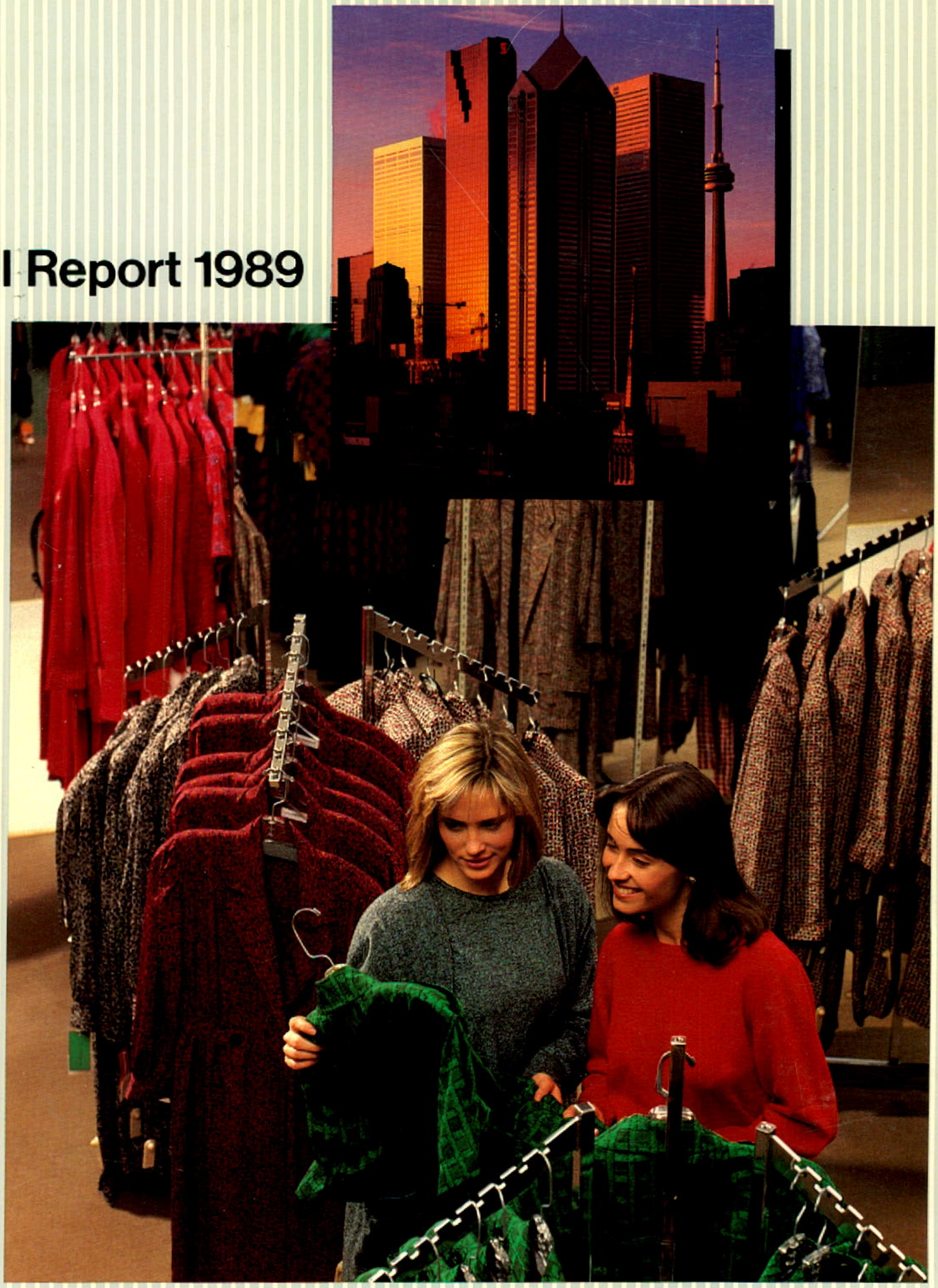
Hudson's Bay Company

Annual Report 1989



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 accounts for approximately 7% of Canadian 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 rvices of these two indus- es at fair prices, and ereby earn a satisfactory turn 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 1989 $ millions	Last Year 1988 $ millions
Earnings Before Extraordinary Items	**121.9**	49.2
Extraordinary Items	**46.3**	(27.0)
Earnings After Extraordinary Items	**168.2**	22.2
Cash Flow From Earnings	**244.7**	134.1
Merchandising		
Sales and Revenue	**4,590.8**	4,491.0
Operating Profit	**314.6**	226.7
Capital Expenditures	**82.3**	48.3
Real Estate		
Operating Profit	**84.6**	66.4
Acquisition, Development and Construction	**405.5**	57.6
Per Ordinary Share	**$**	$
Earnings Before Extraordinary Items	**2.99**	0.73
Extraordinary Items	**1.38**	(0.89)
Earnings (Loss) After Extraordinary Items	**4.37**	(0.16)
Cash Flow From Earnings	**6.65**	3.50

Directors' Report to Shareholders

Don McGiverin, Governor

Summary

We are pleased to report on an excellent year for your Company. Earnings before extraordinary items for the year ended January 31, 1990 were $2.99 per share compared with $0.73 the year before.

The principal factor underlying the improvement was a 38.8% increase in merchandising operating profit achieved during a year in which Canadian consumer spending was not buoyant.

Real estate operating profit was also ahead by 27.5% with Markborough achieving strong gains in both profit and cash flow.

Interest costs declined by 6.9% as reduced debt levels more than offset the effect of higher short-term rates.

As a result of the improved results, the quarterly dividend on ordinary shares has been increased by 33% to $0.20 per share.

Notable developments of 1989

Continued Growth of Merchandising Profits:

Operating profit from merchandising was ahead for the fifth consecutive year to $314.6 million in 1989, up from $226.7 million the previous year, with Zellers and the Bay each achieving about half the gain.

Zellers, building on its reputation for everyday low prices and on its innovative Club Z frequent buyer program, has strengthened its leadership position in the Canadian discount department store industry. Zellers' gains came from existing stores as well as from stores recently opened under its aggressive expansion program.

The Miracle on Queen Street continued with the opening in November of The Cellar in Simpsons' downtown store. The Cellar features dominant assortments of housewares, fashion linens and stationery and an expansion of the popular Food Hall.

The major increase in operating profit at the Bay was due to a number of factors including:

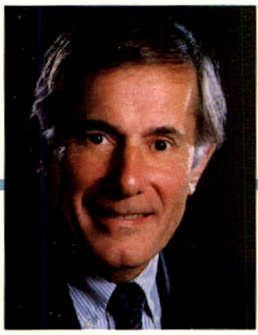
- the merger of the Simpsons and Bay operations in Montreal in February 1989;
- improved margins resulting from the elimination of promotional discounts on low margin merchandise; and
- a reduced expense rate partly as a result of a consolidation into four administrative regions from six.

New Markborough income property investments

Markborough made considerable progress in 1989 toward its goal of increasing its investment in income properties. This progress included the commencement of construction on the Bay-Adelaide Centre, (a 50% owned, 2 million square foot office project in Toronto), the purchase of two office buildings, one newly constructed (in Washington) and the other to be redeveloped (in Chicago), the advancement of preparations for construction of office buildings in London, England, San Francisco, Toronto, and Montreal and the acquisition of four shopping centre sites in Ontario.

Capital Reorganization

The Company strengthened its financial position in 1989 by raising $397 million in ordinary share capital through a rights issue while expending $265 million on the redemption of convertible preferred shares. As a result the Company's debt was reduced by $132 million, preferred dividends of $18 million annually were eliminated and key financial ratios were improved.



"THE 90's" – PULLING AWAY FROM THE PACK

This new decade presents a challenging blend of changes, anxieties, competitive and cost pressures and opportunities. But it is no exaggeration to say that the 1990's present a heavier blend of these conflicting elements for retailing than any decade in this century.

The dynamics of the retail industry are such that the better companies are pulling away from the pack at an accelerating rate. This speed will be damaging to the conformists because real retail sales growth will be slower in the 90's than in the 80's. When store growth outstrips market growth - and it has - somebody will lose money. Survivors will be narrowly focused, strategically sound, technologically advanced and lightning-quick to spot and exploit trends.

We survived in the 80's. In the 90's we intend to pull away from the pack and become one of the premier retailers in terms of earnings per share in the North American retail industry.

To pull away from the pack, we must accomplish the following:

- develop a strategic profit model direction for each Company that all our employees understand
- develop for each of our Companies a clear and distinct identity that our customers understand
- have the best trained, most productive and best compensated executive group in our industry
- continue to build profitable new stores and to refurbish profitable existing stores
- continue to create "distorted environments" that our customers love
- close under-performing stores and dispose of any other under-performing assets
- use technology for profit improvement, not just for information
- become more productive, efficient and flexible in our use of working capital for inventories
- improve our marketing programs to totally coordinate with our strategic direction, our customer identity, our market share requirements and our profit objectives

The 80's demonstrated you need real skills to prosper as a retailer. In the 90's, you will not only need skill, you will have to be an expert in your field, you will have to understand your customer, you will know how to add the best value to your product and you will have to produce your profit objective. Only retailers who can deliver on these requirements will be ready to prosper in the 1990's. At Hudson's Bay, we believe that we are ready.

