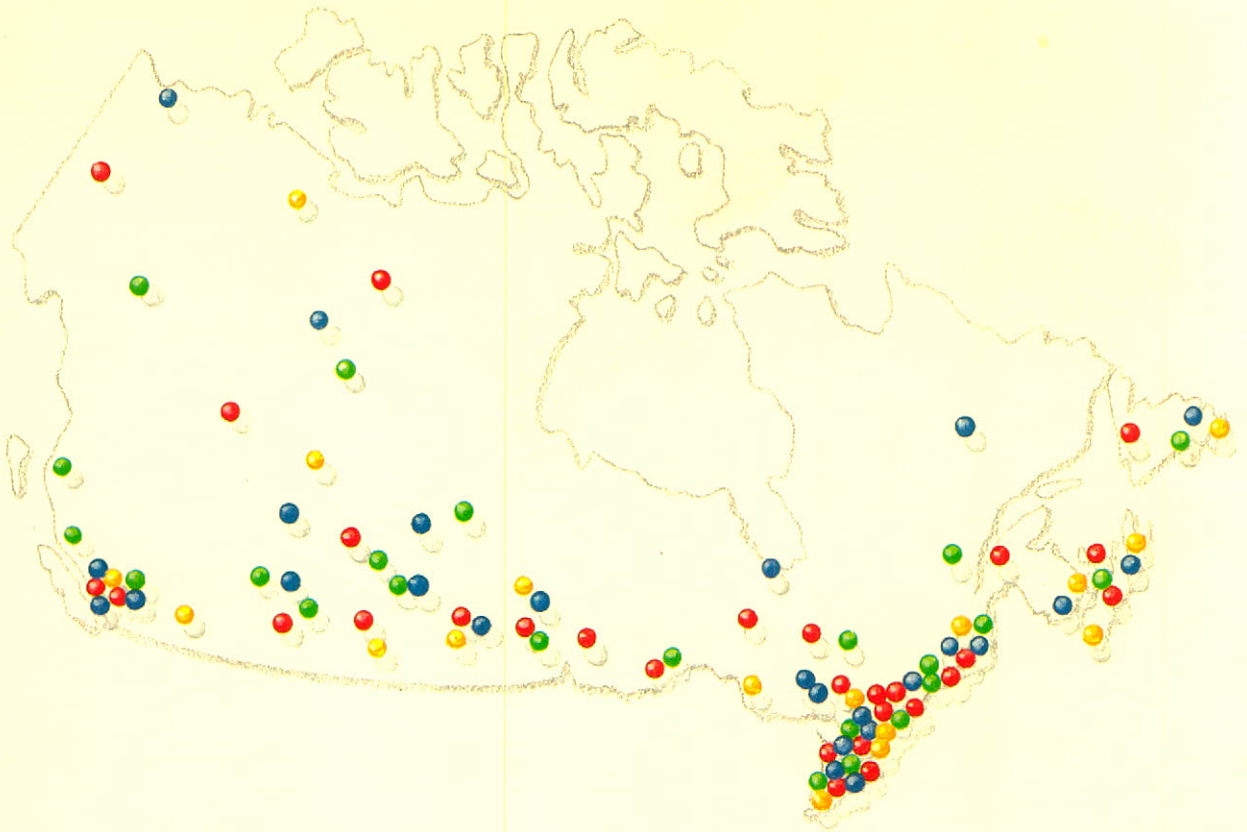


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SEARS CANADA INC. ANNUAL REPORT 1986



CORPORATE PROFILE



Sears Canada Inc., founded September 18, 1952, is one of Canada's largest merchandising operations. The Company is committed to satisfying customers by providing products and services of superior value through both personal shopping and catalogue ordering from coast to coast.

Today Sears operates 77 department stores, most of which are located in suburban centres. Catalogue orders are received by telephone and mail as well as through over 1,500 catalogue sales units, and through facilities provided in all Sears department stores. Catalogues are distributed to approximately 4.0 million families throughout Canada.

Sears extends credit to over 4.2 million Canadians for the purchase of all types of merchandise and services sold through its department stores and catalogue sales offices. These credit accounts are transferred to a wholly owned subsidiary, Sears Acceptance Company Inc.

Sears has a large trucking fleet operated by its wholly-owned subsidiary, SLH Transport Inc.

The retail and catalogue operations of the Company are organized into 3 regions:

- Eastern Region . . . consisting of the Atlantic provinces and Ontario with 35 retail stores and 687 catalogue sales units, and with headquarters in Toronto, Ontario;
- Quebec Region . . . consisting of the province of Quebec with 14 retail stores and 360 catalogue sales units, and with headquarters in Montreal, Quebec;
- Western Region . . . consisting of the Western provinces with 28 retail stores and 501 catalogue sales units, and with headquarters in Edmonton, Alberta.

Central administration for the Company is located in Toronto at 222 Jarvis Street. Buying for the Company is centralized in the headquarters building with the exception of women's fashion buying which is located in Montreal.

Sears has a 25% share interest in Allstate Insurance Company of Canada. Allstate has locations in most Sears department stores. Sears also has a 45% share interest in Photo Engravers & Electrotypers Limited, which produces Sears catalogues, plus a 20% interest in Inglis Limited, a major supplier to Sears of large home appliances. In addition the Company has extensive holdings, either directly or through joint ventures, in regional and suburban shopping centres.



ANNUAL REPORT FOR THE FISCAL YEAR ENDED DECEMBER 31, 1986

Sears Canada Inc.

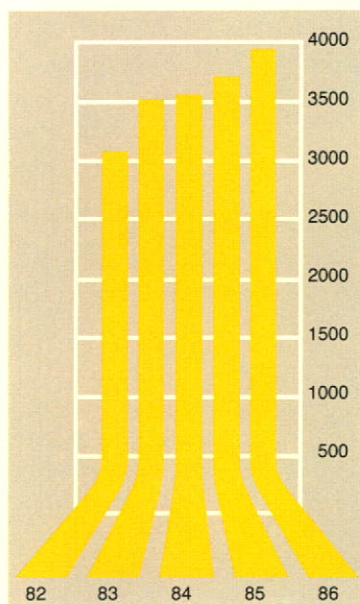
FINANCIAL HIGHLIGHTS

	Year ended December 31, stated in thousands	
	1986	1985 restated
Net sales	\$3,891,817	\$3,789,214
Earnings from operations before income taxes	138,613	114,818
Earnings before extraordinary items	78,728	74,311
Per share	.90	.85
Net earnings including extraordinary items	79,078	86,056
Per share	.90	.99
Dividends declared	20,981	17,463
Per share	.24	.20
Shareholders' equity	756,213	697,074
Per share	8.65	7.98
Federal and provincial income taxes	68,950	51,391
Interest costs	139,858	132,933
Contribution to the Plan for Sharing Profits with Employees	7,328	5,843
Contributions to Company and Government Pension Plans	76,399	33,727
Return on capital employed*	14.4%	14.1%
Return on equity	10.8%	11.2%
Working capital	1,057,881	1,117,222
Total assets	2,546,316	2,332,112

* Pretax earnings plus interest and earnings of associated companies as a percent of average total debt plus deferred income taxes and shareholders' equity.

SALES

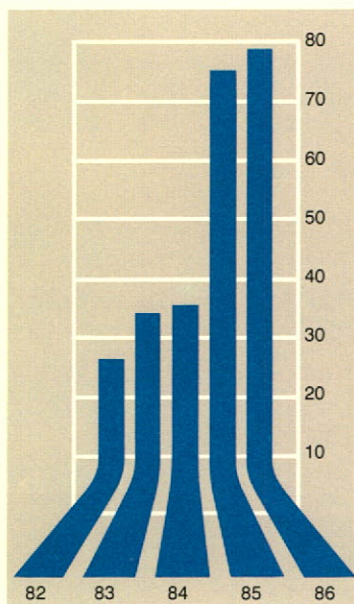
(in millions)



Consolidated net sales of \$3,891,817,000 in 1986 showed an increase of 2.7% over 1985.

