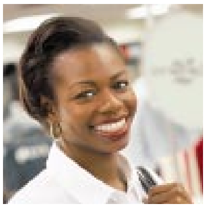


here for you

Hudson's Bay Company
2003 Annual Report

Hbc is a shopping solution that offers Canadians superior products, assortments, service and ease of shopping. Supported by 70,000 associates and a retail network that is unparalleled, Hbc's management team is guided by a single aligned vision. We are "one Hbc".

The Bay is the department store division of Hbc, with locations from coast to coast and a dominant position in the downtown cores of Canada's major cities. The Bay offers a full line of quality fashion merchandise in apparel, appliances, accessories and home categories at mid-to-upper price points, accompanied by traditional department store services. There are 99 Bay stores.

Zellers is the mass merchandise division of Hbc, with Zellers and Zellers Select locations in communities nationwide. Offering customers value, service and price competitiveness on national and private-brand merchandise is Zellers' top priority. There are more than 300 Zellers stores.

Home Outfitters is Hbc's specialty kitchen, bed and bath decor superstore chain with unbeatable selection and service. With locations across Canada, Home Outfitters offers customers more choices, more brands and great ideas. Home Outfitters is Canada's fastest-growing specialty store chain. There are 45 Home Outfitters stores.

In 2003, after a thorough analysis of the Canadian retail market and Hbc's opportunities to achieve growth, the Company outlined a plan for $1.5 billion in incremental sales growth from existing operations by 2008. Six growth objectives, which are managed within our organization, were identified. These initiatives are targeted to deliver comparable store sales increases throughout Hbc's family of stores: the Bay, Zellers and Home Outfitters.

- **Big Ticket/Home: $430 million –** Based on Hbc growing market share from its current 3.5 per cent to 8 per cent by 2008 in the highly fragmented furniture, mattress, appliance and electronics business. The initiative is based on leveraging Hbc's new systems capabilities and customer service platform.
- **Merchandise Continuum: $415 million –** Build assortments based on customer and local market demand, utilizing Hbc's dominant reach and full assortment. This will ensure the assortment by store better mirrors the customers in each market.
- **Opportunity Buy: $350 million –** Capture 7 per cent of potential "off-price" market in Canada. Create excitement within the everyday low price environment by adding exciting deals.
- **Store Service: $175 million –** Improve productivity across all retail formats through role specialization and by driving incremental sales in specific areas with dedicated sales associates.
- **Customer Relationship Management: $130 million –** Drive incremental profitable behaviour from Hbc's best customers by servicing key segments based on demonstrated needs and shopping patterns.
- **Merchandise Movement/ Supply Growth: $165 million in working capital improvement –** Improve in-stock rates, gross margins and inventory turnover as a result of a single efficient and effective Hbc merchandise pipeline.

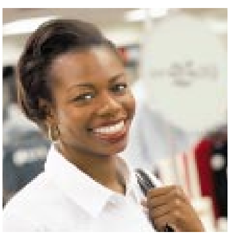
Canada's most trusted retailer

global leader in ethical sourcing

334-year commitment to corporate social responsibility

direct to customer outreach programs

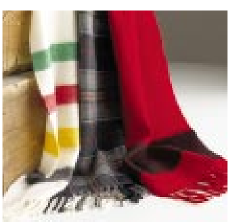
focus on driving sales growth

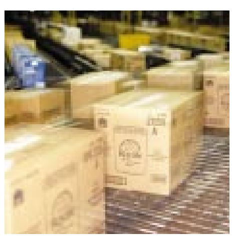


serving Canadians coast-to-coast

destination for international brands

one customer served through multiple channels

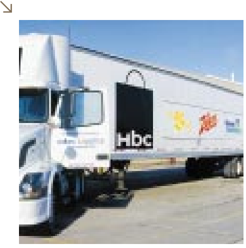


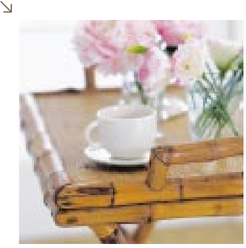


customer-centric business strategy

historically low debt levels

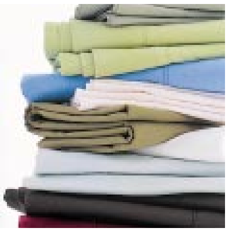
common integrated support services



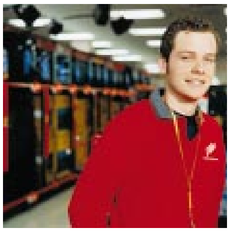


Canada's most popular loyalty program

millions of Hbc Credit Card users



common Hbc Gift Card



investing in communities

retail technology leaders

recognized for environmental leadership

exclusive and differentiated assortments

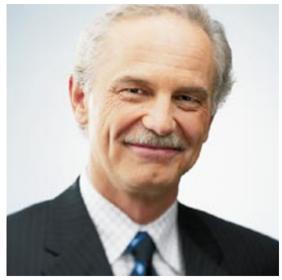
70,000 dedicated associates

strong fiscal management

Over the past five years, we at Hbc have transformed the way we think, act and operate our business – with a singular focus on serving our customers. It is one thing to have a customer-centric focus. It is another to deliver consistently across all our channels.

Our operations have been totally re-engineered. Today, we are equipped with the knowledge and understanding of what our customers need. With more of the products that they want. With a retail network that is unparalleled. And a commitment to create value for our many stakeholders. We are here for you.

to our shareholders



George J. Heller
President and Chief Executive Officer, Hudson's Bay Company

L. Yves Fortier, C.C., Q.C.
Governor, Hudson's Bay Company

Fiscal 2003 began with a disappointing first quarter; however, performance by your Company gained momentum and the three subsequent quarters on a cumulative basis demonstrated year-over-year improvement in earnings per share, working capital management and cash flow. This, despite unprecedented external events throughout the year, such as public health crises, massive power blackouts and sweeping forest fires that affected the lives of Canadians and the retailers who serve them. Overall, normalized operating earnings of $173 million in 2003 were below 2002, the entire shortfall occurring in that weak first quarter. In fact, normalized operating earnings for the three remaining quarters were 6.3 per cent above last year's results.

Beyond these challenges, 2003 also marked an important transition point for your Company. Completed last year were the majority of the profound changes and new competencies set about five years ago to rebuild Hudson's Bay Company into a modern, dynamic and valuable retailer to customers and shareholders alike. As we enter our 334th year of operation, 2003 represented a defining year in the history of Hudson's Bay Company.

A new customer-centric Hbc ready for growth

For the past five years, we have focused on the reconstruction of Hbc as a shopping solution and brand, offering an end-to-end assortment of goods and services that parallel Canadian consumer spending patterns. With that arduous rebuilding substantially behind us, we now have an efficient and effective retail platform that rivals our peers. There is no part of the foundation of this great Company that has not been re-engineered and improved: from our financing structure to the technology platform, from the logistics of our supply chain to our management of vendor relationships and the resulting product assortment.

In a world where reacting tactically to short-term demands seems to be applauded more than building for the long term, we are operating Hbc with a fundamentally new and sustainable business model for the 21st century. With the science of retailing our focus over the past five years, we now relish the opportunity to once again compete as merchants. Now, Hbc is focusing on the art of retailing, building our business around our customers and delivering growth to our shareholders through merchandising initiatives.

The retail platform

With an aligned and leveraged retail platform based on a fully integrated organization – "one Hbc" – we can now effectively and efficiently execute our strategy and pursue growth in precise, focused, measurable and profitable ways.

At the same time, we continue to refine our 500-plus store portfolio into the largest, most accessible retail network in Canada. In 2003, we closed two Bay and four Zellers stores, and opened a total of 11 new Bay, Zellers and Home Outfitters locations, including new Bay stores in Victoria, British Columbia and Winnipeg, Manitoba. Home Outfitters is Canada's fastest-growing specialty chain and with the opening of a new store in Halifax, Nova Scotia is now national in scope and size, with 45 stores by year-end versus 37 last year.

Operating such a large Hbc retail force is possible only because of advanced technologies and processes that are the backbone for serving customers through our network of stores. Whether behind the scenes seamlessly moving inventory or up-front making in-store checkouts easier, it is built on a single efficient Hbc support system.

With respect to technology, your Company was lagging behind our industry only five years ago. Not so today. Hbc was named one of the 50 leading technology users in our industry in 2003 by *Executive Technology* magazine.

In our Hbc Logistics group, we continue to consolidate existing facilities into high-efficiency distribution centres that handle all of the Hbc family of stores. Employing a single Hbc logistics facility cuts out three full days from the supply chain. We have reduced inventory while improving in-stock rates on the shelves.

The new Hbc is capable of delivering the assortment, selection and value to meet consumers' shopping needs no matter where they live. We call this our merchandise continuum strategy and it will enable us to achieve growth through product offerings based on customer demands in each market. In 2004, we will leverage the full power of our merchandise continuum strategy with the introduction of Bay brands, such as Nine & Co. and ToGo at 50 Zellers stores located in regions where we do not operate a Bay store.

With this centralized merchandise strategy, we are optimizing total Hbc sales and effectiveness within our organization and targeting top-line sales growth, while taking advantage of the consolidated buying power of all our banners. This means cost savings and higher quality merchandise.

Consolidating financing support and non-merchandise procurement functions across Hbc has resulted in non-merchandise sourcing savings of $9 million on a run rate basis for 2003. We anticipate further savings of $6 million in 2004.

Hbc operates high-efficiency distribution centres that handle all of the Hbc family of stores.

We aligned and integrated our customer programs, creating one valuable loyalty program, one convenient credit card program and one Hbc Gift Card. These common programs create value for our customers, attracting them to Hbc by providing them with a simplified and more rewarding shopping experience.

By many measures, Hbc Rewards, with eight million active users, is one of Canada's most popular loyalty programs, with 81 per cent of consumers aware of it, up substantially from 49 per cent only two years before. Participation continues to climb, with two-thirds of Hbc sales linked to Rewards, up 250 basis points on the year.

We expect participation to continue to grow in 2004, particularly after the results of the introduction this past November of in-store Hbc Rewards point redemptions in exchange for Hbc Gift Cards. In the first 60 days, we issued more than 100,000 gift cards. The Hbc Gift Card is becoming the gift card of choice in Canada, with more than 1.9 million cards sold in 2003.

Our single credit card plays an important role in supporting the new "one Hbc" business model. In 2003, Hbc Credit Card usage grew, in part, because of improved customer communication through regular dialogue via monthly statements. This keeps shoppers engaged with what's going on at Hbc while turning an operating expense into a profitable customer communication tool. Hbc Credit Card use increased 110 basis points in 2003 to nearly 30 per cent of all sales. In 2004, we will test a quarterly communiqué with Hbc Rewards customers who do not receive an Hbc credit statement.

In short, we have built the foundation for a new, dynamic and profitable Hbc with a single view of the Canadian marketplace, serving one customer in many different ways, maintained by an industry-leading support structure.

Understanding our customers

We are building our business based on two fundamental considerations: what Canadians buy and how best to use our considerable assets to provide a greater share of their needs and capture more of the dollars they spend. With our new competencies in place we are focusing on the "customer in market", offering better targeted products from our full Hbc assortment, irrespective of retail format.

The popularity and success of the customer programs outlined earlier are the result of one of our greatest resources for understanding the needs of Canadian shoppers: our Customer Relationship Management (CRM) program. We now have a total profile of each customer by consolidating and integrating data derived from a variety of programs and touch points. If, for example, a customer buys women's fashion, we can alert her when a new exclusive brand hits her store; if she buys a lot of children's goods, we can target sales in this area.

And it goes much further. This information about customers gives Hbc the ability to leverage Canada's best consumer database – putting us in six out of 10 Canadian homes – to identify our most profitable customers and shift our efforts directly toward serving and retaining these customers. Through our CRM program, we can focus efforts on core product categories, measure results, leverage customer touch points, develop new customer outreach programs, grow and retain high-value, multiple-relationship customers and cross-sell to departments and banners.

The new-found power of the aligned and focused Hbc has also led us to view the market more strategically. Specifically, our analysis of the marketplace led to a refinement of our focus. Although Hbc will always be a general merchant that will strive to meet the needs of the majority of Canadians, a thorough assessment of our key areas of strength and those of our competitors has led us to identify core assortment areas for which we will build on our dominance: women's wardrobe, kid's world, home décor and wellness.

Bolstered by our new and improved retail operation and armed with a clear view of our customer and the marketplace, we are now ready for our growth phase, one that concentrates all of our resources on providing our customers with more of the products they want, from a retail network that is unparalleled and a shopping experience that is unsurpassed.

Growing Hbc

Your Company is now clearly focused on realizing growth through the simultaneous execution of the fundamentals of any retail organization: price, products, service, location and marketing. This focus is targeted to deliver $1.5 billion in incremental sales and revenue growth over the next five years.

In a world of choice, retailers must strive to separate themselves from the competition. Consumers are increasingly faced with sameness from retailer to retailer, boring them to the point that they feel they are

We are focusing on the "customer in market", offering better targeted products from our full Hbc assortment irrespective of retail format.

shopping from their own closets. In the midst of this environment, Hbc strives to provide Canadians with what they want: exciting and exclusive products that provide good value in shopping environments that excite and serve their needs. Fundamentally, it's about being a customer-centric merchant. At Hudson's Bay Company, we understand that there's more to retailing than stocking shelves and buying brands – you need to know how to merchandise and bring consumers what they want, where and when they want it, at prices that entice them.

Hbc continues to differentiate itself by offering some of the best Canadian and international brands available on an exclusive basis. Recognized within our industry for establishing brands and providing the greatest access to the Canadian market through more than 500 stores, Hbc is now sought out internationally for our ability to attract, nurture and help grow brands.

Last year, Hbc announced several significant new exclusive brands for fall 2003 and spring 2004 delivery in our stores. This headline list includes Canadian designer Lynda Reeves and the "House & Home": Style for Living collection, GlucksteinHome by world-renowned designer Brian Gluckstein, and the upcoming launch of international teen superstar Hilary Duff's collection, "Stuff by Duff". These high-profile brands follow on the heels of the exciting and successful launch of urban casual wear from Mossimo at Zellers.

With the continuing success of the I.N.C., Style & Co. and Tools of the Trade brands at the Bay, Hbc announced our continued commitment to our portfolio of exclusive Federated Department Store brands. We have expanded the Alfani brand across women's and men's clothing and accessories; introduced Greendog for kids; and are launching Très You, a new line of career apparel for Zellers this Fall.

In terms of location, we are everywhere Canadians shop. From power centres to fashion malls to the downtowns of Canada, Hbc is building compelling, appropriately merchandised stores. And as the last great Canadian merchant located in the downtown cores of this country, we recognize the important role retailers can play in revitalizing our cities. In 2003, we began to roll out a strategy to increase awareness of our five downtown flagship stores as shopping destinations.

Today, the customer's demand for value continues to grow unabated. Hbc, through everyday pricing programs in all formats and an increasing "Power Buy" capability, is meeting these essential criteria – and we are doing so profitably.

We continue to aggressively pursue a "Power Buy" strategy across all banners, including online. This off-price merchandise represents a significant opportunity for consumers to find unique, high-quality merchandise at great value. Canadian consumers increasingly demand exceptional value and this program allows us to profitably deliver high-quality goods at remarkable prices.

The Company plans to create substantial growth in furniture, appliances, mattresses and electronics by creating Hbc big ticket/ home assortments in all markets by leveraging all banners. We are developing in-store departments that will provide unequalled customer service, targeted product selection and home fashion solutions that balance price, style, quality and service, expanding our reach and leveraging our new "one Hbc" competencies.

It is impossible to talk about our successes without acknowledging the incredible efforts of our 70,000 dedicated associates. At Hbc, we continue to recruit and retain the best staff and invest in training to ensure the best possible shopping experience and support are available to our customers. At the Bay, we have recognized that our customers prefer uniformed associates and a full-service sales experience when shopping for certain merchandise. The Zellers service breakthrough established in 2002, with uniformed associates and separation of service functions, continues to return benefits in terms of customer feedback and increased sales.

Moving forward

Among the most positive elements of the Company's 2003 performance was a much improved balance sheet. We cut debt and costs while improving the financial fundamentals, our inventories are lower and better balanced, and we have added significantly to our exclusive and differentiated product portfolio.

We begin 2004 in a favourable position. Our strategic positioning and financial flexibility have never been better.

For the second year in a row, we are also proud to report to our shareholders on our progress in the area of corporate social responsibility. Included in this year's annual report on page 64 is an analysis on the impact of our operations beyond the bottom line. As a commercial operation that existed for almost 200 years before Canada became a

Hbc is one of Canada's largest employers with 70,000 associates located across the country.

nation, we are keenly aware that our position as citizens is fundamental to Hudson's Bay Company and is never far from our thoughts or actions. You will see that 2003 was a year in which we accomplished significant progress in ethical sourcing, moving international retailers toward greater cooperation in monitoring the factories that deliver products to us. We have further refined and strengthened programs that, in 2003, invested more than $11 million in the communities in which we live and work, and we continue to improve programs that minimize the environmental impact of our operations.

Walter Loeb, a Director on the Hudson's Bay Company Board since 1998, will not be standing for re-election this year, having reached the statutory age of retirement. Walter's retail experience has been invaluable to the Board of Directors and to the whole organization. Walter will be missed, and we thank him for his immense contribution to the Company.

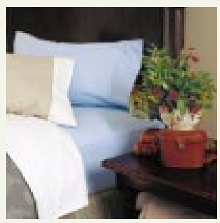
Retailing is never easy and ever changing. However, the rebuilding of Hbc has followed a careful, thoughtful and strategic plan to ensure we have the competencies and science, along with the flexibility and art, needed to serve an increasing share of the needs of the 21st century Canadian consumer. We have outlined to the marketplace our plans to realize value over the next five years. The Board of Directors and Management are confident of the ultimate realization of this primary duty – to enhance the value of their investment in this great Company while contributing to the long-term well-being of all Canadians.

(Signed)

George J. Heller
President and
Chief Executive Officer

(Signed)

L. Yves Fortier, C.C., Q.C.
Governor



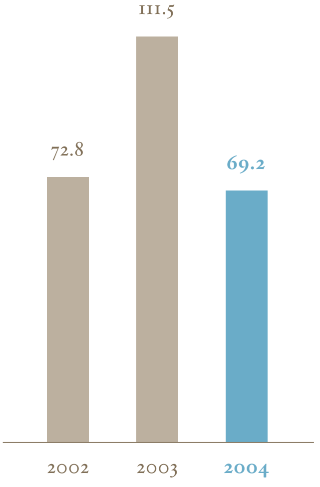
financial review

financial highlights

(millions of dollars)	2004	2003	2002
Sales and revenue	7,400.1	7,383.8	7,445.8
Net earnings	69.2	111.5	72.8
Cash flow from operating activities	392.1	182.8	189.3
Capital expenditures	114.8	133.1	143.8
Debt:equity ratio	0.13:1	0.25:1	0.18:1
(dollars)			
Per share			
Net earnings	0.82	1.40	0.85
Net earnings – diluted	0.82	1.34	0.84
Dividends	0.36	0.36	0.36

Sales and Revenue
($ millions)

Net Earnings
($ millions)



Earnings per Share
($)

management's discussion and analysis

Business Profile

Hudson's Bay Company (Hbc or the Company), established in 1670, is Canada's largest department store retailer, oldest corporation and one of Canada's largest employers. The Company provides Canadians with the widest selection of goods and services through its retail channels. These include more than 500 stores, consisting mainly of the Bay, Zellers, and Home Outfitters, Hbc's newest store format, a kitchen, bed and bath superstore chain of 45 stores. In addition, Hbc operates a Financial Services division offering credit card, loyalty and other customer services, and is engaged in several other smaller operating and retailing activities: Fields, a chain of 106 small value-priced general merchandise stores located in western Canada; and Hbc Direct, the Company's direct-to-consumer business, which includes catalogue operations, third party loyalty programs and the Company's online customer fulfillment offering.