George Kosich

Extraordinary items

There were extraordinary earnings of $1.38 per share in 1989 representing tax recovery on prior years' losses.

In the years these losses were incurred, generally accepted accounting principles did not permit taking credit for the potential (but at the time, uncertain) recovery of taxes. To the extent that recovery has now been realized, the application of these conservative accounting principles effectively overstated reported losses.

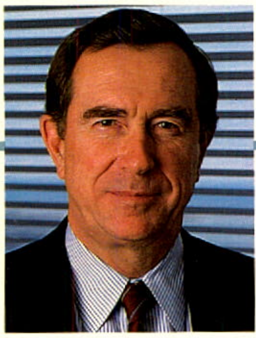
Realization of the remaining tax losses which, under present legislation and rates would amount to approximately $1.25 per share, is anticipated in 1990.

In 1988 there was an extraordinary loss of $0.89 per share relating to the disposal of non-core operations.

Outlook for 1990

We anticipate that the Canadian economy will grow at the rate of only 1.0% to 2.0% in 1990. This compares with average annual growth of 4.0% over the past five years. We expect a slowdown in consumer spending in the first half of 1990, particularly in the important Ontario market. However, we anticipate a strengthening of softwear sales in the fourth quarter prior to the introduction of the proposed 7% General Sales Tax in 1991. Despite these mixed conditions, we expect to achieve an increase in merchandising operating profit in 1990.

Markborough's operating profit is expected to be somewhat lower than in 1989 because of an anticipated decline in sales of industrial property in Ontario.



QUALITY, VALUE AND ATTENTION TO DETAIL

Real estate is an enormous component of the North American economy with many facets, from construction and development to sales and finance. Markborough is engaged in two broad but quite distinct aspects of the real estate field; the development of investment property for long-term appreciation and income, and the development of land for sale and generation of cash flow in the short to medium term. The outlook varies from place to place and by type of property, but some generalization is possible.

We develop outstanding master planned communities which offer the amenities and lifestyle wanted by many of today's home buyers. Most of our development of land for sale is in the American south and southwest - Florida, Texas, Arizona and Colorado. Land was purchased during a time of rapid growth and expansion in these areas, the early to mid-1980's. The largest investment is in Texas. The late 1980's have seen depressed conditions, especially in oil, real estate and banking, in most of these markets. Our sales have been very slow. However, there is evidence that conditions have bottomed out and are starting to improve. Our land is well located in cities which are basically sound with potential for good growth again in the 1990's.

A decade ago, investment property could usually be developed to generate positive leverage with debt. Rental income would be greater than debt service on money borrowed for the investment in new income property. As we enter the 1990's, rental income from new property is usually inadequate to cover debt service. This fundamental change is primarily a result of increased competition in the real estate development industry. At the same time, the value of high quality investment real estate has increased substantially, relative to income, as investors have accepted lower immediate returns in anticipation of appreciating capital values.

We are developing property now and in the 1990's to create value and for future capital appreciation, but not usually with the expectation of immediate positive cash flow. In fact, we are using cash flow from our older established properties to support the investment in new properties. This is especially true for office development where competition is strongest.

In the competitive environment of the 1990's, the successful developer must be aggressive in searching for new opportunities, but patient and careful in selecting those that will permit the creation of value. Timing is important to avoid periods of excessive development competition. Careful attention must be paid to the fundamentals of location, economic growth and demand. More than ever, we emphasize quality, value and attention to detail in all our development activity. Markborough has the financial strength and the management capability to compete effectively in the years ahead.

Neil Wood

Management

Top management of the Company was strengthened by the appointment in October 1989 of three Executive Vice-Presidents, N.R. (Bob) Peter, Paul S. Walters and Gary J. Lukassen.

Mr. Peter is President of the Bay and Simpsons. Mr. Walters is President of Zellers and has responsibility for Fields. Mr. Lukassen is the Chief Financial Officer for the Company.

Human Resources

The Company's 421 retail stores across Canada are staffed by over 65,000 full and part-time employees who must be appropriately challenged, motivated, mentored and rewarded if the Company is to achieve its full potential. In conjunction with our Human Resources management team, we have developed programs to raise the overall productivity of our organization by generating employee behaviour that is consistent with the marketing strategies of our companies. We are confident that the application of these innovative programs combined with the enthusiasm and skill of our people will produce superior results.

Appreciation

We thank our employees for the dedication and hard work they have exhibited throughout the year. We also greatly appreciate the continuing support of our customers, suppliers and shareholders.

On behalf of the Board

DONALD S. McGIVERIN, Governor

GEORGE J. KOSICH, President

March 15, 1990

Markborough's expansion of its income property portfolio in 1989 included purchase of the new Indiana Plaza office building in Washington (left) and acquisition of an interest in the Mapleview regional centre under construction in Burlington, Ontario (inset).

Summary of Operations
By Division

	Results in thousands of dollars	This Year	Last Year
the Bay	Sales and revenue	**1,859,096**	1,723,248
	Operating profit	**114,926**	70,328
	Assets employed	**942,499**	868,540
Simpsons	Sales and revenue	**436,868**	610,611*
	Operating profit	**14,483**	18,479*
	Assets employed	**327,163**	455,584*
Zellers	Sales and revenue	**2,149,563**	2,011,116
	Operating profit	**179,497**	142,178
	Assets employed	**756,638**	703,161
FIELDS	Sales and revenue	**89,754**	88,354
	Operating profit	**3,444**	1,914
	Assets employed	**18,267**	17,732
Markborough	Sales and revenue	**167,655**	163,749
	Operating profit	**73,756**	54,812
	Assets employed	**1,091,534**	741,110

*Includes Montreal division which was merged with the Bay at the end of the 1988 fiscal year

Division Profiles

The Bay operates 78 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.

Retail Stores

	Stores	Square Feet (000's)
Nova Scotia	**3**	412
Quebec	**18**	2,758
Ontario	**23**	3,490
Manitoba	**4**	1,046
Saskatchewan	**4**	529
Alberta	**15**	1,999
British Columbia	**11**	1,937
	78	12,171

(excludes 286,000 sq. ft. of clearance space)

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 12 Simpsons 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 155,000 sq. ft.

	Stores	Square Feet (000's)
Ontario	**12**	2,673

(excludes 82,000 sq. ft. of clearance space)

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 208 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	**13**	902
New Brunswick	**11**	650
Quebec	**42**	2,965
Ontario	**70**	4,587
Manitoba	**7**	486
Saskatchewan	**12**	672
Alberta	**23**	1,453
British Columbia	**23**	1,466
	208	13,546

Fields provides outstanding values and the lowest prices in family clothing, footwear and household linens. Fields stores operate in a convenient, friendly, "no frills" environment, and are located in British Columbia, Alberta and Saskatchewan. Merchandise procurement, distribution and all support services are centralized in Vancouver. Credit is available to customers through the use of bank cards. Fields operates 123 stores, which range from 650 to 25,400 square feet. A typical store is in a freestanding unit, or strip plaza, averaging 7,400 square feet.

	Stores	Square Feet (000's)
Saskatchewan	**4**	22
Alberta	**40**	285
British Columbia	**79**	609
	123	**916**

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 60% of Markborough's assets are invested in income properties with most of the remainder in land development. Approximately 45% 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

	Net Interest
31 shopping centres	7,723,550 sq. ft.
11 office/commercial buildings	735,700 sq. ft.
23 industrial buildings	906,300 sq. ft.
Construction in progress	2,156,200 sq. ft.
1 hotel	192 rooms
2 apartment buildings	340 suites
Land held for and under development	11,000 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 320 year-old performance guarantee." Bob Peter

Operating profit in 1989 of $114.9 million represents an increase of $44.6 million or 63.4% over 1988. Improved operating results over 1988 occurred in each quarter throughout the year.

Improved gross margins and continued tight control over expenses were the major contributors to better results.

Sales and revenue were up 7.9% to $1.9 billion with all regions of the country contributing to this increase. Sales increases were recorded primarily in the second half of the year with the first half negatively impacted by the elimination of some low margin sales events. The transfer of three Montreal Simpsons stores to the Bay and the movement of the St. Bruno store into premises formerly occupied by Simpsons had a positive effect on the results of the Quebec Region. In addition, a new store in Erin Mills (Mississauga) and a replacement store in downtown London opened during the year.

The Bay's commitment to its large downtown stores was emphasized with major projects completed in Vancouver, Winnipeg and Montreal.

The Market Square concept, which includes fashion linens, housewares and fine china and which initially opened in Calgary in 1988, was expanded to Winnipeg in October and completed in November in Vancouver and Montreal. The results have been exceptional.

Major renovations were completed in the three Toronto area stores of Square One, Bramalea and Towne & Countrye. This program of renovating branch stores will continue in 1990 with plans to completely renovate four stores as well as a major expansion and renovation of a fifth store. The flagship stores in Vancouver and Montreal will also undergo further renovation.

New stores are scheduled to open during 1990 in Langley, British Columbia and Burlington and Markham in Ontario.

