PRO PELLE CUTEM

Hudson's Bay Company

ANNUAL REPORT 1988

Company Profile

Hudson's Bay Company is Canada's oldest and one of its largest enterprises, with holdings in merchandising and real estate. It owns and operates four major retail companies, The Bay, Simpsons, Zellers and Fields, and a large real estate development subsidiary, Markborough Properties Inc.

Through its four operating divisions, Hudson's Bay Company covers the Canadian retail market across all price zones and from coast to coast. On a combined basis, it is Canada's largest retailer, accounting for approximately 7% of retail sales (excluding food and autos). Markborough is engaged in the ownership and management of shopping centres and office buildings and in the development of land, principally in Canada and the United States.

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

A Brief History

King Charles II granted, on May 2, 1670, to 18 investors, 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", to trade for furs. During its first century, the Company established forts on Hudson Bay and traded with the Indians.

As competition from the North West Company increased in the 1780's the Company moved into the interior. The two rival companies amalgamated in 1821 under the Hudson's Bay Company name.

In 1870, the Company's chartered territory, Rupertsland, was 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.

Early in this century, the Company turned its attention to retailing which became its most important activity.

The Company built downtown department stores in each of the major cities of Western Canada (1913-1968). It moved into eastern Canada through acquisitions (1960 and 1971) and expanded to the suburbs of major Canadian cities beginning in the 1960's. It acquired Zellers in 1978 and Simpsons the following year.

In real estate, the Company acquired control of Markborough Properties in 1973.

The Company had major investments in oil and gas (Hudson's Bay Oil & Gas, Siebens and Roxy Petroleum) between 1950 and 1987.

In 1979, Kenneth R. Thomson and his family interests acquired a 75% controlling interest in the Company.

Hudson's Bay Company was continued as a Canadian corporation in 1970.

Financial Highlights

	This Year 1988 $ millions	Last Year 1987 $ millions
Merchandising		
Sales and Revenue	**4,491.0**	4,344.8*
Operating Profit	**219.5**	168.6*
Real Estate		
Operating Profit (Before Asset Write Downs)	**64.1**	60.2
Asset Write Downs	—	(196.6)
Earnings (Loss)		
Before Asset Write Downs and Extraordinary Items	**49.2**	23.2
Before Extraordinary Items	**49.2**	(78.5)
Extraordinary Items	**(27.0)**	(18.0)
Earnings (Loss) After Extraordinary Items	**22.2**	(96.5)
Cash Flow From Earnings	**134.1**	148.5*
Capital Expenditures	**76.0**	88.6*
Ordinary Shareholders' Equity	**705.7**	714.4

Per Ordinary Share	**$**	$
Earnings (Loss)		
Before Asset Write Downs and Extraordinary Items	**0.73**	(0.17)
Before Extraordinary Items	**0.73**	(3.58)
After Extraordinary Items	**(0.16)**	(4.18)
Cash Flow From Earnings	**3.50**	4.03*
Dividends	**0.60**	0.60
Equity	**22.77**	23.67

*Excluding discontinued operations

Directors' Report to Shareholders

Summary

1988 was an encouraging year for your company; we achieved our best results since 1980. Earnings per share before extraordinary items were 73¢ compared with a loss per share, on a comparable basis, of 17¢ in 1987.

Don McGiverin, Governor

The improvement was achieved because operating profits from both major segments of the company — merchandising and real estate — increased in 1988. The improvement in merchandising operating profit was particularly encouraging because of its magnitude, up 30.2%, and because it continues a four year upward trend.

We expect to achieve further gains in our merchandising and real estate operating profits during the current year.

Notable Events of 1988

Simpsons Montreal

The Bay and Simpsons department stores in Montreal were merged on January 28, 1989 and in future will operate under the Bay name. The merger resulted from an ongoing review of under performing assets. Simpsons Montreal had been losing money for many years. Substantial investment would have been required for store modernization and projections showed that the merger of the two businesses would reduce the amount of new investment needed and greatly enhance the rate of return on capital invested.

Three Simpsons stores, at Anjou, Laval and Pointe Claire, were transferred to the Bay. Two stores, Downtown and St. Bruno, where facilities were duplicated by the Bay, were closed.

The Simpsons Downtown store property, a prime office/retail site, will be transferred to Markborough Properties for redevelopment.

Hudson's Bay Company is committed to a large and growing investment in Montreal and the Province of Quebec through the activities of the Bay, Zellers and Markborough.

Downtown Toronto Development

After an exhaustive hearing process, the Bay Adelaide project (50% owned by Markborough) in downtown Toronto, appears to be close to receiving necessary municipal approvals. This high quality commercial development on the last major site in the city's financial core will be a significant feature on the Toronto skyline and streetscape and will bring many benefits to the city, including an urban park, off site low cost housing and completion of the underground concourse from Front to Dundas Streets. This underground concourse will provide thousands of people working in the downtown business core with access from three directions to Simpsons downtown store without setting foot outdoors. The Bay Adelaide project should, over the long term, be beneficial to both the retail and real estate segments of your company.

Red Carpet Bankruptcy

Red Carpet Distribution Inc., which had purchased the assets of the former Hudson's Bay Wholesale division in a leveraged buyout in 1987, defaulted on its obligations to a major bank. In August 1988 the assets of Red Carpet were seized by the bank. At the time, Red Carpet was indebted to Hudson's Bay Company for about $60 million. An after tax provision of $27.0 million was recorded in the second quarter to cover the expected loss.

George Kosich, President

The Arcadian Court in Simpsons Downtown, an institution with Toronto diners, was elegantly remodelled in 1988.

The final amount of the loss will depend on the priority of various claims and may not be known for some time. Our provision is expected to be adequate and may prove to be conservative.

Northern Stores Investment

The performance of Northern Stores Inc., which purchased the assets of the former Northern Stores division in another leveraged buyout in 1987, was very different from that of Red Carpet. Northern Stores Inc. paid off, ahead of schedule, the entire $34.0 million balance owing on the buyout. Part of the proceeds, $8.0 million, was converted to an equity investment in Northern Stores Inc., representing 14.4% of its outstanding shares.

1988 Results

The Company recorded earnings before extraordinary items of $49.2 million compared with a loss the year before of $78.5 million (which included an after tax write down of $101.7 million in real estate assets). After payment of preferred dividends the earnings per share were 73¢ in 1988 compared with a loss of 17¢ per share before write down and a loss of $3.58 per share after write down in 1987.

Sales and Revenue increased by 3.0% in 1988 to $4.7 billion. A 9.0% increase at Zellers more than made up for marginal sales reductions at the Bay and Simpsons.

Merchandising operating profits increased in 1988 for the fourth consecutive year to $219.5 million, up 30.2% from $168.6 million the year before.

Zellers performed very strongly with operating profit ahead by $48.1 million to $139.2 million. The improvement resulted from higher sales and lower expenses. After a disappointing spring season the Bay recovered to achieve a $6.6 million gain in operating profit due to a higher rate of gross profit. At Simpsons, operating profit was up by $1.4 million, also the result of an improved gross profit rate.

Weak fur prices and lower volumes led to an operating loss of $6.1 million at our remaining fur auction operation in New York, a deterioration of $3.7 million from the year before.

In real estate, operating profit of Markborough increased to $54.8 million in 1988 from $47.9 million (prior to write down) the year before. Both the land development and income properties divisions of Markborough contributed to the gain.

Operating profit from other real estate activities declined in 1988 to $9.3 million from $12.3 million the year before. Profit in both years arose mainly from the disposition of surplus merchandising properties.

Directors' Report to Shareholders (Cont'd)

Cosmetics, jewellery and fashion accessories are featured in the beautifully remodelled main floor of the Bay, Downtown, Montreal.

Interest expense was up by $1.2 million to $199.9 million as a result of higher rates in the latter part of the year. The average rate of interest for 1988 increased marginally.

There was an extraordinary loss of $27.0 million in 1988 comprising the after tax provision arising from the default of Red Carpet Distribution. In 1987 there was an extraordinary loss of $18.0 million relating to disposal of non strategic assets.

Financial

For the first time in many years, cash flow, in 1988, was sufficient to cover investment requirements and your company was able to reduce its debt without selling off assets — a very encouraging performance.

Cash inflow from earnings amounted to $134.1 million. There was a net cash outflow of $56.7 million from investing activities. The high priority given to asset management resulted in a reduction in working capital of $46.7 million. After distributing $45.4 million in dividends, the net cash inflow from activities was $78.7 million. This compares with an outflow in 1987 of $93.6 million after excluding the $251.0 million in proceeds from disposals.

Debt was reduced in 1988 by $122.2 million to $1,939.9 million and the ratio of debt to assets employed improved by 1.4% to 65.3%.

