Merchandise Investments (Note 4)	**3,471**	–
Loss	**(5,584)**	(107,434)
Loss Per Ordinary Share		
Loss before extraordinary items	**($1.23)**	($5.40)
Loss	**($1.09)**	($5.40)

Consolidated Statement of Retained Earnings

Year Ended January 31, 1986

	This Year $ 000's	Last Year $ 000's
Retained Earnings at Beginning of Year	**526,610**	668,926
Loss	**(5,584)**	(107,434)
Dividends Paid		
Preferred shares	**(20,615)**	(20,645)
Ordinary shares	**(14,288)**	(14,237)
Retained Earnings at End of Year	**486,123**	526,610

Hudson's Bay Company

Consolidated Balance Sheet

January 31, 1986

	This Year	Last Year
	$ 000's	$ 000's
Current Assets		
Cash	**8,335**	8,724
Short-term securities (Note 7)	**50,650**	20,223
Accounts receivable	**1,109,743**	923,347
Income taxes recoverable	**5,094**	–
Merchandise inventories	**994,677**	886,799
Prepaid expenses	**28,246**	24,722
	2,196,745	1,863,815
Secured Receivables (Note 5)	**109,555**	58,065
Property For Sale and Future Development	**361,850**	312,843
Investments (Note 6)	**447,165**	504,190
Fixed Assets		
Land	**146,553**	144,576
Buildings	**710,058**	659,087
Equipment and leasehold improvements	**655,658**	648,815
	1,512,269	1,452,478
Less accumulated depreciation	**464,864**	431,997
	1,047,405	1,020,481
Deferred Charges	**90,158**	77,994
Goodwill	**100,892**	106,423
Deferred Income Taxes (Note 3)	**16,455**	7,001
	4,370,225	3,950,812

	This Year	Last Year
	$ 000's	$ 000's
Current Liabilities		
Bank indebtedness (Note 7)	**460,576**	288,912
Notes payable (Note 7)	**473,965**	465,224
Accounts payable and accrued expenses	**612,770**	483,662
Income taxes payable	**–**	6,434
Long-term debt due within one year (Note 7)	**196,398**	173,082
	1,743,709	1,417,314
Long-Term Debt (Note 7)	**1,448,185**	1,403,731
Pensions (Note 8)	**–**	19,993
Minority Interest in Subsidiaries	**64,370**	74,690
Shareholders' Equity		
Capital stock (Note 9):		
Preferred shares	**230,709**	240,486
Ordinary shares	**376,981**	259,489
	607,690	499,975
Additional paid-in capital (Note 10)	**10,378**	9,574
Retained earnings	**486,123**	526,610
Cumulative translation adjustment (Note 1 b))	**9,770**	(1,075)
	1,113,961	1,035,084
	4,370,225	3,950,812

Hudson's Bay Company

Consolidated Statement of Assets Employed

January 31, 1986

	This Year	Last Year
	$ 000's	$ 000's
Merchandising		
Accounts receivable	**1,053,903**	867,670
Inventories	**994,677**	886,799
Accounts payable	**(562,934)**	(455,381)
Other current assets	**28,789**	26,388
Working capital	**1,514,435**	1,325,476
Investments	**115,200**	152,594
Fixed assets	**615,243**	677,655
Goodwill	**70,461**	75,739
Other assets	**117,179**	88,676
Pensions	**–**	(19,993)
	2,432,518	2,300,147
Real Estate		
Working capital	**22,954**	32,148
Secured receivables	**80,939**	44,783
Property for sale and future development	**361,850**	312,843
Investments and fixed assets:		
Shopping centres	**184,243**	199,926
Commercial	**244,724**	168,536
Residential	**87,418**	81,051
Goodwill	**30,431**	30,684
Other assets	**1,595**	2,600
	1,014,154	872,571
Natural Resources		
Working capital	**(4,064)**	(4,128)
Investments and fixed assets	**247,742**	183,251
	243,678	179,123
Assets Employed	**3,690,350**	3,351,841
Provided From		
Debt: (Note 7)		
Floating rate	**64,616**	639,589
Capped floating rate	**570,000**	–
Fixed rate	**1,893,858**	1,609,479
	2,528,474	2,249,068
Deferred income taxes	**(16,455)**	(7,001)
Minority interest in subsidiaries	**64,370**	74,690
Shareholders' equity:		
Preferred shareholders (including accrued dividends)	**233,208**	243,092
Ordinary shareholders	**880,753**	791,992
	1,113,961	1,035,084
	3,690,350	3,351,841

Hudson's Bay Company

Consolidated Statement of Cash Flow and Funding

Year Ended January 31, 1986

	This Year	Last Year
	$ 000's	$ 000's
Cash Flow From Operating Activities		
Earnings (loss) before income taxes, minority interest and extraordinary items	**2,520**	(87,392)
Current income tax expense	**(18,529)**	(18,552)
	(16,009)	(105,944)
Items not affecting cash flow:		
Depreciation and amortization	**92,553**	83,537
Cash received from affiliates and joint ventures in excess of equity earnings	**3,309**	15,149
Write off of pension liability	**(12,111)**	–
Cash inflow (outflow) from earnings	**67,742**	(7,258)
Net effect of changes in non-cash working capital (Note 11)	**(200,489)**	(257,538)
Net cash outflow from operating activities	**(132,747)**	(264,796)
Cash Flow From Investing Activities		
Fixed assets:		
Acquisitions	**(146,857)**	(152,979)
Dispositions	**66,160**	7,768
Investments:		
Acquisitions and net advances	**3,727**	(51,840)
Dispositions	**55,272**	4,994
Property for sale and future development	**(49,007)**	(11,213)
Secured receivables	**(51,490)**	443
Deferred charges	**(8,760)**	(18,639)
Other	**(4,441)**	726
Net cash outflow from investing activities	**(135,396)**	(220,740)
Cash Flow From Dividends		
Preferred shareholders	**(20,615)**	(20,645)
Ordinary shareholders	**(14,288)**	(14,237)
Minority shareholders	**(221)**	(226)
Net cash outflow from dividends	**(35,124)**	(35,108)
Net Cash Outflow From Activities and Dividends	**(303,267)**	(520,644)
Funding		
Debt: (Note 7)		
Long-term:		
Increase	**204,141**	346,597
Reduction	**(182,687)**	(365,355)
Increase in net short-term debt	**173,294**	540,993
	194,748	522,235
Equity:		
Preferred shares	**(8,950)**	(2,242)
Ordinary shares	**117,469**	1,051
Minority interest	**–**	(400)
	108,519	(1,591)
Net Cash Inflow From Funding	**303,267**	520,644

Notes to the Consolidated Financial Statements

Year Ended January 31, 1986

1. Significant Accounting Policies

These consolidated financial statements have been prepared by management in accordance with accounting principles generally accepted in Canada and conform in all material respects with the historical cost accounting standards of the International Accounting Standards Committee. The significant policies are summarized below:

a) Consolidation

These consolidated financial statements include the accounts of Hudson's Bay Company and of all its subsidiary companies.

b) Foreign currency translation

Assets and liabilities denominated in foreign currencies and the assets and liabilities of subsidiaries operating in the United Kingdom and in the United States are translated into Canadian dollars at the exchange rates prevailing at the balance sheet dates with the exception of hedged long-term debt repayable in U.S. dollars, which is translated at the rate at which it is hedged.

Earnings denominated in foreign currencies and the earnings of subsidiaries operating in the United Kingdom and in the United States are translated into Canadian dollars at approximately the exchange rates prevailing at the time they are earned.

Accumulated exchange gains and losses arising from the translation of the financial statements of subsidiaries operating in the United Kingdom and in the United States are classified as "cumulative translation adjustment" under the heading of Shareholders' Equity on the Consolidated Balance Sheet.

c) Leases

All leases, including those relating to store premises, have been classified as operating leases under which rentals are included in determining earnings of the period in which they accrue.

d) Loss per ordinary share

The loss per ordinary share reflects the accrual of preferred dividends and is based on the weighted average number of ordinary shares outstanding during the year.

e) Accounts receivable

In accordance with recognized retail industry practice, accounts receivable classified as current assets include customer instalment accounts of which a portion will not become due within one year.

f) Merchandise inventories

Merchandise inventories are valued at the lower of cost and net realizable value less normal profit margins. The cost of retail inventories is determined principally on an average basis by the use of the retail inventory method and the cost of other inventories is determined on a first-in, first-out basis.

g) Capitalization of interest

Interest that relates to properties which either are held for sale or development or are under construction is capitalized to such assets when their cost is lower than net realizable value. The amount so capitalized during the year is $34,936,000 (last year $29,504,000).

h) Property for sale and future development

Property for sale and future development is carried at the lower of cost and net realizable value at the estimated time of development or sale.

i) Investments

The Company follows the equity method in accounting for its investments in joint ventures and in companies in which the Company's ownership interest exceeds 20% and the Company is able to elect a significant proportion of the board of directors of the investee company.