The Bay opened a sparkling new 180,000 square foot store on August 16, 1989, part of a major expansion of the downtown London Galleria. The new store replaces an older one and anchors an expanded Galleria that will revitalize retailing in the downtown area. The store consists of three floors of fashions, housewares, linens, china and cosmetics, custom designed to serve the downtown London customer. Store Manager, Jerry Barsky, shown second from left with some of his associates, leads a keen group of approximately 300 employees. The Galleria store is one of two for the Bay in London, a diversified and growing city of 360,000 in Southwestern Ontario.

Simpsons

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

Bob Peter

Results for Simpsons in 1989 were affected by the merger of its Montreal division into the Bay at the beginning of the year.

Operating profit for Simpsons declined \$4.0 million to \$14.5 million in 1989. However, on a comparable basis, in Toronto only, operating profit improved by \$2.6 million.

Sales and revenue declined by \$173.7 million to \$436.9 million with discontinued stores in Montreal accounting for \$150.3 million of the decrease.

Improvement in continuing operations was due to better gross profit as well as a reduction in expenses.

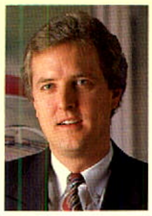
During 1989, major renovations were completed in the downtown Queen Street store. The Cellar, a unique combination of fashion linens, housewares, stationery and expanded Food Hall opened in November on the lower level. The fourth floor was completely renovated to accommodate women's moderate fashions and one of North America's largest shoe operations opened on the second floor. In addition, Simpsons opened The Thomson Gallery, giving the public an opportunity to view one of Canada's foremost collections of privately-owned Canadian Art. Simpsons' commitment to outstanding dining continued with the opening of The Gallery restaurant.

Simpsons' twelfth store in the Toronto area opened in August in Erin Mills. This 140,000 square foot outlet is Simpsons' prototype for new stores opening in 1990 in the Markham and Burlington areas of greater Toronto.

Major renovations in 1990 are planned for the Sherway store, one of Simpsons' larger branch units.

The Erin Mills store which opened August 23, is a prototype for future Simpsons' branch stores. Many of the characteristics of the downtown Queen Street store — upscale assortments, advanced store design and friendly customer service — have been migrated to Erin Mills under the direction of Store Manager, Bruce Marshall (centre foreground) and his enthusiastic associates. The Erin Mills regional centre is strategically located in Mississauga, a fast-growing city of 400,000, located immediately to the west of Metropolitan Toronto.

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." Paul Walters

Operating profit at Zellers rose to $179.5 million in 1989, a 26.3% improvement over the $142.2 million achieved in 1988. This continued strong performance reflects consumer acceptance of Zellers' strategy of providing the lowest prices and outstanding value supported by an aggressive marketing and advertising program. In addition, dedication to expense management enabled Zellers to maximize the retention of gross profit. Operating margin increased to 8.6% from 7.3% in 1988 and return on assets showed a substantial gain over 1988.

Sales and revenue increased 6.9% to $2,150 million. Both hardlines, led by home fashion, and softlines, led by children's wear, enjoyed substantial increases, supporting the marketing strategy to expand both in national brands and private label. Zellers increased its market share in a majority of regions in Canada.

The 1990 retail marketplace will be intensely competitive and extremely challenging. To meet this challenge, Zellers will focus on its value image and price statements with the best prices in the industry, strong promotional campaigns, Club Z and aggressive store expansion. Club Z continues as an important promotional differentiator with more than 50% of Canadian households currently Club Z members.

Computer technology is a prime source of productivity gains in today's business environment. Zellers is heavily committed to technological improvements in the areas of product control and distribution, financial control and efficiency and, most importantly, customer service. The development emphasis in 1990 will be on point of sale systems to process customers through the checkouts more efficiently and improve the marketing information available to better operate the business. These new systems are planned to be launched in early 1991.

Zellers opened 11 new stores in 1989 and plans to open 6 new stores in 1990. Over 40 stores will be modernized in 1990 as part of Zellers' asset management and store development strategies.

Zellers opened its 5th store in the Halifax/Dartmouth area on August 2, a 66,000 square foot unit in the Atlantic Super Centre. This is one of a number of recent openings of community "super centres", anchored by Zellers and Loblaws. Store Manager, Ernie Coles, (second from left) and his associates have been very pleased with the response of their customers to Zellers' lowest prices and Club Z. The Halifax/Dartmouth market is the largest in the Maritime Provinces with a population of approximately 300,000.

Markborough

300 South Wacker Drive, Chicago, purchased for redevelopment

Markborough recorded substantially improved financial results in 1989. Operating profit was $73.8 million, an increase of 34.6% over the previous year's profit. Substantial increases were realized in profit from income producing properties and land sales in Mississauga, Ontario were also a major contributor to the improvement.

Markborough operates in three product groups - Shopping Centres, Urban Development and Community Development, and all groups made good progress during 1989.

Place Vertu, Montreal - a 100,000 square foot office tower under construction

"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

The Urban Group had a number of major accomplishments during the year. Final approval was obtained for construction of the Bay Adelaide Centre in Toronto, a 50% owned, 2.0 million square foot office and retail complex in a prime downtown location and construction has now commenced. Office buildings were acquired in both Chicago and Washington. In the Chicago building, a major renovation and re-leasing is now underway. In Washington, the acquired building is newly completed but unleased and marketing is proceeding aggressively. Approval was obtained for development of an office building in San Francisco, additional land has been acquired in London, England to expand the Bull Wharf site and additional industrial land inventory was purchased in the Toronto market.

The Markborough Communities Group operated in very competitive conditions in all of its United States locations, but good progress was made. In Houston, sales of lots to homebuilders increased quite dramatically during 1989. Substantial additional investment was made in community infrastructure in Houston, Tampa and Austin. In Calgary, residential land development was profitable again in 1989 and servicing has commenced on a new community. In the Meadowvale Community in Mississauga, a major regional planning hurdle was cleared, paving the way for detailed planning of the final phase of that community.

The Shopping Centre Group continued to search aggressively for opportunities for both new centres and for expansion of existing properties. During 1989, land was acquired in Barrie and Bowmanville, Ontario, and a site acquired in Ajax during the previous year was expanded. An expansion of the regional Surrey Place Mall was completed and a second phase of expansion is about to be commenced. Sales and rental income continued to improve in most properties.

Markborough Place, Phase II, Mississauga, scheduled for completion May 1990

Cloverdale Mall, Toronto, refurbished during 1989

Lakes for Edgewater, a Markborough development in Houston

FIELDS

"Fields' mission is to provide outstanding value and the lowest prices on basic and casual family clothing, footwear and related accessories, in rural and neighbourhood urban markets in Western Canada." Janis Noiseux

Operating profit for Fields Stores for 1989 improved to \$3.4 million, up 80.0% from the \$1.9 million achieved in 1988. The major contributing factor was a marked increase in the gross profit rate.

Improved operating profit, together with increased attention to asset management, has resulted in significant gains in Fields' cash flow and return on assets.

Sales and revenue increased 1.6% in 1989 to \$89.8 million. Strong sales increases in footwear and linens, as well as moderate growth in women's and children's wear departments, were offset by sales shortfalls in men's and boys' wear.

Gross profit rate improved as a result of lower markdowns, reflecting improved inventory management. Expenses were slightly higher than in 1988 due to increased occupancy costs but were generally well controlled.

Fields now operates 118 family clothing stores and 5 P.S.S. (Plus Sizes, Plus Savings) stores in the three Western Provinces. During 1989, Fields opened 12 new stores and closed 6 unprofitable stores. Eleven of these new stores were Fields and one was P.S.S.

A further 8 to 10 Fields stores and 3 to 5 P.S.S. stores are planned for 1990.

Store Manager, Gena Kitchenham (center), and her associates brought "Everyday low prices — Everyday" to Cedar Hills Plaza, a neighbourhood centre in Surrey, B.C., when they opened Fields Store # 123 in March 1989. At 12,700 square feet, Cedar Hills quickly became one of Fields' largest volume stores. Surrey is a burgeoning suburban community of 200,000, southeast of Vancouver.

MANAGEMENT DISCUSSION AND ANALYSIS

A. CORPORATE FINANCIAL REVIEW 1987-89

1. Earnings

Earnings before extraordinary items were $122 million ($2.99 per share) in 1989 compared with $49 million ($0.73 per share) the year before.

In addition, in 1989 there was an extraordinary item of $46 million ($1.38 per share) representing tax recovery on prior years' losses. In 1988 there was an extraordinary loss of $27 million ($0.89 per share) related to dispositions of non-strategic assets.