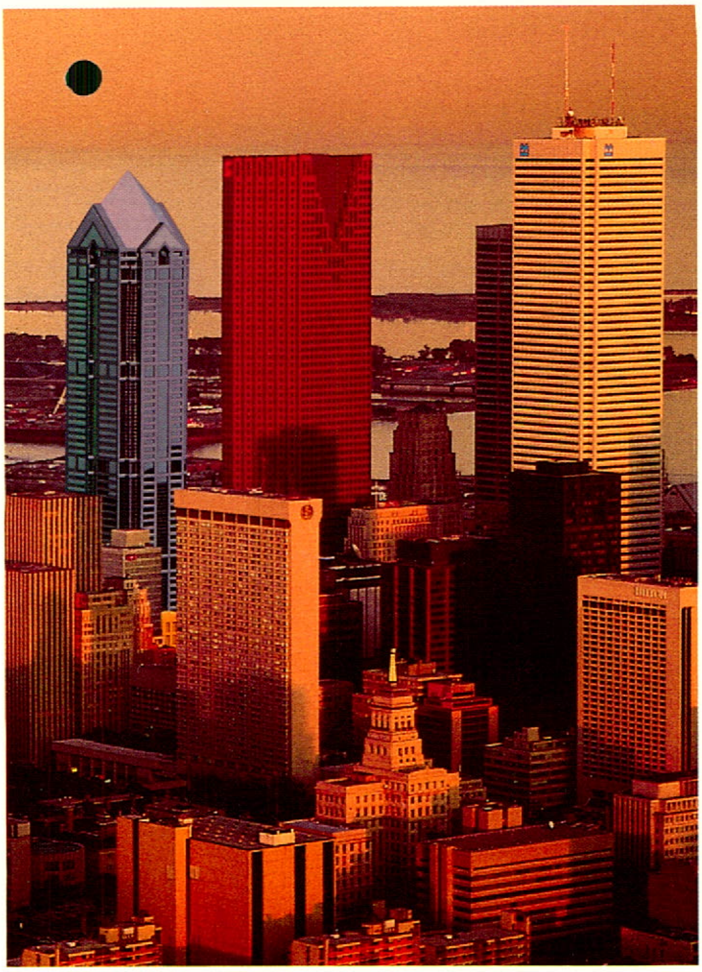
Retail Environment 1988

Retail spending in Canada during 1988, excluding the food and automotive sectors, rose about 7% over 1987 levels. Department store sales increased 4.1%.

The growth in sales, reflecting changing consumer priorities and tastes, was uneven and, in some cases, surprising. For example, despite a marginal decline in housing starts, spending on durable goods for homes ran substantially ahead of the overall growth in retail sales. In particular, furniture, appliance and home entertainment sales climbed 8.4%, more than twice the rate for department store sales generally. In non-durable goods, although sales of infants' and children's wear were strong, sales of adult and teenage clothing increased only slightly over 1987. Women's wear sales were particularly weak as customers showed little response to spring and fall fashion offerings.

Price competition continued to characterize the market, although not as intensely as in recent years. Retail sales also varied geographically. The Atlantic and Central Canada regions, together with British Columbia, recorded greater increases than the national average while sales in the Prairies were below the national average.

These market conditions produced mixed results for retailers. Those who concentrated on hard goods and home merchandise generally outperformed those who specialized in fashion-oriented goods. Zellers, with an operating profit increase of 52.8%, recorded one of the best performances in the industry.



Architect's depiction of the high rise portion of the Bay Adelaide project (left) inserted into the Toronto skyline.

Outlook 1989

Nationally, retail sales will probably increase at a lower rate in 1989 than in 1988. The principal causes are expected to be higher interest rates, which will both partially offset consumers' income increases and reduce their ability to finance debt, and a continuing slowdown in new household formation which will reduce new housing starts. Fewer housing starts will, in turn, reduce demand for household appliances and furniture. The apparel market, however, is expected to benefit from new women's wear offerings which will more accurately reflect contemporary taste and needs.

Overall, we anticipate increased merchandising operating profit, principally as a result of refinements to our marketing and assortment strategies and rigorous expense control. In addition, the merger of our Bay and Simpsons operations in Montreal will contribute positively.

We expect our real estate operations to benefit from continued growth in operating profits from both the land development and income properties divisions of Markborough Properties.

Board and Management

J.W. (Bud) Bird, a director since 1985 resigned in November, 1988 shortly after his election to Parliament as the member for Fredericton. We congratulate Mr. Bird on his victory and extend our grateful appreciation for his services as a director and member of the Audit Committee.

David Thomson was appointed Chairman and Chief Executive Officer of Simpsons Limited in January 1989. He was succeeded as President and Chief Operating Officer by Paul S. Walters, formerly Executive Vice-President of the Bay.

Appreciation

Our achievements in 1988 were made possible by the dedication and hard work of many thousands of employees. We thank them one and all. We also appreciate the continuing trust and support of our customers, our suppliers and our shareholders.

On behalf of the Board

DONALD S. McGIVERIN, Governor

GEORGE J. KOSICH, President

March 16, 1989

Summary of Operations
By Division

Division	Results (in thousands of dollars)	This Year	Last Year
the Bay	Sales and revenue	**1,723,248**	1,738,339
	Operating profit	**67,467**	60,912
	Assets employed	**868,540**	862,907
Simpsons	Sales and revenue*	**610,611**	617,707
	Operating profit*	**17,395**	15,965
	Assets employed*	**455,584**	424,709
Zellers	Sales and revenue	**2,011,116**	1,844,965
	Operating profit	**139,165**	91,075
	Assets employed	**703,161**	700,217
FIELDS	Sales and revenue	**88,354**	87,943
	Operating profit	**1,762**	1,419
	Assets employed	**17,732**	17,306
Markborough	Sales and revenue	**163,749**	169,766
	Operating profit (loss)	**54,812**	(148,659)
	Assets employed	**741,110**	712,654

*Includes Montreal division which was merged with the Bay at the end of the fiscal year

Division Profiles

Retail Stores

The Bay operates 77 department stores from coast to coast in Canada. It competes aggressively in the broad mid range urban and suburban markets, with a strong franchise in the downtowns of major cities. It provides its customers with superior value by offering fashionable, good quality merchandise at popular prices, backed by traditional department store guarantees and services. The Bay promotes its own credit card and accepts the cards of the major banks and Simpsons.

Merchandise selection and procurement is centralized and combined with Simpsons. A number of service functions are integrated on a corporate basis to reduce costs and improve performance.

Bay stores are tailored by price level and fashion appeal to fit the communities in which they are located. They vary in size from 21,000 sq.ft. in Banff, Alberta to 675,000 sq. ft. in downtown Winnipeg with most suburban branches in the 120,000 to 160,000 sq. ft. range.

	Stores	Square Feet (000's)
Nova Scotia	3	424
Quebec	17	2,691
Ontario	22	3,437
Manitoba	4	1,081
Saskatchewan	4	541
Alberta	15	2,361
British Columbia	12	2,103
	77	12,638

Simpsons aims to be the leading fashion department store in Canada's largest market, Toronto. Simpsons leads the customer in fashion direction, introducing new and exclusive merchandise on a regular basis. Simpsons targets principally the middle to high income consumer and attempts to provide its customers with a superior shopping experience. Simpsons markets its own credit card and accepts cards of the major banks and of the Bay. There are 11 Simpson stores in the Toronto market area. They are profiled by price level and fashion appeal to match their communities. The Toronto downtown store has 973,000 sq. ft. and the suburban branches average 157,000 sq. ft.

	Stores	Square Feet (000's)
Ontario	11	2,623

Zellers is the leading national chain of discount department stores. It targets the budget minded customer with the assurance of the lowest price. Excellent values are offered in both national and private brand merchandise and these are communicated aggressively with frequent advertising in both print and electronic media. Zellers is further distinguished by Club Z, its frequent buyer program. Zellers is able to compete successfully in its competitive retail segment by operating with a very low expense rate.

Zellers' stores are characterized by self service and central checkout. Zellers markets its own credit card and accepts those of the major banks. Merchandising and sales promotion are centrally directed. Zellers operates approximately 200 stores across Canada mainly in shopping malls. The typical store is 65,000 sq. ft. in size.

	Stores	Square Feet (000's)
Newfoundland	5	258
Prince Edward Island	2	107
Nova Scotia	12	828
New Brunswick	10	539
Quebec	41	2,900
Ontario	65	4,152
Manitoba	7	486
Saskatchewan	12	672
Alberta	23	1,453
British Columbia	22	1,375
	199	12,770

Fields Stores provide low prices and outstanding values in basic and casual family apparel in rural and neighbourhood urban markets in British Columbia, Alberta and Saskatchewan. The store environment is friendly, convenient and "no frills". Merchandise procurement, distribution and support services are centralized in Vancouver. Credit is available to Fields customers through the major bank cards. The average size of the 117 Fields stores is 6,000 sq. ft.

	Stores	Square Feet (000's)
Saskatchewan	5	28
Alberta	36	260
British Columbia	76	590
	117	878

Markborough Properties Inc. is a real estate development corporation which participates in two areas of the real estate industry; first, the development, ownership and management of income producing properties such as shopping centres and office buildings; secondly, the development of land for residential and commercial uses.

Approximately 70% of Markborough's assets are invested in income properties and the remaining 30% in land development. Approximately 60% of the portfolio, including all of the shopping centres, is located in Canada. Most of the balance, including the greater part of the land development acreage, is in the United States.