Built on a 334-year tradition of serving the people of Canada, the Hudson's Bay Company of today has been guided by the following mission since 1998:

Hudson's Bay Company is a seamless retail organization built to best serve the needs of the majority of Canadian consumers through several highly focused formats, linked by customer bridges and enabled by common and integrated support services.

Strategy

From 1998 to 2002 Hudson's Bay Company was transformed into an efficient and effective retail platform capable of realizing the vision of being a shopping solution for Canadians by paralleling consumer spend patterns.

The strategy during this five-year period has been communicated to all Hbc stakeholders through the diamond icon:

The Company's five-year focus on this strategy has resulted in significant progress at the top and bottom of the diamond. Over the next five years, the Company will remain committed to this strategy targeting growth in sales volume from the middle of the diamond.

In the past five years, the Company has renovated or replaced virtually all core systems and processes with an industry-leading retail platform that serves all Hbc retail formats more effectively and efficiently. Today, the Hbc back-of-house is a seamless, common, cost-effective suite of technology, processes, logistics and shared services focused on continuous improvement.

The transformation extended to the Company's financial position by removing debt, cutting costs and improving cash flow. The development of several touch points based on the Company's one customer orientation was achieved with the Hbc Rewards program, Hbc credit card offering and Hbc gift card. All touch points build an affinity to Hbc as a retail brand, while providing Hbc with an unprecedented opportunity to establish profitable and rewarding one-to-one relationships with customers.

The 'build' phase of the Company's strategy was fundamentally the development of an entirely new business model. The next stage of the Company's strategic focus is the 'growth' phase. The success of Hbc's strategy from 2004 to 2008 will be demonstrated through the realization of comparable store sales growth.

In the fall of 2003, the Company outlined a plan to grow sales from existing assets by targeting $1.5 billion by 2008. This growth is incremental to the approximately $7.5 billion in sales and revenue that have been achieved annually over the past four years to January 31, 2004. The Company is targeting $9 billion in sales by 2008 and annual earnings per share of $2.85.

The five-year growth plan is based on an analysis of the Canadian marketplace, which included a review of the competitive environment, customer trends and Hbc's areas of strength and merchandise market share. The sales and revenue target of $9 billion by 2008 presumes modest incremental growth from ongoing base operations. The $1.5 billion in growth is projected to be achieved substantially from six targeted strategic initiatives that are focused on identified opportunities in the marketplace and leverage the new Hbc capabilities and strengths.

I Big Ticket/Home – $430 million by 2008
Based on Hbc growing market share from its current 3.5% to 8% in five years, in the highly fragmented furniture, mattress, appliance and electronics business. The initiative requires leveraging Hbc's new systems capabilities and customer service platform.

II Merchandise Continuum – $415 million by 2008
Build assortments based on customer and local market demand, utilizing Hbc's extensive reach therefore maximizing Company share by market.

III Opportunity Buy – $350 million by 2008
Capture 7% of the potential 'off-price' market in Canada by creating excitement within everyday low price environment by adding exciting deals. Additionally, procure product for clearance periods at substantially higher gross margins.

IV Store Service – $175 million by 2008
Improve productivity across all retail formats through role specialization and by driving incremental sales in specific areas with dedicated sales associates.

V Customer Relationship Management – $130 million by 2008
Drive profitable incremental behaviour from Hbc's best customers by identifying key segments based on needs and shopping patterns.

VI Merchandise Movement/Supply Growth – $165 million in working capital improvement by 2008
Improve in-stock, gross margins, and inventory turnover as a result of a single efficient and effective Hbc merchandise pipeline.

Financial Objectives

The following financial objectives have been determined based on the Company's operating results, excluding the transactions described in the Consolidated Results section on page 14 that do not arise as part of normal day-to-day business operations; these amounts are referred to as normalized.

1. **Grow Hbc's normalized earnings per share by 8% to 10% annually.**
   Performance – $0.93 in 2003 vs $1.19 in 2002 – a decrease of 21.8%
   In 2003, earnings per share was lowered by $0.15 due to the impact of Ontario's recent corporate income tax rate increases.

2. **Improve inventory turnover on a cost basis to four times.**
   Performance – 2.9 times in 2003 vs 3.0 times in 2002

3. **Maintain the long-term debt to equity ratio (including securitization described on page 29) below 0.85:1.**
   Performance – 0.50:1 in 2003 vs 0.63:1 in 2002

4. **Realize a normalized return on shareholders' equity of at least 10%.**
   Performance – 3.0% in 2003 vs 3.9% in 2002 – a decrease of 0.9%
   In 2003, the return on shareholders' equity declined by 0.5% due to the impact of Ontario's recent corporate income tax rate increases.

Hbc remains committed to these financial objectives.

Consolidated Results

The Company's fiscal year-end is January 31. The financial tables and commentaries referring to 2003, 2002 and 2001 fiscal years cover the 53-week period ended January 31, 2004, and the 52-week periods ended January 31, 2003 and 2002, respectively. The additional week in fiscal 2003 accounted for $85 million of retail sales and approximately $3 million ($0.03 per share) of earnings before interest and taxes (EBIT) in fiscal 2003, which are included in the results described in the following commentaries.

Selected consolidated financial information for the Company for the last three years is shown in the following table:

(millions of dollars except per share amounts)	2003	2002	2001
Sales and revenue	7,400	7,384	7,446
EBIT	161	199	186
Net earnings	69	111	73
Earnings per share (EPS) – basic	$ 0.82	$ 1.40	$ 0.85
EPS – diluted	$ 0.82	$ 1.34	$ 0.84
Dividends per share	$ 0.36	$ 0.36	$ 0.36
Total assets	4,111	4,276	4,534
Long-term debt, including current portion	509	647	782

The following table summarizes the key statistics for the Company for the years ended January 31, 2004, 2003 and 2002:

	2003	2002	2001
Return on equity (%)	2.6	4.5	2.8
Return on assets employed (%)	5.2	6.4	5.7
Number of stores	562	556	551
Square footage (thousands)	48,193	47,875	47,807
Debt to equity ratio*	0.13:1	0.25:1	0.18:1
Debt to equity ratio (includes securitization funding)*	0.50:1	0.63:1	0.54:1

** Debt represents total debt net of cash and cash equivalents and portfolio investments as described in the net assets section of Management's Discussion and Analysis (MD&A). The debt to equity ratio, including securitization funding, is described in the financing activities section of the MD&A.*

Operating results for fiscal years 2003, 2002 and 2001 were impacted by transactions that, in Management's opinion, do not arise as part of normal day-to-day business operations and could potentially distort the analysis of trends. These transactions are described below:

- Costs recorded in the first quarter of 2003 (Q1 2003) for the discontinuation of the Martha Stewart product line ($7 million or $0.06 per share).
- Cost in Q1 2003 related to a sales tax assessment for prior years ($3 million, including $1 million of interest costs, or $0.03 per share).
- Loss recorded in the fourth quarter of 2003 (Q4 2003) of $2 million ($0.02 per share) related to the repurchase of $300 million of securitized credit card receivables and the refinancing of a similar amount.
- Tax benefits recognized in the fourth quarter of 2002 (Q4 2002) of $14 million ($0.21 per share) resulting mainly from a favourable income tax decision related to prior year's transactions.
- Organizational and accelerated store closure costs recorded in the fourth quarter of 2001 (Q4 2001) of $27 million ($0.23 per share).

The results shown above are reported in Canadian currency and are based on Canadian generally accepted accounting principles (GAAP). However, the following commentaries for fiscal years 2003 and 2002 are based on the Company's GAAP results excluding the transactions described previously; these amounts are referred to as normalized. The term normalized does not have any standardized meaning prescribed by GAAP and is therefore unlikely to be comparable to similar measures presented by other companies. In Management's opinion, these transactions do not arise as part of normal day-to-day operations and by excluding these costs readers are provided with a more meaningful comparison of results for the fiscal years 2003, 2002 and 2001.

Adjustment to Normalize

(millions of dollars except per share amounts)	Actual Results		Securitization Loss		Product Line Discontinuation Costs		Non-Recurring Tax Costs (Benefits)		Normalized Results	
	2003	2002	2003	2002	2003	2002	2003	2002	2003	2002
Sales and revenue	7,400	7,384	–	–	–	–	–	–	7,400	7,384
EBIT	161	199	2	–	7	–	3	–	173	199
Net earnings	69	111	1	–	5	–	2	(14)	77	97
EPS – Basic	$ 0.82	$ 1.40	$ 0.02	–	$ 0.06	–	$ 0.03	$ (0.21)	$ 0.93	$ 1.19

The Company no longer adjusts its results for gains and losses arising from its ongoing securitization program since the results for these periods are presented on a consistent basis.

The Company's normalized results for the last three years are summarized in the following table.

(millions of dollars except per share amounts)	2003	2002	2001
Sales and revenue	7,400	7,384	7,446
Normalized EBIT:			
Major retail divisions (including Financial Services)	209	225	227
Other	(36)	(26)	(15)
Total Normalized EBIT*	173	199	212
Normalized net earnings*	77	97	89
Normalized EPS* – Basic	$ 0.93	$ 1.19	$ 1.08

** Excludes product line discontinuation costs and a sales tax assessment in Q1 2003, a securitization loss in Q4 2003, and non-recurring tax benefits recorded in Q4 2002. Costs for accelerated store closures and organizational changes in Q4 2001 of $27 million ($16 million after tax) were also excluded.*

In accordance with the Canadian Institute of Chartered Accountants accounting standard on Goodwill and Other Intangibles, effective February 1, 2002, the Company no longer amortizes goodwill. In 2001, the Company recorded $11 million ($0.16 per share) of goodwill amortization.

Results for the Bay, Zellers and Financial Services are discussed under the heading "Review of Operations" following this section.

The quarterly sales and earnings of Hbc and other retail companies are significantly impacted by customer sales patterns, whereby, sales in the fourth quarter, due to customers' seasonal holiday buying, are a much greater portion of the annual sales volume. The other quarters are also impacted to a lesser extent by sales patterns such as the back-to-school period in the third quarter. Since there is a large fixed expense component that does not fluctuate by quarter, earnings are much higher in the fourth quarter.

Sales and revenue by quarter for the last three years are shown in the table below:

(millions of dollars)	2003	2002	2001
Sales and revenue:			
First quarter	1,535	1,530	1,513
Second quarter	1,689	1,694	1,702
Third quarter	1,714	1,715	1,763
Fourth quarter	2,462	2,445	2,468
Total	7,400	7,384	7,446

The percentage of retail sales of the Company derived from each of the four geographic regions of Canada for the last three years has been stable, as illustrated in the following table:

	Average	2003	2002	2001
Geographic regions:				
Western	32%	32%	32%	32%
Ontario	44%	44%	44%	44%
Quebec	17%	17%	17%	17%
Maritimes	7%	7%	7%	7%
	100%	100%	100%	100%

EBIT on a GAAP basis and on a normalized basis by quarter for the last three years were as follows:

	EBIT			Normalized EBIT		
(millions of dollars)	2003	2002	2001	2003	2002	2001
EBIT:						
First quarter*	(41)	7	–	(31)	7	–
Second quarter	18	22	46	18	22	46
Third quarter	28	26	29	28	26	29
Fourth quarter*	156	144	111	158	144	137
Total*	161	199	186	173	199	212

** Normalized EBIT excludes product line discontinuation costs and a sales tax assessment in Q1 2003, a securitization loss in Q4 2003, and costs for accelerated store closures and organizational changes booked in Q4 2001.*

In 2003, sales and revenue were $7,400 million compared to $7,384 million in 2002. Excluding the additional week in Q4 2003, sales and revenue in 2003 declined by 1.0% from 2002 reflecting sales declines in the Bay and Zellers. Comparable store sales in 2003 were down 2.6% at Zellers and 2.3% at the Bay compared to 2002. Zellers' sales in 2003 decreased in most product groups except for pharmacy, grocery, health and beauty aids and footwear. The sales decline in the Bay occurred in most product groups, except for cosmetics, jewellery and footwear.

For the Bay and Zellers, sales for 2003 were unfavourably impacted primarily by unseasonably colder weather conditions in the first quarter compared to last year, by the power blackout in Ontario in the third quarter of 2003 ($11 million), and a weaker than expected apparel market.

The Company's gross margin rate represents gross margin (sales less cost of sales) as a percentage of sales. Over the last two years, Hbc's gross margin rate has improved by at least one percentage point with increases in both the Bay and Zellers. The increase in the gross margin rate for fiscal 2003 and fiscal 2002 reflects mainly the benefits from lower net markdowns, the reduction in certain unprofitable store-wide promotional activities, lower product costs due to improved supplier merchandise sourcing, and the shift to everyday lower pricing during the last three years. The Company is targeting marginal improvements in the gross margin rate in fiscal 2004.

In 2003, normalized EBIT of $173 million decreased $26 million from normalized EBIT in 2002 of $199 million. Normalized EBIT comprises normalized EBIT in the major retail divisions and other activities. Normalized EBIT in the major retail divisions in 2003 of $209 million, which decreased $16 million or 7.1% from the year 2002 level, is discussed under the Bay and Zellers commentary sections on pages 19 to 24. The Company's lower normalized EBIT also reflected a $3 million reduction in the net gain arising from the sales of receivables through the securitization program described in the Company's off-balance sheet arrangements section of the Management's Discussion and Analysis (MD&A) and in note 2 of the Company's consolidated financial statements for 2003.

Normalized "Other" EBIT represents items not directly attributable to the major retail divisions and Financial Services. Included in the "Other" category were unallocated corporate expenses and miscellaneous profits and losses from various ongoing and non-recurring secondary retail and other activities. The operations of Fields, Hbc's chain of small general merchandise stores in western Canada, earnings from real estate activities, pension credits, Hbc Direct and customer relationship management program costs, and third-party income from Hbc's logistics and loyalty programs are also included. In 2003, 2002 and 2001, losses from these items were $36 million, $26 million and $15 million, respectively.

Compared to 2002, the increase in the loss for 2003 reflected lower revenue on rental properties, lower pension credits, the inclusion of consulting costs, incremental costs for a prior year's store closure and the absence of one-time net credits recorded in 2002, offset partly by additional income related to Hbc's loyalty program.

Normalized interest expense was $42 million in 2003, a decrease of $3 million from the 2002 level of $45 million. The decrease in interest expense reflected mainly the impact of lower long-term debt levels, offset partly by the absence of interest income earned in the first quarter of 2002 on the funds received from the $200 million of convertible unsecured subordinated debentures (subordinated debentures) issued in November 2001. The Company used the funds from the subordinated debentures to repay the 7.0% equity subordinated debentures and 6.25% series C debentures that matured in April 2002. During 2003, the Company's average interest rate increased to 8.0% from 7.2% in 2002.

For 2003, the Company's normalized effective income tax rate was 41.1% compared to the 36.9% normalized effective income tax rate in 2002. The effective income tax rate in 2003 reflected the impact in the fourth quarter of 2003 from an adjustment to future income taxes to account for the Ontario government's repeal of previously announced corporate income tax rate reductions, offset partly by the effect of several tax reduction initiatives. In 2003, the income tax provision increased due mainly to the adjustment in future income taxes totalling $10 million ($0.15 per share). For 2002, the income tax provision was reduced by an adjustment in future income taxes totalling $4 million ($0.07 per share).

Normalized net earnings in 2003 were $77 million compared to normalized net earnings of $97 million in 2002. The decrease in normalized net earnings for 2003 was due to a lower EBIT and a higher effective income tax rate, offset partly by reduced interest costs. The impact of Ontario's recent corporate income tax rate increases lowered net earnings in 2003 by $10 million ($0.15 per share). Compared to 2002, the lower normalized net earnings in 2003 was also due partly to a lower gain, net of tax, related to the Company's securitization program of $2 million ($0.03 per share) and the impact of the power blackout in Ontario during the third quarter of 2003 ($0.03 per share). After deducting dividends for subordinated debentures, normalized EPS in 2003 was $0.93, a decrease of 21.8% from 2002's normalized EPS of $1.19 and a reduction of 13.9% from 2001's normalized EPS of $1.08.

Net earnings on a GAAP basis and on a normalized basis by quarter for the last three years were as follows:

	Net Earnings			Normalized Net Earnings		
(millions of dollars)	2003	2002	2001	2003	2002	2001
Net earnings:						
First quarter*	(34)	(6)	(11)	(28)	(6)	(11)
Second quarter	5	4	13	5	4	13
Third quarter	9	8	4	9	8	4
Fourth quarter*	89	105	67	91	91	83
Total*	69	111	73	77	97	89

* *Normalized net earnings exclude product line discontinuation costs and a sales tax assessment in Q1 2003, a securitization loss in Q4 2003, non-recurring tax benefits recorded in Q4 2002, and costs for accelerated store closures and organizational changes booked in Q4 2001.*

EPS on a GAAP basis and on a normalized basis by quarter for the last three years were as follows:

	EPS			Normalized EPS		
(dollars)	2003	2002	2001	2003	2002	2001
EPS:						
First quarter*	(0.53)	(0.15)	(0.20)	(0.44)	(0.15)	(0.20)
Second quarter	0.03	0.02	0.15	0.03	0.02	0.15
Third quarter	0.08	0.07	0.03	0.08	0.07	0.03
Fourth quarter*	1.25	1.47	0.88	1.27	1.26	1.11
Full year*	0.82	1.40	0.85	0.93	1.19	1.08

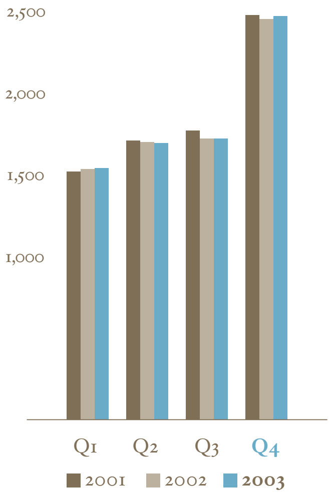
** Normalized EPS excludes product line discontinuation costs and a sales tax assessment in Q1 2003, a securitization loss in Q4 2003, non-recurring tax benefits recorded in Q4 2002, and costs for accelerated store closures and organizational changes recorded in Q4 2001.*

Diluted EPS on a GAAP basis and on a normalized basis by quarter for the last three years were as follows:

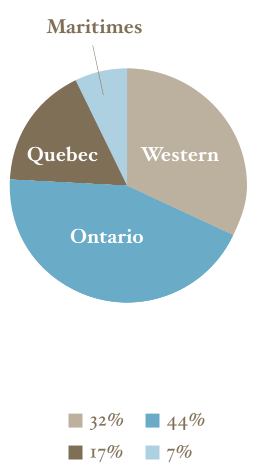
	Diluted EPS			Normalized Diluted EPS		
(dollars)	2003	2002	2001	2003	2002	2001
Diluted EPS:						
First quarter*	(0.53)	(0.15)	(0.20)	(0.44)	(0.15)	(0.20)
Second quarter	0.03	0.02	0.15	0.03	0.02	0.15
Third quarter	0.08	0.07	0.03	0.08	0.07	0.03
Fourth quarter*	1.10	1.30	0.72	1.12	1.12	0.90
Full year*	0.82	1.34	0.84	0.93	1.16	1.03

** Normalized diluted EPS excludes product line discontinuation costs and a sales tax assessment in Q1 2003, a securitization loss in Q4 2003, non-recurring tax benefits recorded in Q4 2002, and costs for accelerated store closures and organizational changes recorded in Q4 2001.*

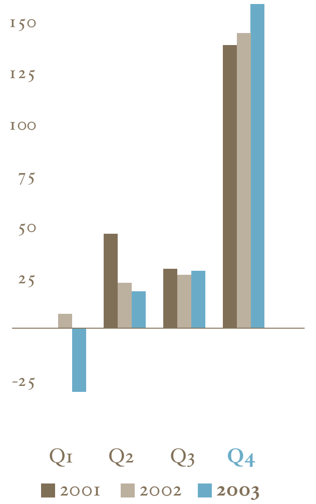
Sales and Revenue
($ millions)



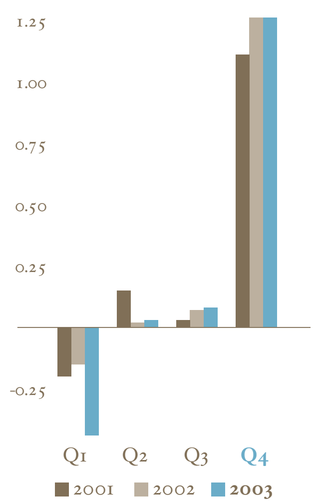
Sales by
Geographic Regions



Normalized EBIT
($ millions)



Normalized Earnings
per Share – Basic
($)



Review of Operations

Retail Environment

Canadian Retail Environment

Department Store Sales (DSS) and Department Store Type Merchandise (DSTM) sales for the calendar year 2003 were up 3.4% and 3.9%, respectively, from the same period last year.