EARNINGS

(in millions)

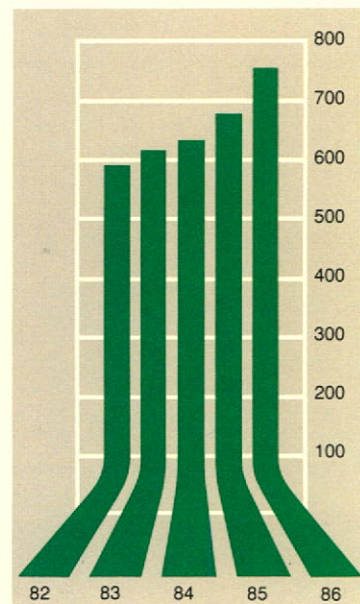


Consolidated earnings before extraordinary items amounted to \$78,728,000 in 1986.

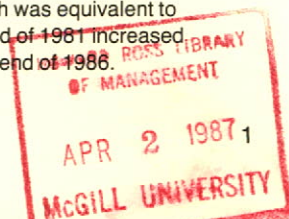
Earnings per share, based on the weighted average number of shares outstanding during the year, were 90¢ in 1986.

SHAREHOLDERS' EQUITY

(in millions)



Total shareholders' equity increased from \$572,637,000 at the end of 1981 to \$756,213,000 at December 31, 1986 and shows a compounded annual growth of 5.7% over the five-year period. Equity per share which was equivalent to \$6.56 at the end of 1981 increased to \$8.65 at the end of 1986.



REPORT TO SHAREHOLDERS

YEAR IN REVIEW

1986 was another record year in both sales and profits for your Company. Although the rate of sales increase did not keep pace with the industry, it did reflect our attempt to maintain a reasonable balance between sales and margins during a very turbulent 1986 in which competitive pressures were extreme. The very large increase in federal income taxes from \$51,391,000 to \$68,950,000 was due in part to the elimination of the inventory tax credit and the imposition of the 1986 income tax surcharge. This was offset by a change in the pension accounting regulations. The after-tax net profit shows an improvement both in dollars and as a ratio to sales. The amount allocated to the Plan for Sharing Profits with Employees increased from \$5,843,000 to an all-time high of \$7,328,000.

In August we opened a new store in The Promenade Centre just north of Toronto. This large full-line store replaces the Richmond Hill store which was only a few miles away. Later that month a new full-line store opened in Ville La Salle in Quebec. In October, we opened the first of a new type of Sears store in New Glasgow, Nova Scotia. This 25,000 square foot store (which has a good selection of apparel, appliances and a catalogue sales desk) has been especially designed to meet the consumer needs in smaller Canadian communities. As appropriate, this type of store will be opened in a number of other small Canadian cities.

Our stores in Vancouver-Burnaby and Winnipeg-Polo Park were completely refurbished during the year giving them the latest in decor, fixturing and merchandise presentation. Similar work was started in Ottawa-Carlingwood and Edmonton-Kingsway and will be completed early in 1987. In addition the apparel areas of many of our stores were given a "new look" with improved decor and fixturing.

Your Company has always opposed Sunday shopping. During 1986, an increasing number of retailers decided to open their stores on Sunday even though the laws in a number of provinces made such action illegal. The situation escalated and in early December several major retail chains announced they too would break the law and open their Ontario stores on Sunday. Sears decided to go against this tide and declared we would remain closed in Ontario. The Supreme Court of Canada in its decision of December 18, 1986, upheld the validity of the Ontario Business Holidays' Act. As a result most retailers operating in provinces with similar legislation closed their doors

on Sunday. Unfortunately the current legislation has a number of inequities and attempts will likely be made to change it. Sears will maintain its strong opposition to any attempt to make Sunday an open shopping day across Canada because we firmly believe that being open six days and several nights provides convenient shopping hours for our retail customers, and that Sunday openings have a negative impact on the quality of life of our employees and the level of service to our customers.

EXPANSION

In 1987 we will open a full-line retail store in Owen Sound, Ontario. As well, we will open a number of catalogue pick-up depots designed to increase the convenience of catalogue shopping.

FINANCIAL

The financial statements detail the results for 1986. In summary, consolidated revenues for the year ended December 31, 1986 were \$3,891,817,000 an increase of 2.7% over the reported figure of \$3,789,214,000 for the year ended December 31, 1985.

Net earnings were \$78,728,000 equivalent to 90¢ per share compared with \$74,311,000 or 85¢ per share in 1985. Final net earnings after including nonrecurring gains were \$79,078,000 or 90¢ per share compared with \$86,056,000 or 99¢ per share in 1985.

Associated companies contributed 10¢ per share to the earnings of the Company compared with 12¢ in 1985.

CORPORATE CHANGES

Mr. Robert J. Collins-Wright retired from the Board after 7 years of active participation. We thank him warmly for the valuable contribution he made over that time.

On December 31, 1986, Mr. William I. Bass and Mr. J. Patrick Galloway retired from the Board after 3 important years of involvement with this Company. We thank them for their wise counsel and wish them well in the years ahead.

Mr. Frank R. Hammond, Vice-President, Field Sales Operations since January 1985 and Vice-President, Retail Sales Operations for 8 years before that, elected to take early retirement as of December 31, 1986. We express our great appreciation for the significant contribution he has made in his 35 years with the Company and wish him continued good health and happiness.

Mr. G. Joseph Reddington, President and Chief Operating Officer of Sears Canada Inc. since March 1, 1986, was appointed Senior Executive Vice President-Field, of Sears, Roebuck and Co., Merchandise Group, Chicago, effective January 1, 1987. Mr. Reddington has won widespread respect throughout the organization and we are sorry he has to leave after such a short but effective stay in Canada. He will continue as a Director of Sears Canada Inc.

Mr. Laurence E. Cudmore has been appointed President and Chief Operating Officer and a member of the Board of Sears Canada Inc. Since November 1, 1984, Mr. Cudmore has been the General Manager of Sears Canada's Eastern Region Retail Stores. Mr. Cudmore is well qualified to take on this important role in the Company.

Mr. Donald S. Shaffer has been appointed Vice-President, Field Sales Operations, Sears Canada Inc., effective January 1, 1987. Prior to this appointment Mr. Shaffer was Group Manager of the Hawaii stores of Sears, Roebuck and Co. Mr. Shaffer brings a broad management experience to this assignment.

On February 2, 1987, Mr. John F. Wirth, Vice President and Comptroller of Sears, Roebuck and Co., Merchandise Group was appointed to the Board of Sears Canada Inc.

THE OUTLOOK

Forecasts for 1987 project very modest growth in sales for our industry. Competition will remain very keen as retailers battle for the consumers' disposable income. In this environment your Company will be a strong contender as it continues in its determination to provide satisfaction, convenience and "Your Money's Worth . . . and More"[®] to Canadian consumers.



Chairman of the Board

"We believe that our Mission and objectives will be achieved when every employee is committed to customer satisfaction"

STRATEGIC MISSION AND DIRECTION

Sears Canada Inc. is a national merchandising corporation committed to satisfying customers by providing products and services of superior value.

Fulfillment of this commitment requires: integrity in everything we do, competent and motivated employees, healthy communities in which to operate and earnings that will not only satisfy the requirements of our shareholders but ensure the long-term real growth of the Corporation.

CORPORATE PHILOSOPHY

Sears believes in the need to excel in every facet of our business so that maximum earnings are achieved from our efforts. The corporation has basic philosophies in specific areas which are fundamental to the way it pursues its mission. They are:

CUSTOMERS

Sears believes that its very existence depends on treating its customers with integrity and by providing them with the assurance that they will receive satisfaction or their money refunded on the products and services they purchase.

EMPLOYEES

We believe in treating our employees as our greatest resource, recognizing that it is mainly through them that customer satisfaction and retention is achieved.

MANAGEMENT

We believe in encouraging individual initiative and input in the achievement of Corporate goals and objectives and to stimulate the pride of accomplishment that is derived from a task well done.