The following table shows, in millions of dollars, the composition of earnings for the past three years with interest costs allocated between the merchandising and real estate sectors:

Composition of Earnings ($ Millions)

	1989	1988	1987
Merchandising			
Operating Profit	**314**	227	175
Interest	**(158)**	(171)	(178)
Total Merchandising	**156**	56	(3)
Real Estate			
Operating Profit	**85**	66	62
Write-Down	**—**	—	(196)
Interest	**(28)**	(29)	(21)
Total Real Estate	**57**	37	(155)
Discontinued Operations	**—**	—	4
General Corporate Expenses	**(10)**	(10)	(9)
Earnings Before Tax	**203**	83	(163)
Tax	**(81)**	(34)	85
Earnings	**122**	49	(78)
Extraordinary Items	**46**	(27)	(18)
Preferred Dividends	**(22)**	(27)	(28)
Earnings Per Share			
Before Extraordinary Items	**$2.99**	$0.73	($3.58)
After Extraordinary Items	**$4.37**	($0.16)	($4.18)

Merchandising earnings have increased significantly as operating profits improved while interest costs have declined. Strong sales growth at Zellers, improved gross profit rates at the Bay and effective expense control at Zellers, the Bay and Simpsons were the principal reasons for the increase in operating profits. The disposition of non-strategic assets and improved control of working capital led to the decline in interest costs.

Real estate earnings also increased over the period due to steady growth in profits from income properties. Because of depressed real estate markets in Texas and other Southern states, Markborough wrote down the value of its U.S. land portfolio in 1987. Since then, results from U.S. land operations have continued to be disappointing. On the other hand, sales of industrial land in Ontario have been strong and were a major contibutor to earnings in 1989.

Preferred dividends will decline to approximately $8 million per year with the redemption on October 31, 1989 of the Series "H" shares.

Earnings per share are calculated on a weighted average number of shares outstanding during the year. In 1989, the number of ordinary shares outstanding increased by 43.9%, primarily as a result of the capital reorganization described on page 2 of this report. If the capital reorganization had taken place at the beginning of the 1989 fiscal year, earnings per share for that year would have been reduced from $2.99 to $2.48.

2. Cash Flow, Capital Spending and Funding

Cash flow from operating activities amounted to $278 million in 1989. This compares with $181 million in 1988, $14 million in 1987 and negative cash flow for a number of years prior to that.

The turnaround has been achieved by higher earnings and better control of working capital in the merchandising sector.

The cash flow problems of the mid-eighties forced the Company to restrain its capital spending in both the merchandising and real estate sectors. In 1989, however, restraints were eased and capital spending on merchandising increased to $79 million from $36 million the year before. Capital spending on real estate increased seven-fold in 1989 to $384 million as Markborough made major additions to its income property portfolio. Capital spending over the next three years is projected to average about $115 million in the merchandising sector and about $250 million in the real estate sector. Management is confident that this program can be financed.

Debt was reduced in 1987 principally with funds from the sale of discontinued operations, and in 1988 with funds from operations. External funding was required in 1989 because of major new real estate investments, and this was provided by $32 million in debt and $151 million in equity.

The following table shows, in millions of dollars, the sources and uses of funds for the past three years:

Sources and Uses of Funds ($ Millions)

	1989	1988	1987
Cash Inflow (Outflow)			
From Earnings	**245**	134	149
Working Capital Change	**33**	47	(135)
Cash Flow from Operations	**278**	181	14
Invested in Merchandising (net)	**(79)**	(36)	(30)
Invested in Real Estate (net)	**(384)**	(55)	(55)
Secured Receivables	**14**	45	31
Cash Flow from Disposals	**36**	—	251
Dividends	**(43)**	(45)	(46)
Other	**(5)**	(11)	(8)
	(183)	79	157
Funding			
Debt	**32**	(84)	(156)
Equity	**151**	5	(1)
	183	(79)	(157)

3. Assets Employed, Debt and Liquidity

The objectives of the Company with respect to financing are:

- to maintain a debt ratio which allows access to capital markets at all times;
- to maintain a level of leverage appropriate to the retail and real estate industries so as to generate superior returns for shareholders;
- to maintain a mix of debt which will provide adequate liquidity at the lowest cost of capital.

The following summary balance sheet shows, in millions of dollars, the assets employed and the debt assigned to each sector, and shareholders' equity for the last three years:

Assets Employed, Debt and Shareholders' Equity ($ Millions)

	1989	1988	1987
Assets Employed			
Merchandising	**2,122**	2,172	2,325
Real Estate	**1,164**	799	768
	3,286	2,971	3,093
Provided From:			
Debt – Merchandising	**1,147**	1,441	1,541
– Real Estate	**813**	499	521
Deferred Tax	**5**	(19)	(40)
Equity	**1,321**	1,050	1,071
	3,286	2,971	3,093
Debt/Equity Ratio	**1.5:1**	1.8:1	1.9:1

A detailed discussion of debt attributable to merchandising and real estate is included in the sector analyses which follow.

4. Asset Protection

The many programs which were in effect to protect the assets of the Company from loss and from liability claims from third parties are backed by insurance contracts to cover major losses.

The amount of self-insured risk assumed by the Company is reviewed periodically by the Board of Directors.

5. Dividends

The Board has announced an increase in the rate of quarterly dividend on the ordinary shares from $0.15 to $0.20 effective April 30, 1990. This reflects the recent improvement in results. Historically, the annual dividend was increased from $0.60 in the mid-1970's to $1.20 in 1980/81 and then, because of poor results, was reduced to $0.60 and has been maintained at that level for the past seven years.

B. MERCHANDISING SECTOR

1. Retail Environment 1989

Retail spending in Canada, excluding the food and automotive sectors, increased by 5.9% over 1988 levels. Department store sales were ahead by 3.7%.

1989 saw major changes in the spending patterns of the Canadian consumer. Relatively strong growth in the spring and summer months did not continue into the winter. The second half of the year was weak, especially in big ticket durables. While strong promotional activity, including extended financing options, helped stimulate furniture and home entertainment sales, major appliance sales showed very little growth over 1988 levels.

The fashion sector also saw mixed growth patterns. Women's apparel generally improved over poor 1988 levels as shoppers responded more favourably to retailers' fashion, quality and price offers. Infant and children's apparel continued its strong growth. However, the men's market was off significantly with dress clothing particularly weak.

Price competition generally remained lower than 1988 levels through the first three quarters. Promotional activity increased during the Christmas selling season in response to weak sales.

Regionally, retail sales in the western provinces of British Columbia and Alberta, along with the Maritimes, outpaced the rest of Canada. However, sales growth in both Quebec and Ontario lagged behind the national rate in part due to weak consumer spending in Toronto and Montreal.

2. Retail Risk Factors

The four elements which combine to produce retail profits are sales, gross margins, operating expenses and interest costs. The following table shows the principal external and internal risk factors which affect these elements.

Retail Risk Factors

	External	Internal
Sales	Economic Activity Competition Inflation	Store Openings and Closings Development & Execution of Marketing Strategies
Margins	Competition	Buying/Pricing Control of Inventories Stock Shortages
Operating Expenses	Inflation Bad Debts	Occupancy Costs Payroll Promotion
Interest	Rates	Amount of Debt

A further risk factor specific to 1990 and 1991 is the impact of the proposed Goods and Services Tax on consumer buying practices.

3. Retail Performance 1989

Operating Profit from Merchandising was up by 38.8% in 1989 to $314 million from $227 million the year before. This continued a five year trend of recovery from the depressed levels of the mid-1980's. The return on assets employed improved to 14.4% in 1989 from 9.5% in the prior year.

Consolidated sales and revenue increased by only 2.2%. However, in the important fourth quarter, sales and revenue advanced by 4.6%. Same store sales were up 1.8%. Inflation in the general merchandise sector was estimated at 4.9%.

The action of the Bay and Simpsons to reduce or eliminate promotional discounts on low margin merchandise had a negative impact on sales but an offsetting positive effect on margins.

The control of working capital and, in particular, inventory management, is a constant priority. At year-end, inventory levels were $3 million lower than a year ago despite inflation and 13 new department stores. Working capital as a whole was down $92 million from last year and this condition, which continued to a greater or lesser extent throughout the year, together with the capital reorganization, led to a reduction in interest expenses in 1989 despite higher rates.

For further details on retail performance, see the Report on Operations section of this report.

4. Capital Spending Commitments

Capital Spending in the Merchandising sector is estimated at an average of $115 million over the next three years. At the year end, approximately $35 million of this amount had been committed for 1990, a further $8 million for 1991 and $2 million for 1992. The 1990 program includes six new stores for Zellers, three for the Bay and two for Simpsons, as well as modernization projects on approximately 60 existing stores.

Additions to working capital related to the 1990 capital program are estimated at $53 million, but this is expected to be partially offset by reductions in working capital in existing stores.

In addition to the above, annual lease commitments related to the 1990 capital program are estimated at $7 million which represents an increase of approximately 5% over total rental expenses in 1989.

5. Debt

The debt attributable to the merchandising sector at the 1989 year end was $1,147 million, of which $932 million was long term and $215 million was short term. Principal sources of short term debt in 1989 were Schedule "A" banks (by way of banker's acceptances and overdrafts), Schedule "B" banks and commercial paper. Seasonal upswings in merchandise inventory are financed by short term debt. The Company negotiates lines of credit for the merchandising sector annually with a number of Canadian banks. Management expects to be able to negotiate lines of credit sufficient to meet its requirements in 1990. Long term debt in the merchandising sector coming due in 1990 amounts to $39 million, and management expects to be able to refinance this amount and to raise any additional long term funds required for the merchandising sector. Foreign exchange and floating interest rate risks are limited by hedges, swaps and caps under guidelines established and reviewed periodically by the Board. Merchandising sector debt at 1989 year end comprised $616 million at fixed rates and $531 million at nominal floating rates. However, rates on $337 million of nominal floating rate debt have been fixed at 11.7% through various currency and interest exchange transactions. Merchandising sector debt subject to foreign exchange risk amounts to $76 million representing the Canadian dollar equivalent of unhedged U.S. dollar obligations.