Unlike the last few years, the U.S. economy outperformed the Canadian economy in 2003. The Canadian economy in 2003 faced a number of uncontrollable occurrences, such as SARS, which unfavourably impacted tourism and directly affected retail sales. The power blackout in Ontario during Q3 2003 also negatively affected most businesses and closed retailers' stores for a few days during the back-to-school period. However, the Canadian retail sector remains healthy, supported by moderate levels of consumer confidence, a strong income growth and a robust job market.

The Canadian retail environment is still very competitive. In 2003, many retailers, primarily U.S.-based, opened new stores, while other retailers scaled back their Canadian businesses. Additionally, several large retailers intensified their efforts to broaden product assortments which, in some instances, created new competition for the Company. Increased domestic and international competition and ongoing format changes provided a challenging operating environment for Canadian retailers.

Retail sales growth in 2004 is expected to be slightly higher than 2003, with year-over-year sales reaching the mid-single digits for both the DSS and DSTM groups.

The Bay

Business Profile

At January 31, 2004, the Bay, Hbc's fashion department store retail brand, had 99 department stores in operation across Canada. The Bay offers style and trend leadership in private and national brands to middle and upper income Canadians. The Bay also continues to expand its portfolio of exclusive brands which are executed and supported to deliver a consistent price and marketing message. Emphasizing fashionable soft goods and products for the home, the Bay provides its customers with traditional department store services. During 2003, the Bay continued the expansion of everyday price programs which delivers stylish programs and recognizable value to consumers, and strengthened its exclusive brand offerings with the introduction of the Hbc Signature Collection, the "House & Home": Style for Living collection by Lynda Reeves and the expansion of four new Federated Merchandising Group brands. In 1999, the Bay launched Home Outfitters, a chain of 45 kitchen, bed and bath superstores with a footprint in the range of 27,000 to 42,000 square feet.

Strategy

The Bay will exceed customer expectations by being Canada's best department store chain, offering affordable style and trend leadership in private and national brands to middle and upper income Canadians.

The strategy will be achieved through the following initiatives:

1. Improve department store offerings.
   - Solidify and build on the Bay's fashion and style leadership position;
   - Develop private brands to deliver value and a consistent fashion look;
   - Continue to re-position the Bay brand to stand for Stylish Ideas Made Easy and Affordable;
   - Differentiate suburban from urban stores to exceed customer expectations.
2. Intensify utilization of space.
   - Improve the productivity per square foot of the Bay stores, particularly through expansions of major home fashion, jewellery, and cosmetics and through complementary licensed businesses;
3. Increase investments in growth assets.
   - Continue to invest in Home Outfitters with 45 stores at January 31, 2004 and plans to open up to four stores during 2004 in major Canadian cities.

Financial Performance

(millions of dollars)	2003	2002	2001
Sales and revenue	2,689	2,648	2,667
Normalized EBIT*	80	105	69
Net assets	1,244	1,269	1,169

** Excludes a securitization loss in Q4 2003 and costs for organizational changes in Q4 2001.*

Performance measures for the last three years were as follows:

	2003	2002	2001
Comparable store sales change (%)	(2.3)	(3.9)	(4.8)
Retail sales per selling square foot (dollars)	169	173	180
Inventory turnover on cost basis (times)	2.56	2.71	2.75
Normalized return on assets employed (%)	6.3	8.7	5.7

Sales and revenue in 2003 of $2,689 million were up $41 million or 1.6% from 2002, with comparable store sales down 2.3%. Excluding the additional week in Q4 2003, sales increased 0.5% from fiscal 2002. The Bay's DSTM market share decreased to 2.3% in calendar 2003 from 2.5% in 2002. On a 52-week basis, average sales per square foot of retail selling space were $169 compared to $173 per square foot in 2002.

In 2003, the Bay experienced sales declines in most product groups except for cosmetics, jewellery, and footwear. The Bay's sales decrease was due mainly to lower apparel and soft home fashion sales caused in part by a reduction in store-wide promotional events in the Christmas holiday season. The sales reduction also reflected the impacts of the unseasonably colder weather conditions in the first quarter compared to last year and the power blackout in Ontario in the third quarter of 2003.

Normalized EBIT for 2003 of $80 million decreased by $25 million or 23.8% from last year. The entire profit decline occurred in the first quarter of 2003 reflecting the impact of the unseasonably cold weather conditions and higher markdowns and costs than the prior year. Normalized EBIT for the last nine months of 2003 was approximately $1 million above the EBIT level in the corresponding period of 2002. In 2003, store pre-opening and closing costs were $5 million compared to $8 million in 2002.

Inventories at January 31, 2004 of $573 million were $28 million above the January 31, 2003 level of $545 million. Excluding Home Outfitters, the Bay's inventory was marginally higher reflecting earlier receipts of merchandise for the first quarter of 2004. Inventory turnover (on a cost basis) at the Bay (excluding Home Outfitters) was 2.73 times compared to 2.79 times last year.

The number of Bay stores in operation and the aggregate gross areas in square feet by province at the last three year-ends were as follows:

	Number of stores			Square Feet (thousands)		
	2003	2002	2001	2003	2002	2001
British Columbia	18	18	18	2,976	2,984	2,983
Alberta	15	15	16	2,404	2,404	2,469
Saskatchewan	3	3	3	429	429	426
Manitoba	3	2	2	965	758	758
Ontario	38	38	38	6,791	6,791	6,786
Quebec	18	19	19	3,004	3,142	3,145
New Brunswick	1	1	1	121	121	121
Nova Scotia	3	3	3	375	375	375
	99	99	100	17,065	17,004	17,063

The number of Home Outfitters stores and the aggregate gross areas in square feet by province at the last three year-ends were as follows:

	Number of stores			Square Feet (thousands)		
	2003	2002	2001	2003	2002	2001
British Columbia	6	5		199	171	
Alberta	8	7	5	312	278	201
Saskatchewan	2	2		66	66	
Manitoba	2	2	2	78	78	78
Ontario	19	17	11	728	672	500
Quebec	7	4	4	254	158	158
Nova Scotia	1			35		
	45	37	22	1,672	1,423	937

The Company owns the land and buildings of six large downtown Bay stores in operation, including the Toronto downtown Queen Street store building and approximately 60% of the related land, and three other Bay stores, and the buildings (on leased land) of six suburban Bay stores. The remaining stores are generally held under long-term leases. In 2003, the Bay closed two stores and took possession of one store as described in the following paragraph. During 2003, Home Outfitters opened eight stores. The Home Outfitters stores are held under long-term leases.

During the second quarter of 2003, Hbc opened a store in Victoria (Victoria Centre), a former Eatons store, and closed its previously occupied Victoria store which will be sold. At the end of the third quarter of 2003, Hbc opened another renovated former Eatons store in Winnipeg (Polo Park). The Bay took possession of the Victoria Centre store on January 31, 2003 and the Polo Park store on July 31, 2003. During the fourth quarter of 2003, the Bay closed its Place Versailles store in Montreal and announced the closure of its Cloverdale store in Toronto in the first quarter of 2004.

Operating Highlights for 2003

During 2003, the Bay implemented a number of initiatives in support of its strategic objectives, including:

- The continued growth of the value priced business, particularly Outline and Market Square, at everyday budget price points, and the expansion of the Bay Value program, offering exclusive high quality national brands at everyday pricing.
- The continued drive to expand exclusive arrangements and to market national brands in line with the strategy of competitive differentiation. Brands exclusive to the Bay announced in 2003 included the launch of four new brands of Federated Merchandising Group, a division of Federated Department stores, Hbc Signature and Lynda Reeves "House & Home".
- The continued rationalization of the Bay's real estate portfolio. This included the renovation and opening of two stores, one in Victoria (Victoria Centre) and a 207,000 square foot store in Winnipeg (Polo Park), which were renovated to the Company's department store format. The Bay also closed its Place Versailles store in Montreal and announced the closing of its Cloverdale store in Toronto.
- The focused mentoring and sales development program for sales associates in full-service business departments.
- The implementation of a real-time customer survey, accessible online or by telephone, providing immediate feedback to store management.
- The expansion of Home Outfitters by opening eight stores in 2003 bringing the number of stores to 45.

Outlook for 2004

The Bay is well positioned to grow sales and EBIT in 2004. Sales growth is targeted to occur through key strategic initiatives including its Big Ticket business and an increase in opportunity buys, and the continued growth of the Home Outfitters business, with up to 49 stores by January 31, 2005.

In line with Hbc's strategic initiatives, an extensive review of key lines of business will continue which is projected to have future sales and profit growth. During 2004, the Bay will commence the expansion of the Market Mall, Calgary store to 200,000 square feet, with completion scheduled for the first quarter of 2005.

Zellers

Business Profile

Zellers is Hbc's mass merchandise retail brand with 312 stores at January 31, 2004. Zellers offers national and private brand merchandise at prices that provide value to its customers. During 2003, Zellers continued to renovate to the new prototype format featuring wide aisles, and improved presentation and selection of merchandise. As of January 31, 2004, Zellers had renovated 158 of its stores with various elements of its newest prototype format, representing approximately 57% of total store selling space. Included in the 312 stores are 55 former Kmart Canada locations, acquired by Zellers in 1998, which are at an early stage in the development to the prototype format. The former Kmart Canada stores comprise approximately 17% of total store selling space. Zellers operates 23 of its smaller stores as "Zellers Select". Of the stores with the new prototype format at the 2003 year-end, Zellers has 21 stores that operated the neighbourhood market concept, an expanded offering of grocery items, and 23 stores that include an expanded assortment of electronics.

Strategy

Zellers' strategy is to become the preferred store of Canadian "Moms" by offering a broad assortment of products that respond to her needs and wants, including her family and her home with fast, friendly, convenient service.

This strategy will be achieved through the following initiatives:

- A refined value proposition – anticipating Mom's assortment needs and wants with a combination of priced-right national and exclusive private and captive brands.
- An improved real estate portfolio – becoming a nationwide chain with larger, conveniently located stores by market, positioned to effectively deliver the best assortment and service to Mom.
- Enhanced systems, technology and processes to support enhanced decision-making.

Financial Performance

(millions of dollars)	2003	2002	2001
Sales and revenue	4,625	4,656	4,693
Normalized EBIT*	129	120	158
Net assets	1,449	1,566	1,561

* *Excludes product line discontinuation costs and sales tax assessment in Q1 2003, a securitization gain in Q4 2003, and costs for accelerated store closures and organizational changes in Q4 2001.*

Performance measures for the last three years were as follows:

	2003	2002	2001
Comparable store sales change (%)	(2.6)	(0.5)	1.1
Retail sales per selling square foot (dollars)	198	201	201
Inventory turnover on cost basis (times)	3.09	3.14	2.96
Normalized return on assets employed (%)	8.3	7.7	9.3

Sales and revenue decreased 0.7% in 2003, with comparable store sales down 2.6%. Excluding the additional week in Q4 2003, sales declined 1.9% from fiscal 2002. DSTM market share for Zellers was 4.2% in calendar year 2003, down from 4.4% in calendar year 2002, due mainly to the new store growth of a key competitor in the marketplace. On a 52-week basis, Zellers' average sales were $198 per square foot of retail selling space in 2003 compared to $201 in each of 2002 and 2001.

The sales decline reflected lower softline sales, which were down in most categories due largely to the continuing industry trend of lower consumer spending on apparel as well as deflation in the category, and the unseasonably colder weather in the first quarter of 2003. Hardline sales were down mainly in home entertainment, toys, seasonal products and home fashions, offset partly by increases in pharmacy, grocery and health and beauty aids. Sales in 2003 were also unfavourably impacted by the power blackout in Ontario during the third quarter. Zellers' private and exclusive brand sales in 2003 met its goal of 30% of total retail sales, a level first achieved in 2001.

Normalized EBIT of $129 million in 2003 increased $9 million from normalized EBIT in 2002 of $120 million. Included in 2003 were store closure costs and pre-opening costs of new stores of $6 million, compared with $16 million in 2002 and $18 million in 2001. Due to a change in the accounting policy for goodwill effective February 1, 2002, and in accordance with the Canadian Institute of Chartered Accountants accounting standard on goodwill, normalized EBIT in 2003 and 2002 does not include goodwill amortization compared to $11 million of goodwill amortization in 2001. The increase in normalized EBIT for 2003 compared to EBIT in 2002 reflected mainly the impact of higher gross margin rates due to lower products costs, the result of an improvement in procurement activities, and lower store closure costs, offset partly by a lower sales volume and lower credit card income. The lower credit card income was mainly due to a lower net gain ($3 million) related to the Company's securitization program, increased securitization costs and higher gross write-offs.

Inventory at January 31, 2004 was $887 million or $96 million (9.8%) lower than the 2002 fiscal year-end inventory level of $983 million, mainly reflecting the impact of technologies implemented over the last five years and the continued improvement of inventory management systems and processes. Inventory turnover on a cost basis of 3.09 was marginally below the inventory turnover in 2002 of 3.14.

The number of Zellers stores and aggregate gross areas in square feet by province at the last three year-ends were as follows:

	Number of stores			Square Feet (thousands)		
	2003	2002	2001	2003	2002	2001
British Columbia	38	38	39	3,537	3,499	3,616
Alberta	30	30	30	2,745	2,727	2,695
Saskatchewan	12	12	12	964	964	912
Manitoba	8	9	9	829	905	904
Ontario	130	132	137	12,188	12,240	12,523
Quebec	60	60	61	5,413	5,365	5,369
New Brunswick	12	12	12	1,017	992	961
Nova Scotia	14	14	14	1,302	1,302	1,302
Prince Edward Island	2	2	2	203	203	203
Newfoundland and Labrador	6	6	7	445	445	511
	312	315	323	28,643	28,642	28,996

At January 31, 2004, Hbc owned six Zellers stores. The remaining Zellers stores are generally held under long-term leases. During 2003, Zellers opened one new store, expanded five stores, and closed four stores.

Operating Highlights for 2003

During 2003, Zellers implemented a number of initiatives in support of its strategic objectives to increase the business value. Highlights of the key initiatives include:

- The completion of the implementation of its entire merchandise assortment to Everyday Low Pricing in the first quarter of 2003.
- The launch of both the Mossimo brand of apparel, footwear and home products and adding the Westinghouse small appliances and home products, as part of the ongoing refinement of private and exclusive brands.
- The announcement of an exclusive agreement to offer Hilary Duff's new line of merchandise, "Stuff by Duff", in the Spring of 2004. The product launch includes fashion apparel and accessories, home accessories and cosmetics and will be expanded to include other categories throughout the year.
- The implementation of a real time customer survey, accessible online or by telephone, providing immediate feedback to store management.
- The opening of one new prototype store, and expansion of five stores to the newest prototype which includes Zellers Neighbourhood Market, and the closure of four underperforming stores.

Outlook for 2004

During 2004, Zellers will continue to refine its portfolio of private and captive brands, including the introduction of the Hilary Duff product line in the first quarter. Sales growth is anticipated to be moderate with most growth coming from increased offerings in home and leisure and other hardline areas. Profit growth is expected from sales increases and continued cost management.

Financial Services

Business Profile

The Financial Services division's primary function is to manage Hbc's credit card portfolios for the Bay and Zellers. Processing of the portfolio is handled by a single system, managed in Toronto. The division operates three regional credit service centres in Vancouver, Toronto and Montreal. At January 31, 2004, there were 3.1 million active customer accounts in the combined portfolio, approximately 1.7 million Bay cardholders and 1.4 million Zellers cardholders.

Financial Services' main activity is the issuance of temporary revolving lines of credit to assist customers in purchasing Hbc merchandise and services. Included in this activity is credit product development, new accounts acquisition, portfolio risk management, marketing, and account management consisting of customer services and collection activities.

Strategy

The strategy of Financial Services is to be the settlement vehicle of choice for Hbc's customers and its retail operations.

Three key strategic objectives support the strategy, and include:

- Creating value propositions to the customer for the use of Hbc's credit card (including specific discounts, accelerated loyalty accumulation, and differentiated financing alternatives).
- Initiating effective targeted marketing programs and providing ease of shopping that is more rewarding.
- Operating credit services to realize a profit level that meets corporate hurdle rates.

Financial Performance

(millions of dollars)	2003	2002	2001
Sales and revenue	333	322	328
Normalized EBIT*	160	165	175
Credit card receivables at year-end	539	559	487

** Excludes a securitization loss recorded in Q4 2003.*

Key performance measures for the last three years were as follows:

	2003	2002	2001
Average balance per active customer account (dollars)	466	430	400
Average volume per active account (dollars)	871	802	743
Average monthly active accounts (thousands)	2,925	3,025	3,198
Net bad debt expense for year (millions of dollars)	95	78	69
Gross bad debt expense as a percentage of average balance (%)	9.0	8.3	7.7
Percentage of receivables 30 days past due or less (%)	95.0	94.7	94.9
Credit card blend (%)	28.7	27.6	27.4

Credit card receivables at January 31, 2004 totalled $539 million or 3.7% below 2002's receivable balance of $559 million, which was 14.7% above 2001's level of $487 million. Excluding the adjustments to account for the securitization of credit card receivables, the receivables balance at the 2003 fiscal year-end was $481 million or a 4.4% decrease from the 2002 year-end level, which was 14.2% above the 2001 year-end balance. The credit card receivables level at January 31, 2004 was below last year's level due entirely to the impact of an additional week of collections compared to last year.

Over the past seven years, the Company has sold to independent Trusts, with limited recourse, $900 million of undivided co-ownership interests in its credit card receivables. In the fourth quarter of 2003, $300 million of this amount, which was scheduled for liquidation beginning January 31, 2004, was replaced with an equivalent amount of undivided co-ownership interest which is scheduled to begin liquidation on January 31, 2007. In 2001, the Company sold $100 million of receivables under the securitization program. The securitized portion of the credit card receivables is not included in the year-end receivable balances disclosed in the previous table. The off-balance sheet arrangements section of the MD&A describes in more detail the securitization of Hbc's credit card receivables.

Revenue and normalized EBIT of the Financial Services division are included with the results of the major retail divisions, the Bay and Zellers. Financial Services revenue in 2003 was $333 million, compared with $322 million in 2002 and $328 million in 2001.