SHAREHOLDERS

We believe we have a major responsibility to our shareholders to protect their investment and to provide them with an acceptable return on that investment.

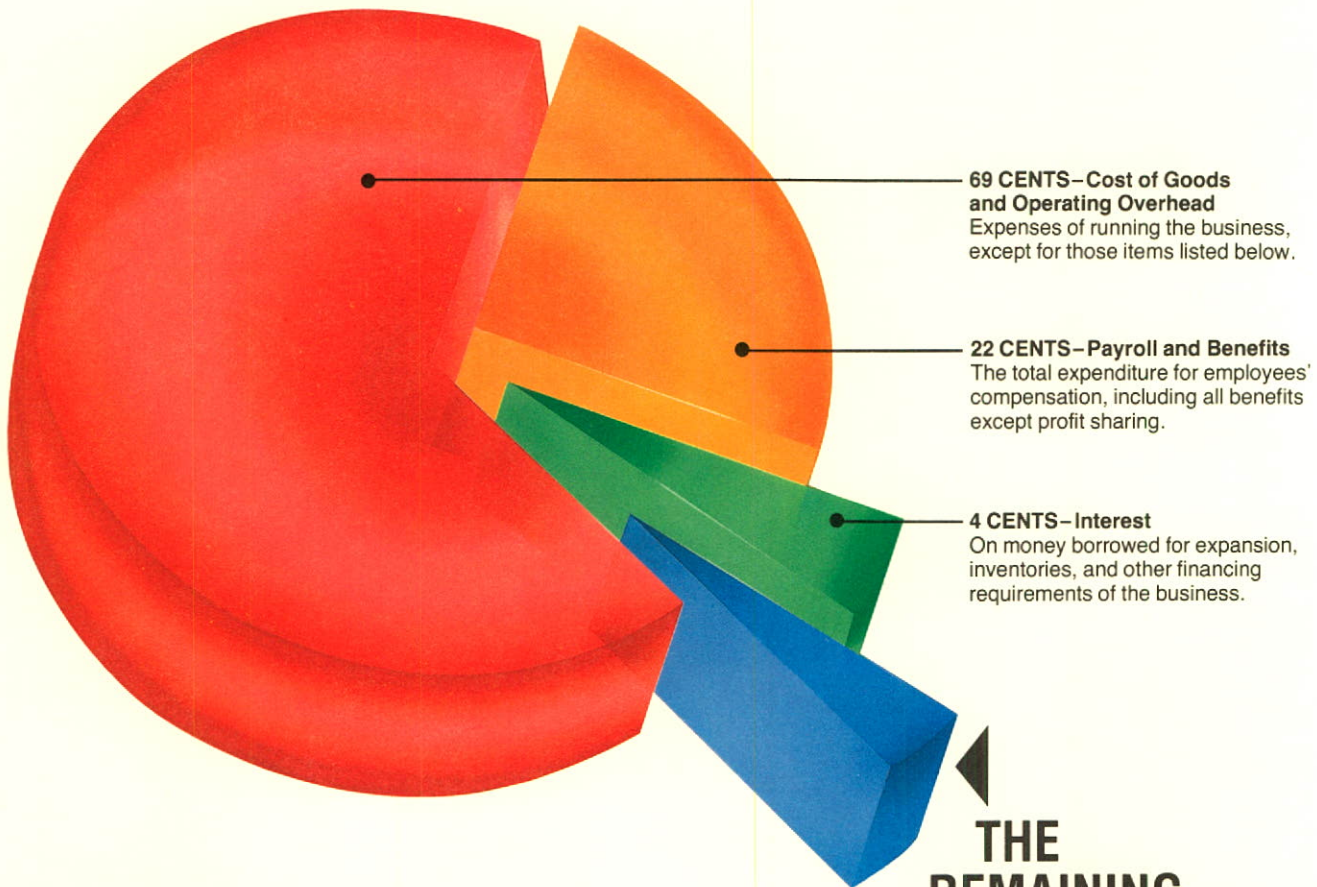
COMMUNITIES

We believe we have a responsibility to help ensure the well-being of the communities we serve by being an ethical, responsible, caring, and successful Corporation. We believe in an ongoing interaction with all levels of government on issues that affect our Corporation, our employees, our customers, and our shareholders.

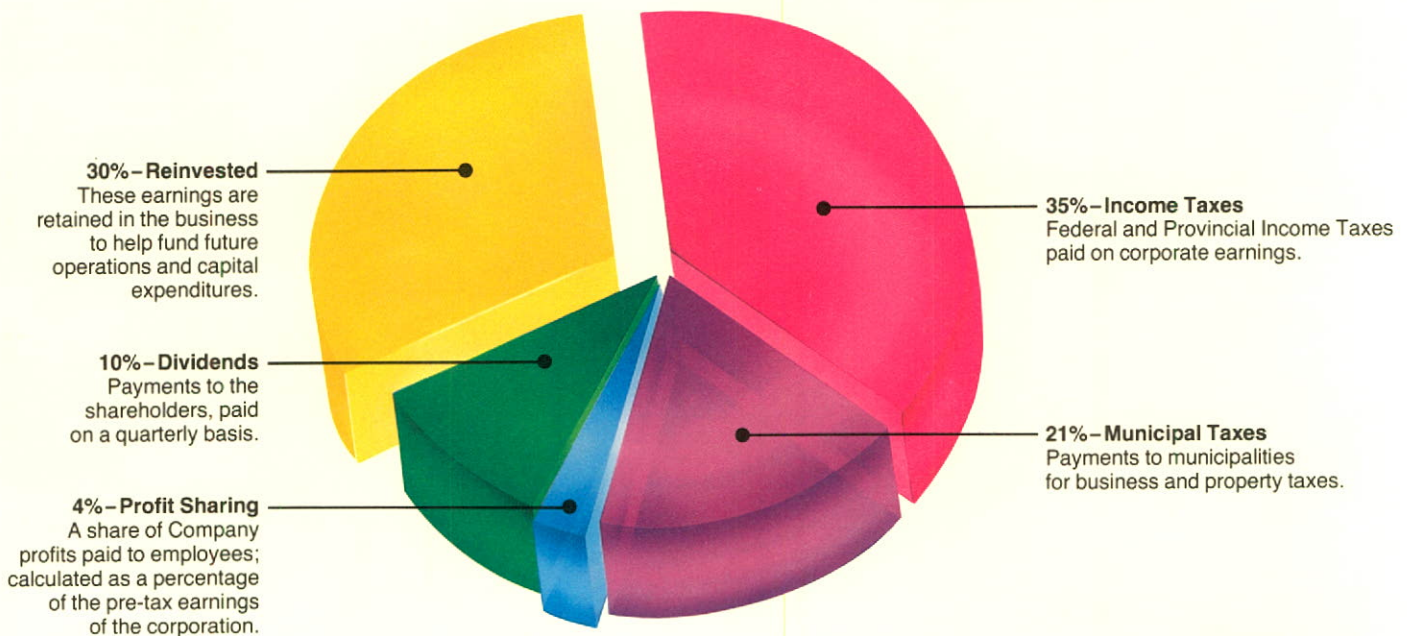
SUPPLIERS

Our suppliers of products and services are an important component of our business and they must be treated with integrity. We believe in mutually beneficial long-term associations with suppliers.

What happens to each dollar of sales?



**THE
REMAINING
5 CENTS IS PAID OUT
OR INVESTED AS
SHOWN BELOW**



It was an exciting year in catalogue and retail. In 1986 Sears opened two full line department stores – Promenade Mall, Toronto, and Ville La Salle, just outside Montreal. Last year also marked the opening of Sears first "small store", located in New Glasgow, Nova Scotia. It is part of a new marketing strategy designed specifically to meet the needs of smaller cities and communities. Emphasis is on family fashions, appliances and household items.