6. Sale of Non-Core Businesses

The Company completed its strategy of disposing of non-core businesses with the disposal in mid-1989 of its fur sales operation in the United States at a loss which is not yet fully determined. Management believes that the $27 million after tax provision for losses set up as an extraordinary item in 1988 as a result of the bankruptcy of Red Carpet Distribution Inc. will be sufficient to cover ultimate losses relating to both Red Carpet and the sale of the U.S. fur operation.

C. REAL ESTATE

1. Real Estate Environment 1989

Markborough is a diversified real estate company both as to product and as to location and for this reason, as might be expected, encounters a variety of economic conditions. At one extreme the Toronto-centred region has enjoyed extraordinary growth and general economic strength over the last five years. On the other hand, much of Texas and Denver have been depressed since the beginning of 1986 when the major decline in oil prices resulted in a drastic reduction in investment and employment.

The collapse of the savings and loan industry has been a major negative factor affecting the real estate market in the United States during the past few years. A serious consequence to Markborough has been the shortage of traditional funding sources for builders - who are Markborough's principal customers for residential lots.

Markborough's shopping centre interests are entirely located in Canada where the retailing business experienced competitive conditions in 1989 with some weakening of consumer demand, although this situation has had little impact on Markborough's results.

Markborough's office and industrial buildings are located in four cities in North America and in London, England. Market demand varied widely among these cities in 1989.

2. Real Estate Risk Factors

Markborough's land development business is subject to the risk factors that apply to the housing industry in general. They include demographic shifts, economic growth, interest rates and the amount and quality of competition. Markborough's risk level is reduced because of the geographic spread of its holdings which are located principally in three U.S. states and two Canadian provinces.

The shopping centre business is subject to the risks that apply to the retail industry in general, principally relating to the level of economic activity and consumer spending.

In office buildings, the principal risk factors relate to the level of economic activity and competitive space on the market during the lease-up and lease renewal periods in the cities where the buildings are located.

In new development, whether in land or in income properties, there are usually risks related to the obtaining of regulatory approvals.

3. Real Estate Performance 1989

Operating profit from Real Estate was $85 million in 1989, up from $66 million the year before. Markborough earned $74 million of the 1989 profit and $55 million of the 1988 profit, with the balance coming principally from sale of properties no longer required by the merchandising sector.

Markborough realized substantial increases in profit from income producing properties in 1989. Land sales in the Meadowvale community in Mississauga were also a major contributor to earnings' growth.

For further details on Markborough's performance, see pages 14 and 15 of this report.

4. Geographic Distribution of Assets

The following table shows the distribution of Markborough's assets geographically and between income properties and land development, in millions of dollars:

Geographic Distribution of Assets ($ Millions)

	Canada			U.S.			U.K			TOTAL		
	1989	1988	1987	1989	1988	1987	1989	1988	1987	1989	1988	1987
Income Properties	415	365	363	202	86	83	100	51	33	717	502	479
Land and Housing	81	31	31	339	244	206	–	–	–	420	275	237
Other	14	38	13	44	24	71	2	3	–	60	65	84
TOTAL	510	434	407	585	354	360	102	54	33	1,197	842	800

5. Capital Spending Commitments

Capital spending in the real estate sector is estimated to total $645 million over the next three years on the development of new income properties, including acquisitions and expansions. This represents the development of projects which have already been acquired, projects for which purchases have not closed or for which site assemblies are incomplete, and proposed expansions of existing properties. Eight projects are expected to be on-stream by the end of 1992, representing 2.1 million square feet of additional commercial space.

No new land acquisitions are anticipated during the next three years but net additional investment during the period in existing land operations is estimated to total $100 million dollars.

6. Debt

The debt attributable to the real estate sector at the 1989 year end was $813 million. This amount of debt is supported primarily by the surplus cash flow and value (after specific debt) of the income property portfolio. Bank financing is generally arranged for 100% of costs during the acquisition and development phase for income properties. Long term financing is arranged at or near completion and lease-up, subject to satisfactory long term rates. For land projects, financing is arranged for as near as possible to 100% of peak cash requirements with appropriate partial release provisions as sales progress. Corporate operating lines are used for bridge financing and to finance general corporate requirements and smaller capital projects. A commercial paper program was also instituted to complement the operating lines at a lower cost.

Long term debt in the real estate sector coming due in 1990 amounts to $39 million, and management expects to be able to refinance this amount and to raise any additional long term funds required based upon existing cash flow. Foreign exchange and floating interest rate risks are limited by hedges and swaps under guidelines established and reviewed periodically by the Board. Real estate sector debt at the 1989 year end comprised $237 million at fixed rates and $576 million at nominal floating rates. However, rates on $218 million of nominal floating rate debt have been fixed through various interest exchange agreements.

7. Current Value

The financial statements of the Company are prepared on the historic cost basis. Under this method of accounting, increases in the underlying value of assets are not recorded until realized. Management believes that in the real estate industry current value information is an important supplement to the historic cost accounts.

Based on calculations by management of Markborough, market values of real estate assets as at January 31, 1990 exceeded book values by approximately $725 million after allowing for income taxes which would be payable on realization.

Consolidated Statement of Earnings

Year Ended January 31, 1990

	This Year $ 000's	Last Year $ 000's
Sales and Revenue (Note 2)		
Merchandising:		
The Bay	**1,859,096**	1,723,248
Simpsons	**436,868**	610,611
Zellers	**2,149,563**	2,011,116
Fields	**89,754**	88,354
Other	**55,506**	57,708
	4,590,787	4,491,037
Real estate	**180,541**	180,703
	4,771,328	4,671,740
Source of Earnings (Note 2)		
Merchandising:		
The Bay	**114,926**	70,328
Simpsons	**14,483**	18,479
Zellers	**179,497**	142,178
Fields	**3,444**	1,914
Other	**2,208**	(6,195)
	314,558	226,704
Real estate:		
Markborough	**73,756**	54,812
Other	**10,841**	11,554
	84,597	66,366
Segment Operating Profit	**399,155**	293,070
General Corporate Expenses	**(10,236)**	(9,505)
Interest Expense (Note 3)	**(186,087)**	(199,932)
Earnings Before Income Taxes and Extraordinary Items	**202,832**	83,633
Income Taxes (Note 4)	**(80,924)**	(34,461)
Earnings Before Extraordinary Items	**121,908**	49,172
Extraordinary Items (Note 5)	**46,281**	(27,000)
Net Earnings	**168,189**	22,172
Earnings Per Ordinary Share (Note 6)		
Earnings before extraordinary items	**$2.99**	$0.73
Net earnings (loss)	**$4.37**	($0.16)

Consolidated Statement of Retained Earnings

Year Ended January 31, 1990

	This Year $ 000's	Last Year $ 000's
Retained Earnings at Beginning of Year	**266,956**	290,076
Net Earnings	**168,189**	22,172
Dividends Paid		
Preferred shares	**(22,029)**	(27,031)
Ordinary shares	**(20,792)**	(18,342)
Redemption and Cancellation of Preferred Shares (Note 11)	**(26,531)**	81
Retained Earnings at End of Year	**365,793**	266,956

CONSOLIDATED BALANCE SHEET

January 31, 1990

	This Year $ 000's	Last Year $ 000's
Current Assets		
Cash	**5,017**	5,043
Short-term deposits (Note 10)	**42,082**	30,344
Accounts receivable	**1,072,115**	1,040,474
Income taxes recoverable	**843**	-
Merchandise inventories	**942,259**	945,685
Prepaid expenses	**46,096**	46,237
	2,108,412	2,067,783
Secured Receivables (Note 7)	**38,210**	50,168
Property for Sale and Development	**289,260**	221,992
Investments (Note 8)	**195,125**	103,077
Fixed Assets		
Land	**299,115**	163,311
Buildings	**606,743**	531,662
Equipment and leasehold improvements	**651,486**	587,674
	1,557,344	1,282,647
Less accumulated depreciation	**(488,592)**	(445,546)
	1,068,752	837,101
Deferred Charges	**6,722**	25,959
Goodwill	**91,640**	93,953
Pensions (Note 9)	**99,532**	70,589
Deferred Income Taxes	**-**	18,517
	3,897,653	3,489,139

	This Year $ 000's	Last Year $ 000's
Current Liabilities		
Bank indebtedness (Note 10)	**373,395**	228,794
Notes payable (Note 10)	**232,696**	339,723
Accounts payable and accrued expenses	**569,247**	467,439
Income taxes payable	**-**	1,522
Long-term debt due within one year (Note 10)	**77,800**	129,468
	1,253,138	1,166,946
Long-Term Debt (Note 10)	**1,318,353**	1,272,212
Deferred Income Taxes	**5,401**	-
Shareholders' Equity		
Capital (Note 11)	**958,813**	781,135
Retained earnings	**365,793**	266,956
Cumulative translation adjustment	**(3,845)**	1,890
	1,320,761	1,049,981
	3,897,653	3,489,139