Normalized EBIT in 2003 was $160 million, $5 million below 2002's EBIT of $165 million and $15 million below the 2001 level. The reduction in normalized EBIT in 2003, compared to 2002, reflected mainly lower net gains on the Company's securitization program ($3 million), higher gross write-offs and higher securitization expense, offset partly by the growth in revenue. The increase in revenue reflected the improvement in the credit card blend at the Bay and Zellers.

The average balance per active customer account was up, and the average monthly active accounts were down reflecting the impact of the new Hbc credit card, launched in October 2001, which consolidated card activity on one proprietary card. Gross write-offs in 2003 of $123 million were $15 million higher than 2002, reflecting the general economic conditions and the impact of personal bankruptcy levels on the Canadian economy. Net bad debt expense in 2003 of $95 million was $17 million above the 2002 level of $78 million due mainly to higher gross write-off levels in 2003.

The quality of the credit card receivables portfolio at January 31, 2004, was stable compared to the 2002 year-end with 95.0% of the receivable portfolio classified as current and 30 days past due which is consistent with the aging of the portfolio over the last two years.

Operating Highlights for 2003

During 2003, Financial Services implemented a number of initiatives in support of its strategic objectives. Highlights of the key initiatives include:

- The revision of delinquent account strategies and the continued roll-out of the profit-based authorization and credit limit models to control the increase in average charge-off balances and to improve collection performance.
- The increase in inbound calling sales capabilities for products and services offered by Financial Services.
- The completion of the first stage in integrating systems to allow Hbc Rewards access to Hbc's customer service operations.
- The development of a bankruptcy scoring model with the objective of reducing customer charge-off rates in the long term.

Outlook for 2004

For 2004, service charge revenues are expected to grow as a result of both an increase in credit card blend and volume, coupled with average customer account balance increases. The revenue growth is expected to be offset partly by higher gross charge-offs which are targeted to be at a consistent percentage of average credit card receivables.

In 2004, interest rates are expected to decrease which should decrease the cost of funding Hbc's securitization program. However, the recent execution of the standby servicing arrangement, which is described in the off-balance sheet arrangements section of the Company's MD&A, will slightly increase the cost to Hbc of the securitization program.

Overview of Financial Condition

Net Assets

The following summary provides details of the Company's net assets as financed by debt, future income taxes, and equity for the last three years:

(millions of dollars)	2003	2002	2001
Net assets:			
The Bay	1,244	1,269	1,169
Zellers	1,449	1,566	1,561
Other	215	308	372
	2,908	3,143	3,102
Financed by:			
Net debt	321	602	457
Future income taxes	156	146	116
Equity	2,431	2,395	2,529
	2,908	3,143	3,102
Total assets	4,111	4,276	4,534
Debt to equity ratio*	0.13:1	0.25:1	0.18:1

**Debt represents total debt net of cash and cash equivalents and portfolio investments.*

Net assets and net debt consist of:

(millions of dollars)	2003	2002	2001
Net assets:			
Total assets (net of trade accounts payable and other accounts payable and accrued liabilities)	3,185	3,298	3,566
Cash and cash equivalents	(154)	(38)	(317)
Current portion of future income taxes	(29)	(25)	(57)
Portfolio investments	(35)	(32)	(31)
Employee future benefits other than pensions	(59)	(60)	(59)
	2,908	3,143	3,102
Net debt:			
Total debt (including short-term borrowings and long-term debt)	510	672	805
Cash and cash equivalents	(154)	(38)	(317)
Portfolio investments	(35)	(32)	(31)
	321	602	457

In the above table, net assets for the Bay and Zellers include credit card receivables that are also included in the assets of Financial Services, amounting to $539 million at January 31, 2004, $559 million at January 31, 2003, and $487 million at January 31, 2002.

Net assets at January 31, 2004 of $2,908 million were 7.5% lower than last year's net asset level due mainly to lower inventories, net of trade payables, lower fixed asset levels reflecting the impact of property sales in 2003, and reduced credit card and other receivables. The lower inventory level of Zellers, offset partly by increased inventories of the Bay and Home Outfitters, accounted for the decrease in inventories. Home Outfitters' inventory level was higher due entirely to the opening of new stores in fiscal 2003. Other net assets of $215 million decreased $93 million from last year's level reflecting largely a lower fixed asset level due to property sales in 2003 and reduced income taxes recoverable.

Total assets at January 31, 2004 of $4,111 million were 3.9% lower than last year's total asset level of $4,276 million, reflecting primarily the effect of lower inventories, lower fixed asset levels, and reduced credit card and other receivables, offset partly by higher short-term deposits.

Cash Flows

Cash and cash equivalents at January 31, 2004 totalled $154 million compared to $38 million at January 31, 2003. Cash and cash equivalents represent unrestricted short-term deposits. At January 31, 2004, cash and cash equivalents included the proceeds from the $120 million issue of 7.5% unsecured medium term notes.

The following table provides an analysis of Hbc's cash flows for the fiscal years of 2003 and 2002:

Year ended January 31 (millions of dollars)	2004	2003
Cash Flow:		
Net cash inflow from operating activities	392	183
Investing activities:		
Capital expenditures	(115)	(133)
Fixed asset dispositions	66	58
Repurchase of credit card receivables	(300)	–
Sale of credit card receivables	300	–
Other	(25)	(11)
Net cash outflow for investing activities	(74)	(86)
Net cash inflow before financing activities	318	97
Financing activities:		
Debt, including equity subordinated debentures	(162)	(337)
Equity	–	(7)
Dividends	(40)	(47)
Net cash outflow for financing activities	(202)	(391)
Increase (decrease) in cash and cash equivalents	116	(294)

Cash and cash equivalents in 2003 increased $116 million compared to a cash decrease of $294 million in 2002. The cash increase in 2003 reflected mainly the net cash inflow from operating activities of $392 million, the $120 million issue of 7.5% unsecured medium term notes and cash proceeds from property sales ($73 million), offset partly by the repayment on maturity to debenture holders of the 6.25% series D debentures ($113 million) and the 6.35% series E debentures ($146 million), dividend payments of $40 million, and capital and software expenditures of $138 million.

For 2003, net cash inflow from operating activities of $392 million increased by $209 million from the 2002 net cash inflow of $183 million reflecting mainly lower inventories, net of trade payables, and lower credit card and other receivables, offset partly by lower cash profits and higher cash income taxes. Net cash outflow for investing activities in 2003 of $74 million was $12 million lower than the 2002 net cash outflow of $86 million reflecting mainly lower capital and software expenditures, and increased cash proceeds from property sales in 2003.

The net cash outflow for financing activities in 2003 of $202 million was $189 million lower than the net cash outflow in 2002 of $391 million. In 2003, the Company paid $259 million to debenture holders of the 6.25% series D debentures (matured on March 14, 2003) and 6.35% series E debentures (matured on December 1, 2003), repaid other short-term borrowings ($23 million), made dividend payments of $40 million, and issued $120 million of 7.5% unsecured medium term notes maturing on June 15, 2007. During 2002, the Company paid $291 million to debenture holders upon the maturity on April 1, 2002 of the 7.0% equity subordinated debentures and the 6.25% series C debentures, paid $41 million to debenture holders of the 6.25% series D debentures and 6.35% series E debentures, purchased 892,900 Hbc common shares ($8 million) and made dividend payments of $47 million.

To realize the optimum debt to equity structure and to minimize Hbc's dependence on external borrowings, the Company focuses on maximizing its free cash flow which is defined as net cash inflow (outflow) before financing activities less sale or repurchase of credit card receivables, dividends paid and common shares issued or purchased (equity). In 2003, free cash flow of $278 million improved by $235 million from the 2002 level. This improvement in 2003 mainly reflected the increased net cash inflow from operating activities, higher cash proceeds from property sales, and lower capital and software expenditures. The increase in net cash inflow from operating activities reflected mainly lower inventories, net of trade payables, and lower credit card and other receivables.

Financing Activities

The Company obtains funds through various avenues. Funds are generated through cash from operations and improvements in working capital. The Company also has the ability to reduce capital spending to fund debt requirements; however, a long-term decline in capital expenditures may negatively impact profit growth. Other principal sources of funding are the issuance of long-term debentures, the securitization of credit card receivables, the sale and leaseback of real estate properties, a syndicated loan arrangement with a group of lenders, the issuance of convertible subordinated debentures, and the issuance of common equity. The availability of sources of funding to the Company are dependent on a variety of factors including economic conditions, capital markets, and the Company's financial condition.

To achieve the sales growth described in the Company's five-year strategic plan, additional working capital is projected to be required. However, the Company is targeting improvements in inventory management systems and inventory control processes that will offset the working capital increases supporting the sales growth plan. Working capital requirements follow a fairly consistent pattern during the year with the lowest working capital level usually occurring at the fiscal year-end.

At January 31, 2004, the Company's net debt of $321 million, after deducting $189 million in unrestricted investments and short-term deposits, was $281 million below the 2002 year-end debt level of $602 million. Included in the 2003 year-end debt level was $509 million of long-term debt, including $125 million due within one year, which was at fixed interest rates. The $281 million decrease in debt levels in 2003 was due principally to the impacts of reduced inventories, net of trade payables, reduced credit card receivables, lower other net current assets, and proceeds received from property sales in 2003.

There are no legal or practical restrictions on the ability of Hbc subsidiary companies to transfer funds to the Company. In the reporting period, the Company has not been in default or arrears on any dividend payments, lease payments, interest or principal payments on debt.

At January 31, 2004, total committed payments for long-term debt and operating leases were as follows:

		Payments Due by Period			
($ millions)	Total	Less than 1 year	1–3 years	4–5 years	After 5 years
Long-term debt	509	125	262	121	1
Operating leases	2,477	248	470	421	1,338
Total contractual obligations	2,986	373	732	542	1,339

The above table does not include purchase orders for merchandise that are part of the normal course of business. In addition, the Company has non-pension employee benefit plans as described in note 6 of the consolidated financial statements. The estimated contributions for Hbc are approximately $22 million for each of the next five years. The Company had no significant purchase obligations and no capital lease obligations at the 2003 fiscal year-end.

The Company has long-term operating lease obligations that are not capitalized on the balance sheet in accordance with accounting principles generally accepted in Canada. These leases are primarily related to store locations and comprise 98.7% of total lease commitments in 2004. The minimum lease term is generally 20 years; however, the Company has regular renewal options to extend the lease term beyond the minimum lease term. The Company also has long-term leases for transportation and other equipment with various lease terms.

At January 31, 2004, the Company had $125 million of debt due within one year (excluding short-term indebtedness) which represents the 7.10% series F debentures (matures May 13, 2004). Additionally, a $200 million undivided co-ownership interest sold under the securitization program is scheduled to begin liquidation on January 31, 2005. Such liquidation would result in a portion of the collections otherwise available to the Company being remitted to the independent Trust which owns such undivided co-ownership interest. The remittance of $200 million to such Trust would result in the Company's retained interest in the credit card receivables increasing by an equivalent amount. The Company is investigating alternatives including the extension of the scheduled liquidation commencement date or the replacement of the $200 million of undivided co-ownership interest with one or more securitization purchasers. In the Company's view, the funds to pay the amounts due within one year will be available through various sources of funding, as described in the first paragraph of the financing activities section of the MD&A, as well as by utilizing the available cash at January 31, 2004 of $154 million.

The Company's debt to equity ratio at January 31, 2004, was 0.13:1 compared to last year's ratio of 0.25:1. If the Company had financed its business by issuing $900 million of debt on the security of its credit card receivables, rather than by selling undivided co-ownership interests in the receivables, the Company's debt to equity ratio at January 31, 2004, would have been 0.50:1 compared to 0.63:1 at the 2002 year-end. The debt to equity ratio, including securitization funding, met the Company's long-term financial objective of a debt to equity ratio below 0.85:1.

On March 14, 2003, the Company repaid $113 million of the 6.25% series D debentures and on December 1, 2003, repaid $146 million of the 6.35% series E debentures. During the fourth quarter of 2003, the Company issued $120 million of 7.5% unsecured medium term notes maturing on June 15, 2007. On January 23, 2004, the Company also replaced $300 million of its $900 million credit card receivables securitization program which had been scheduled for liquidation beginning January 31, 2004, with an equivalent amount of undivided co-ownership interest which is scheduled for liquidation beginning January 31, 2007.

On July 15, 2003, the Company replaced its existing unsecured $480 million operating line with a 364-day $650 million secured revolving asset-based credit facility. The new credit facility includes a letter of credit capacity and is secured by the Company's merchandise inventory. This credit facility bears interest at variable rates, which can be based on a blend of the Canadian prime rate, BA rate, LIBOR rate and U.S. base rate. At January 31, 2004, the Company had not drawn on its $650 million asset-based credit facility (excluding letters of credit) which is similar to the position at January 31, 2003 on its $480 million credit operating facility (cancelled in July 2003). The asset-based credit facility expires in July 2004. Prior to July 2004, the Company plans to renegotiate a new credit operating facility. Over the last three years, the Company's average draw on the operating lines was $104 million in 2003, $50 million in 2002 and $195 million in 2001. Due to the seasonal nature of the retail business, the draw on the operating lines to fund normal operating activities peaks in the fourth quarter; the peak was $144 million in the fourth quarter of 2003 compared to $235 million and $340 million in the same periods of 2002 and 2001, respectively. As funding needs have declined, the Company expects to negotiate a lower operating facility.

Under the terms of the new asset-based credit facility, the borrowing base availability, as defined by the asset-based Credit Agreement, must not fall below a specified minimum amount for ten consecutive days before the Company must comply with a fixed charge coverage ratio. Since the commencement date of the credit facility, the borrowing base availability has exceeded the specified minimum amount by a multiple of at least five times. In addition, the Company's fixed charge coverage ratio at January 31, 2004 exceeded the minimum financial covenant level.

The Company's debt is rated by Standard and Poor's Canada (S&P) and by Dominion Bond Rating Service (DBRS). During the second quarter of 2003, S&P and DBRS issued a change in the outlook of the Company from stable to negative. The Company's debt was classified as non-investment grade which results in a higher cost to borrow funds in the future and potentially limits the Company's ability to borrow funds in some markets. A summary of the Company's ratings is provided in the following table:

	May 2003		April 2002		November 2001	
	Ratings	Outlook	Ratings	Outlook	Ratings	Outlook
S&P:						
Unsecured debentures	BB+	Negative	BB+	Stable	BBB-	Negative
Convertible unsecured subordinated debentures	BB	Negative	BB	Stable	BB+	Negative
DBRS:						
Unsecured debentures	BB (high)	Negative	BB (high)	Stable	BBB (low)	Negative
Convertible unsecured subordinated debentures	BB	Negative	BB	Stable	BB (high)	Negative

Outstanding Shares

As at March 11, 2004, the Company had 69,324,662 outstanding common shares with a book value of $1,403 million.

The Company also has $200 million of 7.5% subordinated debentures which mature on December 1, 2008. These debentures are convertible to common shares at the option of the holder at any time prior to maturity date at a conversion price of $17.38 per common share, being a rate of 57.54 common shares for each $1,000 principal amount of debentures. If all of the subordinated debentures were converted by the holders, outstanding common shares would increase by 11.5 million shares. The 7.5% subordinated debentures may not be redeemed prior to December 1, 2005. Subsequent to December 1, 2006, the Company may, at its option, redeem the debentures at any time to maturity through the issuance of common shares of the Company. The Company also has the right to deliver common shares to satisfy interest payments on the debentures.

The Company has reserved 7,289,938 common shares for issuance under its stock option plans. At January 31, 2004, 5,059,343 stock options were outstanding with 3,034,443 options exercisable. The options outstanding range in exercise price from $7.57 to $34.90. Refer to note 12 of the consolidated financial statements for details of the stock options.

Off-Balance Sheet Arrangements

Off-balance sheet arrangements, comprising the $900 million credit card receivable securitization, guarantees and derivative financial instruments, are described below.

Credit Card Receivables Securitization

Over the last seven years, the Company has sold, with limited recourse, $900 million of undivided co-ownership interests in its credit card receivables to independent Trusts under the Company's securitization program. The Company indirectly benefits from the low funding costs incurred by the Trusts, which finance their ownership of undivided co-ownership interests by issuing highly rated commercial paper.

The undivided co-ownership interests purchased by the Trusts are created under co-ownership agreements. Under these agreements, the Company commits substantially all of its existing and future credit card receivables to the securitization program. The Company retains the unsold undivided co-ownership interest in the receivables. The aggregate outstanding amount of receivables under the securitization program varies depending on the volume of credit card transactions and payments.

Under the securitization program, the Company is permitted to sell undivided co-ownership interests up to the amount by which the amount of receivables satisfying certain eligibility criteria exceeds a required minimum retained interest amount. A portion of the current eligible receivables amount in excess of the $900 million of undivided co-ownership interests sold to the Trusts (in the range of 14% to 19% of the sold amounts), must be retained by the Company under the securitization program and cannot be sold by the Company. See note 2 of the consolidated financial statements.

The co-ownership agreements provide that the amount of the Company's retained undivided co-ownership interest will be reduced to cover losses suffered as a result of credit card defaults, up to a specified amount. Accordingly, the Company incurs first losses on the receivables up to this amount before the Trusts incur any such losses.

Under the co-ownership agreements, payments from cardholders are divided between the Trusts and the Company on a pre-agreed basis. At the time of liquidation or an amortization event for an undivided co-ownership interest, a portion of the collections otherwise paid to the Company will be paid to the Trusts.

Amortization events include covenant non-compliance by the Company (subject to applicable cure periods); Company insolvency events; a reduction in the aggregate amount of receivables below the minimum required amounts; rating reductions below specified minimums; or a failure of the receivables to meet certain minimum performance levels.

The scheduled liquidation commencement dates for the existing $900 million of undivided co-ownership interests sold to the Trusts are January 31, 2005 (as to $200 million), March 31, 2006 (as to $400 million) and January 31, 2007 (as to $300 million). The liquidation of co-ownership interests would take a period of time to be completed. In the meantime, the Company may arrange for replacement financings by selling additional undivided co-ownership interests in the receivables pool or by issuing debt or through other financings, as described in the first paragraph of the financing activities section of the MD&A.

The Company currently manages the receivables and administers the credit card accounts included under the securitization program. In this role, the Company collects the receivables and applies amounts in accordance with the co-ownership agreements. To protect the Trusts in the event that certain adverse circumstances arise, including covenant non-compliance (subject to applicable cure periods); Company insolvency events; or Company rating reductions below specified minimums, a standby servicing arrangement has been established with a third party.

Guarantees

The Company has guarantees and general indemnification commitments to counterparties which are disclosed in note 20 of the consolidated financial statements. Historically, the Company has not made any significant payments with respect to these guarantees and indemnification provisions, and Management believes that the risk of significant loss is low.

Derivative Financial Instruments

Foreign exchange and floating rate interest rate risks are managed, as deemed appropriate, by forward rate agreements, interest rate swaps and caps under guidelines established and reviewed periodically by the Board of Directors of Hbc.

The Company enters into forward exchange contracts to lock in prices in Canadian dollars for future purchases of merchandise from foreign suppliers. As at January 31, 2004, the Company had US $46 million of outstanding foreign exchange contracts bought forward with settlement dates on these contracts ranging from February 2004 to April 2004. All of these agreements have been made with Canadian chartered banks. The Company believes that its exposure to credit and market risks for these financial instruments is negligible.

Historically, the Company has purchased approximately $450 million of U.S.-denominated purchases on an annual basis. Any income or loss on forward exchange contracts is treated as an adjustment to merchandise purchases. If the improvement of the Canadian dollar in fiscal 2003 continues into the following year, the Company's product costs will continue to improve.

In addition, the Company had in place a number of interest rate swap agreements at 5.8% on notional principal amounts totalling $75 million of floating debt which expired during the year. As at January 31, 2004 the Company did not have any interest rate swap or cap agreements in place.