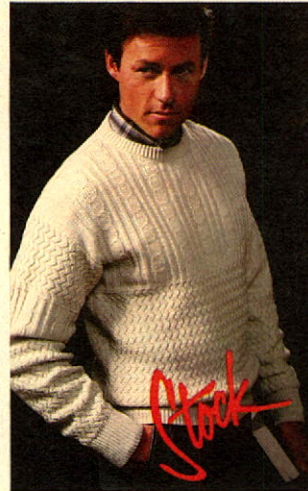


A self-serve catalogue desk is an integral feature of the New Glasgow store, providing the customer with both catalogue and retail shopping.

Another "first" in '86 was the introduction of "Together", Sears first-ever all fashion catalogue. This new marketing venture was geared to attract the younger apparel customer who does not normally shop the Sears catalogue. Recognizing that the catalogue customer continues to be the heart of our business, we also introduced the Sears Catalogue Club last year. Free to all Sears account customers, it will serve as a reward for their patronage, and as a sales incentive. Members accumulate points with purchases and earn valuable certificates redeemable towards future purchases.

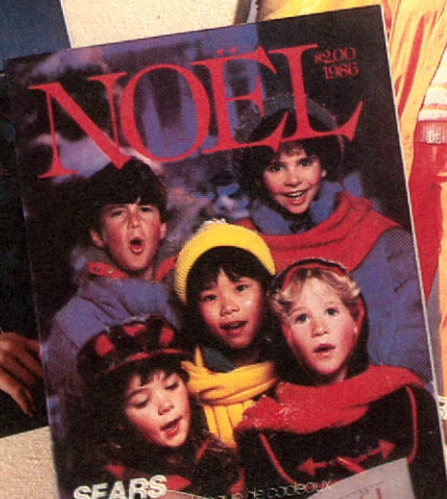
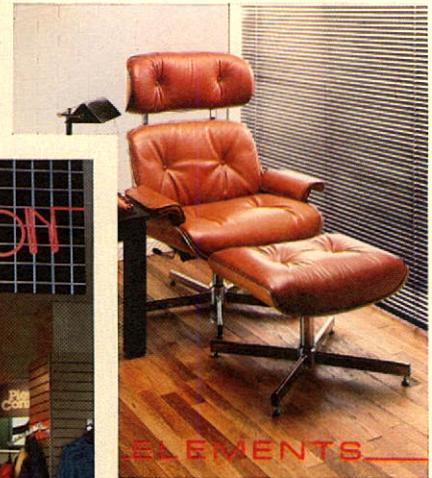
Customers' growing confidence in Sears famous brand name products continues to encourage our buyers to carry on their commitment to the development of superior value products.

In 1986, Sears introduced the extraordinary Kenmore series, "QL 2000" – the finest line of refrigerators we have ever offered. Last year also witnessed the launching of "Elements", a co-ordinated collection of contemporary home furniture, destined to become a strongly recognized name with the Canadian consumer.



The debut last fall of an exclusive line of apparel by American men's wear designer, Robert Stock, provided our customer with upscale men's fashions at reasonable prices. There are now over 100 lines of merchandise from paint, to drapes, to appliances, to shoes, that Sears can proudly claim to be Canada's Best Sellers. Independent surveys have proven that Sears sells more of these lines than anyone else in Canada.

'86 was more than just an eventful year, it was proof positive that Sears Canada is determined to stay ahead of its competitors and maintain its position as the country's premiere retailer.



THE SPIRIT OF SEARS

Sears employees have demonstrated over the years a spirit of caring and sharing that is a constant source of pride to the Company. Their dedication to serving our customers, and to service in the community has made Sears one of the most respected corporations in the country.

Sears annual Employees' Charitable Fund drive, our biggest single fund-raising event was our most successful ever in 1986 due to the tireless efforts and warm generosity of Sears people. Volunteers also donated their time after hours to man telephones for the United Way Call-Out Campaign and also for the Variety Club Telethon, as well as purchasing thousands of lottery tickets to make the Telethon a smashing success.

Sears also annually contributes the use of its telephone facilities to the Variety Club Charity. Across the country, Sears employees eagerly participated in local fund-raising events for many worthwhile causes.

As a Company, we place a high value on the development of young Canadians. Sears offers ten annual scholarships to help provide a University education for the sons and daughters of our employees all across Canada. Sears has also been an active sponsor of Junior Achievement on a national scale for

the past 15 years. J/A is a hands-on program that helps students obtain valuable business and communication skills. Also on behalf of Sears, every secondary school in Canada received the 9th volume of the Dictionary of Canadian Biography. This dictionary covers the lives of famous Canadians throughout history. Volume 1 was first presented in 1967 as one of Sears Centennial projects.

We believe that Sears people are our strongest resource. It is their vision and input that keeps our company in the marketing forefront.



In 1986, over 3,700 ideas were submitted through the National Employees' Suggestion Program. This tremendous response will result in substantial cost savings to the Company. Top cash award of \$5,500 went to John Lam, Service Engineer, Kenmore Service Centre, Toronto.

The Chairman's Challenge has become a prestigious annual event in which Sears honours those who have demonstrated outstanding performance in attaining planned goals.

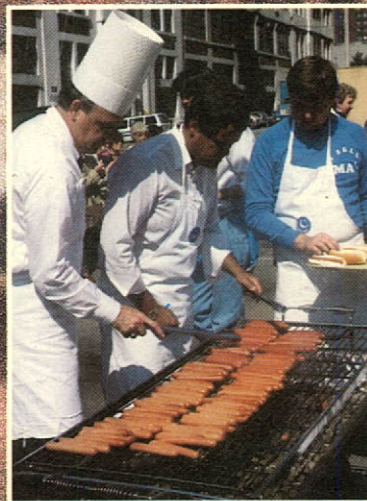
In 1986, the challenge evolved around the theme, "We are Sears... the best and getting better". Goals were met and exceeded through tremendous efforts and teamwork.

And yet all is not just hard work. Sears people know how to enjoy themselves too. You'll see them across the country on company teams playing hockey, baseball, soccer and other sports, as well as competing at numerous track meets. Last year over 10,000 Sears employees and their families attended our company-sponsored Family Day at Canada's Wonderland, just outside Toronto.

During the Christmas season, Sears choir at Headquarters served as goodwill ambassadors not only entertaining their fellow employees, but visiting the sick and the elderly too. The choir's warmth and harmony perhaps best exemplify what Sears people are really all about.

It is the cooperative, dedicated and enthusiastic efforts of employees in all areas of the Company that has enabled us to achieve our leadership position.

To all of them we say, thank you and congratulations - keep up the good work!



Year ended December 31,
stated in thousands

1986

1985
restated

ASSETS

Current Assets

Cash	\$ 6,972	\$ 6,057
Accounts receivable (Note 3)	1,183,679	1,122,493
Inventories	700,707	666,928
Prepaid advertising and other charges	95,566	80,416

	<u>1,986,924</u>	<u>1,875,894</u>
Investments and Other Assets (Note 4)	75,491	70,737

Fixed Assets (Note 5)

Land	29,446	29,561
Buildings and improvements	379,683	359,092
Equipment and fixtures	323,813	288,391

	<u>732,942</u>	<u>677,044</u>
Less accumulated depreciation	321,410	300,408

	<u>411,532</u>	<u>376,636</u>
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Deferred Charges (Note 2)	72,369	8,845
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	<u>\$2,546,316</u>	<u>\$2,332,112</u>
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LIABILITIES

Current Liabilities

Bank advances and short-term notes	\$ 335,885	\$ 274,534
Accounts payable	213,516	195,261
Accrued liabilities	157,955	147,755
Income and other taxes	73,174	94,574

Principal payments on long-term obligations due within one year (Note 6)	148,513	46,548
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	<u>929,043</u>	<u>758,672</u>
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Long-Term Obligations (Note 6)	810,431	848,599
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Deferred Income Taxes	50,629	27,767
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	<u>1,790,103</u>	<u>1,635,038</u>
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SHAREHOLDERS' EQUITY

Capital Stock (Note 7)	272,430	271,388
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Retained Earnings	483,783	425,686
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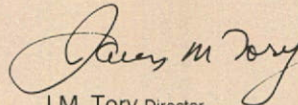
	<u>756,213</u>	<u>697,074</u>
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	<u>\$2,546,316</u>	<u>\$2,332,112</u>
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Approved by the Board:



C.R. Sharpe Director



J.M. Tory Director

Sears Canada Inc.