Real Estate Holdings

Markborough Properties Inc.	**Net Interest**
21 shopping centres	8,140,350 sq.ft.
11 office/commercial buildings	733,500 sq.ft.
23 industrial buildings	905,900 sq.ft.
Construction in progress	30,000 sq.ft.
1 hotel	192 rooms
2 apartment buildings	340 suites
Land held for and under development	10,077 acres

the Bay

"Our purpose is to create top-of-mind awareness of the Bay as the destination store for the broadest merchandise assortments, marketed through contemporary, fashionable environments, ease of shopping and backed by a 319 year-old performance guarantee". Bob Peter

Market Square, Calgary Downtown.

Operating profit increased by 10.8% over 1987 to $67.5 million in 1988.

Improved gross margins and tight expense controls, especially in the important fourth quarter, had a major positive impact on operating profit.

Elimination of some low-margin sales events, an uncertain market in fashion commodities and continued sluggish economies in the West, all contributed to a 0.9% decrease in sales and revenue to $1.7 billion. New stores were opened in major regional centres in Brossard (Montreal), Yorkdale (Toronto) and Kingsway (Edmonton) during the year and partially offset the decline in sales.

The Bay's commitment to its large flagship stores was reflected in a number of major projects in 1988.

Market Square, highlighted in the accompanying photograph, opened in November in the Calgary downtown store. This unique concept floor includes fashion linens, housewares, fine china and a major food market offering specialty and prepared foods, fresh fish and meat, produce and baked items. Customer acceptance has been outstanding.

The completion of renovations to the main floor of the Montreal downtown store created a world-class showcase for jewellery, cosmetics, women's fashion accessories, hosiery and a junior men's world.

The furniture floors in the Vancouver, Winnipeg and Montreal downtown stores were all remodelled, as was the Home Store in Ottawa, to offer an appropriate environment for a broad selection of quality home furnishings.

The program will continue through 1989 with further renovations in the Vancouver and Montreal flagship stores.

New stores will be opened in 1989 in Erin Mills (Mississauga, Ontario) and in downtown London, Ontario where a 180,000 square foot store will replace the existing store. Branch stores in Ontario, Quebec and British Columbia will be renovated.

In addition to upgrading its premises, the Bay is committed to refining and improving assortments and service through 1989.

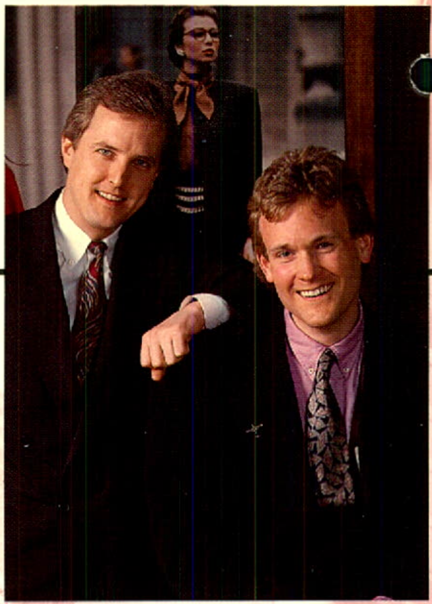
Bob Peter, President

Contemporary casual in spring fashion from the Bay.

Simpsons

"We will combine the elements of assortment breadth, quality, fashionability, advanced store design and superior customer service to establish Simpsons as Toronto's premier department store".

Paul Walters



Paul Walters, President and David Thomson, Chairman

Operating profit of Simpsons increased by $1.4 million to $17.4 million in 1988.

Sales decreased by 1.1% to $610.6 million, due in part to fewer low-margin storewide discount events and an increased emphasis on the upscale market, which resulted in a decline in sales of moderate and moderate-low priced merchandise.

Gross profit rate increased significantly as markdown rates were improved and stock shortages were reduced.

Expenses increased, but included one-time costs of a middle management downsizing at year end.

During 1988, the second phase of the Scarborough Town Centre store renovation was completed and the Arcadian Court Restaurant in the Downtown Toronto Store was restored and remodelled to provide a decor of contemporary elegance.

In mid January, 1989 Simpsons announced its intention to merge its Montreal operation with the Bay and to withdraw from that market.

With only five stores, Simpsons Montreal was unable to achieve the sales volume necessary to offset the high costs of operating in a major metropolitan area.

The merger will strengthen Simpsons by permitting management to concentrate on a single market, Toronto, Canada's largest. Simpsons' position in that market will be reinforced by the opening in 1989 of its twelfth store, a 140,000 square foot outlet in the fast growing Erin Mills area of Mississauga.

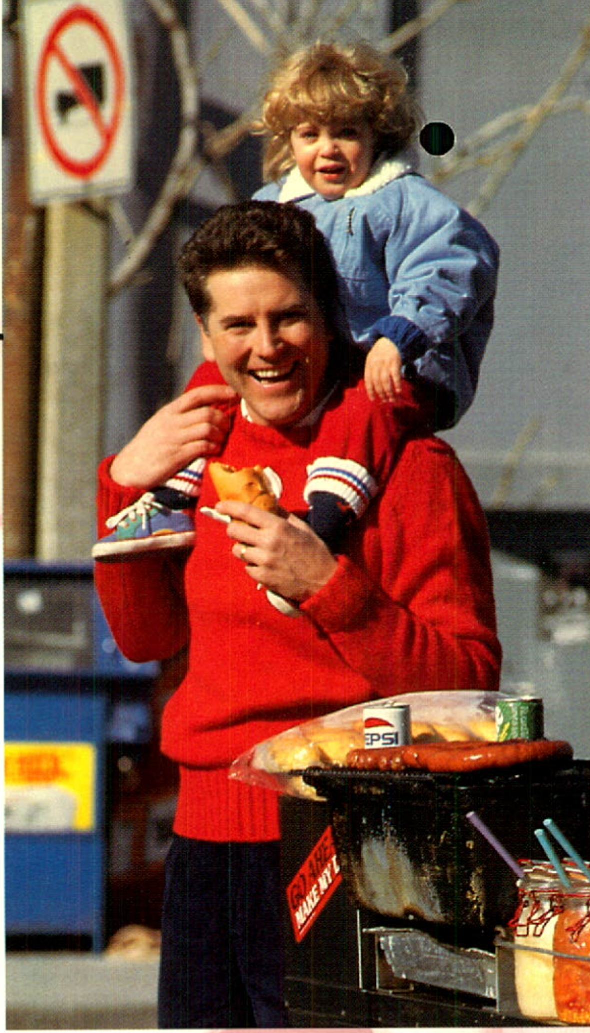
The renovation program will continue in 1989 at the Downtown Toronto store.

Luxury and comfort combine for "the style of your life" at Simpsons.

The third floor, downtown Toronto, is Simpsons' showcase for elegance and fashion in women's wear.

Zellers

"Our objective is to be the premier discount department store in Canada, as measured by market share and return on investment, and to provide the customer with assurance of stability, value and lowest prices". Hani Zayadi



Two happy shoppers off to accumulate more Club Z points.

Operating profit at Zellers rose 52.8% to $139.2 million in 1988 from $91.1 million in 1987 as the result of a substantial increase in sales. Zellers' expense management strategy, adopted in 1987 and continued in 1988, allowed every incremental gross profit dollar to fall to the bottom line. Heightened sensitivity to asset management, coupled with the improved operating profit, contributed to significant gains in Zellers' cash flow and return on assets.

Hani Zayadi, President

Sales and revenues increased 9.0% to $2.0 billion. Same store sales grew 8.3%, hardlines sales rose 10.6% and fashion sales, led by women's and children's wear, increased by 6.7%. Although expenses were tightly managed, increased marketing expenditures enabled Zellers to aggressively promote its value image and overall lowest price statements. During the year, Zellers solidified its price leadership positioning with promotional campaigns such as "The lowest price is the law", "The law of Toyland" and "Dare to compare". As a result, Zellers' market share increased in every region in Canada.

Club Z, the frequent buyer program first launched in 1986, continued to be an important promotional differentiator, with more than 50% of Canadian households currently Club Z members. A major credit account solicitation program, initiated during 1987 and intensified in 1988, also contributed to Zellers' above-average sales growth.

New stores were opened in Laval, Quebec and Kitchener, Ontario. Additionally, stores were re-opened in Montreal North, Quebec and Dawson Creek, Alberta. In 1989, Zellers plans to open 18 stores predominantly in Eastern Canada, of which six will be replacements. Over 20 stores will be modernized in 1989 as part of Zellers' asset management and store development strategies.

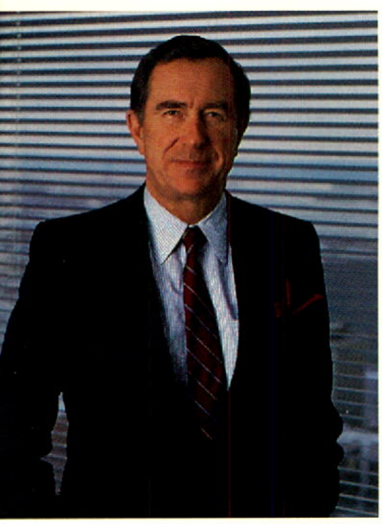
Customers appreciate the everyday lowest prices in one of Zellers' newest stores in Laval, Quebec.