Canadian Roxy Petroleum Ltd., a consolidated subsidiary of the Company, follows the full cost method of accounting for its investments in natural resource joint ventures whereby all costs of exploring for and developing oil and gas reserves are capitalized to separate cost centres established for Continental Canada and offshore East Coast Canada (see note 6c)). Such costs include those related to lease acquisitions, geological and geophysical activities, rentals on undeveloped properties, costs of drilling both productive and non-productive wells and overhead related to exploration and development activities. Costs accumulated in the Continental Canada cost centre, including provision for necessary future development expenditures, are depleted using the unit-of-production method based upon estimated proven oil and gas reserves. The unamortized costs in the Continental Canada cost centre are reviewed annually to ensure these costs do not exceed a ceiling value which consists of the aggregate of the estimated future undiscounted cash flows from proven reserves, using unescalated costs and current prices, and the appraised value of unproved properties, all net of debt principal and interest related thereto and a provision for income taxes on assets for which there is no corresponding tax basis. If the unamortized costs exceed the ceiling value, the excess is expensed in the current year. All costs, net of incidental revenues with respect to a tertiary recovery pilot project, are being accumulated until the project is completed and commercial scale activities commence, at which time the costs will be amortized on the unit-of-production method. Depreciation of petroleum and natural gas production equipment and related facilities is being provided on the unit-of-production method.

Investments in other companies are carried at cost, with dividends being reflected in earnings when received.

j) Fixed assets

Fixed assets are carried at cost.

Buildings (other than income properties), equipment and leasehold improvements are depreciated on the straight-line method at rates which will fully depreciate the assets over their estimated useful lives. The depreciation rates applicable to the various classes of assets are as follows:

Buildings	2 - 5%
Equipment	7 - 33 1/3%
Leasehold improvements	3 - 10%

Buildings held for the purpose of producing rental income (income properties) are generally depreciated on the sinking fund method at rates ranging between 3% and 5% over terms of 35 to 50 years.

k) Deferred charges

Deferred charges include debt discount and expense, costs associated with currency and interest hedging transactions and unamortized exchange gains and losses on long-term debt denominated in foreign currencies which are amortized on the straight-line method over the terms of the issues to which they relate. The amortization is included with interest on long-term debt in the Consolidated Statement of Earnings.

l) Goodwill

Goodwill comprises the unamortized balance of the excess of the cost to the Company over the fair value of its interest in the identifiable net assets of subsidiaries, principally Markborough Properties Inc. and Zellers Inc., at their respective dates of acquisition.

The goodwill which relates to acquisitions subsequent to 1973, $78,675,000 (last year $84,206,000) after deducting accumulated amortization of $13,627,000 (last year $11,494,000), is being amortized on the straight-line method over 40 year periods.

m) Pension costs

Current pension costs, substantially all of which arise under trusteed pension plans, are charged to operations. The costs of plan improvements are charged to operations over appropriate periods as they are funded.

2. Supplementary Segmented Information

The Company is engaged in merchandising through retail stores, including investments in other companies, through wholesale distribution of tobacco and other products and through fur auction operations. The retail stores include full-line and promotional department stores and stores located in smaller communities. The Company has interests in the real estate industry, principally through its subsidiary, Markborough Properties Inc., and also has interests in natural resources through its subsidiary, Canadian Roxy Petroleum Ltd.

Reported industry segments are merchandising, real estate and natural resources with merchandising further divided, where significant, into retail, wholesale and fur. Information pertaining to these segments is included in these consolidated financial statements and is supplemented by the following additional information.

Sales and revenue include the Company's equity in the pre-tax earnings of companies and joint ventures accounted for under the equity method, as follows:

	This Year	Last Year
	$ 000's	$ 000's
Pre-tax equity earnings (loss):		
Merchandising	**3,258**	969
Real estate	**34,189**	56,838
Natural resources	**1,041**	5,727
	38,488	63,534
Less income taxes thereon	**(11,410)**	(28,880)
Equity earnings	**27,078**	34,654

Other supplementary segmented information related to the Consolidated Statement of Earnings is as follows:

	This Year	Last Year
	$ 000's	$ 000's
Dividends received in respect of investments carried at cost included in revenue and earnings from merchandising operations	**2,688**	2,688
Depreciation and amortization:		
Deducted in arriving at operating profit:		
Merchandising	**71,565**	69,980
Real estate	**5,900**	5,137
Natural resources	**930**	330
	78,395	75,447
Included in interest expense (amortization of deferred charges (see note 1 k))	**14,158**	8,090
	92,553	83,537

Investments in joint ventures and other companies accounted for by the equity method which are included by segment in the Consolidated Statement of Assets Employed are as follows:

	This Year	Last Year
	$ 000's	$ 000's
Merchandising	**7,259**	40,708
Real estate	**86,825**	107,764
Natural resources	**184,022**	182,174
	278,106	330,646

Merchandising assets employed predominantly relate to retail operations. During the year the Company disposed of a number of non-strategic merchandising properties for an aggregate consideration of $64,900,000, resulting in pretax gains of $35,200,000 which have been included in earnings from real estate operations in the Consolidated Statement of Earnings.

The Company has operations outside Canada, including fur and real estate operations in the United Kingdom and in the United States. None of these operations generates 10% or more of the Company's revenue or employs 10% or more of its assets.

3. Income Taxes

The average statutory Canadian income tax rate for the Company this year was 49.0% (last year 48.1%). The following schedule reconciles a nominal provision (credit) at these rates with the amount actually provided in the Consolidated Statement of Earnings.

	This Year	Last Year
	$ 000's	$ 000's
Earnings (loss) before income taxes	**2,520**	(87,392)
Nominal income tax provision (credit) at statutory Canadian income tax rates	**1,235**	(42,074)
Increase (decrease) resulting from:		
Inventory allowance	**(14,514)**	(13,196)
Tax-free dividends	**(1,414)**	(1,399)
Equity in net earnings of affiliates and joint ventures	**2,889**	2,491
Tax effect of current losses not recognized	**24,699**	73,470
Provision for income taxes per Consolidated Statement of Earnings	**12,895**	19,292

Deferred income taxes comprise tax benefits relating to:

	This Year	Last Year
	$ 000's	$ 000's
Losses incurred prior to 1982	**41,000**	43,450
Depreciation	**103,550**	76,050
	144,550	119,500
Less deferred income tax credits	**(128,095)**	(112,499)
	16,455	7,001

Cumulative income tax losses at January 31, 1986 amounted to approximately $645,000,000. Of this total, the Company has taken credit for the potential future income tax recovery from the carry forward of approximately $287,000,000, consisting of $82,000,000 of losses the benefit of which may be carried forward until January 31, 1987 and $205,000,000 in respect of depreciation recorded in the consolidated financial statements but not yet claimed for income tax purposes.

Cumulative income tax losses at January 31, 1986 which have not been recognized in the consolidated financial statements amounted to approximately $358,000,000. These losses may be carried forward until the year ending January 31:
1988 – $64,000,000; 1989 – nil; 1990 – $64,000,000;
1991 – $44,000,000; 1992 – $132,000,000; 1993 – $52,000,000;
1994 – $2,000,000.

4. Gain on Disposition of Merchandising Investments

During the year ended January 31, 1986 the Company disposed of a number of non-strategic merchandising investments as part of a program to dispose of assets that are not part of the mainstream of the Company's business. The proceeds of these disposals totalled approximately $66,000,000, resulting in an aggregate gain of $6,582,000 before income taxes of $3,111,000. Earnings from these operations to date of disposal amounted to $1,577,000 (last year loss of $3,814,000), net of income taxes of $1,100,000 (last year $1,426,000); corresponding revenues were $18,223,000 (last year $46,941,000).

5. Secured Receivables

Secured receivables include mortgages which arise principally from sales of real property and loans outstanding under the employee share ownership plan.

	This Year	Last Year
	$ 000's	$ 000's
Total secured receivables	**167,467**	89,809
Less amounts due within one year classified as accounts receivable	**(57,912)**	(31,744)
	109,555	58,065
Average rate of interest	**10.3%**	9.4%

Maturities during the five years ending January 31, 1991 are as follows:
1987 – $57,912,000; 1988 – $27,735,000; 1989 – $26,702,000; 1990 – $33,356,000; 1991 – $10,706,000.

Under certain conditions, the amounts due may be paid prior to maturity.

6. Investments

Investments comprise the following:

	This Year	Last Year
	$ 000's	$ 000's
Sears Canada Inc.	**102,524**	107,956
Real estate joint ventures	**86,285**	107,764
Natural resource joint ventures	**184,022**	182,174
Dome Petroleum Limited	**61,658**	61,658
Other	**12,676**	44,638
	447,165	504,190

a) Sears Canada Inc. ("Sears")

The investment in Sears consists of 12,764,448 common shares (last year 13,440,798 shares), representing 14.6% (last year 15.4%) of all of the outstanding shares of Sears, and is accounted for by the cost method.