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

Sears Canada Inc.

**CONSOLIDATED
STATEMENTS
OF EARNINGS
AND RETAINED
EARNINGS**

Year ended December 31,
stated in thousands

1986

1985
restated

CONSOLIDATED EARNINGS

Total revenues	\$3,891,817	\$3,789,214
Deduct:		
Cost of merchandise sold, operating, administrative and selling expenses	3,532,221	3,465,941
Depreciation	39,979	36,514
Interest on long-term obligations	116,418	86,809
Other interest	23,440	46,124
Municipal realty and business taxes	41,146	39,008
	3,753,204	3,674,396
Earnings from operations before income taxes	138,613	114,818
Income taxes (Note 8):		
Current	41,325	39,476
Deferred	27,625	11,915
	68,950	51,391
Earnings from operations	69,663	63,427
Equity in earnings of associated companies	9,065	10,884
Earnings before extraordinary items	78,728	74,311
Extraordinary items (Note 11)	350	11,745
Net earnings	\$ 79,078	\$ 86,056
Earnings per share:		
Before extraordinary items	\$.90	\$.85
Net earnings	\$.90	\$.99

Year ended December 31,
stated in thousands

1986

1985
restated

CONSOLIDATED RETAINED EARNINGS

Balance at beginning of the year, as previously reported	\$ 431,995	\$ 362,233
Adjustment of prior years' earnings (Note 12)	(6,309)	(5,140)
Balance at beginning of the year, as restated	425,686	357,093
Net earnings for the year	79,078	86,056
	504,764	443,149
Dividends declared	20,981	17,463
Balance at the end of the year	\$ 483,783	\$ 425,686

Sears Canada Inc.

**CONSOLIDATED
STATEMENT
OF CHANGES
IN FINANCIAL
POSITION**

Year ended December 31,
stated in thousands

1986

1985
restated

OPERATING ACTIVITIES

Sources of Funds

Earnings before extraordinary items	\$ 78,728	\$ 74,311
Non-cash charges deducted in arriving at net earnings, principally depreciation and deferred income taxes	65,504	58,146
Equity in earnings of associated companies	(9,065)	(10,884)
Funds from operations	135,167	121,573
Amounts received from associated companies	5,585	5,098
Increase in accounts payable and other liabilities	7,055	97,362
Extraordinary items	350	11,745
Total available operating funds	148,157	235,778

Uses of Funds

Increase in accounts receivable	61,186	144,001
Increase in inventories	33,779	52,946
Net increase (decrease) in investments	1,274	(1,093)
Net additions to fixed assets	74,875	55,777
Increase (decrease) in deferred charges and other assets	80,460	(5,923)
Total operating funds used	251,574	245,708
Net funds used in operations	103,417	9,930

DIVIDENDS AND FINANCING ACTIVITIES

Sources of Funds

Proceeds from long-term obligations	106,307	83,947
Issue of capital stock	1,042	163
	107,349	84,110

Uses of Funds

Repayment of long-term obligations	44,302	24,729
Dividends paid to shareholders	20,981	17,463
	65,283	42,192
Net funds generated by financing activities net of dividends	42,066	41,918

Increase (decrease) in short-term indebtedness	\$ 61,351	\$ (31,988)
Short-term indebtedness at end of year	\$335,885	\$274,534

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. SUMMARY OF ACCOUNTING POLICIES:

Principles of Consolidation:

The consolidated financial statements include the accounts of Sears Canada Inc. and all subsidiaries.

Inventories:

Inventories are valued at the lower of approximate cost and net realizable value. Cost is determined for retail store inventories by the retail inventory method and for catalogue order and miscellaneous inventories on a first-in, first-out or average cost basis applied by individual items.

Prepaid Advertising:

Catalogue production costs are deferred and amortized over the life of each catalogue on the basis of the estimated sales from the catalogue.

Investments:

Investments in associated companies are carried at cost plus equity in undistributed earnings since dates of acquisition. Other investments are carried at cost.

Fixed Assets:

Fixed assets are stated at cost. Depreciation and amortization provisions are generally computed by the straight-line method based on the estimated useful lives of 4 to 10 years for equipment and fixtures and of 30 to 50 years for buildings and improvements.

Bond and Debenture Issue Costs:

Bond and debenture discount and expense are amortized by the reducing balance method or by the straight-line method, as applicable, to the due dates of the respective bonds and debentures.

Foreign Currency Translation:

Long-term obligations payable in U.S. dollars are translated at the exchange rate in effect at the balance sheet date or at the rates fixed by forward exchange contracts.

Unrealized foreign exchange gains and losses and the cost of forward exchange contracts are deferred and amortized over the remaining terms of the obligations.

Profits on Instalment Sales:

Profits on instalment sales, but not the service charges on such sales, are taken into earnings at the time of sale. The service charges are taken into earnings as billed.

Pensions:

Current service costs under the Company's pension plan are charged to operations as they accrue. The excess of the market value of pension fund assets over the actuarial present value of the accrued pension obligations as at January 1, 1986 and any surpluses or deficits arising since that date are amortized over the expected average remaining service life of the employee group covered by the plan. Actuarial valuations are calculated using the projected benefit method pro rated on services, based on management's best estimate of the effect of future events (see Note 2).

Net Earnings per Share:

Net earnings per share are calculated based on the weighted average number of shares outstanding during the fiscal year.

2. CHANGE IN ACCOUNTING FOR PENSIONS:

The Company maintains a defined benefit, final average pension plan which covers substantially all of its regular full-time employees. The plan provides pensions based on length of service and final average earnings.

Effective January 1, 1986, the Company adopted, on a prospective basis, the new recommendations of the Canadian Institute of Chartered Accountants regarding pension costs and obligations. The effect of the change was to reduce pension expense from \$26,726,000 (as calculated under the previous policy) to \$1,986,000.

The present value of the accrued pension obligations and the pension fund assets available to meet these obligations, at market value, as at December 31, 1986 and December 31, 1985 and the Company pension expense for 1986 and 1985 are shown below:

	December 31, 1986 (in thousands)	December 31, 1985 (in thousands)
Pension fund assets	\$543,826	\$429,689
Accrued pension obligations	448,764	378,352
Pension expense for the year ended	1,986	24,451

Under provincial pension commission rules the Company is required to make annual contributions to the pension plan. In 1986 the Company contributed \$24,312,000 to the plan. The excess of this contribution over the 1986 expense has been included in deferred charges on the balance sheet.

In addition, under these pension commission rules, the Company is required to fund certain pension obligations related to past service. This funding is required over several years but may be accelerated. During 1986 the Company accelerated \$40 million of past service payments. This amount has also been included in deferred charges on the balance sheet.

3. ACCOUNTS RECEIVABLE:

	December 31, 1986 (in thousands)	December 31, 1985 (in thousands)
Customer instalment accounts	\$1,113,860	\$1,069,941
Miscellaneous accounts	89,311	71,276
	1,203,171	1,141,217
Less allowance for doubtful accounts	19,492	18,724
	\$1,183,679	\$1,122,493

In accordance with recognized trade practices, customer instalment accounts include amounts which will not become due within one year.

4. INVESTMENTS AND OTHER ASSETS:

	December 31, 1986 (in thousands)	December 31, 1985 (in thousands)
Investments in associated companies	\$ 73,031	\$ 65,781
Other investments	1,777	3,866
Notes receivable on Common Shares of Sears Canada Inc. issued under the Employees' Stock Purchase Plan	683	1,090
	\$ 75,491	\$ 70,737

The investments in associated companies include a 25% share interest in Allstate Insurance Company of Canada, a 45% share interest in Photo Engravers & Electrotypers Limited, a 20% share interest in Inglis Limited, interests in several companies which supply merchandise to the Company and interests in shopping centres in which the Company's stores are located. Pursuant to a long-term agreement, Photo Engravers produces catalogues for the Company. Inglis is a major supplier of large home appliances. Merchandise purchases from associated companies (including insurance purchased from Allstate) amounted to approximately \$168 million for the year ended December 31, 1986, and there were no significant amounts receivable or payable on that date.