Markborough

"Not all of our results can be measured by earnings or by cash flow from operations. Much of the benefit of real estate ownership is achieved through the creation and appreciation of values".

Neil Wood

Fairview Mall, Toronto, where a major expansion was completed in 1988.



Neil Wood,
Chairman and President

Operating profit of Markborough in 1988 was $54.8 million compared with an operating loss the year before of $148.7 million. The 1987 loss included a write down of $196.6 million related to U.S. land assets.

Markborough operates in three product groups, shopping centres, urban development and community development, all of which showed profit improvement in 1988.

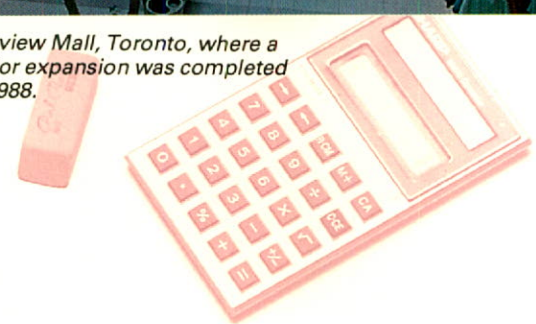
Cash inflow before investing activities, an important measurement of operating results in the real estate industry, increased by 11.3% in 1988.

The development of high quality income producing properties continues to be a major goal.

Expansion of four shopping centres in Markborough's portfolio — Fairview Mall, Toronto, Galeries de la Capitale, Quebec, Southcentre and Market Mall, both in Calgary, was completed in 1988 and promising sites were acquired for new centres in Ontario. Construction commenced on the first phase expansion of Surrey Place in Vancouver and planning has begun for renovations, redevelopment or expansion of several other centres.

In addition to the Bay Adelaide Centre described on page 2 of this report, a number of important urban development projects are expected to commence this year. They will include Bull Wharf, an eight storey office building in London, England, additions to the Markborough Place office complex and the Delta Meadowvale Inn, both in Mississauga, Ontario and a 22 floor joint venture office building in Montreal.

In land development, sales of serviced industrial land were strong in the Meadowvale area of Mississauga, Ontario. In the United States, housing starts have declined substantially in each of the last two years and this is reflected in results of Markborough's community development group. However, new projects are beginning to show results in Tampa and Dallas, a new community in Austin is just starting its sales program and Houston, where Markborough has several projects, is showing signs of recovering in residential real estate as in its economy in general.



Markborough's management believes that much of the benefit of real estate ownership arises through the appreciation of values; management estimates that Markborough's asset appreciation in exess of book value at January 31, 1989 was $926.2 million before tax and $612.4 million after tax.

The magnificent clubhouse of the Stonebriar Country Club, focal point of Stonebriar, a new community under development in Dallas.

FIELDS

"We will offer the lowest prices and best values in family clothing, footwear and related accessories in the low to moderate-low end of the fashion market".

Ron Hughes, President

Customers enjoy the friendly, "no frills" atmosphere in one of Fields' newest stores in Calgary.

Operating profit for Fields Stores improved for 1988 to $1.7 million, up from $1.4 million in 1987. Sales increased marginally by 0.5% to $88.4 million, reflecting the continuing slow economic pace in the rural markets of the Western Provinces and the general softening of demand for ready-to-wear commodities. Strong sales in the fourth quarter and good performance in children's and infants' wear throughout the year offset sales shortfalls in men's and women's wear.

Gross profit rate improved as a result of lower markdowns. Expenses were marginally higher than last year, due entirely to increased occupancy costs.

During 1988, Fields opened 18 new stores and closed seven stores. Four of the new stores were P.S.S. (Plus Sizes, Plus Savings). This is a new concept in value-priced larger-size women's wear in stores of approximately 1,000 sq. ft.

Fields now operates 113 family clothing stores and four P.S.S. stores in the three Western Provinces. The Company plans to open a further six to nine Fields stores and eight to ten P.S.S. stores during 1989.

Fields' customers for everything but the hard hat.

Consolidated Statement of Earnings

Year Ended January 31, 1989

	This Year $ 000's	Last Year $ 000's
Sales and Revenue (Note 2)		
Merchandising:		
The Bay	**1,723,248**	1,738,339
Simpsons	**610,611**	617,707
Zellers	**2,011,116**	1,844,965
Fields	**88,354**	87,943
Other	**57,708**	55,890
	4,491,037	4,344,844
Real Estate	**180,703**	188,237
Ongoing operations	**4,671,740**	4,533,081
Discontinued operations	**—**	312,097
	4,671,740	4,845,178
Source of Earnings (Note 2)		
Merchandising:		
The Bay	**67,467**	60,912
Simpsons	**17,395**	15,965
Zellers	**139,165**	91,075
Fields	**1,762**	1,419
Other	**(6,337)**	(773)
	219,452	168,598
Real estate:		
Markborough — operations	**54,812**	47,941
— asset write downs (Note 3)	**—**	(196,600)
Other	**9,301**	12,302
	64,113	(136,357)
Ongoing operations	**283,565**	32,241
Discontinued operations	**—**	2,953
Operating Profit	**283,565**	35,194
Interest Expense (Note 4)	**(199,932)**	(198,737)
Earnings (Loss) Before Income Taxes and Extraordinary Items	**83,633**	(163,543)
Income Taxes (Note 5)	**(34,461)**	85,069
Earnings (Loss) Before Extraordinary Items	**49,172**	(78,474)
Extraordinary Items (Note 6)	**(27,000)**	(17,989)
Net Earnings (Loss)	**22,172**	(96,463)
Earnings (Loss) Per Ordinary Share (Note 1 d)		
Earnings (loss) before extraordinary items	**$0.73**	($3.58)
Net earnings (loss)	**($0.16)**	($4.18)

Consolidated Statement of Retained Earnings

Year Ended January 31, 1989

	This Year $ 000's	Last Year $ 000's
Retained Earnings at Beginning of Year	**290,076**	432,807
Net Earnings (Loss)	**22,172**	(96,463)
Dividends Paid		
Preferred shares	**(27,031)**	(28,383)
Ordinary shares	**(18,342)**	(17,885)
Cancellation of Preferred Shares (Note 11)	**81**	—
Retained Earnings at End of Year	**266,956**	290,076

Consolidated Balance Sheet

January 31, 1989

	This Year $ 000's	Last Year $ 000's
Current Assets		
Cash	**5,043**	5,379
Short-term deposits (Note 10)	**30,344**	25,261
Accounts receivable	**1,040,474**	1,027,663
Income taxes recoverable	**—**	71,071
Merchandise inventories	**945,685**	939,604
Prepaid expenses	**46,237**	37,796
	2,067,783	2,106,774
Secured Receivables (Note 7)	**50,168**	146,481
Property for Sale and Development	**221,992**	207,599
Investments (Note 8)	**103,077**	74,089
Fixed Assets		
Land	**163,311**	136,521
Buildings	**531,662**	560,033
Equipment and leasehold improvements	**587,674**	583,909
	1,282,647	1,280,463
Less accumulated depreciation	**(445,546)**	(433,024)
	837,101	847,439
Deferred Charges	**25,959**	45,177
Goodwill	**93,953**	96,266
Pensions (Note 9)	**70,589**	49,999
Deferred Income Taxes	**18,517**	40,375
	3,489,139	3,614,199

	This Year $ 000's	Last Year $ 000's
Current Liabilities		
Bank indebtedness (Note 10)	**228,794**	200,017
Notes payable (Note 10)	**339,723**	374,319
Accounts payable and accrued expenses	**467,439**	455,491
Income taxes payable	**1,522**	—
Long-term debt due within one year (Note 10)	**129,468**	240,829
	1,166,946	1,270,656
Long-Term Debt (Note 10)	**1,272,212**	1,272,207
Shareholders' Equity		
Capital (Note 11)	**781,135**	775,802
Retained earnings	**266,956**	290,076
Cumulative translation adjustment	**1,890**	5,458
	1,049,981	1,071,336
	3,489,139	3,614,199

On behalf of the Board:

D. McGinnis
Director

Marcel Bélanger
Director

Consolidated Statement of Cash Flow and Funding
Year Ended January 31, 1989

	This Year $ 000's	Last Year $ 000's
Cash Flow from Ongoing Operating Activities		
Operating profit	**283,565**	32,241
Interest	**(199,932)**	(188,811)
Current income tax recovery	**10,085**	63,564
Items not affecting cash flow:		
Depreciation and amortization	**71,135**	78,400
Equity earnings from affiliates and joint ventures in excess of cash received	**(2,011)**	(3,507)
Pension credits	**(28,779)**	(29,961)
Asset write downs — Markborough	**—**	196,600
Cash inflow from earnings	**134,063**	148,526
Net effect of changes in operating working capital (Note 12)	**46,714**	(134,083)
Net cash inflow from ongoing operating activities	**180,777**	14,443
Cash Flow from Ongoing Investing Activities		
Fixed assets:		
Acquisitions	**(76,007)**	(88,649)
Dispositions	**12,037**	21,274
Investments:		
Acquisitions and net advances	**(31,145)**	(12,049)
Dispositions	**3,038**	1,894
Property for sale and development	**577**	(6,991)
Secured receivables	**44,765**	30,834
Deferred charges	**(4,327)**	(2,348)
Other	**(5,632)**	(5,807)
Net cash outflow from ongoing investing activities	**(56,694)**	(61,842)
Cash Outflow for Dividends		
Preferred shareholders	**(27,031)**	(28,383)
Ordinary shareholders	**(18,342)**	(17,885)
Cash outflow for dividends	**(45,373)**	(46,268)
Net Cash Inflow (Outflow) from Ongoing Activities and Dividends	**78,710**	(93,667)
Cash Inflow from Discontinued Operations (Including Disposal Proceeds)	**—**	251,020
Net Cash Inflow from Activities and Dividends	**78,710**	157,353
Funding		
Debt (Note 10):		
Long-term:		
Increase	**94,907**	167,740
Reduction	**(59,041)**	(227,003)
Reduction in net short-term debt	**(119,990)**	(96,712)
	(84,124)	(155,975)
Equity:		
Preferred shares	**(10,472)**	(14,956)
Ordinary shares	**15,886**	13,578
	5,414	(1,378)
Net Cash Outflow to Reduce Funding	**(78,710)**	(157,353)

Consolidated Statement of Assets Employed

January 31, 1989

	This Year $ 000's	Last Year $ 000's
Merchandising		
Accounts receivable — customer	**822,827**	780,998
Merchandise inventories	**945,685**	939,604
Accounts payable — trade	**(222,530)**	(197,499)
Other current assets — net	**(11,545)**	63,837
Working capital	**1,534,437**	1,586,940
Secured receivables	**11,100**	94,362
Investments	**13,538**	5,642
Fixed assets	**456,334**	481,571
Deferred charges	**22,580**	41,383
Goodwill	**64,282**	66,342
Pensions	**69,391**	49,138
	2,171,662	2,325,378
Real Estate		
Working capital	**34,041**	39,082
Secured receivables	**39,068**	52,119
Property for sale and development	**221,992**	207,599
Investments	**89,539**	68,447
Fixed assets	**380,767**	365,868
Goodwill	**29,671**	29,924
Other assets	**4,577**	4,655
	799,655	767,694
Assets Employed	**2,971,317**	3,093,072
Provided From		
Debt (Note 10):		
Long-term	**1,272,212**	1,272,207
Net short-term	**667,641**	789,904
	1,939,853	2,062,111
Deferred income taxes	**(18,517)**	(40,375)
Equity:		
Preferred shareholders (including accrued dividends)	**344,298**	356,932
Ordinary shareholders	**705,683**	714,404
	1,049,981	1,071,336
	2,971,317	3,093,072

Notes to the Consolidated Financial Statements

Year Ended January 31, 1989

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. Accounting policies of the real estate segment of the Company's business are substantially in accordance with the recommendations of the Canadian Institute of Public Real Estate Companies. The significant policies are as follows:

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 in 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) Earnings (loss) per ordinary share
The earnings (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.

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 carrying value is lower than net realizable value.

h) Property for sale and development
Property for sale and development is carried at the lower of cost and net realizable value at the estimated time of development or sale. Cost includes predevelopment expenses, interest, realty taxes and other directly related expenses. General and administrative expenses which can be clearly identified with the development of a property are allocated to the cost of that property.

i) Investments
The Company follows the equity method in accounting for its investments in real estate joint ventures. Investments in other companies are carried at the lower of cost and estimated realizable value, with dividends being reflected in earnings when received.

j) Fixed assets
Fixed assets are carried at cost which, in the case of properties held for the purpose of producing rental income (income properties), includes interest, realty taxes and other carrying charges incurred in the pre-development and construction periods and initial leasing costs.

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	8 — 20%
Leasehold improvements	2½ — 10%

Buildings which constitute 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 expense" 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 two subsidiaries, Zellers Inc. and Markborough Properties Inc., at their respective dates of acquisition.

The goodwill which relates to acquisitions subsequent to 1973, $71,736,000 (last year $74,049,000) after deducting accumulated amortization of $20,566,000 (last year $18,253,000), 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 accrued benefit method has been used to calculate the costs of pension plans. Adjustments arising from plan amendments, experience gains and losses, changes in actuarial assumptions, and the difference between the actuarial present value of accrued pension obligations and the value of pension plan assets as of February 1, 1986 are amortized over the expected average remaining service lives of the respective employee groups (see note 9).

2. SUPPLEMENTARY SEGMENTED INFORMATION

Reported industry segments are merchandising and real estate. The merchandising segment comprises Canadian retail stores, which include full-line and promotional department stores, and United States fur auction operations. The real estate segment comprises two areas of the real estate industry in which the Company participates principally through its subsidiary, Markborough Properties Inc.: the development, ownership and management of income-producing properties and the development of land for future residential, retail, office and industrial uses.

As a result of the decision to merge The Bay and Simpsons department stores in Montreal effective January 28, 1989 and to close and redevelop the former Simpsons downtown store, $26,666,000 of merchandising assets employed has been reclassified as real estate property for sale and development.

Operations discontinued last year have been segmented and comprise the Northern Stores Division, the Wholesale Division, a subsidiary company — Canadian Roxy Petroleum Ltd. and an investment in Dome Petroleum Limited.

Information pertaining to operations in these segments included in these consolidated financial statements is supplemented by the following additional information.

In the Consolidated Statement of Earnings sales and revenue include the Company's equity in the pretax earnings of real estate joint ventures accounted for under the equity method (see note 8). Depreciation and amortization is included as follows:

	This Year	Last Year
	$000's	$000's
Deducted in arriving at operating profit:		
Merchandising — ongoing operations	**55,221**	56,689
Real estate	**5,662**	7,246
Discontinued operations	**—**	3,100
	60,883	67,035
Included in interest expense (amortization of deferred charges (see note 1k))	**10,252**	14,465
	71,135	81,500

Activities outside Canada comprise fur auction operations in the United States and real estate operations in both the United States and the United Kingdom. None of these operations generates 10% or more of the Company's revenue and only real estate operations in the United States employs more than 10% of its assets. United States real estate operations generated revenue of $61,500,000 (last year $58,500,000) and operating losses of $900,000 (last year $206,700,000) and employed assets of $353,200,000 (last year $360,500,000).

3. REAL ESTATE ASSET WRITE DOWNS

During the year ended January 31, 1988 Markborough Properties Inc. undertook an in-depth evaluation of its entire United States land portfolio and related secured receivables arising from sales thereof. Depressed market conditions, which management believed would not recover in the short-term, necessitated write downs amounting in total to $196,600,000 to reduce asset carrying values to estimated net realizable values. The after tax amount of these write downs was $101,700,000. Most of the United States properties represented large land assemblies to be developed over a number of years.

4. INTEREST EXPENSE

Interest expense may be analyzed as follows:

	This Year	Last Year
	$000's	$000's
On long-term debt	**141,893**	153,569
Net short-term	**87,448**	65,862
	229,341	219,431
Less amount capitalized (see note 1g)	**(29,409)**	(20,694)
Interest expense	**199,932**	198,737

5. INCOME TAXES

The average statutory Canadian income tax rate for the Company this year was 45.8% (last year 50.3%). The following schedule reconciles a nominal tax provision (credit) at these rates with the amount actually provided (credited) in the Consolidated Statement of Earnings.

	This Year	Last Year
	$000's	$000's
Earnings (loss) before income taxes	**83,633**	(163,543)
Nominal income tax provision (credit) at statutory Canadian income tax rates	**38,304**	(82,262)
Increase (decrease) in taxes resulting from:		
Tax rates in other jurisdictions	**(2,263)**	(7,408)
Capital gains and losses	**(3,985)**	3,202
Recovery of current losses at prior years' rates	**1,064**	(2,186)
Non-deductible costs	**1,341**	3,585
Provision (credit) for income taxes per Consolidated Statement of Earnings	**34,461**	(85,069)

Cumulative tax losses for accounting purposes at January 31, 1989 amounted to approximately $275,000,000. Of this total, the Company has taken credit for the potential future income tax recovery from the carry forward of approximately $20,000,000 of losses. The losses may be carried forward until the following years ending January 31:

1991 – $19,000,000; 1992 – $ 95,000,000; 1993 – $28,000,000;
1995 – $32,000,000; 1996 – $101,000,000.

6. EXTRAORDINARY ITEMS

Extraordinary items comprise the following:

	This Year	Last Year
	$000's	$000's
Losses relating to disposition of operations	**(45,000)**	(57,490)
Recovery on disposition of investment	**—**	5,706
	(45,000)	(51,784)
Deferred income tax credits	**18,000**	33,795
	(27,000)	(17,989)

a) Losses relating to disposition of operations

During the year ended January 31, 1989 the Company provided for an estimated loss of $27,000,000, net of deferred income tax credits of $18,000,000, against the amount due in the form of vendor take-back notes from Red Carpet Distribution Inc. ("Red Carpet"), whose assets were seized on August 12, 1988 by a Canadian bank under section 178 of the Bank Act. Red Carpet, which had acquired the Company's Wholesale Division in 1987, was placed into bankruptcy on January 31, 1989.