The Company's holding of common shares of Sears is held in escrow by The Royal Trust Company pursuant to the provisions of the Company's $2.25 cumulative redeemable exchangeable preferred shares series F. During the year 676,350 shares of Sears were exchanged for the Company's series F preferred shares (see note 9).

b) **Real estate joint ventures**

The investment in real estate joint ventures, consisting of shopping centre, commercial, industrial and residential interests, is carried at cost plus the Company's equity in undistributed earnings since acquisition. The Comany's share of real estate joint ventures is summarized as follows:

	This Year	Last Year
	$ 000's	$ 000's
Assets		
Accounts receivable	**103,633**	127,060
Property for sale and future development	**192,663**	121,997
Fixed assets, net	**321,509**	279,169
	617,805	528,226
Liabilities		
Bank indebtedness	–	1,114
Accounts payable and accrued expenses	**78,065**	80,707
Long-term debt	**453,455**	338,641
	531,520	420,462
Investment in real estate joint ventures	**86,285**	107,764
Revenue	**123,360**	219,706
Expenses		
Interest	**30,598**	30,532
Depreciation	**4,673**	4,451
Other	**53,900**	127,885
	89,171	162,868
Pre-tax earnings of real estate joint ventures	**34,189**	56,838

The Company is contingently liable at January 31, 1986 for $66,000,000, representing the liabilities of its co-owners in unincorporated joint ventures but against such contingent liability the Company would have a claim upon the joint venture assets of its co-owners. The value of the assets of each of these joint ventures exceeds the contingent liability.

c) **Natural resource joint ventures**

The Company's share of natural resource joint ventures is summarized as follows:

	This Year	Last Year
	$ 000's	$ 000's
Oil and gas properties	**158,282**	170,908
Accounts receivable	**20,955**	10,762
Other assets	**21,185**	10,665
Accounts payable and accrued expenses	**(16,400)**	(10,161)
Investment in natural resource joint ventures	**184,022**	182,174
Revenue	**28,245**	22,501
Expenses		
Depletion and depreciation	**10,241**	8,931
Production and operating costs	**4,907**	4,440
Interest	**2,682**	1,523
Other	**1,789**	1,880
Provision against offshore East Coast Canada cost centre	**7,585**	–
	27,204	16,774
Pre-tax earnings of natural resource joint ventures	**1,041**	5,727

The carrying value of the offshore East Coast Canada cost centre was reduced to nil by Canadian Roxy Petroleum Ltd. at December 31, 1985 to reflect the lack of commercial quantities of reserves.

d) **Dome Petroleum Limited ("Dome")**

At January 31, 1986 the investment in Dome, carried at cost, consisted of 4,110,517 series D preferred shares. On February 10, 1986 Dome acquired the right to cause the Company to exchange each of its series D preferred shares for one 10% series 1 cumulative subordinated convertible preferred share. This right was exercised by Dome on February 17, 1986 and the Company received 4,110,517 series 1 preferred shares on March 12, 1986. On March 13, 1986 Dome announced the suspension of the payment of dividends on all its preferred shares, including the series 1 preferred shares, until June 1, 1987. The Company has the right to convert the series 1 preferred shares to Dome common shares at $3.33 per share and Dome has the right to force conversion at that price if the price of Dome common shares reaches $3.885. If all of the series 1 preferred shares held by the Company were converted, the Company would receive in exchange 18,515,842 common shares of Dome. At January 31, 1986 the closing price of a Dome common share on the Toronto Stock Exchange was $2.73.

To the date of exchange of the series D preferred shares, Dome was obligated to pay interest to the Company, in lieu of dividends otherwise accruing on the series D preferred shares, at a variable rate per annum equal to 2% plus the domestic prime rate of a Canadian chartered bank. The Company offset the interest received against short-term interest expense.

e) **Other**

Other investments include interests in merchandising companies carried at cost plus the Company's equity in undistributed earnings since acquisition.

7. Debt

Total debt of the Company amounts to $2,528,474,000 (last year $2,249,068,000) which may be analyzed by category and by interest obligation as follows:

	This Year	Last Year
	$ 000's	$ 000's
By category:		
Bank indebtedness	**460,576**	288,912
Notes payable	**473,965**	465,224
Long-term debt due within one year	**196,398**	173,082
Less short-term securities[a]	**(50,650)**	(20,223)
Less Dome Petroleum Limited preferred shares (see Note 6 d))	**–**	(61,658)
Net short-term debt	**1,080,289**	845,337
Long-term debt	**1,448,185**	1,403,731
Total debt	**2,528,474**	2,249,068
By interest obligation:		
Floating rate – short-term	**17,116**	522,255
– long-term	**47,500**	117,334
	64,616	639,589
Capped floating rate – short-term[b]	**570,000**	–
	634,616	639,589
Fixed rate – short-term[c]	**296,775**	150,000
– long-term[d]	**1,597,083**	1,459,479
	1,893,858	1,609,479
Total debt	**2,528,474**	2,249,068

Long-term debt comprises the following:

	This Year	Last Year
	$ 000's	$ 000's
Secured on property:		
Hudson's Bay Company Properties Limited		
5¾% first mortgage bonds series A due 1990	**7,684**	7,684
7½% first mortgage bonds series B due 1991	**5,204**	5,204
11½% first mortgage bonds series C due 1995	**23,469**	23,469
9⅞% first mortgage bonds series D due 1997	**35,987**	35,987
10 % first mortgage bonds series E due 1998	**27,407**	27,907
Markborough Properties Inc.		
Mortgages and obligations on property for sale and future development, 9.2% average (last year 11.4%), repayable by instalments to 1993	**134,979**	131,842
Mortgages on income property permanent financing, 11.4% average (last year 11.0%), repayable by instalments to 2005	**117,972**	82,014
Mortgages on income property interim financing, 10.3% average (last year 11.1%), repayable by instalments to 1987	**108,647**	80,374
Canadian Roxy Petroleum Ltd.		
Term loan, 13.875%, due 1987	**13,500**	15,000
Other	**4,346**	7,666
	479,195	417,147
Secured on accounts receivable:		
Hudson's Bay Company		
Floating rate term loan due 1988[d]	**50,000**	–
Hudson's Bay Company Acceptance Limited		
13¼% debentures series C due 1989	**3,437**	4,628
8¾% debentures series D due 1991	**20,000**	20,000
8¼% debentures series E due 1993	**20,000**	20,000
10½% debentures series F due 1996	**22,471**	22,471
13¾% debentures series G due 2001	**47,544**	47,544
Simpsons Acceptance Company Limited		
6¾% debentures series E due 1986	**10,000**	10,000
8⅜% debentures series F due 1992	**10,000**	10,000
8⅜% debentures series G due 1992	**15,000**	15,000
9⅞% debentures series H due 1997	**17,370**	17,370
	215,822	167,013
Secured by floating charge on assets of subsidiaries:		
Zellers Inc.		
7 % sinking fund debentures series C due 1986	**2,393**	2,393
10¼% sinking fund debentures series 1974 due 1994	**8,370**	8,432
	10,763	10,825
Unsecured:		
Hudson's Bay Company		
13¾% series D notes due 1986	**50,000**	50,000
16½% series G notes due 1986	**1,000**	1,000
18 % notes due 1987	**56,060**	56,060
10½% debentures due 1989	**35,064**	37,322
17 % notes due 1989	**33,828**	33,828
12½% note due 1989	**161**	142
14¼% notes due 1989	**50,000**	50,000
13.85% loan due 1990	**25,000**	25,000
11½% debentures due 1990	**91,550**	91,550
Dual currency bonds due 1991-1993 (U.S.$99,000,000)[e]	**141,075**	131,670
10 % debentures due 1994 (U.S.$31,732,000)	**45,218**	42,204
15.36% term loan due 1995-1997 (£5,592,000)	**11,239**	8,332
Floating rate debt:[d]		
Bankers' acceptances due 1985	**–**	50,000
Series F notes due 1986 and 1987[f]	**47,500**	47,500
Promissory notes due 1987	**20,000**	20,000
Syndicated bank loans due 1985-1987	**64,741**	75,561
Term loan due 1988	**57,908**	57,908
Term loan due 1989	**31,352**	31,352
Notes due 1989 (U.S.$50,000,000)	**71,250**	66,500
Bankers' acceptances due 1989	**50,000**	50,000
Notes due 1991	**28,500**	25,608
Simpsons Limited		
5¾% debentures series E due 1985	**–**	188
6½% debentures series F due 1987	**1,655**	1,969
9½% debentures series G due 1989	**2,927**	3,764
8⅜% debentures series H due 1993	**6,870**	6,870
9⅛% debentures series I due 1994	**4,692**	4,692
11¾% debentures series J due 1995	**10,364**	11,864
	937,954	980,884
Subordinated		
Zellers Inc.		
5½% convertible subordinated debentures series 1971 due 1991[g]	**849**	944
	1,644,583	1,576,813
Less amounts due within one year	**(196,398)**	(173,082)
	1,448,185	1,403,731

(a) Short-term securities at January 31, 1986 include interest bearing instruments of $47,400,000 (last year $19,900,000) held by various financial institutions. These instruments, the amount of which increases or decreases depending on movements in international financial markets, were acquired to fulfil obligations of various currency and interest hedging transactions.