5. FIXED ASSETS:

	December 31, 1986 (in thousands)	December 31, 1985 (in thousands)
Fixed assets include the following capitalized leased assets:		
Buildings	\$ 26,979	\$ 26,979
Equipment	14,757	8,144
	<u>41,736</u>	<u>35,123</u>
Less accumulated amortization	11,200	10,455
	<u>\$ 30,536</u>	<u>\$ 24,668</u>

6. LONG-TERM OBLIGATIONS:

	December 31, 1986 (in thousands)	December 31, 1985 (in thousands)
Sears Canada Inc.:		
First Mortgage Bonds:		
7¾% Series D due Feb. 15, 1991	\$ 12,286	\$ 14,989
8¼% Series E due May 1, 1993	13,250	14,750
Floating Charge Debentures:		
4¾% due Oct. 15, 1988	1,055	1,142
11¼% Series B due Aug. 15, 1994	21,000	23,559
11½% Series D due June 15, 1995	22,750	26,182
Unsecured Debentures:		
Series 1 due Dec. 31, 1987	25,000	25,000
Series 2 due Feb. 2, 1987	52,000	52,000
Series 3 due June 15, 1987	35,000	35,000
Term Note due June 13, 1994 (U.S. \$90,000,000)	116,397	116,397
Capital lease obligations, interest rates from 8% to 17%	35,129	29,081
	<u>333,867</u>	<u>338,100</u>
Sears Acceptance Company Inc.:		
Secured Debentures:		
6¼% Series F due Mar. 1, 1986	—	10,000
7% Series G due Nov. 1, 1986	—	12,200
7¼% Series H due Aug. 15, 1987	12,400	12,400
8¾% Series I due June 15, 1989	8,700	8,700
9½% Series J due Feb. 1, 1990	6,670	6,670
8¾% Series K due May 15, 1992	25,000	25,000
9¼% Series L due Mar. 15, 1994	19,000	19,975
11½% Series M due Nov. 15, 1994	13,760	14,298
11½% Series N due Nov. 15, 1994	3,400	3,825
10¾% Series P due Nov. 15, 1996	25,457	26,113
10¾% Series Q due Nov. 15, 1988	4,000	6,000
10% Series S due July 15, 1998	24,064	26,048
12¾% Series T due June 15, 2000	37,400	40,000
Floating Rate		
Series U due Oct. 31, 1990	25,000	25,000
14¾% Series V due April 1, 1996	66,390	66,390
17½% Series W due Nov. 1, 1988 (U.S. \$40,000,000)	51,752	51,752
16¾% Series X due April 28, 1989	40,000	40,000
14% Series Y due Aug. 15, 1991	50,000	50,000
10¾% Series Z due Oct. 1, 1992	75,000	75,000
10% Series 1 due Oct. 3, 1993	100,000	—
	<u>587,993</u>	<u>519,371</u>

December 31,
1986
(in thousands)

December 31,
1985
(in thousands)

Sears Properties Inc.:		
Mortgage and bond indebtedness, 5¼% to 6%	2,779	3,152
St. Laurent Shopping Centre Limited:		
Mortgage Bonds maturing from 1990 to 1995, 8% to 14¼%	34,305	34,524
	<u>958,944</u>	<u>895,147</u>
Less principal payments due within one year included in current liabilities	148,513	46,548
	<u>\$810,431</u>	<u>\$848,599</u>

The First Mortgage Bonds of Sears Canada Inc., the mortgage and bond indebtedness of Sears Properties Inc., and the First Mortgage Sinking Fund Bonds of St. Laurent Shopping Centre Limited are primarily secured by first charges on the fixed assets of those companies. The General Mortgage Bonds, the Third Mortgage Bonds and the Fourth Mortgage Bonds of St. Laurent Shopping Centre Limited are secured primarily by second, third and fourth charges, respectively, on the fixed assets of that company. The Floating Charge Debentures of Sears Canada Inc. are secured, subject to the security given on its First Mortgage Bonds, by a floating charge on all the assets of the Company. The Secured Debentures of Sears Acceptance Company Inc. are secured by an assignment of the customer instalment accounts receivable referred to in Note 3.

The Series 1, Series 2 and Series 3 Unsecured Debentures of the Company, which are redeemable at the option of the Company, bear interest for each interest period at a rate equal to the average daily prime lending rates of the Company's two principal bankers for the interest period, plus ½% in the case of Series 1 and less ¼% in the case of Series 2.

Through a swap transaction the Company has fixed the repayment of the Term Note at a Canadian dollar amount of \$116,397,000 and has fixed the interest rate at 14.73%.

The Series U Secured Debentures of Sears Acceptance Company Inc. bear interest at a rate equal to the average daily prime lending rates of the Company's two principal bankers for the interest period less ½% (¼% after 1987).

Sears Acceptance Company Inc. has entered into forward exchange contracts to purchase U.S. dollars for payment of the principal of and each interest payment on the Series W Secured Debentures.

The mortgage and bond indebtedness of Sears Properties Inc., maturing at various dates from 1987 to 1998, includes \$1,333,000 (U.S. \$966,000) at December 31, 1986 and \$1,511,000 (U.S. \$1,080,000) at December 31, 1985 payable in U.S. funds.

Subsequent to December 31, 1987, principal payments required on long-term obligations for the fiscal years ending on the dates shown are as follows:

December 31, 1988	— \$77,085,000
December 31, 1989	— \$72,685,000
December 31, 1990	— \$61,620,000
December 31, 1991	— \$81,052,000

7. CAPITAL STOCK:

There is an unlimited number of shares authorized and as at December 31, 1986 and December 31, 1985, 87,458,213 and 87,327,913 shares were issued and outstanding respectively.

Under a stock option plan introduced in 1985 the following options have been granted and exercised:

Options granted	Option price	Expiry date	Options exercised	Options outstanding
51,500	\$ 7.38	January 1990	2,500	49,000
408,550	7.77	April 1990	140,270	268,280
136,095	11.48	January 1991	8,460	127,635

8. INCOME TAXES:

A reconciliation of the income tax expense at the statutory tax rates with the actual income tax expense is as follows:

	Year ended December 31, 1986 (in thousands)	Year ended December 31, 1985 (in thousands) restated
Earnings before income taxes	<u>\$138,613</u>	<u>\$114,818</u>
Statutory tax rate	<u>51.2%</u>	<u>49.9%</u>
Income taxes at statutory tax rate	<u>\$ 70,970</u>	<u>\$ 57,294</u>
Increase (decrease) in income taxes resulting from:		
Miscellaneous non-deductible items	952	3,625
Inventory tax credit	(1,572)	(9,194)
Non-taxable portion of capital gains	(234)	(25)
Miscellaneous non-taxable items	(1,166)	(309)
Income tax expense	<u>\$ 68,950</u>	<u>\$ 51,391</u>
Effective tax rate	<u>49.7%</u>	<u>44.8%</u>

9. COMMITMENTS:

Minimum lease payments, exclusive of property taxes, insurance and other expenses payable directly by the Company, under capital leases and operating leases that have an initial term of more than one year as at December 31, 1986 are as follows:

	Capital leases (in thousands)	Operating leases (in thousands)
1987	\$ 5,866	\$ 48,364
1988	5,642	42,839
1989	5,642	38,354
1990	5,487	32,754
1991	4,481	27,344
Subsequent years	<u>47,957</u>	<u>363,469</u>
Minimum lease payments	\$75,075	\$553,124
Less imputed interest	<u>39,946</u>	
Capital lease obligations	<u>\$35,129</u>	

Total rentals charged to earnings under all operating leases for the year ended December 31, 1986 amounted to \$69,270,993 (\$65,013,000 for the year ended December 31, 1985).