On behalf of the Board:

Director

Marcel Bélanger

Director

Consolidated Statement of Cash Flow and Funding

Year Ended January 31, 1990

	This Year $ 000's	Last Year $ 000's
Cash Flow from Operating Activities		
Earnings before income taxes and extraordinary items	**202,832**	83,633
Current income tax recovery (expense)	**(4,130)**	10,085
Items not affecting cash flow:		
Depreciation and amortization	**68,866**	71,135
Equity earnings from affiliates and joint ventures less than (in excess of) cash received	**3,574**	(2,011)
Pension credits	**(26,480)**	(28,779)
Cash inflow from earnings	**244,662**	134,063
Net effect of changes in operating working capital (Note 12)	**32,984**	46,714
Net cash inflow from operating activities	**277,646**	180,777
Cash Flow from Investing Activities		
Merchandising:		
Capital expenditures	**(82,270)**	(48,282)
Dispositions	**2,977**	12,037
Other	**(12,796)**	21,858
Real estate:		
Acquisition, development and construction	**(405,474)**	(57,646)
Dispositions	**21,875**	2,288
Other	**21,873**	13,051
Disposition of business operations	**35,784**	-
Net cash outflow from investing activities	**(418,031)**	(56,694)
Cash Outflow for Dividends		
Preferred shareholders	**(22,029)**	(27,031)
Ordinary shareholders	**(20,792)**	(18,342)
Cash outflow for dividends	**(42,821)**	(45,373)
Net Cash Inflow (Outflow) from Activities and Dividends	**(183,206)**	78,710
Funding		
Debt (Note 10):		
Long-term:		
Increase	**355,431**	94,907
Reduction	**(303,616)**	(59,041)
Reduction in net short-term debt	**(19,756)**	(119,990)
	32,059	(84,124)
Equity:		
Preferred shares	**(268,805)**	(10,472)
Ordinary shares	**419,952**	15,886
	151,147	5,414
Net Cash Inflow from (Outflow to Reduce) Funding	**183,206**	(78,710)

Consolidated Statement of Assets Employed

January 31, 1990

	This Year $ 000's	Last Year $ 000's
Merchandising		
Accounts receivable - customer	**873,753**	822,827
Merchandise inventories	**942,259**	945,685
Accounts payable - trade	**(281,506)**	(222,530)
Other current assets - net	**(91,765)**	(11,545)
Working capital	**1,442,741**	1,534,437
Secured receivables	**20,711**	11,100
Investments	**13,564**	13,538
Fixed assets	**481,902**	456,334
Deferred charges	**3,374**	22,580
Goodwill	**62,222**	64,282
Pensions	**97,984**	69,391
	2,122,498	2,171,662
Real Estate		
Working capital	**54,342**	34,041
Secured receivables	**17,499**	39,068
Property for sale and development	**289,260**	221,992
Investments	**181,561**	89,539
Fixed assets	**586,850**	380,767
Goodwill	**29,418**	29,671
Other assets	**4,896**	4,577
	1,163,826	799,655
Assets Employed	**3,286,324**	2,971,317
Provided From		
Debt (Note 10):		
Long-term	**1,318,353**	1,272,212
Net short-term	**641,809**	667,641
	1,960,162	1,939,853
Deferred income taxes	**5,401**	(18,517)
Equity:		
Preferred shareholders (including accrued dividends)	**104,364**	344,298
Ordinary shareholders	**1,216,397**	705,683
	1,320,761	1,049,981
	3,286,324	2,971,317

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Year Ended January 31, 1990

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 States and in the United Kingdom are translated into Canadian dollars at the exchange rates prevailing at the balance sheet dates.

Earnings denominated in foreign currencies and the earnings of subsidiaries operating in the United States and in the United Kingdom are translated into Canadian dollars at approximately the exchange rates in effect 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 States and in the United Kingdom 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 is determined after deducting preferred dividends paid and accrued during the year 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 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 pre-development 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 certain 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, $69,423,000 (last year $71,736,000) after deducting accumulated amortization of $22,879,000 (last year $20,566,000), 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. The difference between the actuarial present value of accrued pension obligations and the value of pension plan assets as of February 1, 1986 and adjustments arising from plan amendments, experience gains and losses and changes in actuarial assumptions since that date are amortized over the expected average remaining service lives of the respective employee groups (see note 9).

n) Comparative figures

Certain of last year's comparative figures have been reclassified to conform with this year's presentation.

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 until their disposal as of June 30, 1989, United States fur auction operations (see note 5). 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.

On January 28, 1989 the carrying value at the time of closure for redevelopment of the former Simpsons retail store in downtown Montreal, $26,666,000, was reclassified from the merchandising to the real estate segment.

Information pertaining to operations in these industry 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	**56,711**	55,221
Real estate	**6,319**	5,662
	63,030	60,883
Included in interest expense (amortization of deferred charges (see note 1 k))	**5,836**	10,252
	68,866	71,135

Activities outside Canada comprise real estate operations in both the United States and the United Kingdom. Operations in neither of these countries generate more than 10% of the Company's revenue although those in the United States do employ more than 10% of its assets. United States real estate operations generated revenue of $36,400,000 (last year $61,500,000) and operating profits of $2,300,000 (last year losses of $900,000) and employed assets of $585,100,000 (last year $353,200,000).

3. INTEREST EXPENSE

Interest expense may be analyzed as follows:

	This Year	Last Year
	$000's	$000's
On long-term debt	**134,749**	141,893
Net short-term	**85,317**	87,448
	220,066	229,341
Less amount capitalized (see note 1 g))	**(33,979)**	(29,409)
Interest expense	**186,087**	199,932

4. INCOME TAXES

The average statutory Canadian income tax rate for the Company this year is 42.2% compared with 45.8% last year. However, since July 1, 1989 the Company has been subject to large corporations tax, which this year amounted to 1.6% of earnings before income taxes. The following schedule reconciles a nominal tax provision at these rates with the amount actually provided in the Consolidated Statement of Earnings.

	This Year	Last Year
	$000's	$000's
Earnings before income taxes	**202,832**	83,633
Nominal income tax provision at statutory Canadian income tax rates	**85,595**	38,304
Increase (decrease) in taxes resulting from:		
Large corporations tax	**3,236**	—
Tax rates in other jurisdictions	**(4,489)**	(2,263)
Capital gains and losses	**(1,916)**	(3,985)
Adjustments to prior years' taxes	**(912)**	1,064
Non deductible costs (non taxable credits)	**(590)**	1,341
Provision for income taxes per Consolidated Statement of Earnings	**80,924**	34,461

This year the Company realized previously unrecorded tax benefits relating to losses incurred in prior years in the amount of $46,281,000. This amount is included in extraordinary items (see note 5). Remaining unrecorded cumulative tax losses for accounting purposes at January 31, 1990 amounted to approximately $141,000,000, which may be carried forward until the following years ending January 31:

1992 – $31,000,000; 1993 – $51,000,000; 1995 – $37,000,000; 1996 – $22,000,000.

5. EXTRAORDINARY ITEMS

Extraordinary items comprise the following:

	This Year	Last Year
	$000's	$000's
Realization of tax benefit from losses not recognized in prior years (see note 4)	**46,281**	—
Net losses relating to disposition of operations	**—**	(27,000)
	46,281	(27,000)

Effective June 30, 1989 the Company completed its strategy of disposing of non-core businesses with the disposal of its fur auction operations in the United States. This disposal will result in a loss to the Company. However, as certain receivables were not included in the disposal but are being collected by the purchaser on behalf of the Company and in view of the present depressed conditions in the industry, it will be some time before the precise loss on disposal can be determined.

A provision was made last year on the bankruptcy of Red Carpet Disribution Inc. ("Red Carpet") for an estimated loss of $27,000,000, after deducting deferred income tax credits of $18,000,000, against the amount due from Red Carpet in the form of vendor take-back notes. The liquidation of assets and settlement of preferential debts of Red Carpet, which had acquired the Company's wholesale division in 1987, is progressing slowly but prospects for recovery on the notes are appreciably better than they were a year ago.

Considering the current status of both the fur disposal and the Red Carpet liquidation, management is of the opinion that it is neither necessary to increase, nor appropriate to reduce, the amount of the provision for "net losses relating to disposition of operations" recorded last year.

6. EARNINGS PER SHARE

During the year ended January 31, 1990 the number of ordinary shares outstanding was increased by 43.9%, primarily as a result of a Rights Offer which was conditional upon the redemption of preferred shares series H (see note 11). Earnings per share figures are generally calculated on average numbers of shares outstanding (see note 1 d)). However, if an "adjusted earnings per share" figure is calculated as though these share transactions had taken place at the beginning of the fiscal year, the resulting figure is less than the amount shown on the Consolidated Statement of Earnings, as follows:

	Before extra-ordinary items	**After extra-ordinary items**
Earnings per ordinary share	**$2.99**	**$4.37**
Adjusted earnings per ordinary share	**$2.48**	**$3.53**

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 and loans outstanding under the employee share ownership plan.