Additional financial information is disclosed in note 13 of the Company's consolidated financial statements.

Capital Expenditures

Capital expenditures, including software expenditures, were $138 million in 2003, $156 million in 2002 and $182 million in 2001. Of the 2003 capital expenditures, $57 million was incurred at the Bay, $44 million at Zellers and the majority of the remainder was invested in information systems.

In 2004, the Company expects to invest between $200 million and $250 million in capital expenditures. Zellers plans to open two new stores, expand nine stores and renovate 17 stores. The Bay expects to open up to four new Home Outfitters stores and commence the expansion of the Market Mall, Calgary store to 200,000 square feet. The Company will continue to invest in critical information systems including a custom order fulfillment system and integrated business intelligence system, and in the maintenance and upgrade of the existing information technology infrastructure. With the major systems investments made in prior years, technology investments in the future are expected to represent a lower percentage of the total capital budget as more funds will be allocated to store expansions and renovations.

The Company's long-term strategies for each of its major retail divisions are to add profitable stores that improve market penetration and accessibility to its customers, and to renovate, enlarge and upgrade existing stores as required. The Company remains committed to continuing to expand in communities where there are suitable market opportunities and will close unprofitable or underperforming stores.

Retail Properties

The number and aggregate gross areas in square feet of the Company's retail stores and its distribution centres at the last three year-ends were as follows:

	Number			Square Feet (thousands)		
	2003	2002	2001	2003	2002	2001
Retail stores	562	556	551	48,193	47,875	47,807
Distribution centres	9	10	11	3,507	3,622	3,530

The Bay's and Zellers' operating review sections describe the properties in each business. The Company also owns a chain of 106 small value-priced general merchandise stores located in western Canada. In addition to those properties, the Company owns two distribution centres and The Simpson Tower, a 32-storey office building in Toronto.

Total Taxes and Tariffs

Over the last three years, the Company incurred taxes and tariffs totalling $342 million in 2003, $332 million in 2002 and $356 million in 2001. Of the $342 million incurred in 2003, 14.3% represented income taxes, compared to 12.7% in 2002 and 16.6% in 2001. The largest component of taxes and tariffs were charges by municipalities across Canada for realty and business taxes.

Risk Management

Exposure to various risks is an integral part of conducting business. The following table sets out major identified risk factors that are common in the retail business and lists the principal external and internal retail risk factors, grouped by five categories.

Retail Risk Factors

Category	External	Internal
Financial	Accounting standard changes Capital risk Commodity prices Financial instruments Foreign exchange rates Interest rates Liquidity Taxes	Cash flow Debt blend: fixed/floating, long-term/short-term Debt levels Occupancy costs Rates charged on credit cards Real estate portfolio
Operational	Consumer confidence Consumer price sensitivity Marketing Natural disasters Retail competitors Weather and other environmental factors	Advertising strategy Asset management Business continuity plans Change management Customer satisfaction Information reporting Inventory management Outsource management People management Technology Vendor management
Credit	Credit card competitors Default/settlement of customer accounts Economy	Adjudication Measurement Promotional strategies Rewards programs
Regulatory and Fiduciary	Contractual arrangements Fiduciary responsibilities Regulatory compliance	Health and safety
Strategic	Acquisitions and divestitures Government regulations and policies Shareholder relations Societal changes	Corporate reputation Brand protection Corporate governance Ethical merchandise sourcing Marketing strategies Risk tolerance Strategy implementation Succession planning

Competitive risk, the economy and consumer attitudes are each important risk factors which impact earnings. The Company monitors its market share and its place in the retail market, and adjusts its strategy as appropriate. Typical adjustments might include re-locating stores, reviewing merchandise offerings or pricing, and changing marketing programs. While many competitors sell some of the same products as Hbc, no single retail chain covers the wide range of DSTM commodities that are sold in the Hbc family of stores. The Company has the option to change commodity allocation among store formats, and also within each store, in a relatively short time frame, as customer demand shifts, either nationally or in a particular market.

No company can fully protect itself against unknown events in the economy. Hbc sets budgeted inventory levels and promotional activity to be in accord with estimated Gross Domestic Product and consumer spending changes as well as strategic growth initiatives. Capital spending can be adjusted when retail sales growth changes.

Hbc, like most major retailers around the world, administers a program to monitor vendor partners with respect to compliance with fundamental human and labour rights. Some special interest groups have promoted proposals that call for broad public disclosure regarding the specific facilities and vendors that produce merchandise for Hbc's stores. The Company continues to believe that disclosure of this valuable proprietary asset to the level recommended by many of these groups would have a significant negative impact on its ability to effectively source product, and would have little impact on effecting positive change. Hbc has taken a leading position in developing a Code of Vendor Conduct and a compliance verification program. Hbc requires all facilities manufacturing private brand merchandise sold in Hbc's retail stores to be monitored for compliance with the Code by independent auditors. In addition, the Company is working with a broad coalition of retailers in Europe, Asia and North, South and Central America, to establish a consistent global standard, auditing processes and vendor monitoring programs.

In an era of increasing customer choice, corporate or brand reputation is assuming greater significance as a critical factor in evaluating the viability of retailers to attract and retain customers. Trust has emerged as one of the attributes most often cited by consumers in evaluating their likelihood to shop with a retailer. The inputs into the reputation of a Company are varied and vast. Hudson's Bay Company regularly monitors stakeholders' assessments of the Company's reputation through ongoing customer tracking studies and market research. The Company has a number of programs and procedures in place to ensure the reputation of Hbc is considered in conduct and response to issues or circumstances that give rise to scrutiny of the values and social responsibility considerations of Hudson's Bay Company. These include product recall procedures; crisis and issue management protocols; the approach and disclosure requirement of the Corporate Social Responsibility report released as part of the Company's Annual Report, as well as general approved procedures to all Company communication elements.

Financial Services earnings comprise a significant portion of overall Hbc earnings. Bad debt expense and competition from other types of cards are the largest risks faced by the division. Hbc uses sophisticated software and behavioural scoring tables to manage bad debt risks. The Financial Services division meets card competition through in-store and other marketing programs, as well as by continuously improving the benefits available to cardholders.

Capital management risk, which involves Hbc's access to capital markets and level of interest expense, is discussed under the financing activities and off-balance sheet arrangements sections of the MD&A. The Company must deal with foreign exchange risk because a significant portion of merchandise purchases are paid for in U.S. dollars; accordingly, unforeseen shifts in exchange rates impact the gross margin on imported goods. Hbc uses forward exchange contracts to reduce the impact of movements in the Canadian dollar.

The Company has a number of integrated programs in place to mitigate the financial impact from property losses or third-party liability claims; each year Hbc reviews the level of risk that will be retained. These programs are secured by conventional insurance contracts. The total cost of risk management, including insurance premiums, fees, legal and self-retained losses, was approximately $17 million in 2003, $16 million in 2002 and $15 million in 2001.

Critical Accounting Estimates

The Company's significant accounting policies are described in note 1 of the consolidated financial statements. The Company's discussion and analysis of its financial condition and results of operations are based upon the Company's consolidated financial statements, which have been prepared in accordance with Canadian generally accepted accounting principles. The preparation of these financial statements requires the Company to make estimates and judgements that affect the reported amounts of assets, liabilities, revenues and expenses. The Company bases its estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances.

Some of the Company's significant accounting policies involve a higher degree of judgement or complexity than its other accounting policies. The policies described below are considered to be critical accounting estimates, as they require significant estimation or judgement.

Inventory valuation

Merchandise inventories are carried at the lower of cost and net realizable value less normal gross profit margins. The cost of inventories is determined principally on an average basis by the use of the retail inventory method.

Under the retail inventory method, inventory is segregated into categories of merchandise having similar characteristics, and is stated at its current retail selling value. Inventory retail values are converted to a cost basis by applying specific average cost factors for each merchandise category. Cost factors represent the average cost-to-retail ratio for each merchandise category based on beginning inventory and the fiscal year purchase activity.

The valuation of merchandise inventories requires significant management judgement in certain areas, which can lead to different financial results. The areas requiring judgement include (1) setting the original retail value for the merchandise held for sale, (2) recognizing merchandise for which the customer's perception of value has declined and appropriately marking the retail value of the merchandise down to the perceived value, and (3) estimating the shrinkage that has occurred between annual physical inventory counts.

The judgements and estimates for the first two areas above are based on assumptions about count and anticipated demand, market conditions, customer preferences, and fashion trends. When a decision is made to permanently mark down merchandise, the resulting gross profit reduction is recognized in the period the markdown is recorded.

Shrinkage is estimated as a percentage of sales for the period from the last physical inventory count date to the end of the fiscal period. Such estimates are based on experience and the most recent physical inventory results.

The accounting estimates used in the determination of inventory valuation have not changed significantly over the past two years.

Inventory valuation is determined at the Bay and Zellers segment levels. The assumptions used for each of the segments are specific to their situation. Each of the segments has different experiences for shrinkage, markdowns, and other factors. While the Bay has merchandise that is more predominantly susceptible to markdowns, Zellers is on the everyday lower pricing program, with a lesser need for markdowns.

Inventory and cost of sales are the most significant components of the consolidated balance sheet and consolidated statement of earnings, respectively. Any changes to assumptions can thus have a significant impact on both inventory and cost of sales.

Credit Card Receivables

The Company recognizes gains or losses on transfers of receivables or interests in receivables that qualify as sales and recognizes as assets certain financial components that are retained as a result of such sales, which consist primarily of the retained rights to future interest income relating to the transferred assets.

The Company recognizes a gain or loss equal to the difference between the fair value of consideration to be received for the sale of receivables or interests in receivables and the allocated cost of the receivables or interests sold. Retained interests are initially recorded at an allocated carrying amount. Assumptions related to the future performance of the Company's credit card portfolio have a significant impact on the calculation of the gain or loss on sale of the receivables and the carrying value of the retained interests.

The allocated cost of the receivables or interests in receivables sold and the allocated carrying amount of retained interests are estimated based upon the present value of the expected future cash flows, calculated using Management's best estimates of key assumptions about yield, customer payment rates, net charge-off rates, securitization expense rates, and discount rates necessary to derive an estimate of fair value over the receivables' expected life. The initial gain on sale of credit card receivables or interests in receivables is reduced by the fair value of the service liability estimated to manage the securitized portfolio.

Of the assumptions listed above, the following are the most sensitive. Any changes to these assumptions may impact the earnings recognized in connection with the transfer of receivables or interests in receivables.

- The yield, or income generated by the receivables, is billed at a contractual rate monthly and does not require significant judgement or estimates. However, this calculation is based on the expected balance of receivables, which is affected by the expected credit card customer payment rate. The estimate of payment rates is based on historical payment rates. However, if actual payments are significantly different than expected payments, the gains or losses can be expected to change from period to period.
- Net charge-off rates, or bad debt, expected from the sold receivables are based on recent write-off trends. To the extent there are positive or negative factors affecting the customers' ability or intent to pay off the outstanding balance (e.g. level of consumer debt, unemployment rates, etc.), the actual bad debts realized could exceed or be less than the amounts estimated.

Any adverse changes to assumptions can have a material impact on retained interests, including the retained rights to future interest income from the serviced assets.

Refer to note 2 of the annual consolidated financial statements for an analysis of the sensitivity to adverse changes in the assumptions.

The Company does not believe that there are any trends that will materially impact the methodology or assumptions used in determining gains or losses from credit card securitization.

The assumptions used to account for the securitization of accounts receivable have not changed significantly from the initial application of the accounting standard in July 2001.

The assumptions used to determine securitization gains and losses are different between the banners, reflecting the demographics of their customer base. The Bay tends to have a lower yield, higher customer payment rates and lower charge-off rates than does Zellers.

Any gains or losses on the sale of securitized accounts receivable are reflected in the earnings before interest and income taxes, for both of the Bay and Zellers, and can be material. Retained interests are included as part of credit card receivables in the consolidated balance sheets, while the service liability is included in other accounts payable and accrued liabilities.

Hbc Rewards

Hbc Rewards is a loyalty program that allows enrolled cardmembers to earn points that can be redeemed for a broad range of catalogue merchandise offers and other non-merchandise redemption offers. The Company establishes reserves to cover the cost of future redemptions of Hbc Rewards points based upon points outstanding that are ultimately expected to be redeemed by cardmembers and the current weighted average cost per point of redemption.

The ultimate points to be redeemed are based on many factors, including a review of past behaviour of cardmembers by year of enrollment and future expected growth. Past behaviour is used to estimate the ultimate redemption rate of current cardmembers. The weighted average cost per point of redemption is based on the expected point redemption patterns and their related costs.

In addition, the cumulative balance sheet liability for unredeemed points is adjusted over time based on actual redemption and cost experience as well as current trends with respect to redemptions. The liability for the Hbc Rewards program is included in other accounts payable and accrued liabilities in the consolidated balance sheets.

The liability associated with Hbc Rewards is significant. To the extent that the estimates differ from actual experience, the Hbc Rewards program cost could be higher or lower, as applicable. If the behaviour patterns change materially from the estimate used to determine the liability, this can affect income or loss. The cost of the Hbc Rewards program is allocated to each of the Bay and Zellers.

The estimates used to determine the Hbc Rewards liability can change over time, based on actual experience. In the past year, Hbc has changed some of the assumptions used to determine the liability to better reflect actual experience.

Income taxes

Income taxes are determined using the asset and liability method of accounting. This method recognizes future tax assets and liabilities that arise from differences between the accounting basis of the Company's assets and liabilities and their corresponding tax basis. Future taxes are measured using income tax rates expected to apply when the asset is realized or the liability settled. Certain assumptions are required in order to determine the provision for income taxes, including the resolution of tax disputes and the realization of future tax assets.

The Company currently has future tax assets resulting from non-capital loss carry forwards, which will reduce taxable income in the future. The Company assesses the realization of these future tax assets on a quarterly basis, to determine whether an income tax valuation allowance is required. Based on available information, the Company determines whether it is more likely than not that all or a portion of the remaining net future tax assets will be realized. The main factors considered in making this determination include expected future earnings determined through the use of internal forecasts, cumulative losses in recent years, the carry forward period associated with the future tax assets, and the nature of the income that can be used to realize the future tax asset. If actual experience were to differ from the Company's estimate, future increases or decreases in the benefit of non-capital loss carry forwards could occur. Any changes in estimate would affect the income tax expense and the future tax assets shown in the consolidated statements of earnings and consolidated balance sheets, respectively. For the fiscal year ended January 31, 2004, the current portion of future tax assets recognized in the consolidated balance sheets amounted to $29 million, and is included in prepaid expenses and other current assets.

The Company is audited regularly by federal and provincial authorities in the areas of income taxes and the remittance of sales taxes. These audits consider the timing and amount of deductions and compliance with federal and provincial tax laws. In evaluating the exposures associated with various filing positions, the Company accrues charges for probable exposures. To the extent the Company were to prevail in matters for which accruals have been established or be required to pay amounts in excess of reserves, the Company's effective tax rate in a given financial statement period could be materially affected.

For the fiscal year ended January 31, 2004, the non-current portion of future income tax liability recognized in the consolidated balance sheets was $185 million.

Employee future benefits

The Company's pension asset and future benefits other than pension obligation and expense are dependent on the assumptions used in calculating these amounts. The assumptions are determined by management and are reviewed annually by management and its actuaries. These assumptions include the discount rate, the rate of compensation increase, the overall health care cost trend rate and the expected long-term rate of return on plan assets. Actuarial assumptions for mortality and employee turnover rates are based on standard tables, adjusted as necessary to reflect the Company's experience in prior years, and reflecting actual provisions in the benefit plans. Expected trends in rates used are considered when determining the assumptions. Differences between actual experience and the assumptions made by management will result in increases or decreases in the Company's pension and future benefits expense in future years.

All costs relating to employee future benefits are allocated across all banners. There have been no significant changes to the assumptions used in determining the pension and future benefits obligation and expense over the past two fiscal years.

The current portion of the accrued benefit liability for non-pension benefit plans is included in other accounts payable and accrued liabilities in the consolidated balance sheets. The non-current portion of this liability has its own caption, as does pensions, in the consolidated balance sheets. See note 6 of the consolidated financial statements for more details on employee future benefits, as well as a sensitivity analysis of certain assumptions for employee future benefits other than pensions.

The following table discloses the impact on earnings of a 1% increase or decrease in the following assumptions used to determine the pension obligation and expense.

	Effect of 1% change – expense (income)	
Assumption (millions of dollars)	Increase	Decrease
Rate of return on plan assets	(9)	9
Discount rate	–	3
Compensation rate	2	(2)

Recently issued accounting pronouncements

New Accounting Standards Adopted in Fiscal 2003
The Canadian Institute of Chartered Accountants (CICA) has amended the accounting standard relating to stock-based compensation to require employee stock options be accounted for using the fair value-based method and be recognized as an expense in the financial statements. As permitted by the amended standard, the Company has elected to prospectively apply the fair value-based method of accounting for the Company's stock options granted on or after February 1, 2003. As a result, $0.4 million of compensation expense was recognized during the year ended January 31, 2004. The Company continues to account for all other options outstanding using the settlement method of accounting, under which no compensation expense is recorded. Additional information is included in note 12 of the consolidated financial statements.

The CICA has issued a new accounting standard on asset retirement obligations, which requires recognition, measurement and disclosure of liabilities for asset retirement obligations and the associated asset retirement costs. The standard applies to legal obligations associated with the retirement of a tangible long-lived asset that results from its acquisition, construction, development or normal operations. The Company has adopted this accounting standard in fiscal 2003. There was no material impact on the Company's financial position or results of operations in fiscal 2003 as a result of adopting this standard, and based on asset retirement obligations as at January 31, 2004, it is not expected that the adoption of the standard will materially affect the Company's financial position or results of operations in fiscal 2004.

New Accounting Standards Not Yet Adopted
The CICA has recently amended the standards on presentation of financial instruments. The amendment will require obligations that must or can be settled by delivery of a number of the issuer's own equity instruments, where the number depends on the amount of the obligations, to be presented as liabilities. The amendment is effective for years beginning on or after November 1, 2004. In 2005, the Company will classify approximately $180 million of subordinated debentures as debt compared to classifying the subordinated debentures in shareholders' equity at January 31, 2004. This change will result in the Company including additional interest expense in net earnings, but it will have minimal impact on the Company's earnings per share for future years.

Effective for the 2004 fiscal year, the Company will be required to comply with the new accounting guideline on hedging relationships. This guideline requires companies to identify, designate and document their hedging relationships and the effectiveness of the relationships, and is required to be adopted on a prospective basis. Based on hedging relationships in place at January 31, 2004, the Company does not believe the implementation of the guideline will have a material impact on the Company's financial position or results of operations in fiscal 2004.

During 2002, the CICA approved an accounting standard on the impairment of long-lived assets, which is required to be applied prospectively for years beginning on or after April 1, 2003. This standard established principles for recognition, measurement, presentation and disclosure of any impairment of long-lived assets. Hbc will adopt this standard on a prospective basis, effective February 1, 2004.

The Emerging Issues Committee of the CICA has recently approved a new abstract on accounting for certain consideration received from a vendor. The new abstract will affect the accounting for, and classification of, amounts received from a vendor, such as cooperative advertising payments. The abstract requires that such amounts received from vendors be treated as a reduction of prices of the vendors' products and services, and should be included as a reduction of inventory and related cost of sales, unless certain conditions are met. The guidance will apply to all financial statements for annual and interim periods ending on or after August 15, 2004, with retroactive application required. The Company is currently evaluating the impact of this new guidance.