10. CAPITAL EXPENDITURES:

Capital expenditures planned for the fiscal year ending December 31, 1987 are estimated at approximately \$87 million.

11. EXTRAORDINARY ITEMS:

During the year the Company reached an agreement with the landlord of its Harbour Center store in Vancouver B.C. to amend the existing lease agreement to allow the Company to reduce its leased space. The after tax cost of effecting this agreement is \$3,370,000.

On November 30, 1986 the Company sold its share of the Cornwall Square Shopping Center located in Cornwall, Ontario. The Company's share of the proceeds was \$8,500,000 and resulted in an after tax gain of \$3,720,000.

The extraordinary gain in 1985 was primarily the result of selling the Company's Vancouver B.C. catalogue distribution facility.

12. PRIOR PERIOD ADJUSTMENTS:

Quebec sales taxes:

The Company was assessed for taxes which the Minister of Revenue of Quebec alleged the Company should have collected in respect of sales made to residents of Quebec at telephone order locations in Ontario. The Company contested the assessment and while successful at the trial division was unsuccessful at the appeals division. The Supreme Court of Canada denied an application for leave to appeal and the Company has paid the assessment and interest thereon. As a result \$2,960,000 net of income taxes has been charged to retained earnings as a prior period adjustment, and comparative figures have been restated to reflect this payment.

Federal income taxes:

The Company has been assessed for income taxes on amounts received in respect of the unearned portion of maintenance agreements sold by the Company. The Company objected to the assessment on the basis that the Income Tax Act did provide for a deduction for the unearned portion of such amounts. The Federal Court trial division denied the Company's claim and the Company has paid the tax and interest on such unpaid amounts. The amount of tax has been recorded as deferred taxes while the interest of \$3,349,000 has been recorded as a prior period adjustment and charged to retained earnings. Comparative figures have been restated to reflect this payment. The Company has appealed the decision to the Court of Appeal and expects the case to be heard in 1987.

13. SUBSEQUENT EVENT:

The Company has entered into an agreement to issue \$100,000,000 principal amount of 9¼% unsecured debentures on February 26, 1987. The proceeds of the issue will be used to retire unsecured debentures which mature during 1987.

TEN YEAR SUMMARY

1986 52 weeks December 31, 1986	1985 52 weeks December 31, 1985	1984 52 weeks December 31, 1984	1983 52 weeks December 31, 1983 unaudited	1982 52 weeks December 31, 1982 unaudited
--	--	--	---	---

RESULTS FOR THE YEAR (in thousands)*

Net sales**	\$3,891,817	\$3,789,214	\$3,652,320	\$3,502,068	\$3,126,186
Depreciation	39,979	36,514	33,622	33,754	33,166
Earnings from operations before income taxes	138,613	114,818	34,181	23,656	16,014
Income taxes	68,950	51,391	7,963	3,609	(869)
Earnings before extraordinary items	78,728	74,311	36,175	33,572	25,828
Net earnings	79,078	86,056	36,175	33,572	25,828
Dividends declared	20,981	17,463	17,461	17,461	17,461
Fixed asset additions:					
Owned	67,927	58,008	34,301	27,763	30,275
Leased under capital leases	8,099	3,134	—	1,159	535

YEAR-END POSITION (in thousands)*

Accounts receivable	1,183,679	1,122,493	978,492	880,834	787,761
Inventories	700,707	666,928	613,982	630,712	539,489
Fixed assets (net)	411,532	376,636	357,372	357,668	361,328
Total assets	2,546,316	2,332,112	2,125,644	2,024,153	1,826,524
Working capital	1,057,881	1,117,222	1,010,401	845,914	898,950
Long-term obligations	810,431	848,599	805,713	657,294	713,020
Shareholders' equity	756,213	697,074	628,318	609,604	593,493

PER SHARE OF CAPITAL STOCK (in dollars)*

Earnings before extraordinary items	.90	.85	.41	.38	.30
Net earnings	.90	.99	.41	.38	.30
Dividends declared	.24	.20	.20	.20	.20
Shareholders' equity	8.65	7.98	7.20	6.98	6.80

FINANCIAL RATIOS

Return on average equity (%)	10.83	11.21	5.84	5.58	4.43
Current ratio	2.14	2.47	2.50	2.15	2.82
Return on sales (%)	2.02	1.96	0.99	0.96	0.83
Debt/Equity ratio	63/37	63/37	64/36	63/37	60/40
Return on capital employed (%)	14.39	14.06	10.01	8.97	9.48
Pretax margin (%)	3.56	3.03	0.94	0.68	0.51

NUMBER OF SELLING UNITS

Retail stores	77	75	74	73	72
Catalogue sales offices	1,548	1,428	1,370	1,316	1,263

*Certain amounts have been restated to reflect accounting changes applied retroactively in 1981 and 1979 and for the prior period adjustments recorded in 1986 and 1981.

**Net sales have been restated in 1983 and 1984 to reflect the reclassification of clearance centre sales and service department revenue from the cost of merchandise sold to net sales.

1981 52 weeks February 3, 1982	1980 53 weeks February 4, 1981	1979 52 weeks January 30, 1980	1978 52 weeks January 31, 1979 unaudited	1977 52 weeks January 4, 1978
---	---	---	--	--

\$3,129,625	\$2,954,606	\$2,618,213	\$2,390,651	\$2,093,378
34,485	36,218	32,500	30,508	28,992
32,867	76,072	103,495	89,305	68,520
8,675	31,380	44,187	37,403	27,650
31,462	49,796	67,488	57,209	45,318
31,462	49,796	67,488	57,209	45,318
27,938	31,430	29,416	20,526	18,077
37,125	40,475	37,282	33,841	42,046
—	6,064	1,548	16,255	—

705,448	675,904	639,273	555,842	522,613
532,180	532,906	472,144	433,621	402,398
364,796	362,923	353,234	347,156	323,106
1,741,258	1,700,331	1,580,814	1,433,731	1,341,837
836,165	709,941	664,301	601,789	556,706
671,430	543,442	500,955	533,652	512,176
572,637	569,113	549,341	435,691	391,486

.36	.57	.85	.76	.60
.36	.57	.85	.76	.60
.32	.36	.36	.27	.24
6.56	6.52	6.31	5.71	5.20

5.51	8.90	13.70	13.83	12.03
2.78	2.26	2.31	2.37	2.34
1.01	1.69	2.58	2.39	2.16
61/39	59/41	56/44	63/37	64/36
10.95	12.43	14.98	14.07	12.47
1.05	2.57	3.95	3.74	3.27

70	68	65	63	62
1,191	1,115	1,020	923	819

STATEMENT OF MANAGEMENT RESPONSIBILITY

Management is responsible for the accuracy, integrity and objectivity of the financial information contained in this Annual Report. The consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles and include certain amounts that are based on best estimates and judgements. Financial information used elsewhere in the Annual Report is consistent with that in the financial statements.

Management has developed, maintains and supports an extensive program of internal audits that provides reasonable assurance that financial records are reliable and that assets are safeguarded.

The Board of Directors, through the activities of the Audit Committee, ensures that management fulfills its responsibilities for financial reporting and internal control. The Audit Committee, the majority of whom are outside directors, meets periodically with the financial officers of the Company, the internal auditors and external auditors to discuss audit activities, internal accounting controls and financial reporting matters. The Board of Directors, on the recommendation of the Audit Committee, has approved all of the information contained in the Annual Report.

The Company's external auditors, Touche Ross & Co., have conducted an examination of the financial records of the Company in accordance with generally accepted auditing standards. Their report is shown below.