(b) The effective interest rate on U.S.$450,000,000 (Canadian equivalent $641,250,000) short-term debt bearing interest at the three or six month LIBOR rate has been capped at 12 1/2% for a term of five or seven years depending on the specific interest rate cap agreement. U.S. $50,000,000 (Canadian equivalent $71,250,000) of the amount quoted above has been allocated to the Markborough Properties Inc. portion of floating rate debt of its joint ventures. This debt is not included in consolidated short-term debt as these joint ventures are accounted for using the equity method.

(c) The effective interest rates on certain short-term debt have been fixed by way of various currency and interest exchange agreements as follows:
$95,875,000 at 12.7% per annum
U.S. $140,980,000 (Canadian equivalent $200,900,000) at an average rate of 12.8% per annum.

(d) The effective interest rates on floating rate long-term debt, other than that referred to in note (f) below, have been fixed by way of various currency and interest exchange agreements as follows:
$120,000,000 at an average rate of 13.0% per annum
U.S.$186,375,000 (Canadian equivalent $253,751,000) at 12.9% per annum

(e) The dual currency bonds bear interest at 8% per annum on a notional principal amount of 165,000,000 Swiss Francs. The effective hedged Canadian equivalent rate on this borrowing is 12.75% per annum.

(f) The floating rate series F notes bear interest at 3% above the average monthly deposit rates of two Canadian chartered banks.

(g) The holders of Zellers Inc. 5 1/2% Convertible subordinated debentures series 1971 have the right until September 1991 to exchange such debentures for ordinary shares of Hudson's Bay Company at the rate of 32.43 ordinary shares per $1,000 of debentures principal.

The majority of the long-term debt is subject to redemption at the option of the issuers at various times or under certain conditions. For the most part, redemption earlier than within three or four years of maturity of the securities would require the payment of redemption premiums.

Aggregate maturities and sinking fund requirements during the five years ending January 31, 1991 are as follows:
1987 – $196,398,000; 1988 – $265,968,000; 1989 – $169,022,000; 1990 – $301,069,000; 1991 – $142,557,000.

8. Pensions

Of the $19,993,000 shown on the balance sheet at the end of last year, an amount of $12,111,000, carried in respect of funded pension plans, was determined to be surplus to requirements. The assets of such plans exceed pension obligations and no further funding payments will be required in respect of obligations incurred to date. Accordingly, this amount, net of deferred income taxes of $8,998,000, is included in current earnings. The remainder of approximately $7,000,000 relating to unfunded plans is included in accrued expenses and will be extinguished by payments to pensioners.

9. Capital Stock

The authorized classes of shares of the Company consist of an unlimited number of ordinary shares without nominal or par value and an unlimited number of preferred shares without nominal or par value. Unlimited numbers of the preferred shares have been designated as "redeemable preferred shares series B", "$1.512 convertible redeemable preferred shares series D" and "redeemable preferred shares series E", 11,750,000 shares have been designated as "$1.80 cumulative redeemable preferred shares series A", 800,000 have been designated as "variable rate, cumulative redeemable preferred shares series C", 4,500,000 have been designated as "$2.25 cumulative redeemable exchangeable preferred shares series F" and 4,500,000 have been designated as "$2.25 cumulative redeemable preferred shares series G".

Shares issued and outstanding comprise the following:

	This Year		Last Year	
	Number of shares	**$ 000's**	Number of shares	$ 000's
Preferred shares:				
$1.80 cumulative redeemable preferred shares series A (stated capital $22.50 each)	**4,806,459**	**108,145**	4,951,259	111,403
Variable rate, cumulative redeemable preferred shares series C (stated capital $25.00 each)	**762,500**	**19,062**	800,000	20,000
$1.512 convertible redeemable preferred shares series D (stated capital $18.00 each)	**52,873**	**952**	61,175	1,101
$2.25 cumulative redeemable exchangeable preferred shares series F (stated capital $22.50 each)	**4,254,816**	**102,548**	4,480,266	107,982
$2.25 cumulative redeemable preferred shares series G (stated capital $22.50 each)	**100**	**2**	–	–
		230,709		240,486
Ordinary shares	**28,886,002**	**376,981**	23,787,166	259,489
		607,690		499,975

The changes in shares issued and outstanding during the two years ended January 31, 1986 are as follows:

	Number of shares	$ 000's
Preferred shares series A:		
Issued and outstanding at January 31, 1984	5,076,334	114,217
Less purchased for cash and cancelled	(125,075)	(2,814)
Issued and outstanding at January 31, 1985	4,951,259	111,403
Less purchased for cash and cancelled	(144,800)	(3,258)
Issued and outstanding at January 31, 1986	4,806,459	108,145
Preferred shares series C:		
Issued and outstanding at January 31, 1984 and January 31, 1985	800,000	20,000
Less purchased for cash and cancelled	(37,500)	(938)
Issued and outstanding at January 31, 1986	762,500	19,062
Preferred shares series D:		
Issued and outstanding at January 31, 1984	65,738	1,183
Less purchased for cash and cancelled	(3,793)	(68)
Less converted into ordinary shares	(770)	(14)
Issued and outstanding at January 31, 1985	61,175	1,101
Less purchased for cash and cancelled	(6,950)	(126)
Less converted into ordinary shares	(1,352)	(23)
Issued and outstanding at January 31, 1986	52,873	952
Preferred shares series F:		
Issued and outstanding at January 31, 1984 and January 31, 1985	4,480,266	107,982
Less converted into series G shares	(100)	(2)
Less exchanged for shares of Sears Canada Inc.	(225,350)	(5,432)
Issued and outstanding at January 31, 1986	4,254,816	102,548
Preferred shares series G:		
Issued in the year ended January 31, 1986 on conversion of series F shares and outstanding at January 31, 1986	100	2
Ordinary shares:		
Issued and outstanding at January 31, 1984	23,728,311	258,424
Issued:		
Under the employee share ownership plan	58,384	1,051
On conversion of series D shares	473	14
Less purchased for cash and cancelled	(2)	–
Issued and outstanding at January 31, 1985	23,787,166	259,489
Issued:		
Under the employee share ownership plan	97,612	2,514
Under the executive stock option plan	2,000	37
Under the dividend reinvestment plan	217,161	5,249
Under the rights offer	4,778,153	109,574
On conversion of series D shares	836	23
On conversion of Zellers Inc. 5½% convertible subordinated debentures series 1971	3,074	95
Issued and outstanding at January 31, 1986	28,886,002	376,981

The series A shares may be redeemed at the Company's option at prices declining from $23.10 at February 1, 1986 to $22.50 after December 31, 1988.

The holders of the series C shares are entitled to receive dividends at the rate of 8.53% until September 15, 1989. On that date and thereafter at five-year intervals the rate will be 52% of the average of the five-year guaranteed investment certificate rate of certain trust companies plus 2%. The shares may be redeemed at the Company's option at their issue price at certain intervals.

The series D shares may be redeemed at the Company's option at prices declining from $18.90 at February 1, 1986 to $18.00 after January 31, 1991. Each series D share is convertible into 0.5752 ordinary shares at the holder's option until January 31, 1991.

Each of the series F shares entitles the holder to acquire three common shares of Sears Canada Inc. ("Sears"), owned by the Company and held in escrow by the Royal Trust Company (see note 6 a)), until March 31, 1990 or until earlier redemption by the Company. The holder may exercise this right by either requiring the Company to redeem the series F share at $25.00 and directing the proceeds to be used to pay for three common shares of Sears, or making a cash payment of $25.00 to purchase three common shares and converting the series F share into one series G share of the Company. The Company may not otherwise redeem the series F shares prior to April 1, 1986. Thereafter, under certain circumstances, these shares may be redeemed at prices declining from $26.00 at April 1, 1986 to $25.00 after March 31, 1992.

The Company has the right to redeem series G shares after March 31, 1988 at prices declining from $26.00 at April 1, 1988 to $25.00 after March 31, 1992. After the expiration of the exchange privilege attached to the series F shares and before the redemption of all of such series F shares, a holder of series G shares will have the right to convert such shares on a share for share basis into series F shares.