The CICA has issued guidance on accounting for variable interest entities Accounting Guideline 15, Consolidation of Variable Interest Entities. However, the CICA expects to issue an exposure draft of proposed amendments to the guideline to harmonize with corresponding guidance in the United States. The accounting guideline, effective for periods beginning on or after November 1, 2004, provides guidance on consolidation and disclosure of variable interest entities. The Company will continue its assessment of the impact of the accounting guideline and the expected amendments. The Company does not expect a material impact on its financial condition or results of operations in fiscal 2005.

Forward-Looking Statements

This report contains statements about expected future events that are forward-looking and subject to risks and uncertainties. Accordingly, Hbc's actual results, performance or achievements could differ materially from those expressed or implied by such statements, and such statements are qualified in their entirety by the inherent risks and uncertainties surrounding future expectations. These statements do not reflect the potential impact of any acquisitions, mergers or divestitures completed after the date of issuance of this report. In addition, factors that could cause actual results to differ materially from future expectations include general business and economic conditions in Canada and competition within the Canadian retail industry generally.

Additional Information

Additional information, including the Company's Annual Information Form, is available on SEDAR at www.sedar.com.

management's statement on financial reporting

The Management of Hudson's Bay Company is responsible for the preparation, presentation and integrity of the consolidated financial statements contained on pages 41 to 43 of this Annual Report and of financial information, discussion and analysis consistent therewith, 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 44. 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 has established a code of business conduct and 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, all members of which are outside and unrelated directors, meets quarterly with Management and with the internal and external auditors to review audit results, internal accounting controls and accounting principles and procedures. Internal and external auditors have unlimited access to the Audit Committee. The Audit Committee recommends to the Board the accounting firm to be named in the resolution to appoint auditors at each annual meeting of shareholders. The Audit Committee reviews the consolidated financial statements and the other contents of the Annual Report with Management and the external auditors and reports to the directors prior to their approval for publication.

KPMG LLP, 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. The Auditors' Report to the Shareholders is presented below.

(Signed)

George Heller
President and Chief Executive Officer
Toronto, Canada, March 11, 2004

(Signed)

Michael Rousseau
Executive Vice-President and Chief Financial Officer

auditors' report to the shareholders

We have audited the consolidated balance sheets of Hudson's Bay Company as at January 31, 2004 and January 31, 2003, and the consolidated statements of earnings, retained earnings and cash flows for the years then ended. These financial statements are the responsibility of the Company's Management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by Management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at January 31, 2004 and January 31, 2003 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

(Signed)

KPMG LLP
Chartered Accountants
Toronto, Canada, March 11, 2004

consolidated financial statements

Consolidated Statements of Earnings

Years ended January 31 (thousands of dollars except per share amounts)	Notes	2004	2003
Sales and revenue			
The Bay		2,689,478	2,648,339
Zellers		4,624,692	4,656,274
Other		85,881	79,200
		7,400,051	7,383,813
Earnings before interest expense and income taxes			
The Bay		78,226	104,931
Zellers		120,296	120,401
Other		(37,388)	(26,022)
		161,134	199,310
Interest expense	17	(42,662)	(45,428)
Earnings before income taxes		118,472	153,882
Income taxes	3	(49,243)	(42,421)
Net earnings		69,229	111,461
Earnings per share – basic	18	$ 0.82	$ 1.40
Earnings per share – diluted	18	$ 0.82	$ 1.34

(See accompanying notes to the Consolidated Financial Statements)

Consolidated Statements of Retained Earnings

Years ended January 31 (thousands of dollars)	Notes	2004	2003
Retained earnings at beginning of year		740,853	668,304
Net earnings		69,229	111,461
Dividends and accretion – convertible debentures	10	(12,232)	(13,842)
Dividends – common shares		(24,946)	(25,070)
Retained earnings at end of year		772,904	740,853

(See accompanying notes to the Consolidated Financial Statements)

Consolidated Balance Sheets

January 31 (thousands of dollars)	Notes	2004	2003
Current assets			
Cash in stores		8,033	7,308
Short-term deposits		168,943	51,418
Credit card receivables	2	538,734	559,151
Other accounts receivable		64,811	117,412
Merchandise inventories		1,485,088	1,551,104
Prepaid expenses and other current assets		78,669	122,860
		2,344,278	2,409,253
Secured receivables	4	7,052	12,105
Fixed assets	5	1,089,334	1,205,333
Goodwill		152,294	152,294
Pensions	6	365,175	349,549
Other assets	7	152,540	147,153
		4,110,673	4,275,687
Current liabilities			
Short-term borrowings	9	1,309	24,744
Trade accounts payable		415,350	436,368
Other accounts payable and accrued liabilities		510,751	541,599
Long-term debt due within one year	9	125,436	258,870
		1,052,846	1,261,581
Long-term debt	9	383,107	388,543
Employee future benefits other than pensions	6	59,112	59,709
Future income taxes	3	184,976	171,115
Shareholders' equity			
Convertible debentures	10	202,089	199,231
Capital stock	11	1,402,563	1,402,007
Contributed surplus		53,076	52,648
Retained earnings		772,904	740,853
		2,430,632	2,394,739
		4,110,673	4,275,687

(See accompanying notes to the Consolidated Financial Statements)

On behalf of the Board:

(Signed)

L. Yves Fortier, C.C., Q.C.
Director

(Signed)

Peter W. Mills, Q.C.
Director

consolidated financial statements

Consolidated Statements of Cash Flows

Years ended January 31 (thousands of dollars)	Notes	2004	2003
Operating activities			
Earnings before income taxes		118,472	153,882
Net cash income taxes		(4,348)	20,144
Items not affecting cash flows:			
Amortization	16	193,558	187,156
Pension credits		(4,000)	(10,000)
Net gain on sale of credit card receivables	2	(980)	(4,781)
Net change in operating working capital	14	89,419	(163,638)
Net cash inflow from operating activities		392,121	182,763
Investing activities			
Capital expenditures		(114,830)	(133,100)
Disposition of fixed assets		66,151	58,364
Other assets		(17,775)	(9,816)
Repurchase of credit card receivables	2	(300,000)	–
Sale of credit card receivables	2	300,000	–
Miscellaneous		(8,009)	(1,526)
Net cash outflow for investing activities		(74,463)	(86,078)
Net cash inflow before financing activities		317,658	96,685
Financing activities			
Long-term debt:			
Issued		340,000	395,000
Redeemed		(478,870)	(529,146)
		(138,870)	(134,146)
Increase (decrease) in short-term borrowings	9	(23,435)	556
Equity subordinated debentures redeemed	10	–	(202,589)
Capital stock:			
Common shares issued	11	556	1,095
Common shares purchased for cash and cancelled	11	–	(8,258)
Dividends paid – convertible debentures	10	(15,000)	(22,065)
Dividends paid – common shares		(24,946)	(25,070)
Net cash outflow for financing activities		(201,695)	(390,477)
Increase (decrease) in cash and cash equivalents		115,963	(293,792)
Cash and cash equivalents at beginning of year		37,558	331,350
Cash and cash equivalents at end of year		153,521	37,558

January 31 (thousands of dollars)	2004	2003
Short-term deposits	168,943	51,418
Less: restricted funds	(15,422)	(13,860)
Cash and cash equivalents at end of year	153,521	37,558

(See accompanying notes to the Consolidated Financial Statements)

notes to consolidated financial statements

Years ended January 31, 2004 and January 31, 2003

Note 1. Accounting Principles and Policies

These consolidated financial statements have been prepared by Management in accordance with accounting principles generally accepted in Canada. The significant accounting policies are as follows:

a) Fiscal year

The Company reports its year end as January 31. Retail sales and related activities are reported on a retail calendar basis ending on the nearest Saturday prior to January 31. The year ended January 31, 2004 contains 53 weeks and the year ended January 31, 2003 contains 52 weeks.

b) Foreign currency translation

Foreign currency assets and liabilities are translated into Canadian dollars at exchange rates in effect at the balance sheet dates.

Foreign currency costs and earnings are translated into Canadian dollars at exchange rates in effect at the time they are incurred or earned.

c) Income taxes

Income taxes are determined using the asset and liability method of accounting. This method recognizes future tax assets and liabilities that arise from differences between the accounting basis of the Company's assets and liabilities and their corresponding tax basis. Future taxes are measured using tax rates expected to apply when the asset is realized or the liability settled.

d) Credit card receivables

In accordance with accepted retail industry practice, credit card receivables, of which a portion will not become due within one year, are classified as current assets. They represent open-ended revolving credit card customer accounts and are shown after deducting an allowance for doubtful accounts.

The Company recognizes gains or losses on transfer of receivables that qualify as sales and recognizes as assets certain financial components that are retained as a result of such sales, which consist primarily of the retained interest in receivables sold and the retained rights to future interest income from the serviced assets. Retained interests are initially recorded at an allocated carrying amount, which is estimated based upon the present value of the expected future cash flows, calculated using Management's best estimates of key assumptions about account repayment rates, securitization interest expense rates, discount rates and other factors necessary to derive an estimate of fair value over the receivables' expected life of 19 months. Subsequently, retained interests are evaluated for other than temporary impairments. The initial gain on the sale of credit card receivables is reduced by the fair value of the service liability estimated to manage the securitized portfolio.

e) Cash and cash equivalents

Cash and cash equivalents consist of short-term deposits with maturities of less than three months and exclude restricted funds. Cash in stores is considered restricted, as it is required as a cash float for store operations.

f) Merchandise inventories

Merchandise inventories are carried at the lower of cost and net realizable value less normal gross profit margins. The cost of inventories is determined principally on an average basis by the use of the retail inventory method.

g) Fixed assets

Fixed assets are carried at cost. The costs of buildings (excluding the office tower noted below), equipment, equipment held under capital leases and leasehold improvements are amortized on the straight-line method over their estimated useful lives. The cost of property for sale or development is not amortized, since it represents either land or vacant properties.

The amortization periods applicable to the various classes of fixed assets are as follows:

Asset	Amortization Periods
Buildings	20–40 years
Equipment	3–12½ years
Equipment held under capital leases	5–8 years
Leasehold improvements	10–40 years

Buildings include an office tower, the cost of which is being amortized on the sinking fund method at a rate of 3% over a 40-year period.

h) 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 Zellers Inc., Towers Department Stores Inc. and Kmart Canada Co. at their respective dates of acquisition.

Goodwill is not amortized. On an annual basis, the Company evaluates and, if necessary, adjusts goodwill for any impairment.

i) Employee future benefits

The Company maintains both defined contribution and defined benefit (including career and final average earnings formulas) pension plans.

Employee future benefits other than pensions represent medical and dental care and life insurance commitments to certain employees and retirees of acquired companies, long- and short-term disability payments and compensated absences. The Company accrues its obligations under these plans net of any plan assets. Certain of the defined benefit pension plans are subject to periodic increase adjustments to their pension benefits.

The most recent actuarial valuation of the principal pension plan for funding purposes was as at January 1, 2002. The next actuarial valuation of the principal pension plan for funding purposes will be due as at a date no later than January 1, 2005. The most recent actuarial valuation of the non-pension post-retirement benefits was as at July 1, 2003 and of the post-employment benefits was as at September 30, 2003.

For reporting purposes, assets and liabilities are measured as at December 31.

The accrued benefit obligations for the defined benefit plans have been determined using the projected benefit method pro-rated on services, including the impact of future salary escalation, based on Management's best estimate of discount rates, salary escalation and retirement ages of employees. For benefit expense purposes, a market-related value of assets and Management's best estimate assumption of investment returns have been used to determine the expected return on plan assets.

Actuarial gains and losses related to both assets and liabilities are amortized on a straight-line basis over the expected average remaining service lifetime of the membership to the extent that they exceed 10% of the greater of the accrued benefit plan obligation and the market-related value of the benefit plan assets. Past service costs and transitional assets are amortized on a straight-line basis over the expected average remaining service lifetime of affected members.

With respect to the defined contribution plans, the expense is equal to the Company contribution.

j) Other assets

Other assets include systems development costs which are amortized on the straight-line method over periods of up to seven years.

k) Hbc Rewards

Hbc Rewards is a loyalty program that allows enrolled cardmembers to earn points that can be redeemed for a broad range of catalogue merchandise offers and other non-merchandise redemption offers. The Company establishes a liability to cover the cost of future redemptions of Hbc Rewards points at the time of sale when the points are earned by card-members. The liability is based upon points outstanding that the Company estimates will be redeemed by cardmembers and the current weighted average cost per point of redemption.

The estimated points expected to be redeemed are based on many factors, including a review of past behaviour of cardmembers by year of enrollment and future expected growth. The liability for the Hbc Rewards program is included in other accounts payable and accrued liabilities in the Consolidated Balance Sheets.

l) Vendor allowances

The Company receives cash or allowances from vendors as merchandise price adjustments and in respect of advertising and marketing. Purchase price adjustments are recorded as adjustments to merchandise cost, and marketing and advertising allowances are recorded as a reduction of advertising expense in earnings before interest and taxes.

m) Stock-based compensation plans

The Company has five active stock-based compensation plans, as described in note 12. Compensation expense is recorded under the stock ownership plan, the share appreciation rights agreement and the phantom stock plan.

In the year ended January 31, 2004, the Canadian Institute of Chartered Accountants (CICA) amended Handbook Section 3870, which provides guidance on accounting for stock-based compensation, to require the use of the fair value-based method to account for stock options. In accordance with transitional options allowed under the revised accounting standard, the Company has prospectively applied the fair value-based method to all stock options granted on or after February 1, 2003. Accordingly, compensation cost is measured at fair value at the date of grant and is expensed over the vesting period.

The Company continues to use settlement accounting to account for stock options granted prior to February 1, 2003. No compensation expense has been recorded for the stock options granted during this period under the stock option plans. The Company provides additional note disclosure, which presents, on a pro-forma basis, certain financial data determined using the fair value method of accounting for stock-based compensation (see note 12).

n) Off-balance sheet financial instruments

To hedge its interest rate risks, the Company utilizes interest rate swaps, forward rate agreements and caps, as deemed appropriate. Accrued interest receivable and payable under the interest rate swaps and forward rate agreements are included in other accounts receivable or other accounts payable. The up-front fees paid under interest rate caps are amortized to interest expense on the straight-line method over the terms of the related contracts and the unamortized amounts are included in other assets.

To hedge its foreign exchange risks, the Company utilizes forward foreign exchange contracts. Foreign currency is purchased at a foreign exchange rate established by these contracts, at a predetermined date.

o) Use of estimates

The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires Management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the year. The Company's most significant estimates include inventory valuation, credit card receivables, employee future benefits, Hbc Rewards, and income tax provisions. Management reviews these estimates on an ongoing basis. Actual results could differ from these estimates.

p) Comparative figures

Where necessary, certain of last year's figures have been reclassified to conform with this year's presentation.

Note 2. Credit Card Receivables

January 31 (thousands of dollars)	2004	2003
Managed credit card portfolio	1,380,692	1,403,038
Securitized receivables	(900,000)	(900,000)
Retained interest in receivables sold	58,042	56,113
Net credit card receivables	538,734	559,151
Managed allowance for doubtful accounts	31,521	30,005

Over the last seven years, the Company has sold, with limited recourse, $900 million of undivided co-ownership interests in its credit card receivables to independent Trusts under the Company's securitization program. The Company indirectly benefits from the low funding costs incurred by the Trusts, which finance their ownership of undivided co-ownership interests by issuing highly rated commercial paper.

The undivided co-ownership interests purchased by the Trusts are created under co-ownership agreements. Under these agreements, the Company commits substantially all of its existing and future credit card receivables to the securitization program. The Company retains the unsold undivided co-ownership interest in the receivables. The aggregate outstanding amount of receivables under the securitization program varies depending on the volume of credit card transactions and payments.

Under the securitization program, the Company is permitted to sell undivided co-ownership interests up to the amount by which the amount of receivables satisfying certain eligibility criteria exceeds a required minimum retained interest amount. A portion of the current eligible receivables amount in excess of the $900 million of undivided co-ownership interests sold to the Trusts (in the range of 14% to 19% of the sold amounts), must be retained by the Company under the securitization program and cannot be sold by the Company.

The co-ownership agreements provide that the amount of the Company's retained undivided co-ownership interest will be reduced to cover losses suffered as a result of credit card defaults, up to a specified amount. Accordingly, the Company incurs first losses on the receivables up to this amount before the Trusts incur any such losses.

Under the co-ownership agreements, payments from cardholders are divided between the Trusts and the Company on a pre-agreed basis. At the time of liquidation or an amortization event for an undivided co-ownership interest, a portion of the collections otherwise paid to the Company will be paid to the Trusts.

Amortization events include covenant non-compliance by the Company (subject to applicable cure periods); Company insolvency events; a reduction in the aggregate amount of receivables below the minimum required amounts; rating reductions below specified minimums; or a failure of the receivables to meet certain minimum performance levels.

The scheduled liquidation commencement dates for the existing $900 million of undivided co-ownership interests sold to the Trusts are January 31, 2005 (as to $200 million), March 31, 2006 (as to $400 million) and January 31, 2007 (as to $300 million). The liquidation of co-ownership interests would take a period of time to be completed. In the meantime, the Company may arrange for replacement financings by selling additional undivided co-ownership interests in the receivables pool or by issuing debt or through other financings.

The Company currently manages the receivables and administers the credit card accounts included under the securitization program. In this role, the Company collects the receivables and applies amounts in accordance with the co-ownership agreements. To protect the Trusts in the event that certain adverse circumstances arise, including covenant non-compliance (subject to applicable cure periods); Company insolvency events; or Company rating reductions below specified minimums, a standby servicing arrangement has been established with a third party.

The following table provides information on earnings derived from the financial services business including net gains on sale of receivables to the Trusts:

January 31 (thousands of dollars)	2004	2003
Profit on service charges and other revenue	186,902	185,454
Securitization expense	(28,830)	(25,297)
Net gain on sale of credit card receivables	980	4,781
Net financial services earnings	159,052	164,938
Net bad debt expense included above	95,229	78,034

During the year ended January 31, 2004, the Company replaced $300 million of its $900 million credit card receivables securitization program that was scheduled for liquidation beginning January 31, 2004, by selling an equivalent amount of undivided co-ownership interests (scheduled for liquidation beginning January 31, 2007) under the securitization program to a highly rated, independent Trust. A net loss of $0.8 million was recognized, reflecting both the accounting for the termination of the portion of the securitization program scheduled for liquidation and the introduction of the replacement transaction.

The net gain on sale of credit card receivables is net of $53 million of amortization of service liability, $54 million of service liability initially recognized in the year ended January 31, 2004, and the $0.8 million loss on the replacement and sale of $300 million of credit card receivables, as described above. The balance of the service liability was adjusted by a negligible amount to reflect the replacement and sale of credit card receivables. In the year ended January 31, 2003, the net gain on sale of credit card receivables was net of $49 million of amortization and $54 million of service liability that was initially recognized.