During the year ended January 31, 1988 the Company incurred net pretax losses totalling $57,490,000 in respect of transactions, including the cancellation of interest swap arrangements no longer required, related to the disposal of certain of its operating divisions and interests in other entities. These entities included the Northern Stores Division, the Wholesale Division, Canadian Roxy Petroleum Ltd. and Marshall Wells Limited. Total net proceeds relating to these disposals amounted to $345,700,000, comprising net cash received of $250,700,000 and vendor take-back notes of $95,000,000. Income tax credits related to these net losses amounted to $26,974,000.

b) Recovery on disposition of investment

At January 31, 1987 the Company wrote down its investment in preferred shares of Dome Petroleum Limited to a carrying value of $18,500,000, which represented the approximate quoted market value at that date on The Toronto Stock Exchange of the common shares into which they were convertible. On the disposition of the investment during 1987, $5,706,000 of the amount of the write down was recovered and deferred income tax credits of $6,821,000 were recorded.

7. SECURED RECEIVABLES

Secured receivables include mortgages which arise principally from sales of real property, vendor take-back notes arising from the disposition of operations (see note 6a) and loans outstanding under the employee share ownership plan.

	This Year	Last Year
	$000's	$000's
Total secured receivables	**98,003**	199,170
Less amounts due within one year classified as accounts receivable	**(47,835)**	(52,689)
	50,168	146,481

Maturities during the five years ending January 31, 1994 are as follows:

1990 – $47,835,000; 1991 – $7,220,000; 1992 – $13,699,000;
1993 – $ 3,446,000; 1994 – $1,959,000.

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

8. INVESTMENTS

Investments comprise the following:

	This Year	Last Year
	$000's	$000's
Real estate joint ventures	**89,539**	68,447
Northern Stores Inc.	**8,050**	—
Other	**5,488**	5,642
	103,077	74,089

The Company's share of real estate joint ventures is summarized as follows:

	This Year	Last Year
	$000's	$000's
Assets	**787,419**	723,850
Liabilities	**(697,880)**	(655,403)
Investment in real estate joint ventures	**89,539**	68,447
Revenue	**112,426**	105,339
Expenses	**(89,601)**	(84,629)
Asset write downs	**—**	(116,500)
Pretax earnings (loss) of real estate joint ventures	**22,825**	(95,790)

The investment in Northern Stores Inc. consists of 1,400,000 common shares which were acquired when the Company exercised its option to convert a portion of the vendor take-back notes (see note 6a). The investment represents 14.4% of all of the common shares outstanding at January 31, 1989.

The Company is contingently liable at January 31, 1989 for $144,000,000, representing certain liabilities of its co-owners and partners in unincorporated joint ventures but against such liabilities the Company would have a claim upon the joint venture assets of its co-owners and partners. The value of the assets of each of these joint ventures exceeds the contingent liability.

9. PENSIONS

As of January 31, 1989 the aggregate actuarial present value of accrued pension benefits is $331,000,000 and the aggregate market value of pension plan assets is $567,000,000.

The amount described as "pensions" on the Consolidated Balance Sheet represents the recorded portion of the excess of pension plan assets over accrued pension benefits net of other obligations to retired employees.

10. DEBT

Total debt of the Company may be analyzed as follows:

	This Year $000's	Last Year $000's
Bank indebtedness (a)	**228,794**	200,017
Notes payable (a)	**339,723**	374,319
Long-term debt due within one year (b)	**129,468**	240,829
Less short-term deposits	**(30,344)**	(25,261)
Net short-term debt	**667,641**	789,904
Long-term debt (b)	**1,272,212**	1,272,207
	1,939,853	2,062,111

Long-term debt comprises the following:

	This Year $000's	Last Year $000's
Secured on property:		
Hudson's Bay Company Properties Limited		
5¾% first mortgage bonds series A due 1990	**7,484**	7,659
7½% first mortgage bonds series B due 1991	**4,954**	4,954
11½% first mortgage bonds series C due 1995	**22,505**	22,665
9⅞% first mortgage bonds series D due 1997	**31,985**	34,705
10% first mortgage bonds series E due 1998	**25,897**	26,254
Markborough Properties Inc. and subsidiaries (includes U.S. $214,864,000 attributable to assets in the United States) (includes floating rate debt of $175,753,000 (last year $231,731,000) (b))		
Mortgages and obligations on property for sale and development at an average year end rate of 10.2% (last year 8.7%) and maturing by 1994	**84,575**	106,572
Mortgages on income property permanent financing at an average year end rate of 11.1% (last year 11.2%) and maturing by 2006	**164,475**	158,688
Mortgages on income property interim financing at an average year end rate of 10.7% (last year 8.7%) and maturing by 1991	**79,250**	116,576
Other	**—**	991
	421,125	479,064
Secured on accounts receivable:		
Hudson's Bay Company Acceptance Limited		
13¼% debentures series C due 1989	**3,425**	3,425
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	**20,780**	20,780
13¾% debentures series G due 2001	**44,544**	44,544
Floating rate debt: (b)		
Term loan due 1990	**50,000**	50,000
Term loan due 1993	**35,000**	35,000
Term loan due 1993	**50,000**	50,000
Simpsons Acceptance Company Limited		
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	**15,670**	15,670
	284,419	284,419
Secured by floating charge on assets of subsidiary:		
Zellers Inc.		
10¼% sinking fund debentures series 1974 due 1994	**7,706**	7,831
	713,250	771,314

	This Year $000's	Last Year $000's
Unsecured:		
Hudson's Bay Company		
10½% debentures due 1989	**21,190**	21,190
12½% note due 1989	**231**	204
14¼% notes due 1989	**46,084**	46,768
13.85% note due 1990	**25,000**	25,000
10% notes due 1991	**96,105**	96,105
10¾% notes due 1991	**80,000**	80,000
Dual currency bonds due 1991-1993 (U.S. $95,010,000) (c)	**112,587**	123,754
11% notes due 1993	**25,000**	25,000
10% debentures due 1994 (U.S. $25,235,000)	**29,904**	32,175
15.36% term loan due 1995-1997 (£5,592,000)	**11,575**	12,581
Floating rate debt (b)(d)	**223,685**	258,510
Simpsons Limited		
9½% debentures series G due 1989	**1,652**	1,652
8⅜% debentures series H due 1993	**5,721**	6,064
9⅛% debentures series I due 1994	**3,061**	4,542
11¾% debentures series J due 1995	**5,864**	7,364
	687,659	740,909
Subordinated:		
Zellers Inc.		
5½% convertible subordinated debentures series 1971 due 1991 (e)	**771**	813
	1,401,680	1,513,036
Less amounts due within one year	**(129,468)**	(240,829)
	1,272,212	1,272,207

(a) The effective interest rate on $432,602,000 of the short-term debt at January 31, 1989 has been fixed at 12.2% through various currency and interest exchange transactions.

(b) Long-term debt (including amounts due within one year) at January 31, 1989 includes floating rate debt amounting to $534,438,000. Of this amount, $309,877,000 has been fixed at 12.1% through various currency and interest exchange agreements. The balance has been capped at 12.6% through various interest rate cap agreements.

(c) The dual currency bonds bear interest at 8.0% based on a notional principal amount of 158,350,000 Swiss Francs at January 31, 1989. The effective hedged Canadian interest rate on these bonds is 12.8%.

(d) The Company's floating rate debt comprises term loans and notes with several financial institutions, of which $82,950,000 represents the Canadian dollar equivalent of unhedged U.S. dollar obligations.

(e) The holders of Zellers Inc. 5½% convertible subordinated debentures series 1971 have the right to exchange such debentures for ordinary shares of Hudson's Bay Company at the rate of 32.43 ordinary shares per $1,000 of debenture principal.

Several of the long-term debt issues are 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, 1994 are as follows:

1990 – $129,468,000; 1991 – $206,658,000; 1992 – $324,836,000; 1993 – $221,857,000; 1994 – $243,299,000.

11. CAPITAL

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. Of the preferred shares, 11,750,000 are designated as "$1.80 cumulative redeemable preferred shares series A" with a stated capital of $22.50 each, 800,000 are designated as "variable rate, cumulative redeemable preferred shares series C" with a stated capital of $25.00 each and 10,000,000 are designated as "$1.875 cumulative redeemable convertible preferred shares series H" with a stated capital of $25.00 each. The designation of preferred shares as series B, D, E, F, G and I is to be cancelled subject to ratification by a special resolution of the shareholders to be presented at the Annual and Special General Meeting to be held May 26, 1989. During the year ended January 31, 1989 all remaining outstanding series D and series G preferred shares were redeemed and, in the final quarter, series I preferred shares were issued and redeemed as part of a series of intercompany transactions, the purpose of which was to maximize the use of available tax losses within the group in future years.