In January 1985 the Board approved an Executive Stock Option Plan and allotted one million ordinary shares of the Company for issue thereunder. The plan was ratified by the shareholders on May 28, 1985. Options may be exercised over a five year period commencing one year after the date on which they are granted. To the extent that they have not been exercised, options expire on the sixth anniversary of their date of issue. As at January 31, 1986 options are outstanding with a number of employees to purchase, in aggregate, up to 754,000 ordinary shares at their fair market value on the respective dates on which they were granted. Details of the outstanding options are as follows:

Number of Shares Under Option Outstanding	Date Granted	Issue Price	Date of Expiry
		$	
619,000	January 25,1985	18.50	January 25, 1991
69,000	June 18, 1985	19.75	June 18, 1991
33,500	September 10, 1985	23.25	September 10, 1991
32,500	November 29, 1985	26.875	November 29, 1991
754,000			

During the year ended January 31, 1986 options in respect of 2,000 shares were exercised at a price of $18.50 per share.

On November 25, 1985 the Board approved a Rights Offer whereby holders of ordinary shares on December 20, 1985 were entitled to subscribe for one additional ordinary share at a price of $23.00 for each five shares held. The rights expired on January 16, 1986, at which time 4,593,636 shares had been subscribed for. Under an additional subscription privilege, which formed a part of the Rights Offer, shareholders had committed to acquire the remaining 184,517 shares on or before February 10, 1986. The total proceeds of the Rights Offer were recorded as of January 31, 1986 and that portion of the proceeds received during the first ten days of February 1986, $4,225,000, is included in accounts receivable.

Effective with the dividend paid on October 31, 1985, the Company introduced a Dividend Reinvestment Plan which provides a means for eligible holders of ordinary shares to reinvest dividend proceeds in new ordinary shares at 95% of their market price. At January 31, 1986 elections to participate in the plan had been received from the holders of approximately 73.6% of the ordinary shares.

The cost of shares redeemed or purchased for cash and cancelled in each of the two years ended January 31, 1986 has been allocated as follows:

	Cost	Allocated to	
		Capital stock	Additional paid-in capital
	$ 000's	$ 000's	$ 000's
In the year ended January 31, 1986:			
Preferred shares series A	2,483	3,258	(775)
Preferred shares series D	97	126	(29)
	2,580	3,384	(804)
In the year ended January 31, 1985:			
Preferred shares series A	2,180	2,814	(634)
Preferred shares series D	62	68	(6)
	2,242	2,882	(640)

10. Additional Paid-in Capital

The amount at January 31, 1986 and the changes during the two years then ended are as follows:

	This Year	Last Year
	$ 000's	$ 000's
Amount at beginning of year	**9,574**	8,934
Excess of stated value over cost of shares purchased for cash and cancelled	**804**	640
Amount at end of year	**10,378**	9,574

11. Consolidated Statement of Cash Flow and Funding

The "net effect of changes in non-cash working capital" appearing in the Consolidated Statement of Cash Flow and Funding comprises the following:

	This Year	Last Year
	$ 000's	$ 000's
Decrease (increase):		
Accounts receivable	**(186,396)**	(170,097)
Merchandise inventories	**(107,878)**	(119,789)
Prepaid expenses	**(3,524)**	(4,844)
Income taxes recoverable - net	**(11,528)**	20,894
Increase in accounts payable and accrued expenses	**108,837**	16,298
	(200,489)	(257,538)

12. Leases

a) As lessee

The Company conducts a substantial part of its merchandising operations from leased premises. All leases involving the Company as lessee have been accounted for as operating leases.

Rental expenses charged to earnings amount to $105,700,000 (last year $96,500,000).

The future minimum rental payments required under leases having initial or remaining noncancellable lease terms in excess of one year are summarized as follows:

	$ 000's
Year ending January 31, 1987	99,400
1988	93,700
1989	84,200
1990	78,800
1991	76,600
Thereafter	985,800
Total minimum lease payments	1,418,500

In addition to these rental payments (and, in a few cases, relatively minor contingent rentals), the leases generally provide for the payment by the Company of real estate taxes and other related expenses.

b) As lessor

The Company leases space to others in a number of regional shopping centres and commercial properties. All of these leases are classified as operating leases.

Fixed assets in the Consolidated Balance Sheet include real estate leased to others under operating leases amounting to $430,200,000 (last year $344,000,000), net of accumulated depreciation of $30,900,000 (last year $28,200,000).

Real estate revenues include rentals from the above properties of $59,200,000 (last year $52,500,000).

13. Related Party Transactions

The Company is involved in numerous transactions with related parties in the ordinary course of its business. None of these transactions is significant in relation to these consolidated financial statements.

Approval of Consolidated Financial Statements

These consolidated financial statements, including the notes thereto, have been reviewed by the Audit Committee of the Board of Directors, a majority of whom are outside directors, and have been approved by the Board on the recommendation of the Audit Committee.

On behalf of the Board:

Director

Marcel Bélanger

Director

Toronto, Canada
March 14, 1986

PEAT MARWICK

Auditors' Report to the Shareholders

We have examined the consolidated balance sheet and the consolidated statement of assets employed of Hudson's Bay Company as at January 31, 1986 and the consolidated statements of earnings, retained earnings and cash flow and funding for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these consolidated financial statements present fairly the financial position of Hudson's Bay Company as at January 31, 1986 and the results of its operations and its cash flow and funding for the year then ended in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Peat, Marwick, Mitchell & Co.

Chartered Accountants

Toronto, Canada
March 14, 1986

Hudson's Bay Company

Ten Year Consolidated Financial Summary

	1985
Results For The Year	
(in thousands of dollars)	
Sales and revenue:	
Retail	4,312,682
Wholesale	637,659
Fur	41,372
Merchandising	4,991,713
Real estate	276,112
Natural resources	3,723
Total sales and revenue	5,271,548
Source of earnings:	
Retail	111,415
Wholesale	10,032
Fur	1,975
Merchandising	123,422
Real estate	126,434
Natural resources	3,057
Operating profit	252,913
Interest expense	(250,393)
Earnings (loss) before income taxes and minority interest	2,520
Income taxes	(12,895)
Earnings (loss) before minority interest	(10,375)
Minority interest	1,320
Earnings (loss) before extraordinary items	(9,055)
Extraordinary items	3,471
Net earnings (loss)	(5,584)
Dividends paid:	
Preferred shares	20,615
Ordinary shares	14,288
Cancellation of ordinary shares	–
Increase (decrease) in retained earnings	(40,487)
Capital expenditures	146,858
Depreciation	69,376
Year End Financial Position	
(in thousands of dollars)	
Merchandising	2,432,518
Real estate	1,014,154
Natural resources	243,678
Assets employed	3,690,350
Debt	2,528,474
Deferred income taxes	(16,455)
Minority interest	64,370
Preferred shareholders' interest (including accrued dividends)	233,208
Ordinary shareholders' equity	880,753
Results Per Ordinary Share	
(in dollars)	
Earnings (loss) before extraordinary items	(1.23)
Net earnings (loss)	(1.09)
Dividends	.60
Shareholders' equity	30.49
Shareholders and Employees	
Number of ordinary shareholders	14,000
Ordinary shares outstanding (in thousands)	28,886
Range in share price (in dollars)	28-15⅛
Number of employees	39,000

Note: Where appropriate, figures have been restated for the purpose of comparability.