	This Year	Last Year
	$000's	$000's
Total secured receivables	**108,697**	98,003
Less amounts due within one year classified as accounts receivable	**(70,487)**	(47,835)
	38,210	50,168

Maturities during the five years ending January 31, 1995 are as follows:

1991 – $70,487,000; 1992 – $13,414,000; 1993 – $9,612,000;
1994 – $ 6,287,000; 1995 – $ 893,000.

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	**181,561**	89,539
Northern Stores Inc.	**8,050**	8,050
Other	**5,514**	5,488
	195,125	103,077

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

	This Year	Last Year
	$000's	$000's
Assets	**851,290**	787,419
Liabilities	**(669,729)**	(697,880)
Investment in real estate joint ventures	**181,561**	89,539
Revenue	**125,603**	112,426
Expenses	**(101,814)**	(89,601)
Pretax earnings of real estate joint ventures	**23,789**	22,825

The Company is contingently liable at January 31, 1990 for $147,400,000, representing certain liabilities of its co-owners and partners in unincorporated real estate 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.

The investment in Northern Stores Inc. consists of 1,442,000 common shares, representing 11.1% of all of the common shares outstanding at January 31, 1990.

9. PENSIONS

As of January 31, 1990 the aggregate actuarial present value of accrued pension benefits is $335,000,000 and the aggregate market value of pension plan assets is $618,000,000.

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)	**373,395**	228,794
Notes payable (a)	**232,696**	339,723
Long-term debt due within one year (b)	**77,800**	129,468
Less short-term deposits	**(42,082)**	(30,344)
Net short-term debt	**641,809**	667,641
Long-term debt (b)	**1,318,353**	1,272,212
	1,960,162	1,939,853

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**	7,484
7½% first mortgage bonds series B due 1991	**4,954**	4,954
11½% first mortgage bonds series C due 1995	**21,518**	22,505
9⅞% first mortgage bonds series D due 1997	**29,626**	31,985
10% first mortgage bonds series E due 1998	**25,479**	25,897
Markborough Properties Inc. and subsidiaries (includes U.S. $153,546,000 attributable to assets in the United States) (includes floating rate debt of $227,818,000 (last year $175,753,000) (b))		
Mortgages and obligations on property for sale and development at an average year end rate of 9.5% (last year 10.2%) and maturing by 1992	**81,029**	84,575
Mortgages on income property permanent financing at an average year end rate of 10.7% (last year 11.1%) and maturing by 2011	**307,417**	164,475
Mortgages on income property interim financing at an average year end rate of 12.4% (last year 10.7%) and maturing by 1993	**75,975**	79,250
	553,482	421,125
Secured on accounts receivable:		
Hudson's Bay Company Acceptance Limited		
13¼% debentures series C due 1989	**—**	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	**20,348**	20,780
13¾% debentures series G due 2001	**44,544**	44,544
Floating rate debt: (b)		
Term loan due 1993	**—**	35,000
Term loan due 1993	**50,000**	50,000
Term loan due 1994	**25,000**	—
Term loan due 1995	**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	**14,325**	15,670
	269,217	284,419
Secured by floating charge on assets of subsidiary:		
Zellers Inc.		
10¼% sinking fund debentures series 1974 due 1994	**6,706**	7,706
	829,405	713,250

	This Year $000's	Last Year $000's
Unsecured:		
Hudson's Bay Company		
10½% debentures due 1989	**—**	21,190
12½% note due 1989	**—**	231
14¼% notes due 1989	**—**	46,084
13.85% note due 1990	**25,000**	25,000
10% notes due 1991 (U.S. $74,800,000)	**88,638**	96,105
10¾% notes due 1991	**80,000**	80,000
Dual currency bonds due 1991-1993 (U.S. $92,022,000) (c)	**109,046**	112,587
11% notes due 1993	**25,000**	25,000
10% debentures due 1994 (U.S. $22,491,000)	**26,652**	29,904
15.36% term loan due 1995-1997 (£5,592,000)	**11,128**	11,575
Floating rate debt (b)(d)	**189,900**	223,685
Simpsons Limited		
9½% debentures series G due 1989	**—**	1,652
8⅜% debentures series H due 1993	**3,546**	5,721
9⅛% debentures series I due 1994	**2,980**	3,061
11¾% debentures series J due 1995	**4,364**	5,864
	566,254	687,659
Subordinated:		
Zellers Inc.		
5½% convertible subordinated debentures series 1971 due 1991 (e)	**494**	771
	1,396,153	1,401,680
Less amounts due within one year	**(77,800)**	(129,468)
	1,318,353	1,272,212

(a) Short-term floating rate debt at January 31, 1990 was $564,009,000. Of this amount, $160,780,000 has been fixed at 10.6% through various currency and interest exchange transactions. Most of the remainder has been capped at 12.6% LIBOR through various U.S. dollar interest rate cap agreements.

(b) Long-term debt (including amounts due within one year) at January 31, 1990 includes floating rate debt amounting to $542,718,000. Of this amount, $394,250,000 has been fixed at 11.1% through various currency and interest exchange agreements. The balance has been capped at 12.6% LIBOR through various U.S. dollar interest rate cap agreements.

(c) The dual currency bonds bear interest at 8.0% based on a notional principal amount of 153,370,000 Swiss Francs at January 31, 1990. 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 $47,400,000 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, 1995 are as follows:

1991 – $ 77,800,000; 1992 – $326,473,000; 1993 – $194,371,000;
1994 – $166,007,000; 1995 – $252,799,000.

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.

During the year ended January 31, 1990 all remaining outstanding series H shares were either redeemed or converted into ordinary shares of the Company and the designation of preferred shares as series B, D, E, F, G and I was cancelled.

During the year ended January 31, 1989 all remaining outstanding series D and series G preferred shares were redeemed and series I preferred shares were issued and redeemed as part of a series of intercompany transactions.

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	**3,859,618**	**86,841**	4,058,518	91,317
Series C	**648,867**	**16,222**	673,910	16,848
Series H	**—**	**—**	9,516,000	234,681
		103,063		342,846
Ordinary shares	**44,608,986**	**842,405**	30,992,635	422,452
		945,468		765,298
Additional paid-in capital		**13,345**		15,837
		958,813		781,135

The changes in shares issued and outstanding during the two years ended January 31, 1990 are as follows:

	Number of shares	$000's
Preferred shares series A:		
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
Purchased for cash and cancelled	(198,900)	(4,476)
Issued and outstanding at January 31, 1990	3,859,618	86,841
Preferred shares series C:		
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
Redeemed	(25,043)	(626)
Issued and outstanding at January 31, 1990	648,867	16,222

	Number of shares	$000's
Preferred shares series D:		
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, 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, 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
Converted into ordinary shares	(2,109)	(52)
Redeemed	(9,513,891)	(234,629)
Issued and outstanding at January 31, 1990	—	—
Ordinary shares:		
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
Issued:		
Under the employee share ownership plan	109,518	2,834
Under the executive stock option plan	342,675	6,606
Under the dividend reinvestment plan	451,852	12,936
Under the rights issue	12,701,928	397,249
On conversion of series H shares	1,462	52
On conversion of Zellers Inc. 5½% convertible subordinated debentures series 1971	8,980	277
Purchased for cash and cancelled	(64)	(1)
Issued and outstanding at January 31, 1990	44,608,986	842,405

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 7.12% until September 15, 1994. On that date the rate will be adjusted to 52% of the average of the five year guaranteed investment certificate rate of certain trust companies plus 2%. Prior to September 15, 1989 the dividend rate was 8.53%. The shares may be redeemed at the Company's option at a price of $25.00 per share until September 15, 2004, at which time any shares still outstanding are to be redeemed at that price.

At a special meeting held on October 26, 1989 the holders of series H shares and the holders of ordinary shares approved a resolution providing for the redemption of all outstanding series H shares on October 31, 1989 at $27.75 per share. Until October 31, 1989, each series H share had been convertible into 0.6944 ordinary shares at the holder's option.

During the year the Board approved a Rights Offer whereby holders of ordinary shares on November 9, 1989 were entitled to subscribe for two additional ordinary shares at a price of $31.25 for every five shares held. The rights expired on December 4, 1989, at which time 12,187,223 shares had been subscribed for. Under an additional subscription privilege, which formed part of the Rights Offer, shareholders acquired the remaining 514,705 shares on or before December 11, 1989.

At January 31, 1990 3,500,000 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 2,323,175 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 1999 and have an average issue price of $23.34 per share. At January 31, 1990 582,400 options were unallocated.

At January 31, 1990 the holders of approximately 44.3% 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, 1990 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, 1990:				
Preferred shares:				
Series A	3,913	4,476	(563)	—
Series H	264,214	234,629	3,055	26,530
	268,127	239,105	2,492	26,530
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)

12. CONSOLIDATED STATEMENT OF CASH FLOW AND FUNDING

The "net effect of changes in operating working capital" appearing in the 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	**26**	336
Accounts receivable	**(65,314)**	(18,242)
Income taxes recoverable – net	**(2,365)**	72,732
Merchandise inventories	**3,426**	(12,578)
Prepaid expenses	**32**	(9,434)
Increase in accounts payable and accrued expenses	**97,179**	13,900
	32,984	46,714

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 $124,000,000 (last year $110,700,000).