Years ended January 31 (thousands of dollars)	2004	2003
Balance of service liability	25,935	24,991
Sale of credit card receivables	300,000	–
Proceeds from collections	1,770,400	1,732,344

The table below shows the key economic assumptions used in measuring the Company's right to interest income due on sold receivables, called an interest only strip, and securitization gains based on the current fair value of future cash flows. The table also displays the sensitivity to adverse changes in the following assumptions:

		Effects of Adverse Changes (millions of dollars)	
	Assumptions	10%	20%
Yield (annual rate)	24.9%	–	–
Average payment rate (monthly)	18.0%	0.7	1.4
Net charge-off (annual rate)	7.4%	–	–
Securitization expense rate	3.2%	–	–
Discount rate	14.5%	–	–

Note 3. Income Taxes

The major components of income tax expense and the income tax rates for the years ended January 31, 2004 and January 31, 2003 are as follows:

Years ended January 31 (thousands of dollars)	2004	2003
Current tax expense	29,243	4,544
Future income taxes	20,000	37,877
Income tax expense	49,243	42,421
Average Canadian income tax rate	36.4%	38.4%

Reconciliations of the income tax provisions at the above rates with the amounts shown in the Consolidated Statements of Earnings are as follows:

Years ended January 31 (thousands of dollars)	2004	2003
Earnings before income taxes	118,472	153,882
Income tax expense calculated at average Canadian income tax rates	43,124	59,091
Change in income taxes resulting from:		
Large corporations tax	7,360	7,491
Net capital gains and losses	(1,431)	(1,441)
Other (non-deductible items and prior year tax reduction)	(10,138)	(18,186)
	38,915	46,955
Adjustments in future income tax balances	10,328	(4,534)
Income tax expense	49,243	42,421

The components of future income tax balances are as follows:

January 31 (thousands of dollars)	2004	2003
Future income taxes – current:		
Deferred items	12,431	10,516
Tax losses carried forward	24,143	31,350
	36,574	41,866
Valuation allowance	(7,363)	(16,516)
	29,211	25,350
Future income taxes – non-current:		
Non-current future income tax assets – deferred items	20,733	19,215
Pensions	(128,072)	(112,399)
Other assets and accrued liabilities	(64,203)	(68,575)
Buildings and equipment	(13,434)	(9,356)
	(184,976)	(171,115)

The current portion of future income taxes of $29,211,000 and $25,350,000 for the years ended January 31, 2004 and 2003, respectively, is included in prepaid expenses and other current assets.

The Company has tax losses carried forward of $69 million. Of this total, $68 million is available until January 2009, and $1 million until January 2011. The benefit of tax losses has been reflected in the Consolidated Financial Statements.

During the year ended January 31, 2003, the Company reduced goodwill in the amount of $8,142,000 as a result of the utilization of previously unrecorded acquisition tax losses.

Note 4. Secured Receivables

January 31 (thousands of dollars)	2004	2003
Mortgages	1,601	4,761
Employee share ownership plan loans	6,486	8,456
Total secured receivables	8,087	13,217
Less amounts due within one year included in other accounts receivable	(1,035)	(1,112)
	7,052	12,105

Maturities of secured receivables are summarized as follows:

Years ending January 31 (thousands of dollars)	
2005	1,035
2006	892
2007	1,046
2008	668
2009	582
Subsequent periods	3,864
	8,087

The mortgages are secured by property and the employee share ownership plan loans are secured by shares of the Company. The average interest rate on secured receivables is 0.7% at January 31, 2004 and 2.2% at January 31, 2003. Under certain conditions, the amounts due may be received prior to maturity.

Note 5. Fixed Assets

January 31 (thousands of dollars)	2004 Cost	2004 Accumulated Amortization	2004 Net Book Value	2003 Cost	2003 Accumulated Amortization	2003 Net Book Value
Land	54,082	–	54,082	77,806	–	77,806
Buildings	317,979	(158,515)	159,464	370,512	(164,376)	206,136
Equipment	1,610,122	(1,044,135)	565,987	1,539,606	(926,823)	612,783
Equipment held under capital leases	8,131	(7,798)	333	8,131	(7,220)	911
Leasehold improvements	535,204	(235,214)	299,990	509,038	(207,199)	301,839
Property for sale or development	9,478	–	9,478	5,858	–	5,858
	2,534,996	(1,445,662)	1,089,334	2,510,951	(1,305,618)	1,205,333

Note 6. Employee Future Benefits

Aggregate information about the Company benefit plans is presented in the table below.

January 31 (thousands of dollars)	2004 Pension Plans	2004 Other Benefit Plans	2003 Pension Plans	2003 Other Benefit Plans
Plan assets				
Market value at beginning of year	1,234,985	13,422	1,345,489	14,689
Actual return on plan assets	131,234	73	(61,062)	95
Employer contributions	8,309	21,353	1,820	19,396
Associate contributions	19,030	–	18,381	–
Benefits paid	(63,809)	(21,353)	(65,784)	(20,758)
Settlement payment	(687)	–	(3,859)	–
Market value at end of year	1,329,062	13,495	1,234,985	13,422
Plan obligation				
Accrued benefit obligation at beginning of year	919,000	92,482	918,929	86,366
Total current service cost	45,137	16,392	42,700	16,226
Interest cost	55,400	5,505	54,897	5,099
Benefits paid	(63,809)	(21,353)	(65,784)	(20,758)
Plan amendments	–	–	570	–
Actuarial (gains) losses	44,962	6,474	(28,453)	5,549
Settlement of obligations	(492)	–	(3,859)	–
Accrued benefit obligation at end of year	1,000,198	99,500	919,000	92,482
Plan surplus (deficit)				
End of year market value less accrued benefit obligation	328,864	(86,005)	315,985	(79,060)
Employer contributions after measurement date	–	1,188	–	–
Unamortized net actuarial loss	142,026	13,015	154,410	6,364
Unamortized past service cost	4,433	1,780	5,083	2,077
Unamortized transitional asset	(110,148)	–	(125,929)	–
	365,175	(70,022)	349,549	(70,619)
Less: current portion	–	(10,910)	–	(10,910)
Accrued benefit asset (liability)	365,175	(59,112)	349,549	(59,709)

The current portion of the accrued benefit liability is included in other accounts payable and accrued liabilities. Market values of plan assets are based on quoted market prices.

Benefit Plan Expense

	2004		2003	
Years ended January 31 (thousands of dollars)	Pension Plans	Other Benefit Plans	Pension Plans	Other Benefit Plans
Company current service cost	26,107	16,392	24,317	16,226
Interest cost	55,400	5,505	54,897	5,099
Expected return on plan assets	(75,004)	(853)	(77,092)	(992)
Amortization of past service cost	650	297	649	297
Amortization of net actuarial loss	779	602	–	–
Amortization of transitional asset	(15,781)	–	(15,781)	(104)
Settlement loss	338	–	–	–
Net (income) expense	(7,511)	21,943	(13,010)	20,526

Actuarial Assumptions

	2004		2003	
Years ended January 31	Pension Plans	Other Benefit Plans	Pension Plans	Other Benefit Plans
Discount rate	6.00%	5.44%	6.50%	5.91%
Expected long-term rate of return on plan assets (net of expenses)	6.17%	6.75%	6.11%	6.75%
Rate of compensation increase	4.00%	4.00%	4.00%	4.00%
Health care inflation rate:				
Initial/ultimate – Benefit expense	–	7.70%/4.30%	–	7.70%/4.30%
Initial/ultimate – Benefit obligation	–	7.54%/4.47%	–	7.70%/4.30%

Both the Company and the members contribute in equal amounts to the defined contribution plans. The defined benefit plans are funded by employee contributions as a percentage of salary and by the Company to support the actuarial-based pension benefits. The defined benefit provisions provide benefits based on members' earnings and service.

The Company's pension and future benefits obligation and expense are dependent on the assumptions used in calculating these amounts. These assumptions include the discount rate, the rate of compensation increase, the overall health care cost trend rate and the expected long-term rate of return on plan assets. The assumptions are of a long-term nature, consistent with the nature of employee future benefits.

The impact of a 1% increase in the assumed health care cost trend rate on the service cost and interest cost is $0.2 million, and on the accrued benefit obligations is $3.8 million. The impact of a 1% decrease in the assumed health care cost trend rate on the service cost and interest cost is a decrease of $0.2 million and on the accrued benefit obligation is a decrease of $3.3 million.

Supplemental information regarding the asset allocation of the defined assets of the largest pension plans and other benefit plans is presented below.

Class	Asset Mix of Pension Plans	Asset Mix of Other Benefit Plans
Cash/short-term investments	2%	–
Bonds	43%	69%
Canadian equities	26%	31%
Global equities	29%	–
	100%	100%

Note 7. Other Assets

January 31 (thousands of dollars)	2004	2003
Systems development costs	108,165	111,990
Portfolio investments	31,970	13,864
Other	12,405	21,299
	152,540	147,153

The portfolio investments represent marketable securities that mature at various dates beyond the next fiscal year. Refer to note 13 for the fair value of the portfolio investments.

Note 8. Asset Retirement Obligations

The CICA has issued a new accounting standard on asset retirement obligations. The new standard requires recognition of statutory, regulatory, contractual and other legal obligations associated with the retirement of a tangible long-lived asset that result from its acquisition, construction, development or normal operations. The new accounting standard is effective for fiscal years beginning on or after January 1, 2004. However, the Company has elected to adopt the new standard for the fiscal year ended January 31, 2004.

The Company has some operating leases that require it to remove leasehold improvements and replace or remove other structures at the end of the lease term. For the year ended January 31, 2004, the Company recorded an asset retirement obligation of approximately $0.1 million with respect to the leases, with negligible earnings impact. The total amount of undiscounted cash flows required to settle the obligations has been estimated to be $1.0 million; this estimate factors in the effect of inflation and the dates that the leases are expected to end, which range from July 2007 to December 2082. In determining the amount of the obligation, the Company has assigned probabilities to the lease end dates to arrive at the expected cash flows.

The Company has other obligations to remove certain tunnels and encroachments. However, there is no firm date on which these obligations are to be met. As a result, the Company cannot reasonably estimate the asset retirement obligation.

Note 9. Debt

At January 31, 2004 and January 31, 2003, the short-term borrowings comprise the following:

January 31 (thousands of dollars)	2004	2003
Bank indebtedness	1,309	24,744
Asset-based credit facility	–	–
	1,309	24,744

In July 2003, the Company entered into an arrangement for a 364-day $650 million secured revolving asset-based credit facility. This credit facility bears interest at variable rates, which can be based on a blend of the Canadian prime rate, BA rate, LIBOR rate and U.S. base rate. The new credit facility includes a letter of credit capacity and is secured by the Company's merchandise inventory. This facility is available for general corporate purposes. At January 31, 2004, the Company had not drawn on the new credit facility (excluding letters of credit). The new credit facility replaced the Company's unsecured $480 million long-term operating line, which expired in August 2003.

Long-term debt comprises the following:

January 31 (thousands of dollars)	2004	2003
Secured:		
14% mortgage due 2009	3,543	3,924
Capital lease obligations at an average rate of 7.0% and maturing in 2003	–	14
	3,543	3,938
Unsecured:		
6.25% debentures series D due March 14, 2003	–	112,484
6.35% debentures series E due December 1, 2003	–	145,991
7.10% debentures series F due May 13, 2004	125,000	125,000
7.38% medium term notes due August 3, 2005	100,000	100,000
7.40% debentures series G due April 5, 2006	160,000	160,000
7.50% medium term notes due June 15, 2007	120,000	–
Total unsecured	505,000	643,475
	508,543	647,413
Less amounts due within one year	(125,436)	(258,870)
	383,107	388,543

As at January 31, 2003, the Company did not have a balance outstanding on its long-term operating line.

The Company has the right at any time prior to maturity to purchase the unsecured debentures in the market, by tender or by private contract.

Maturities of long-term debt are summarized as follows:

Years ending January 31 (thousands of dollars)	
2005	125,436
2006	100,499
2007	160,572
2008	120,654
2009	749
Subsequent periods	633
	508,543

Note 10. Convertible Debentures

As at January 31, 2004 and 2003, the Company had $200 million of 7.5% convertible unsecured subordinated debentures (convertible debentures) outstanding, which mature on December 1, 2008. These convertible debentures were issued on November 26, 2001, when the Company received $200 million, before deducting $6.5 million in issue costs.

These debentures are convertible at the option of the holder at any time prior to the maturity date at a conversion price of $17.38 per common share, being a rate of 57.54 common shares for each $1,000 principal amount of debentures. The 7.5% convertible debentures may not be redeemed by the Company prior to December 1, 2005. Thereafter, and on or before December 1, 2006, the debentures may be redeemed by the Company according to a pre-defined formula. Subsequent to December 1, 2006, the Company may, at its option, redeem the debentures at any time to maturity through the issuance of common shares of the Company. The Company also has the right to deliver common shares to satisfy interest payments on the debentures.

The debentures have been classified as Shareholders' Equity in the Consolidated Balance Sheets. The value of the conversion option for the convertible debentures has been estimated at $20 million. The principal element of the convertible debentures is being accreted over an 84-month period to an amount of $200 million, which is the face value of the convertible debentures, by a charge to retained earnings.

During the year ended January 31, 2003, the Company paid $200 million to the holders of the 7% equity subordinated debentures, which matured on April 1, 2002. Of the total $200 million, $4 million was purchased in February 2002 pursuant to a normal course issuer bid. The Company had exercised its option to pay the full conversion value in cash in lieu of delivering common shares.

The net charges to retained earnings are as follows:

Years ended January 31 (thousands of dollars)	2004	2003
Dividends accrued	15,000	17,250
Convertible debenture accretion	2,857	3,319
Income taxes deductible on dividends	(5,625)	(6,727)
Net charge to retained earnings	12,232	13,842
Dividends paid	15,000	22,065

Note 11. Capital Stock

The authorized classes of shares of the Company consist of unlimited numbers of preferred shares and common shares, all without nominal or par value.

There are no outstanding preferred shares. The changes in common shares issued and outstanding during the years ended January 31, 2004 and January 31, 2003 are as follows:

	Number of Shares	Thousands of Dollars
Issued and outstanding at January 31, 2002	70,050,500	1,418,995
Issued:		
Under dividend reinvestment plan	111,016	1,068
Under stock option plans	2,100	27
Purchased for cash and cancelled	(892,900)	(8,258)
Excess of carrying value of shares purchased over purchase price transferred to contributed surplus	–	(9,825)
Issued and outstanding at January 31, 2003	69,270,716	1,402,007
Issued:		
Under dividend reinvestment plan	53,946	556
Issued and outstanding at January 31, 2004	69,324,662	1,402,563

During the year ended January 31, 2003, the Company purchased 892,900 of its common shares at an aggregate cost of $8.3 million, under a normal course issuer bid. All of these shares were cancelled and the excess of the carrying value over the purchase price, amounting to $9.8 million, was transferred to contributed surplus. Also, upon the purchase and maturity of the 7% equity subordinated debentures, the excess of carrying value over the purchase price of $2.0 million was transferred to contributed surplus. Refer to note 10 for details of the 7% equity subordinated debentures.

In December 2003, the Company announced a normal course issuer bid, under which the Company proposed to purchase, if considered advisable, up to 3,460,000 of its outstanding common shares during the 12 months ending December 19, 2004.

Note 12. Stock-Based Compensation Plans

The Company has five active stock-based compensation plans: two stock option plans, a share ownership plan, a share appreciation rights agreement and a phantom stock plan. The Company also has an inactive stock ownership plan, known as the senior executive share purchase plan.

a) Stock option plans

Under these plans, outstanding options to purchase common shares are at exercise prices equal to the fair market value per share on the dates on which the options were granted. A percentage of the options become exercisable each year and any unexercised options expire at the latest on the tenth anniversary of the date of grant. At January 31, 2004, 7,289,938 common shares are reserved for issuance under these plans.

For the year ended January 31, 2003, the Company opted to use settlement accounting to account for its stock option plans, in accordance with the CICA Handbook Section 3870. No compensation cost was recorded on stock option grants. Transactions under these plans were reflected in the financial statements only upon exercise of the options, at the exercise price. Consideration paid by employees on the exercise of stock options is recorded as share capital.

The CICA has amended Handbook Section 3870 to require the use of the fair value-based method to account for stock options, commencing with fiscal years beginning on or after January 1, 2004. Under the fair value-based method, compensation cost is measured at fair value at the date of the grant and is expensed over the vesting period. In accordance with the permitted transitional options, the Company has prospectively applied the fair value-based method to all employee stock options granted on or after February 1, 2003. Accordingly, options granted prior to that date continue to be accounted for using the settlement accounting method, and the results for the year ended January 31, 2003 have not been restated. The prospective application of the fair value-based method decreased net earnings by $0.4 million, and decreased basic earnings per share by $0.01. There was no impact on diluted earnings per share.

On a pro-forma basis, if the Company had used the fair value-based method of accounting for the stock options granted from February 1, 2002 to January 31, 2003, the Company's net earnings at January 31, 2004 and 2003 would have been $68 million and $111 million, respectively. The basic and diluted earnings per share would have been $0.81 for the year ended January 31, 2004. The basic and diluted earnings per share would have been $1.39 and $1.33, respectively, for the year ended January 31, 2003.

The fair value of each option grant was estimated on the date of grant using an option pricing model with the following weighted average assumptions for options granted in the fiscal years ended January 31, 2004 and 2003:

	Assumptions	
Years ended January 31	2004	2003
Expected dividends	$ 0.36	$ 0.36
Expected volatility	34%	30%
Risk-free interest rate	5.02%	5.54%
Expected life	10 years	10 years

The changes in outstanding stock options for the years ended January 31, 2004, and January 31, 2003, are as follows:

	2004		2003	
Years ended January 31	Number of Options	Weighted Average Price	Number of Options	Weighted Average Price
Outstanding options at beginning of year	5,246,212	$ 18.76	4,789,587	$ 20.50
Granted	739,750	8.32	919,900	12.42
Exercised	–	–	(2,100)	12.70
Cancelled or expired	(926,619)	22.72	(461,175)	23.89
Outstanding options at end of year	5,059,343	$ 16.51	5,246,212	$ 18.76
Reserved for future grant at end of year	2,230,595		2,043,726	
Exercisable	3,034,443	$ 18.99	2,849,312	$ 21.62

The options outstanding at January 31, 2004 range in exercise price from $7.57 to $34.90. Of the exercisable options, 90,675 had an issue price lower than the closing price of $12.82 at January 31, 2004, and consequently were "in the money" as of that date.

The table below summarizes the distribution of these options within meaningful ranges and the remaining contractual life.

	Options Outstanding			Options Exercisable	
Range of Exercise Prices	Number of Options Outstanding	Weighted Average Remaining Contractual Life in Years	Weighted Average Exercise Price	Number of Options Exercisable	Weighted Average Exercise Price
$ 7.57 to $ 10.00	959,000	9.0	$ 8.40	79,375	$ 8.81
$ 10.01 to $ 15.00	607,975	8.0	13.93	168,050	14.26
$ 15.01 to $ 20.00	2,709,218	5.8	16.67	2,113,368	16.55
$ 20.01 to $ 25.00	190,950	2.3	20.84	81,450	20.84
$ 25.01 to $ 30.00	277,500	2.6	27.74	277,500	27.74
$ 30.01 to $ 34.90	314,700	3.2	32.34	314,700	32.34
$ 7.57 to $ 34.90	5,059,343	6.2	$ 16.51	3,034,443	$ 18.99

Details of common shares issued under the stock option plans during the years ended January 31, 2004 and January 31, 2003 are shown in note 11.

b) Employee share ownership plan

Under this plan, the Company contributes $1 for each $6 contributed by employees to acquire common shares. If earnings per share increase over prescribed targets, the Company contribution may increase to a maximum of $1 for each $1 contributed. Employee and Company contributions are used to purchase common shares on the open market. The Company contribution is included as an expense in the Consolidated Statements of Earnings and amounted to $598,600 in the year ended January 31, 2004 and $572,000 in the year ended January 31, 2003.

c) Senior executive share purchase plan

Under this plan, certain employees were eligible to apply for a loan to purchase common shares at market value provided that the aggregate amount of all loans outstanding under the plan did not exceed that employee's current annual salary. Loan offers under this plan have been suspended since December 1998. Loans are repayable in monthly installments over a maximum term of 10 years and are included in secured receivables in the Consolidated Balance Sheets (see note 4). The Company pays a bonus in respect of each loan two years after the granting thereof, to be applied to the repayment of the loan. The bonus is an amount which, after adjusting for income taxes in respect of the bonus, is equal to the greater of (1) 10% of the original amount of the loan and (2) the excess, if any, of the original principal amount of the loan over the market value on the bonus date of the shares purchased with the proceeds of the loan. For the years ended January 31, 2004 and January 31, 2003, no bonuses were paid or accrued under this plan, resulting in no expenses being included in the Consolidated Statements of Earnings.

d) Share appreciation rights agreement

Under this agreement, the Governor of the Board was granted 62,500 units at an issue price of $28.80 per unit. Of these units, 25% are currently exercisable, 25% are exercisable in year 2004 and the remainder on the retirement of the Governor.