1984	1983	1982	1981	1980	1979	1978	1977	1976
3,958,422	3,618,145	3,427,378	3,443,040	3,190,191	2,847,927	1,432,712	1,019,831	992,575
581,813	522,857	485,153	497,058	460,356	408,434	356,967	323,810	263,461
38,338	39,763	38,311	42,604	63,342	66,302	42,568	34,059	26,987
4,578,573	4,180,765	3,950,842	3,982,702	3,713,889	3,322,663	1,832,247	1,377,700	1,283,023
243,452	176,946	126,945	173,003	83,828	96,263	48,712	36,004	52,945
7,300	12,817	60,884	16,737	16,169	16,283	15,343	13,686	10,480
4,829,325	4,370,528	4,138,671	4,172,442	3,813,886	3,435,209	1,896,302	1,427,390	1,346,448
3,779	53,861	7,696	81,858	153,314	177,755	76,495	40,912	34,922
5,319	10,102	10,016	13,060	11,856	8,737	7,392	8,064	7,622
8,029	(4,019)	4,342	12,058	17,556	26,508	11,092	7,706	6,286
17,127	59,944	22,054	106,976	182,726	213,000	94,979	56,682	48,830
87,844	52,681	47,012	67,035	33,349	26,300	17,842	14,856	23,207
6,912	12,535	60,584	16,248	15,735	16,283	15,343	13,686	10,480
111,883	125,160	129,650	190,259	231,810	255,583	128,164	85,224	82,517
(199,275)	(173,696)	(261,307)	(244,307)	(136,533)	(113,741)	(47,868)	(37,351)	(33,443)
(87,392)	(48,536)	(131,657)	(54,048)	95,277	141,842	80,296	47,873	49,074
(19,292)	30,142	8,677	57,208	(30,541)	(52,073)	(29,757)	(16,095)	(21,184)
(106,684)	(18,394)	(122,980)	3,160	64,736	89,769	50,539	31,778	27,890
(750)	488	800	573	(10,186)	(9,423)	(5,894)	(1,897)	(3,080)
(107,434)	(17,906)	(122,180)	3,733	54,550	80,346	44,645	29,881	24,810
—	82,806	(5,420)	382,435	18,811	23,175	98,367	—	—
(107,434)	64,900	(127,600)	386,168	73,361	103,521	143,012	29,881	24,810
20,645	19,918	11,437	11,746	11,874	10,866	—	—	—
14,237	14,234	17,815	28,510	28,455	25,481	16,111	9,181	8,391
—	2,174	552	6,603	—	—	—	—	—
(142,316)	28,574	(157,404)	339,309	33,032	67,174	126,901	20,700	16,419
152,979	94,666	120,335	147,600	172,329	124,977	58,915	43,075	38,163
65,652	62,702	59,827	51,414	43,909	38,886	21,301	16,473	14,598
2,300,147	2,056,035	2,119,307	2,132,011	1,881,474	1,747,420	1,522,050	601,610	525,960
872,571	743,940	742,565	689,182	562,921	408,884	313,750	246,843	231,782
179,123	169,718	592,092	640,594	166,438	133,561	134,084	29,595	23,881
3,351,841	2,969,693	3,453,964	3,461,787	2,610,833	2,289,865	1,969,884	878,048	781,623
2,249,068	1,717,233	2,306,074	2,133,906	1,639,498	1,343,484	1,124,318	535,470	463,473
(7,001)	(1,300)	30,559	51,326	56,566	64,118	54,937	45,306	43,706
74,690	75,046	68,296	69,270	53,557	49,598	58,505	21,308	20,022
243,092	244,786	142,019	147,345	149,499	154,744	136,329	—	—
791,992	933,928	907,016	1,059,940	711,713	677,921	595,795	275,964	254,422
(5.40)	(1.63)	(5.63)	(.34)	1.80	2.98	2.74	2.12	1.77
(5.40)	1.86	(5.86)	15.78	2.59	3.98	8.79	2.12	1.77
.60	.60	.75	1.20	1.20	1.10	.91	.65	.60
33.29	39.36	38.00	44.58	30.01	28.59	25.80	19.50	18.05
15,000	16,100	18,300	19,300	20,800	22,500	30,600	20,900	21,900
23,787	23,728	23,870	23,777	23,712	23,712	23,092	14,155	14,096
23½-17	25¾-20⅛	23-15	30⅝-20¼	31¾-23	35-21¼	24½-17⅛	19⅛-14⅛	20⅞-13½
42,500	44,000	45,000	48,000	47,000	46,000	45,000	20,000	20,000

Directors and Officers

Hudson's Bay Company

Board

Ian A. Barclay
Vancouver
Vice-Chairman of the Board
British Columbia Forest
Products Limited

Marcel Bélanger
Quebec
President
Gagnon et Bélanger Inc.

J. W. (Bud) Bird
Fredericton
President and General Manager
J.W. Bird and Company Ltd.

W. Michael Brown
New York
President
International Thomson
Organization Limited

Graham R. Dawson
Vancouver
President
G.R. Dawson Holdings Ltd.

Thomas S. Dobson
Calgary
Chairman
Easton United Securities
Limited

Gurth C. Hoyer Millar
London, England
Director
J. Sainsbury PLC

Sir Martin Jacomb
London, England
Deputy Chairman
Barclays de Zoete Wedd

George J. Kosich
Toronto
Executive Vice-President
Hudson's Bay Company

Pierre Laurin
Montreal
Vice-President and Director,
Corporate Planning and
Administration
Aluminum Company of
Canada Limited

Alexander J. MacIntosh
Toronto
Partner
Blake, Cassels & Graydon

Donald S. McGiverin
Toronto
Governor
Hudson's Bay Company

Dawn R. McKeag
Winnipeg
President
Walford Investments Ltd.

Peter W. Mills
Toronto
Vice-President and
General Counsel
The Woodbridge Company Ltd.

David E. Mitchell
Calgary
President
Alberta Energy Company Ltd.

T. Iain Ronald
Toronto
Executive Vice-President
Hudson's Bay Company

J. Michael Scott
Toronto
Vice-Chairman
McLeod Young Weir Ltd.

Kenneth R. Thomson
Toronto
Chairman of the Board and
President
Thomson Newspapers Limited

John A. Tory
Toronto
President
The Thomson Corporation Ltd.

Principal Subsidiaries/ Divisions

The Bay Dept. Stores

George J. Kosich
Chief Executive Officer

C.W. (Wally) Evans
President

Simpsons Limited

George J. Kosich
Chairman and Chief
Executive Officer

Allan W. Brent
President

Zellers Inc.

T. Iain Ronald
Chairman and Chief
Executive Officer

Eric Paul
President

The Bay Northern Stores

Marvin E. Tiller
Vice-President

Hudson's Bay Wholesale

J. Lorne Klapp
Vice-President

Hudson's Bay Company Fur Sales

Hugh M. Dwan
President

Markborough Properties Inc.

T. Iain Ronald
Chairman of the Board

Peter A. Anker
President

Canadian Roxy Petroleum Ltd.

Peter W. Wood
Chairman of the Board

Joseph R. Dundas
President

Officers

Donald S. McGiverin
Governor

George J. Kosich
Executive Vice-President

T. Iain Ronald
Executive Vice-President

Douglas W. Mahaffy
Senior Vice-President
Finance and Administration

Stuart W. Fraser
Vice-President, Planning

Brian C. Grose
Vice-President and Controller

Robert N.D. Hogan
Vice-President, Credit

A. Rolph Huband
Vice-President and Secretary

Peter F.S. Nobbs
Vice-President and Treasurer

Donald C. Rogers
Vice-President
Real Estate and Development

Larry W. Rowe
Vice-President
Information Services

B. Lynn Jones
Assistant Treasurer

Corporate Information

Corporate Data

Registered Office
Hudson's Bay House, 77 Main Street,
Winnipeg, Manitoba R3C 2R1

Corporate Office
401 Bay Street
Toronto, Ontario M5H 2Y4

Principal Bankers
Bank of Montreal
Canadian Imperial Bank of Commerce
The Bank of Nova Scotia
The Royal Bank of Canada
The Toronto-Dominion Bank

Registrars and Transfer Agents
The Royal Trust Company, Calgary, Montreal, Toronto, Vancouver and Winnipeg
The Royal Bank of Scotland PLC, London

Stock Exchange Listings
Ordinary Shares – London, Montreal, Toronto and Winnipeg
Preferred Shares:
Series A – Montreal, Toronto and Winnipeg
Series F – Montreal and Toronto

Auditors
Peat, Marwick, Mitchell & Co.

Principal Subsidiary Companies
(wholly owned unless otherewise indicated)

Canadian Roxy Petroleum Ltd. (54.3%)
Petroleum company

Markborough Properties Inc.
Property development company

Simpsons Limited
Department store company

Zellers Inc.
Department store company

Retail Space

The Bay Department Stores	10,349,000 sq. ft.
Zellers Group	16,115,000 sq. ft.
Simpsons	4,877,000 sq. ft.

Real Estate Holdings

Markborough Properties Inc.	Net Interest
41 shopping centres	7,533,000 sq. ft.
14 Office/commercial buildings	1,554,000 sq. ft.
25 industrial buildings	832,000 sq. ft.
Construction in progress	401,000 sq. ft.
1 Hotel	192 rooms
2 apartment buildings	340 suites
and land for future development	

Petroleum Reserves
at December 31, 1985
(working interest before royalty)

Canadian Roxy Petroleum Ltd.	HBC Net Interest
Crude Oil and natural gas liquids	4,966,000 bbls
Natural gas	79,000 mmcf

The Company – A Brief History

Incorporation
King Charles II granted on May 2, 1670 to 18 Adventurers, a Charter incorporating them as The Governor and Company of Adventurers of England trading into Hudson's Bay. This followed the successful voyage of the ketch "Nonsuch", with des Groseilliers aboard, to Hudson Bay to trade for furs.

In 1970, three hundred years after its incorporation, the Company was continued as a Canadian corporation and the headquarters were transferred from the United Kingdom to Canada.