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, 1991	112,000
1992	103,000
1993	95,700
1994	89,900
1995	84,200
Thereafter	1,035,500
Total minimum lease payments	1,520,300

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 $587,000,000 (last year $380,900,000), net of accumulated depreciation of $47,100,000 (last year $45,000,000).

Real estate revenues include rentals from the above properties of $68,700,000 (last year $67,400,000).

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

The management of Hudson's Bay Company is responsible for the preparation and integrity of the consolidated financial statements contained on pages 21 to 31 of this Annual Report and of financial information, discussion and analysis 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 26. 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 Thorne, 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

G J Lukassen

Executive Vice-President
and Chief Financial Officer

Toronto, Canada
March 15, 1990

KPMG Peat Marwick Thorne

AUDITORS' REPORT TO THE SHAREHOLDERS

We have examined the consolidated balance sheets and the consolidated statements of assets employed of Hudson's Bay Company as at January 31, 1990 and January 31, 1989 and the consolidated statements of earnings, retained earnings and cash flow and funding for each of the two years then ended. Our examinations were 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, 1990 and January 31, 1989 and the results of its operations and its cash flow for each of the two years then ended in accordance with generally accepted accounting principles applied on a consistent basis.

Peat Marwick Thorne

Chartered Accountants

Toronto, Canada
March 15, 1990

Ten Year Consolidated Financial Summary

	1989
Results for the Year (in millions of dollars)	
Sales and revenue:	
The Bay	1,859
Simpsons	437
Zellers	2,150
Fields	90
Other	55
Merchandising	4,591
Real estate	180
Ongoing operations	4,771
Discontinued operations	—
Total sales and revenue	4,771
Source of earnings:	
The Bay	115
Simpsons	14
Zellers	180
Fields	3
Other	2
Merchandising	314
Markborough	74
Other	11
Real estate	85
Ongoing operations	399
Discontinued operations	—
Segment operating profit	399
General corporate expenses	(10)
Interest expense	(186)
Earnings (loss) before income taxes	203
Income taxes	(81)
Earnings (loss) before minority interest	122
Minority interest — Zellers	—
Earnings (loss) before extraordinary items	122
Extraordinary items	46
Net earnings (loss)	168
Dividends paid:	
Preferred shares	22
Ordinary shares	21
Cancellation of shares	26
Increase (decrease) in retained earnings	99
Fixed asset additions — ongoing operations	319
Depreciation — ongoing operations	57
Cash flow from earnings — ongoing operations	245
Year End Financial Position (in millions of dollars)	
Merchandising	2,122
Real estate	1,164
Ongoing operations	3,286
Discontinued operations (net of minority interest)	—
Assets employed	3,286
Debt	1,960
Deferred income taxes	6
Minority interest — Zellers	—
Preferred shareholders' interest (including accrued dividends)	104
Ordinary shareholders' equity	1,216
Results Per Ordinary Share (in dollars)	
Earnings (loss) before extraordinary items	2.99
Net earnings (loss)	4.37
Cash flow from earnings — ongoing operations	6.65
Dividends	0.60
Shareholders' equity	27.27
Shareholders	
Number of ordinary shareholders	7,800
Ordinary shares outstanding (in thousands)	33,489
Range in share price (in dollars)	38-24¾

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

1988	**1987**	**1986**	**1985**	**1984**	**1983**	**1982**	**1981**	**1980**
1,723	1,738	1,766	1,621	1,307	1,269	1,212	1,201	1,075
611	618	608	592	713	704	706	725	738
2,011	1,845	1,782	1,560	1,345	1,116	978	929	827
88	88	86	74	70	68	64	59	58
58	56	52	43	38	34	38	44	41
4,491	4,345	4,294	3,890	3,473	3,191	2,998	2,958	2,739
181	188	270	276	243	177	127	173	84
4,672	4,533	4,564	4,166	3,716	3,368	3,125	3,131	2,823
—	312	1,128	1,105	1,113	1,003	1,014	1,042	991
4,672	4,845	5,692	5,271	4,829	4,371	4,139	4,173	3,814
70	64	83	26	10	29	10	38	57
19	17	6	13	(51)	(29)	(34)	(11)	9
142	93	64	51	40	47	31	43	50
2	1	3	1	3	5	3	2	5
(6)	—	(1)	—	2	2	—	2	4
227	175	155	91	4	54	10	74	125
55	(149)	109	99	92	32	21	29	18
11	14	25	30	(2)	23	29	41	18
66	(135)	134	129	90	55	50	70	36
293	40	289	220	94	109	60	144	161
—	4	50	40	24	24	79	55	79
293	44	339	260	118	133	139	199	240
(10)	(9)	(10)	(11)	(11)	(11)	(13)	(12)	(12)
(200)	(198)	(265)	(251)	(199)	(174)	(261)	(244)	(136)
83	(163)	64	(2)	(92)	(52)	(135)	(57)	92
(34)	85	(31)	(7)	(15)	34	13	60	(28)
49	(78)	33	(9)	(107)	(18)	(122)	3	64
—	—	—	—	—	—	—	1	(10)
49	(78)	33	(9)	(107)	(18)	(122)	4	54
(27)	(18)	(40)	3	—	83	(6)	382	19
22	(96)	(7)	(6)	(107)	65	(128)	386	73
27	28	25	21	21	20	11	12	12
18	18	17	14	14	14	18	29	28
—	—	4	—	—	2	1	7	—
(23)	(142)	(53)	(41)	(142)	29	(158)	338	33
76	89	74	135	134	87	101	113	139
54	58	56	54	50	47	44	38	33
134	149	133	68	5	23	(84)	54	73
2,172	2,325	2,113	1,963	1,699	1,480	1,460	1,458	1,203
799	768	972	1,014	872	744	743	689	563
2,971	3,093	3,085	2,977	2,571	2,224	2,203	2,147	1,766
—	—	439	649	706	671	1,183	1,245	841
2,971	3,093	3,524	3,626	3,277	2,895	3,386	3,392	2,607
1,940	2,062	2,277	2,528	2,249	1,717	2,306	2,134	1,639
(19)	(40)	33	(16)	(7)	(1)	31	51	57
—	—	—	—	—	—	—	—	49
344	357	375	233	243	245	142	147	150
706	714	839	881	792	934	907	1,060	712
0.73	(3.58)	0.32	(1.23)	(5.40)	(1.63)	(5.63)	(0.34)	1.80
(0.16)	(4.18)	(1.07)	(1.09)	(5.40)	1.86	(5.86)	15.78	2.59
3.50	4.03	3.70	1.99	(0.68)	0.12	(4.02)	1.80	2.56
0.60	0.60	0.60	0.60	0.60	0.60	0.75	1.20	1.20
22.77	23.67	28.40	30.49	33.29	39.36	38.00	44.58	30.01
8,900	9,300	10,000	14,000	15,000	16,100	18,300	19,300	20,800
30,993	30,187	29,533	28,886	23,787	23,728	23,870	23,777	23,712
26¼-18½	29½-18⅛	33¼-22¼	28-15⅛	23½-17	25¾-20⅛	23-15	30⅝-20¼	31¾-23

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, The Thomson Corporation, an information, publishing and leisure travel company which is associated with the controlling shareholder of Hudson's Bay Company.
Elected 1985

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; 30 years service with the company.
Elected 1985

Gary J. Lukassen, Toronto*
Executive Vice-President, and Chief Financial Officer, Hudson's Bay Company; 15 years service with the company.
Elected 1987

Donald S. McGiverin, Toronto†
Governor, Hudson's Bay Company; 21 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 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, The Thomson Corporation. Mr. Thomson is, beneficially, the controlling shareholder of Hudson's Bay Company.
Elected 1979

John A. Tory, Toronto*†
Deputy Chairman, The Thomson Corporation. 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
Executive Vice-President
and Chief Financial Officer

N.R. (Bob) Peter
Executive Vice-President

Paul S. Walters
Executive Vice-President

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

R.P. (Ron) Hughes
Vice-President and
Managing Director,
Asian Operations

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.R. (Bob) Peter
President

Zellers Inc.

Paul S. Walters
President

Markborough Properties Inc.

Neil R. Wood
Chairman and President

Simpsons Limited

David K.R. Thomson
Chairman and
Chief Executive Officer

N.R. (Bob) Peter
President

Fields Stores

Janis R. Noiseux
President

Corporate Information

Auditors
Peat Marwick Thorne

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 321st Annual Meeting of Shareholders will be held at Commerce Hall, Commerce Court (King and Bay Streets), Toronto, on May 24, 1990 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 and Preferred Shares,
Series A, are listed on the
Montreal and Toronto Exchanges

Design:	Marcel Leutenegger
Photography:	Claude Noël
Type:	Howarth & Smith Limited
Film:	PBC Lithoprep Inc.
Printing:	Bradbury Tamblyn & Boorne Ltd.