Capital comprises issued and outstanding shares and additional paid-in capital as follows:

	This Year		Last Year	
	Number of shares	**$000's**	Number of shares	$000's
Capital stock:				
Preferred shares				
Series A	**4,058,518**	**91,317**	4,278,959	96,277
Series C	**673,910**	**16,848**	699,500	17,488
Series D	**—**	**—**	50,031	900
Series G	**—**	**—**	11,500	282
Series H	**9,516,000**	**234,681**	9,750,000	240,452
		342,846		355,399
Ordinary shares	**30,992,635**	**422,452**	30,187,244	406,566
		765,298		761,965
Additional paid-in capital		**15,837**		13,837
		781,135		775,802

The changes in shares issued and outstanding during the two years ended January 31, 1989 are as follows:

	Number of shares	$000's
Preferred shares series A:		
Issued and outstanding at January 31, 1987	4,776,259	107,466
Purchased for cash and cancelled	(497,300)	(11,189)
Issued and outstanding at January 31, 1988	4,278,959	96,277
Purchased for cash and cancelled	(220,441)	(4,960)
Issued and outstanding at January 31, 1989	4,058,518	91,317
Preferred shares series C:		
Issued and outstanding at January 31, 1987	737,000	18,425
Redeemed	(37,500)	(937)
Issued and outstanding at January 31, 1988	699,500	17,488
Redeemed	(25,590)	(640)
Issued and outstanding at January 31, 1989	673,910	16,848
Preferred shares series D:		
Issued and outstanding at January 31, 1987	50,391	907
Purchased for cash and cancelled	(339)	(7)
Converted into ordinary shares	(21)	—
Issued and outstanding at January 31, 1988	50,031	900
Redeemed	(50,031)	(900)
Issued and outstanding at January 31, 1989	—	—
Preferred shares series G:		
Issued and outstanding at January 31, 1987	12,250	300
Purchased for cash and cancelled	(750)	(18)
Issued and outstanding at January 31, 1988	11,500	282
Purchased for cash and cancelled	(100)	(2)
Redeemed	(11,400)	(280)
Issued and outstanding at January 31, 1989	—	—
Preferred shares series H:		
Issued and outstanding at January 31, 1987	10,000,000	246,617
Purchased for cash and cancelled	(250,000)	(6,165)
Issued and outstanding at January 31, 1988	9,750,000	240,452
Purchased for cash and cancelled	(234,000)	(5,771)
Issued and outstanding at January 31, 1989	9,516,000	234,681
Ordinary shares:		
Issued and outstanding at January 31, 1987	29,532,745	392,987
Issued:		
Under the employee share ownership plan	32,220	910
Under the executive stock option plan	79,700	1,502
Under the dividend reinvestment plan	542,468	11,163
On conversion of series D shares	12	—
On conversion of Zellers Inc. 5½% convertible subordinated debentures series 1971	162	5
Purchased for cash and cancelled	(63)	(1)
Issued and outstanding at January 31, 1988	30,187,244	406,566
Issued:		
Under the employee share ownership plan	154,450	3,205
Under the executive stock option plan	60,750	1,134
Under the dividend reinvestment plan	590,191	11,547
Issued and outstanding at January 31, 1989	30,992,635	422,452

The series A shares may be redeemed at the Company's option at a price of $22.50 per share.

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 certain intervals at the Company's option at a price of $25.00 per share.

The series H shares may be redeemed from June 30, 1989 under certain conditions at the Company's option at a price per share declining from $25.40 on that date to $25.00 after June 29, 1991. Each series H share is convertible into 0.6944 ordinary shares at the holder's option until June 30, 1993.

At January 31, 1989 2,600,000 ordinary shares are reserved for issuance under the Executive Stock Option Plan and options are outstanding with a number of employees to purchase, in aggregate, up to 1,917,650 ordinary shares at their market price per share immediately preceding the respective dates on which the options were granted. The outstanding options expire at various dates between January 1991 and December 1998 and have an average issue price of $19.06 per share. At January 31, 1989 430,600 options were unallocated.

At January 31, 1989 the holders of approximately 62.3% of the ordinary shares were participating in the Dividend Reinvestment Plan which provides a means for eligible holders of ordinary shares to reinvest dividend proceeds in ordinary shares at 95% of their average market price per share for a three day period immediately preceding the dividend payment date.

The cost of shares redeemed or reacquired at amounts other than book value in each of the two years ended January 31, 1989 has been allocated as follows:

	Cost	Allocated to		
		Capital stock	Additional paid-in capital	Retained earnings
	$000's	$000's	$000's	$000's
In the year ended January 31, 1989:				
Preferred shares:				
Series A	4,167	4,960	(793)	—
Series D	927	900	124	(97)
Series G	296	280	—	16
Series H	4,440	5,771	(1,331)	—
	9,830	11,911	(2,000)	(81)
In the year ended January 31, 1988:				
Preferred shares:				
Series A	9,554	11,189	(1,635)	—
Series H	4,441	6,165	(1,724)	—
	13,995	17,354	(3,359)	—

12. CONSOLIDATED STATEMENT OF CASH FLOW AND FUNDING

The "net effect of changes in operating working capital" appearing in the on-going operating activities section of the Consolidated Statement of Cash Flow and Funding comprises the following:

	This Year	Last Year
	$000's	$000's
Decrease (increase) in:		
Cash	**336**	(269)
Accounts receivable	**(18,242)**	15,746
Merchandise inventories	**(12,578)**	(43,980)
Income taxes recoverable	**71,210**	(51,499)
Prepaid expenses	**(9,434)**	(3,539)
Increase (decrease) in:		
Accounts payable and accrued expenses	**13,900**	(50,542)
Income taxes payable	**1,522**	—
	46,714	(134,083)

13. 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 $110,700,000 (last year $108,600,000).

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, 1990	109,600
1991	102,000
1992	91,700
1993	86,000
1994	80,100
Thereafter	957,200
Total minimum lease payments	1,426,600

In addition to these rental payments (and, in a few cases, relatively minor contingent rentals), most of 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.

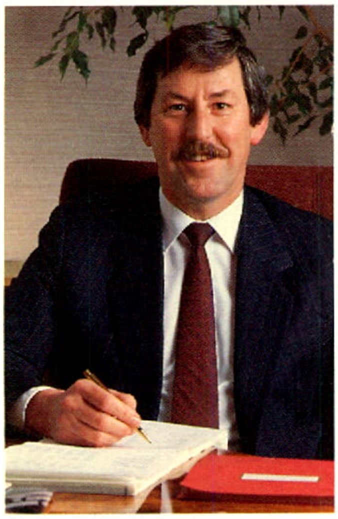
"Fixed assets" in the Consolidated Balance Sheet include real estate leased to others under operating leases amounting to $380,900,000 (last year $365,900,000), net of accumulated depreciation of $45,000,000 (last year $42,600,000).

Real estate revenues include rentals from the above properties of $67,400,000 (last year $62,700,000).

14. 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.

Management's Report to the Shareholders



Gary Lukassen,
Senior Vice-President and
Chief Financial Officer

The management of Hudson's Bay Company is responsible for the preparation and integrity of the consolidated financial statements contained on pages 17 to 27 of this Annual Report and of financial information presented on other pages. The accounting principles which form the basis of the consolidated financial statements and the more significant accounting policies applied are described in note 1 on page 22. Where appropriate and necessary, professional judgments and estimates have been made by management in preparing the consolidated financial statements.

In order to meet its responsibility, management maintains accounting systems and related internal controls designed to provide reasonable assurance that assets are safeguarded and that transactions and events are properly recorded and reported. An integral part of these controls is the maintenance of programs of internal audit coordinated with the programs of the external auditors.

Ultimate responsibility for financial reporting to shareholders rests with the Board of Directors. The Audit Committee of the Board, a majority of whom are outside directors, meets quarterly with management and with internal and external auditors to review audit results, internal accounting controls and accounting principles and procedures. The Audit Committee reviews consolidated financial statements with management and the external auditors and reports to the directors prior to the approval of the audited consolidated financial statements for publication.

Peat Marwick, independent auditors appointed by the shareholders, express an opinion on the fair presentation of the consolidated financial statements. They meet regularly with both the Audit Committee and management to discuss matters arising from their audit, which includes a review of accounting records and internal controls. The Auditors' Report to the Shareholders appears on the following page.