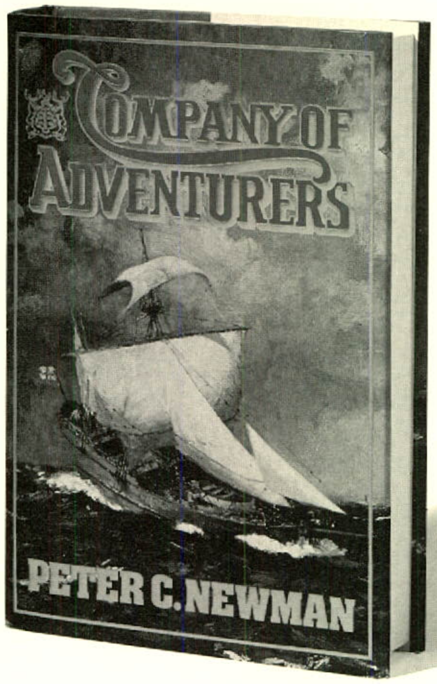
The Fur Trade
During the first century of the Company's existence, the men on the Bay established forts and traded with the Indians.

As competition from the Montreal-based North West Company increased in the 1770's, the Company moved into the interior and gradually built a network of routes and forts spread out over the North and West. The two rival companies amalgamated under the Hudson's Bay Company name in 1821.

Deed of Surrender
In 1870, by Deed of Surrender, the Company's chartered territory was formally transferred to the Government of Canada in return for farm lands in the prairie provinces which were sold to settlers during the next 85 years.

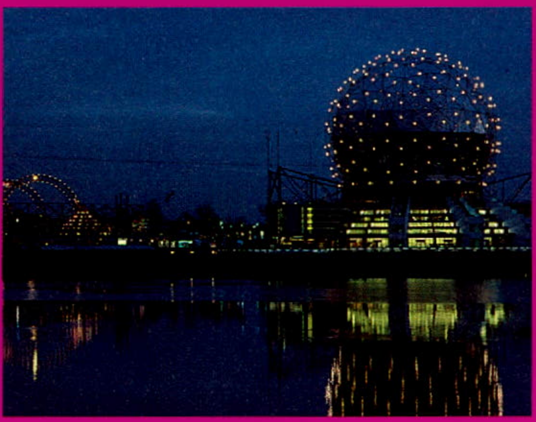
Following the Deed of Surrender, the Company turned its attention to the retail trade, which is now its most important activity.

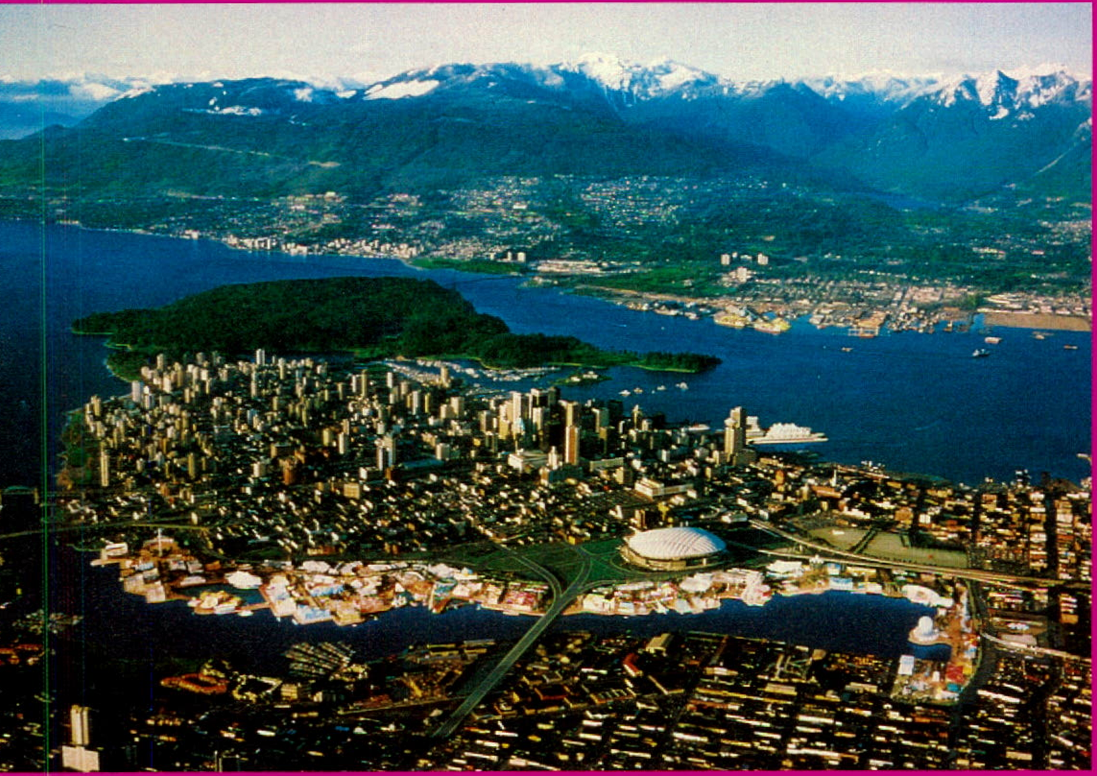
Twentieth Century
The Company built downtown department stores in each of the major cities of western Canada (1913-1968). It co-founded Hudson's Bay Oil and Gas Company Limited (1926). It acquired Henry Morgan & Co. Limited (1960), A. J. Freiman Limited (1971) and 35% of Siebens Oil & Gas Ltd. (1973). It acquired control of Markborough Properties Limited (1973), Simpsons Limited (1978) and Zellers Inc. (1978). It disposed of its Siebens investment (1979), acquired control of Roxy Petroleum (1980) and disposed of its HBOG investment (1982).



"**Company of Adventurers**" is the first of a two volume history in which Peter C. Newman, well known for his pioneering studies of power in Canadian society, explores "the impact of Hudson's Bay Company on Canada as a nation and as a state of mind". Officially launched on the deck of the "Nonsuch" in the Manitoba Museum in October, the book quickly moved up to number one on the best seller lists and is now in its third printing. It has also been published in the United States and in England.