AUDITORS' REPORT

To the Shareholders of Sears Canada Inc.:

We have examined the consolidated statement of financial position of Sears Canada Inc. as at December 31, 1986 and the consolidated statements of earnings, retained earnings and changes in financial position for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these consolidated financial statements present fairly the financial position of the Company as at December 31, 1986 and the results of its operations and the changes in its financial position for the year then ended in accordance with generally accepted accounting principles applied, except for the change in the method of accounting for pensions as explained in Note 2 to the consolidated financial statements, on a basis consistent with that of the preceding year.

Toronto, February 9, 1987

Touche Ross & Co.
Chartered Accountants

Sears Canada Inc.,
at December 31, 1986

BOARD OF DIRECTORS, OFFICERS, COMMITTEES AND HEAD OFFICE

OFFICERS

C. Richard Sharpe	Chairman of the Board and Chief Executive Officer
G. Joseph Reddington	President and Chief Operating Officer
Maurice F. Anderson	Vice-President, Information Systems
J.J. Michael Eagan	Vice-President, Secretary and Corporate Counsel
Larry E. Ginther	Vice-President, Finance and Treasurer
Frank R. Hammond	Vice-President, Field Sales Operations
Harold J. Mandel	Vice-President, Real Estate and Facilities
Richard C. McMillan	Vice-President, Credit
Walter G. Pridham	Vice-President, Public Affairs & Corporate Planning
William R. Turner	Vice-President, Merchandising
Leslie Visosky	Vice-President, Personnel
Neil M. Whitmore	Vice-President, Distribution
Bruce W. McLaren	Corporate Comptroller

Officer changes in 1987 are shown on page 2

COMMITTEES OF THE BOARD

Finance

A. Powis, Chairman
W.I. Bass
J.H. Batogowski
M.F. Bélanger
M. Bozic
L.E. Ginther
B.W. McLaren
A.H. Mingay
G.J. Reddington
C.R. Sharpe
J.M. Tory
W.P. Wilder

Compensation

W.I. Bass, Chairman
M.F. Bélanger
A. Powis
W.P. Wilder

Audit

J.M. Tory, Chairman
H. Corrigan
J.P. Galloway
M.E. Jones
A.H. Mingay
A. Powis

Investment

W.P. Wilder, Chairman
H. Corrigan
W.A. Dimma
L.E. Ginther
C.R. Sharpe
G.J. Reddington

HEAD OFFICE

SEARS

Sears Canada Inc.,

222 Jarvis Street,
Toronto, Ontario, Canada
M5B 2B8

Transfer Agent and Registrar

The Royal Trust Company,
Toronto, Ontario;
Montreal, P.Q.;
Calgary, Alberta

Annual Meeting

The Annual Meeting of
Shareholders of
Sears Canada Inc.
will be held in the
Burton-Wood Auditorium
Sears Canada Inc.
Main floor, 222 Jarvis Street
on Monday, April 27, 1987
at 10:00 a.m.

Edition française du rapport annuel

On peut se procurer l'édition
française de ce rapport en
écrivant au Vice-président,
finances.
Sears Canada Inc.
222 Jarvis Street,
Toronto, Ontario, Canada
M5B 2B8

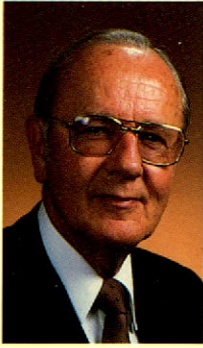
Stock Exchange Information

Symbol: SCC

Listings:

The Montreal Exchange
The Toronto Stock Exchange

BOARD OF DIRECTORS



William I. Bass



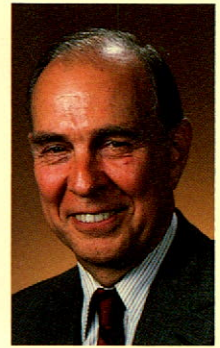
Joseph H. Batogowski



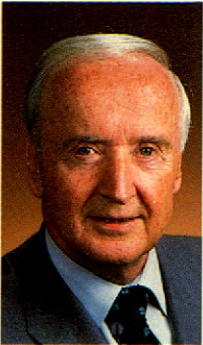
Michel F. Bélanger



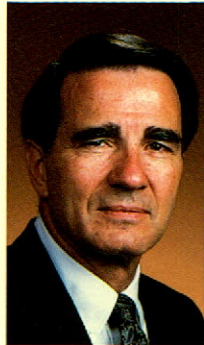
Michael Bozic



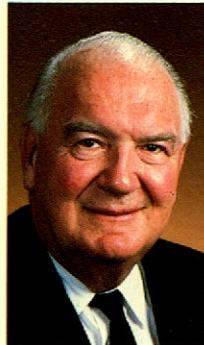
Harold Corrigan, c.a.



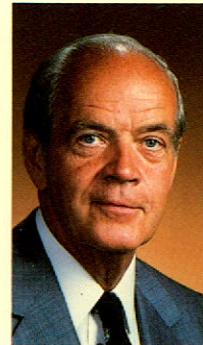
William A. Dimma



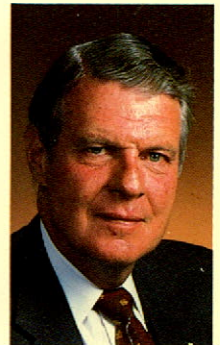
J. Patrick Galloway



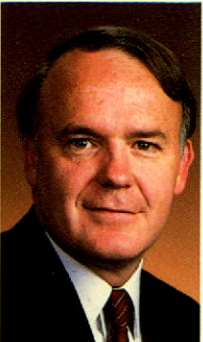
Maclean E. Jones, o.c.



Arthur H. Mingay



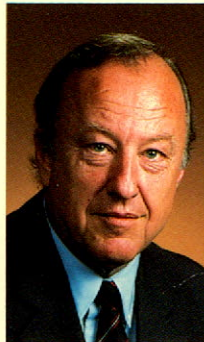
Alfred Powis



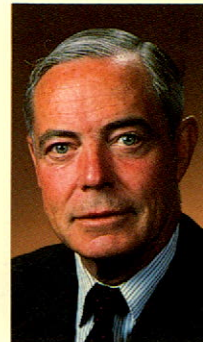
G. Joseph Reddington



C. Richard Sharpe



James M. Tory



William P. Wilder



Jack C. Barrow

William I. Bass
Chairman and Chief Executive Officer,
Sears, Roebuck and Co., Merchandise Group

Joseph H. Batogowski
Senior Executive Vice President-Merchandising,
Sears, Roebuck and Co., Merchandise Group

Michel F. Bélanger
Chairman of the Board and Chief Executive Officer,
National Bank of Canada

Michael Bozic
President and Chief Administrative Officer,
Sears, Roebuck and Co., Merchandise Group

Harold Corrigan, c.a.
Consultant

William A. Dimma
Deputy Chairman, Royal LePage Limited

J. Patrick Galloway
Senior Executive Vice President-Field,
Sears, Roebuck and Co., Merchandise Group

Maclean E. Jones, Q.C.
Partner, Bennett Jones, Barristers and Solicitors

Arthur H. Mingay
Former Chairman, The Canada Trust Company

Alfred Powis
Chairman and Chief Executive Officer, Noranda Inc.

G. Joseph Reddington
President and Chief Operating Officer, Sears Canada Inc.

C. Richard Sharpe
Chairman of the Board and Chief Executive Officer,
Sears Canada Inc.


James M. Tory
Partner, Tory, Tory, DesLauriers and Binnington,
Barristers and Solicitors

William P. Wilder
Chairman of the Board, The Consumers' Gas Company Ltd.

HONORARY DIRECTORS

Jack C. Barrow
Former Chairman of the Board and Chief Executive Officer,
Sears Canada Inc.

James W. Button (photo not available)
Former Special Assistant to the Chairman, Sears, Roebuck and Co.

A woman with short brown hair is smiling and looking to her left. She is wearing a blue denim jacket over a white ribbed tank top and a matching blue denim skirt. She has a white bracelet on her left wrist and a large white earring. The background shows waves crashing on a sandy beach under a bright sky.

*"We believe
that our
Mission and
objectives will
be achieved
when every
employee
is committed
to customer
satisfaction"*