President and
Chief Operating Officer

Senior Vice-President,
Finance and Administration

Toronto, Canada
March 16, 1989

KPMG 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, 1989 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 the Company as at January 31, 1989 and the results of its operations and its cash flow 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

Chartered Accountants

Toronto, Canada
March 16, 1989

Ten Year Consolidated Financial Summary

	1988
Results for the Year (in millions of dollars)	
Sales and revenue:	
The Bay	1,723
Simpsons	611
Zellers	2,011
Fields	88
Other	58
Merchandising	4,491
Real estate	181
Ongoing operations	4,672
Discontinued operations	—
Total sales and revenue	4,672
Source of earnings:	
The Bay	67
Simpsons	17
Zellers	139
Fields	2
Other	(6)
Merchandising	219
Markborough	55
Other	9
Real estate	64
Ongoing operations	283
Discontinued operations	—
Operating profit	283
Interest expense	(200)
Earnings (loss) before income taxes	83
Income taxes	(34)
Earnings (loss) before minority interest	49
Minority interest — Zellers	—
Earnings (loss) before extraordinary items	49
Extraordinary items	(27)
Net earnings (loss)	22
Dividends paid:	
Preferred shares	27
Ordinary shares	18
Cancellation of shares	—
Increase (decrease) in retained earnings	(23)
Capital expenditures — ongoing operations	76
Depreciation — ongoing operations	54
Cash flow from earnings — ongoing operations	134
Year End Financial Position (in millions of dollars)	
Merchandising	2,172
Real estate	799
Ongoing operations	2,971
Discontinued operations (net of minority interest)	—
Assets employed	2,971
Debt	1,940
Deferred income taxes	(19)
Minority interest — Zellers	—
Preferred shareholders' interest (including accrued dividends)	344
Ordinary shareholders' equity	706
Results Per Ordinary Share (in dollars)	
Earnings (loss) before extraordinary items	0.73
Net earnings (loss)	(0.16)
Cash flow from earnings — ongoing operations	3.50
Dividends	0.60
Shareholders' equity	22.77
Shareholders	
Number of ordinary shareholders	8,900
Ordinary shares outstanding (in thousands)	30,993
Range in share price (in dollars)	26¼-18½

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

1987	1986	1985	1984	1983	1982	1981	1980	1979
1,738	1,766	1,621	1,307	1,269	1,212	1,201	1,075	941
618	608	592	713	704	706	725	738	710
1,845	1,782	1,560	1,345	1,116	978	929	827	684
88	86	74	70	68	64	59	58	51
56	52	43	38	34	38	44	41	41
4,345	4,294	3,890	3,473	3,191	2,998	2,958	2,739	2,427
188	270	276	243	177	127	173	84	96
4,533	4,564	4,166	3,716	3,368	3,125	3,131	2,823	2,523
312	1,128	1,105	1,113	1,003	1,014	1,042	991	912
4,845	5,692	5,271	4,829	4,371	4,139	4,173	3,814	3,435
61	80	23	7	26	7	35	54	46
16	5	11	(53)	(31)	(36)	(13)	7	31
91	62	49	38	45	29	41	48	41
1	3	1	3	5	3	2	5	4
—	(1)	—	2	2	—	2	4	6
169	149	84	(3)	47	3	67	118	128
(149)	109	99	92	32	21	29	18	15
12	23	28	(4)	21	26	38	15	12
(137)	132	127	88	53	47	67	33	27
32	281	211	85	100	50	134	151	155
3	48	38	22	22	76	53	77	98
35	329	249	107	122	126	187	228	253
(198)	(265)	(251)	(199)	(174)	(261)	(244)	(136)	(114)
(163)	64	(2)	(92)	(52)	(135)	(57)	92	139
85	(31)	(7)	(15)	34	13	60	(28)	(50)
(78)	33	(9)	(107)	(18)	(122)	3	64	89
—	—	—	—	—	—	1	(10)	(8)
(78)	33	(9)	(107)	(18)	(122)	4	54	81
(18)	(40)	3	—	83	(6)	382	19	23
(96)	(7)	(6)	(107)	65	(128)	386	73	104
28	25	21	21	20	11	12	12	11
18	17	14	14	14	18	29	28	25
—	4	—	—	2	1	7	—	—
(142)	(53)	(41)	(142)	29	(158)	338	33	68
89	74	135	134	87	101	113	139	96
58	56	54	50	47	44	38	33	30
149	133	68	5	23	(84)	54	73	85
2,325	2,113	1,963	1,699	1,480	1,460	1,458	1,203	1,108
768	972	1,014	872	744	743	689	563	409
3,093	3,085	2,977	2,571	2,224	2,203	2,147	1,766	1,517
—	439	649	706	671	1,183	1,245	841	770
3,093	3,524	3,626	3,277	2,895	3,386	3,392	2,607	2,287
2,062	2,277	2,528	2,249	1,717	2,306	2,134	1,639	1,344
(40)	33	(16)	(7)	(1)	31	51	57	64
—	—	—	—	—	—	—	49	46
357	375	233	243	245	142	147	150	155
714	839	881	792	934	907	1,060	712	678
(3.58)	0.32	(1.23)	(5.40)	(1.63)	(5.63)	(0.34)	1.80	2.98
(4.18)	(1.07)	(1.09)	(5.40)	1.86	(5.86)	15.78	2.59	3.98
4.03	3.70	1.99	(0.68)	0.12	(4.02)	1.80	2.56	3.18
0.60	0.60	0.60	0.60	0.60	0.75	1.20	1.20	1.10
23.67	28.40	30.49	33.29	39.36	38.00	44.58	30.01	28.59
9,300	10,000	14,000	15,000	16,100	18,300	19,300	20,800	22,500
30,187	29,533	28,886	23,787	23,728	23,870	23,777	23,712	23,712
29½-18⅛	33¼-22¼	28-15⅛	23½-17	25¾-20⅛	23-15	30⅝-20¼	31¾-23	35-21¼

Directors

Ian A. Barclay, Vancouver†
Associate, McQuaid & Associates Consulting Ltd. Mr. Barclay is a former Chief Executive Officer of a major forest products company.
Elected 1975

Marcel Bélanger, Quebec*†
President, Gagnon et Bélanger Inc., Management Consultants. Mr. Bélanger is a former President of the Canadian Institute of Chartered Accountants.
Elected 1976

W. Michael Brown, New York
President, International Thomson Organisation Limited, an information, publishing and leisure travel company which is associated with the controlling shareholder of Hudson's Bay Company.
Elected 1985

Gary J. Lukassen, Toronto*
Senior Vice-President, Finance and Administration, Hudson's Bay Company; 14 years service with the company.
Elected 1987

Gurth C. Hoyer Millar, London, England
Chairman, J. Sainsbury Properties Ltd., a subsidiary of J. Sainsbury, a major U.K. food retailer.
Elected 1976

George J. Kosich, Toronto*
President and Chief Operating Officer, Hudson's Bay Company; 29 years service with the company.
Elected 1985

Donald S. McGiverin, Toronto†
Governor, Hudson's Bay Company; 20 years service with the company.
Elected 1969

Dawn R. McKeag, Winnipeg†
President, Walford Investments Ltd. Mrs. McKeag is a director of a number of major Canadian companies.
Elected 1975

Peter W. Mills, Toronto
Senior Vice-President and General Counsel, The Woodbridge Company Ltd. Mr. Mills is an officer and director of a number of companies associated with the controlling shareholder of Hudson's Bay Company.
Elected 1985

David E. Mitchell, Calgary
President, Alberta Energy Company Ltd., a diversified company investing in energy resources and industrial development.
Elected 1984

David K. R. Thomson, Toronto
Chairman and Chief Executive Officer, Simpsons Limited, a subsidiary company. Mr. Thomson is an associate of the controlling shareholder of Hudson's Bay Company.
Elected 1987

Kenneth R. Thomson, Toronto*
Chairman and President, Thomson Newspapers Limited. Chairman, International Thomson Organisation Limited. Mr. Thomson is, beneficially, the controlling shareholder of Hudson's Bay Company.
Elected 1979

John A. Tory, Toronto*†
President, The Thomson Company Inc. Mr. Tory is a director and officer of a number of companies associated with the controlling shareholder of Hudson's Bay Company.
Elected 1979

Neil R. Wood*
Chairman and President, Markborough Properties Inc., a subsidiary company.
Elected 1987

* Member Management Committee
† Member Audit Committee

Officers

Donald S. McGiverin
Governor

George J. Kosich
President and
Chief Operating Officer

Gary J. Lukassen
Senior Vice-President,
Finance and Administration

David Crisp
Vice-President,
Human Resources

John M. Cunningham
Vice-President,
Operations

Brian C. Grose
Vice-President and Controller

J.G. (Jerry) Hartman
Vice-President,
Research and Development

Robert N. D. Hogan
Vice-President, Credit

A. Rolph Huband
Vice-President and Secretary

Raymond J. McDonald
Vice-President,
Distribution

Donald C. Rogers
Vice-President,
Real Estate and Development

Larry W. Rowe
Vice-President,
Information Services

Sheila K. Walters
Vice-President,
Store Planning and Construction

Kenneth C. Wong
Assistant Treasurer

Principal Subsidiaries/Divisions

The Bay

N. Robert Peter
President

Simpsons Limited

David K.R. Thomson
Chairman and
Chief Executive Officer

Paul S. Walters
President and
Chief Operating Officer

Zellers Inc.

Hani J. Zayadi
President

Fields Stores

Ronald P. Hughes
President

Hudson's Bay New York Inc.
(Fur Sales)

William H. Evans
President

Markborough Properties Inc.

Neil R. Wood
Chairman and President

Corporate Information

Auditors
Peat Marwick

Registered 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

Annual Meeting
The 320th Annual Meeting of Shareholders will be held at Commerce Hall, Commerce Court (King and Bay Streets), Toronto, on May 26, 1989 at 3:00 p.m.

The annual report of Markborough Properties Inc. is available from that company.

On peut obtenir ce rapport annuel en français sur demande.

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
Preferred Shares:
Series A and Series H
Montreal and Toronto

Design: Marcel Leutenegger
Photography: Claude Noël
Type: Howarth & Smith Limited
Film/Printing: IPI Graphics Inc.