Expo, Vancouver and The Bay

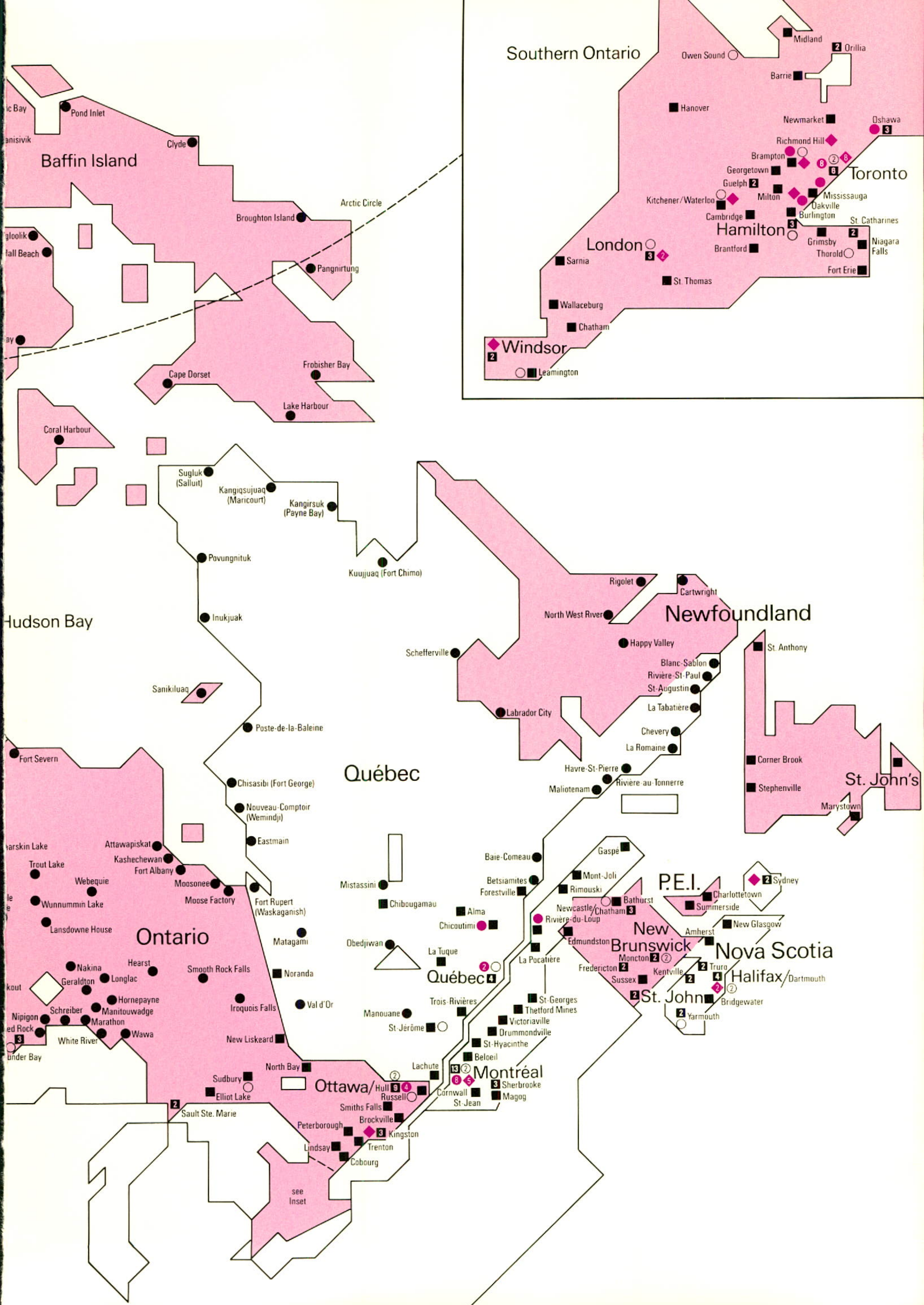




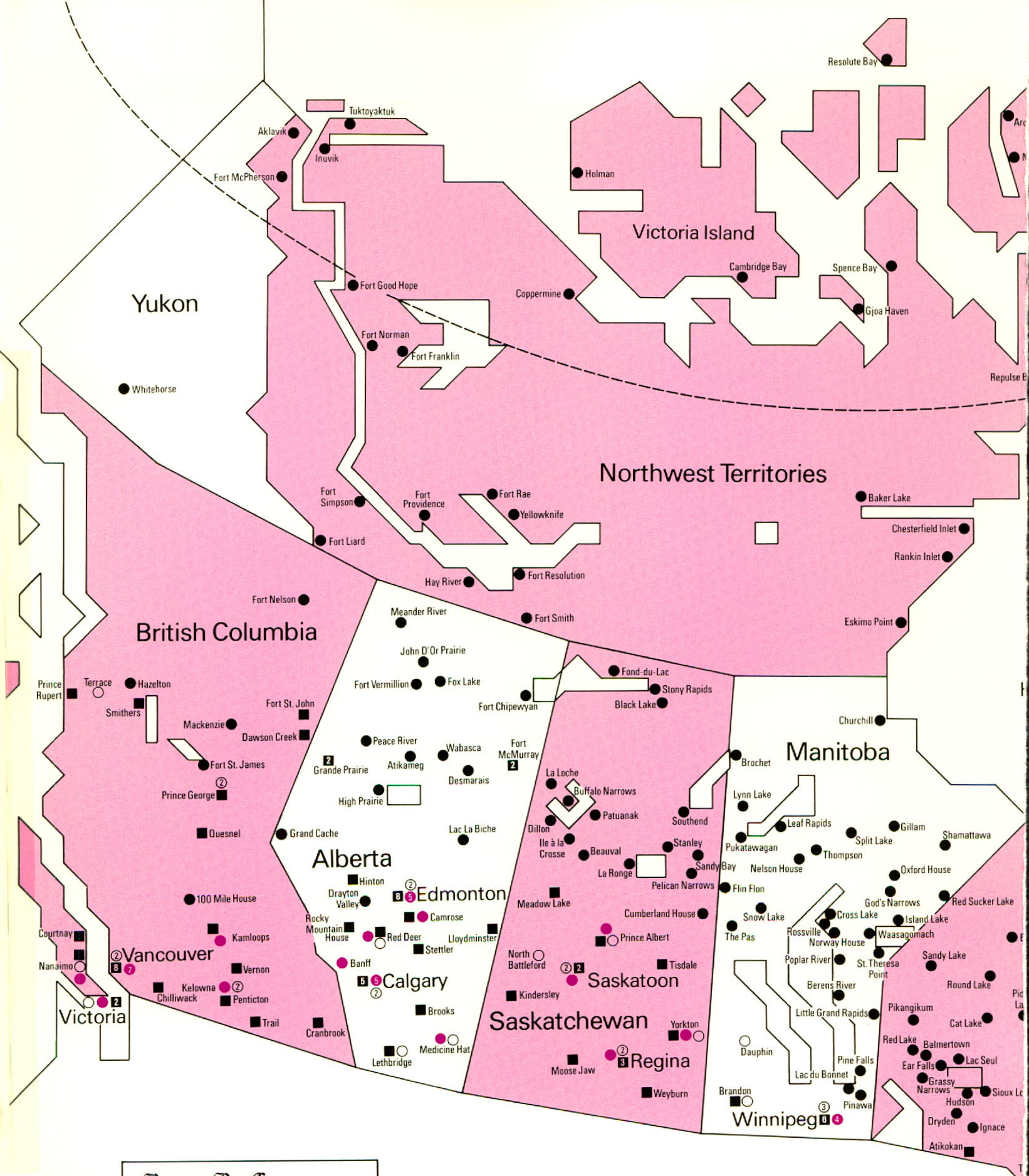
Vancouver, Canada's Pacific metropolis nestled at the foot of the spectacular Coastal Mountain Range, will host Expo '86 from May 2nd to October 13th this year. Millions of visitors will sample the wonders of 80 dazzling pavilions, the excitement of a world festival of the arts and the delights of the city itself.

Vancouver recently celebrated Expo's theme – transportation and communication – by opening Skytrain, a new advanced technology transit system.

The Bay, an institution in Vancouver since 1887, joins the festivities by co-sponsoring the North West Territories Pavilion and by showing off the multi-million dollar modernization of its landmark downtown store. The soft-goods areas have been transformed into a kaleidoscope of colour and new vertical transportation has been installed to speed customers from the new Granville transit station directly into the store. Photos: 1. North West Territories Pavilion, 2. Expo Centre, 3. Skytrain, 4. The Bay downtown – junior fashions, 5. Vancouver showing Expo sites.



Southern Ontario
Midland
Orillia
Owen Sound
Barrie
Hanover
Newmarket
Oshawa
Richmond Hill
Brampton
Georgetown
Toronto
Guelph
Kitchener/Waterloo
Milton
Mississauga
Oakville
Burlington
Cambridge
Hamilton
St. Catharines
Grimsby
Niagara Falls
Thorold
Brantford
London
Sarnia
Fort Erie
St. Thomas
Wallaceburg
Chatham
Windsor
Leamington
Baffin Island
Pond Inlet
Clyde
Arctic Circle
Broughton Island
Pangnirtung
Cape Dorset
Frobisher Bay
Lake Harbour
Coral Harbour
Sugluk (Salluit)
Kangiqsujuaq (Maricourt)
Kangirsuk (Payne Bay)
Povungnituk
Kuujjuaq (Fort Chimo)
Inukjuak
Hudson Bay
Rigolet
Cartwright
North West River
Newfoundland
Happy Valley
Schefferville
St. Anthony
Blanc-Sablon
Rivière-St-Paul
St-Augustin
La Tabatière
Labrador City
Chevery
La Romaine
Sanikiluaq
Poste-de-la-Baleine
Fort Severn
Québec
Havre-St-Pierre
Rivière-au-Tonnerre
Maliotenam
Corner Brook
Stephenville
St. John's
Marystown
Chisasibi (Fort George)
Nouveau-Comptoir (Wemindji)
Eastmain
Attawapiskat
Kashechewan
Fort Albany
Trout Lake
Webequie
Wunnummin Lake
Lansdowne House
Moosonee
Moose Factory
Fort Rupert (Waskaganish)
Baie-Comeau
Gaspé
Mont-Joli
Rimouski
Betsiamites
Forestville
Mistassini
Chibougamau
Alma
Chicoutimi
P.E.I.
Sydney
Charlottetown
Summerside
Bathurst
Newcastle/Chatham
Rivière-du-Loup
New Glasgow
Amherst
New Brunswick
Nova Scotia
Edmundston
La Pocatière
Moncton
Fredericton
Truro
Kentville
Sussex
Halifax/Dartmouth
St. John
Bridgewater
Yarmouth
Ontario
Matagami
Obedjiwan
La Tuque
Québec
Noranda
Hearst
Smooth Rock Falls
Nakina
Geraldton
Longlac
Hornepayne
Manitouwadge
Schreiber
Marathon
Nipigon
Wawa
White River
Iroquois Falls
Val d'Or
Trois-Rivières
St-Georges
Thetford Mines
Victoriaville
Drummondville
Manouane
St-Jérôme
New Liskeard
St-Hyacinthe
Beloeil
Lachute
Montréal
North Bay
Sudbury
Elliot Lake
Ottawa/Hull
Russell
Sherbrooke
Magog
Cornwall
St-Jean
Sault Ste. Marie
Smiths Falls
Brockville
Peterborough
Kingston
Trenton
Lindsay
Cobourg
see Inset



Hudson's Bay Company

Retail and Wholesale Locations
January 31, 1986

- ● The Bay Department Stores (61)
- ● The Bay Northern Stores (173)
- ◆ Simpsons (24)
- ■ Zellers (216)
- ○ Wholesale Branches (52)

Excludes Fields stores in Western Canada (92) and Just Kids in Ontario (15)