Amounts payable are based upon the excess of the market value of the Company's common shares at the exercise date over the issue price of $28.80. As of January 31, 2004, there is no liability under this agreement, since the market price of the Company's common shares is below $28.80.

e) Phantom stock plan

Under this plan, certain directors of the Company receive their annual retainers in the form of units in the plan, and the Company records a liability. The number of units issued is based upon the market value of the Company's common shares at each allocation date during the year. After retirement, these directors receive a cash payment equal to the market value of their accumulated phantom stock units. The number of units issued each year, multiplied by the market value of common shares at the Company's year-end, is recorded as an expense by the Company. As a result of the fluctuation in market value, the amounts included in the Consolidated Statements of Earnings were an expense of $664,214 in the year ended January 31, 2004 and a credit of $34,000 in the year ended January 31, 2003.

Note 13. Financial Instruments

a) Fair values of financial instruments

The Company has estimated the fair values of its financial instruments as of January 31, 2004 and January 31, 2003, using quoted market values, where available, and other relevant information. These estimates are not necessarily indicative of the amounts the Company might pay or receive in actual market transactions and do not include other transaction costs and income taxes.

	2004		2003	
January 31 (thousands of dollars)	Book Value	Fair Value	Book Value	Fair Value
Financial assets				
Portfolio investments	39,140	39,878	37,821	38,221
Financial liabilities				
Fixed-rate long-term debt	(508,543)	(511,943)	(647,413)	(629,004)
Off-balance sheet financial instruments				
Interest rate swaps in a net payable position	–	–	–	(2,015)
Forward foreign exchange contracts	–	(207)	–	(139)

The portfolio investments consist of both current and long-term marketable securities. The portfolio investments that are classified as current are included with prepaid expenses and other current assets in the Consolidated Balance Sheets.

The above table does not include cash, short-term deposits, credit card receivables, other accounts receivable, short-term borrowings, trade accounts payable, other accounts payable or income taxes payable because, due to the immediate or short-term maturity of these financial instruments, their book values approximate fair values.

The fair values shown in the above table, which are estimated as at January 31, 2004 and January 31, 2003, change daily as they approach maturity and as interest and foreign exchange rates increase or decrease.

These fair values are estimated as follows:

- Portfolio investments – based upon quoted market prices
- Fixed-rate long-term debt – based upon discounted future cash flows using discount rates that reflect current market conditions for instruments having similar terms and conditions
- Interest rate swaps in a net payable or receivable position – based upon the estimated net cost of terminating the agreements
- Forward foreign exchange contracts – based upon the estimated net cost of terminating the agreements.

b) Off-balance sheet financial instruments

The Company had in place a number of interest rate swap agreements at 5.8% on notional principal amounts totalling $75 million of floating rate debt, which expired during the fiscal year ended January 31, 2004. Under these agreements, the Company agreed with a counterparty to exchange, at specified intervals and for a specified period, its floating interest for fixed interest calculated on an agreed upon notional principal amount. As at January 31, 2004 the Company did not have any other interest rate swap agreements in place.

The following table indicates the average interest rates on interest rate swaps while they were in effect:

Years ended January 31	2004	2003
Pay-fixed swaps		
Average pay rate	5.78%	5.80%
Average receive rate	3.16%	2.58%

In addition to interest rate agreements, the Company enters into forward foreign exchange contracts to lock in prices in Canadian dollars for future purchases of merchandise from foreign suppliers. At January 31, 2004, there were US$46 million of outstanding forward foreign exchange contracts. The settlement dates of these contracts range from February 2004 to April 2004. At January 31, 2003, US$16 million of forward foreign exchange contracts were outstanding.

The Company believes that its exposure to credit and market risks for these financial instruments is negligible. All of these agreements have been made with Canadian chartered banks.

Note 14. Net Change in Operating Working Capital

The net change in operating working capital appearing in the operating activities section of the Consolidated Statements of Cash Flows comprises the following:

Years ended January 31 (thousands of dollars)	2004	2003
Decrease (increase) in:		
Cash in stores	(725)	84
Credit card receivables	22,346	(62,466)
Other accounts receivable	52,601	(43,918)
Merchandise inventories	66,016	(62,055)
Prepaid expenses and other current assets	2,400	(5,298)
Increase (decrease) in:		
Trade accounts payable	(21,018)	44,560
Other accounts payable and accrued liabilities	(32,201)	(34,545)
	89,419	(163,638)

Note 15. Leases

a) As lessee

The Company conducts a substantial part of its operations from leased stores in shopping centres. All shopping centre leases have been accounted for as operating leases.

Rental expenses related to operating leases charged to earnings in the years ended January 31, 2004 and January 31, 2003, were $273,259,000 and $243,100,000, respectively.

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

Years ending January 31 (thousands of dollars)	Operating Leases
2005	247,908
2006	241,566
2007	227,955
2008	216,524
2009	204,869
Subsequent periods	1,338,396
	2,477,218

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

b) As lessor

Fixed assets in the Consolidated Balance Sheets include an office tower with a cost of $22,100,000 at January 31, 2004 and January 31, 2003, and related accumulated amortization of $11,679,000 and $11,215,000, respectively. Revenue for the years ended January 31, 2004 and January 31, 2003, include third party rental revenue arising from this property of $4,652,000 and $4,568,000, respectively.

Note 16. Amortization

Years ended January 31 (thousands of dollars)	2004	2003
Deducted in arriving at earnings before interest expense and income taxes:		
Fixed assets	163,353	162,271
Systems development costs	25,720	19,838
Other	2,671	3,012
	191,744	185,121
Included in interest expense:		
Debt discount and expense	1,814	2,035
	193,558	187,156

Note 17. Interest Expense

Years ended January 31 (thousands of dollars)	2004	2003
Interest expense on long-term debt	43,143	53,100
Interest expense on short-term debt	14,625	4,768
Interest income	(14,194)	(11,688)
	43,574	46,180
Less amounts capitalized	(912)	(752)
	42,662	45,428

Interest paid in cash amounted to $62,391,000 and $60,516,000 in the years ended January 31, 2004 and January 31, 2003, respectively. Cash interest received was $9,661,000 and $8,916,000 in the years ended January 31, 2004 and 2003, respectively.

Note 18. Earnings per Share

Basic earnings per share is determined after deducting dividends paid and accrued, net of income taxes, and accretion of both the 7.5% convertible unsecured subordinated debentures and the 7% equity subordinated debentures (up to their maturity date of April 1, 2002). Earnings per share are based on the weighted average number of common shares outstanding during the year.

Diluted earnings per share is calculated using the treasury stock method, based on the weighted average number of common shares outstanding as recalculated under the assumption that outstanding stock options are exercised or the convertible debentures are converted, using the if-converted method.

Diluted earnings per share is calculated only for those stock options, both vested and unvested, that have option prices below the average market price in the reporting period. The potential common shares that can arise from the conversion of the 7.5% convertible unsecured subordinated debentures are also included in the calculation. The number of common shares potentially converted on the 7% equity subordinated debentures is included in the calculation of diluted earnings per share for January 31, 2003, only up to the date they were outstanding.

The following table reconciles the numerators and the denominators of the basic and diluted earnings per share calculation.

January 31	2004	2003
Numerator for basic earnings per share	56,997	97,619
Convertible debenture dividends and accretion	–	13,842
Numerator for diluted earnings per share (thousands of dollars)	56,997	111,461
Weighted average common shares	69,295,364	69,663,862
Effect of dilutive options outstanding	–	2,401
Effect of convertible debentures	–	13,701,520
Denominator for diluted earnings per share	69,295,364	83,367,783
Diluted earnings per share	$ 0.82	$ 1.34

The computation of diluted earnings per share for the year ended January 31, 2004 does not include stock options and convertible debentures because doing so would have been anti-dilutive.

Note 19. Segmented Information

The Company has three reportable operating segments: the Bay, Zellers and Financial Services. The Bay operates traditional department stores and Zellers operates mass merchandise stores. The Company's Financial Services group finances credit card receivables resulting from sales charged on the Hudson's Bay Company credit card at the Bay and Zellers and provides credit card insurance. Revenues and profits of Financial Services are included in the results of the Bay and Zellers.

Segmented information as at and for the years ended January 31, 2004 and January 31, 2003 is as follows:

						2004
(thousands of dollars)	The Bay	Zellers	Financial Services	All Other	Eliminations	Total
Earnings						
Sales and revenue	2,689,478	4,624,692	331,903	85,881	(331,903)	7,400,051
EBIT [1]	78,226	120,296	159,052	(37,388)	(159,052)	161,134
Amortization	73,041	83,363	2,169	37,154	(2,169)	193,558
Capital expenditures	55,629	43,580	–	15,621	–	114,830
Net assets						
Credit card receivables	301,527	237,207	538,734		(538,734)	538,734
Inventories	573,464	887,098		24,526		1,485,088
Other current assets [2]	28,008	56,457	130	30,534		115,129
Fixed assets	444,187	526,106	1,439	117,602		1,089,334
Goodwill		152,294				152,294
Other assets, net [3]	226,787	47,190	7,639	171,541		453,157
	1,573,973	1,906,352	547,942	344,203	(538,734)	3,833,736
Current liabilities [4]	(330,331)	(456,885)	(9,892)	(128,993)		(926,101)
Net assets	1,243,642	1,449,467	538,050	215,210	(538,734)	2,907,635

[1] *Earnings (loss) before interest expense and income taxes.*
[2] *Excluding short-term deposits and current portion of future income taxes.*
[3] *Excluding portfolio investments.*
[4] *Excluding short-term borrowings and long-term debt due within one year.*

						2003
(thousands of dollars)	The Bay	Zellers	Financial Services	All Other	Eliminations	Total
Earnings						
Sales and revenue	2,648,339	4,656,274	321,619	79,200	(321,619)	7,383,813
EBIT[1]	104,931	120,401	164,938	(26,022)	(164,938)	199,310
Amortization	71,816	79,711	2,112	35,629	(2,112)	187,156
Capital expenditures	65,042	40,564	47	27,494	(47)	133,100
Net assets						
Credit card receivables	294,898	264,253	559,151		(559,151)	559,151
Inventories	544,529	982,680		23,895		1,551,104
Other current assets[2]	29,063	95,810	3,975	69,422		198,270
Fixed assets	473,735	560,997	1,662	168,939		1,205,333
Goodwill		152,294				152,294
Other assets, net[3]	225,740	39,202	8,179	181,307		454,428
	1,567,965	2,095,236	572,967	443,563	(559,151)	4,120,580
Current liabilities[4]	(299,304)	(528,759)	(10,069)	(139,835)		(977,967)
Net assets	1,268,661	1,566,477	562,898	303,728	(559,151)	3,142,613

[1] *Earnings (loss) before interest expense and income taxes.*
[2] *Excluding short-term deposits and current portion of future income taxes.*
[3] *Excluding portfolio investments.*
[4] *Excluding short-term borrowings and long-term debt due within one year.*

Note 20. Guarantees

Effective February 1, 2003, the Company adopted the new CICA Accounting Guideline 14, Disclosure of Guarantees. This guideline requires disclosure of the maximum potential future payments under certain guarantees, regardless of the likelihood of ever being required to make a payment under the guarantee.

As part of normal operations, the Company regularly reviews its real estate portfolio and store locations. Based on the reviews conducted in prior years, the Company has closed certain store premises that it deemed to be non-strategic. Where these premises were leased, the Company assigned its leases to other retail operators, but remained obligated to the landlord on those leases as the original tenant thereunder despite the assignment. If the assignee were to default on the lease agreement, the Company would remain obligated to the landlord for payment of the lease. The terms of these assigned leases can extend up to the year 2063. As of January 31, 2004, these leases have future minimum lease payments of $44 million in addition to other lease-related expenses, such as property taxes and common area maintenance. The Company's obligation would be offset by payments from existing or future assignees and their obligations to the Company to comply with the assigned leases. Potential liabilities related to these guarantees may be subject to certain defences by the Company. Historically, the Company has not made any significant payments with respect to these lease obligations, and believes that the risk of significant loss is low.

The Company has entered into an operating lease agreement, which requires that the Company guarantee the recovery by the lessor of the book value of the leased equipment at the end of the lease term. The minimum lease term is one year, and can be extended at the Company's option. As of January 31, 2004, the total maximum future payments under this guarantee totals $21 million, which represents the guaranteed portion of the book value of the equipment at this date. The Company's obligation decreases over time, and is partially offset by guarantees made by manufacturers to repurchase the leased equipment at an amount that approximates book value. Historically, the Company has not made any significant payments with respect to these lease obligations, and believes that the risk of significant loss is low.

In the normal course of business, the Company has entered into agreements, pursuant to which the Company provides indemnification commitments to counterparties. These indemnification commitments require the Company to compensate counterparties for costs incurred as a result of breaches of representations or warranties, changes in laws or regulations, or as a result of litigation claims that may be suffered by the counterparty as a result of the transaction. The Company also has director and officer indemnification agreements. The terms of the indemnification commitments will vary based on the contract. Given the nature of these indemnification commitments, the Company is unable to estimate the maximum potential liability. To the best of Management's knowledge, the Company has not made any significant payments with respect to these indemnification commitments.

Note 21. Contingencies

As of January 31, 2004, there are a number of claims against the Company in varying amounts and for which provisions have been made in these consolidated financial statements, as appropriate. It is not possible to determine the amounts that may ultimately be assessed against the Company with respect to these claims but Management believes that any such amounts would not have a material impact on the business or financial position of the Company.

In addition to these claims against the Company, a statement of claim dated August 6, 2002, named the Company, Royal Trust Corporation and Investors Group Trust Company Limited as defendants in a proceeding commenced in the Superior Court of Justice (Ontario) under the Class Proceeding Act by an active Hudson's Bay Company employee and a retired Hudson's Bay Company employee in relation to surplus assets in the Dumai Pension Plan. This matter has not yet been certified by the Court as a class proceeding nor has documentary production been made by any of the parties or examinations for discovery commenced. Accordingly, it is premature to comment on the merits of the claims. The Company is vigorously defending this claim.

On October 2, 2003, the Company, and four other companies, were served with a motion seeking authorization from the Superior Court to institute a class action in relation to the mailing dates of the credit card statements. This motion alleges that certain provisions of the Quebec Consumer Protection Act relating to grace periods were not respected. This matter has not yet been certified as a class proceeding. Accordingly, it is premature to comment on the merits of the claims. The Company is vigorously defending this claim.

five-year financial summary

(For the purposes of comparability, certain figures have been restated or reclassified)

Years ended January 31	2004	2003	2002	2001	2000
Number of weeks	53	52	52	52	52
Operations (millions of dollars)					
Total sales and revenue	7,400	7,384	7,446	7,400	7,194
The Bay	2,689	2,648	2,667	2,703	2,521
Zellers	4,625	4,656	4,693	4,607	4,569
EBIT for the Company	161	199	186	300	271
EBIT – the Bay	78	105	66	162	128
EBIT – Zellers	120	120	134	157	150
EBITDA for the Company	355	386	382	487	454
Interest expense	(43)	(45)	(54)	(62)	(79)
Income taxes	(49)	(43)	(59)	(113)	(96)
Net earnings	69	111	73	125	96
Cash flow from operating activities	392	183	189	467	450
Capital expenditures	(115)	(133)	(144)	(241)	(156)
Financial position (millions of dollars)					
Credit card receivables	539	559	487	500	484
Inventories	1,485	1,551	1,489	1,575	1,599
Total assets	4,111	4,276	4,534	4,376	4,274
Working capital	1,228	1,344	1,203	1,171	1,319
Net debt	321	602	457	694	794
Shareholders' equity	2,431	2,395	2,529	2,303	2,266
Financial ratios					
Return on average shareholders' equity (%)	2.6	4.5	2.8	5.5	4.3
Interest coverage	3.8	4.4	3.5	4.9	3.4
Debt:equity	0.1:1	0.3:1	0.2:1	0.3:1	0.4:1
Pre-tax margin (%)	1.6	2.1	1.8	3.2	2.6
Share data					
Common shares outstanding (millions):					
Year-end	69.3	69.3	70.1	70.6	74.0
Weighted average	69.3	69.7	70.2	71.9	74.6
Range in common share price (high–low)	13–8	16–6	20–13	19–13	24–14
Price:earnings ratio (year-end)	15.6	6.5	17.6	10.4	12.7
Price:book ratio (year-end)	0.4	0.3	0.5	0.6	0.5
Per common share (dollars)					
Net earnings					
Basic	0.82	1.40	0.85	1.60	1.17
Diluted	0.82	1.34	0.84	1.46	1.11
Dividends	0.36	0.36	0.36	0.36	0.36
Statistics					
Gross leasable area (thousands of square feet)					
The Bay	18,737	18,427	18,000	17,533	17,063
Zellers	28,643	28,642	28,996	29,165	28,287
Comparable store sales increase (decrease) (%)					
The Bay	(2.3)	(3.9)	(4.8)	5.6	4.7
Zellers	(2.6)	(0.5)	1.1	0.4	2.3
Sales per selling square foot					
The Bay	169	173	180	188	177
Zellers	198	201	201	199	197
Average number of associates	69,659	71,445	71,730	71,700	69,700
Canadian economy (% change)					
Department store sales (DSS)	3.4	6.0	7.9	2.0	6.3
Department store type merchandise sales (DSTM)	3.9	6.0	4.1	5.1	5.6

corporate social responsibility

Hudson's Bay Company is a modern retailer built to compete in the 21st century, but we're also a Company that is proud of our long heritage and our ongoing responsibilities to this great nation. We are more than a retailer; we are part of the fabric of Canada. The responsibilities we feel toward Canadian society are part of our corporate DNA. It is in this spirit and with pride that we present this, the second annual Hbc Corporate Social Responsibility report.

The foundation of this 334-year-old Company rests on three core principles. First, for more than five centuries we have taken on all those who have entered our market – no matter what the origin or form of competition – and our customers and shareholders have benefited from our competitive spirit. Second, we have and always will contribute to the communities in which we live and work. Third, we recognize that citizenship means living up to responsibilities beyond the return of a profit. Just as our Annual Report reviewed our competitive and financial results, this report deals with the second and third principles.

My career with Hbc began in a northern post close to 40 years ago and my role in the community extended well beyond that of merchant. I was also postmaster, chief electoral officer and provider of basic medical treatment. To work in this great Company is to realize that you have a responsibility beyond merely returning profits to shareholders.

We recognize that we owe more to the people of this country than simply providing quality merchandise and great value. We owe all Canadians our commitment to protect, promote and support the health and vitality of our nation, our customers, our associates and the communities in which we live and work. To that end, we will continue to work closely with organizations such as the United Nations Global Compact and Canadian Business for Social Responsibility to achieve our goals. We applaud the ongoing efforts of both organizations to create greater awareness of the importance of corporate social responsibility, both here at home and around the world.

For 334 years, we have been part of this country's identity, and while we may have shifted our business model to remain competitive, we are still guided by our relationship with the community and engaged as citizens. We have always been, and will continue to be, an agent for positive social change.

Sincerely,

(Signed)

George Heller
President and Chief Executive Officer
Hudson's Bay Company

corporate social responsibility

This second annual Corporate Social Responsibility report reviews year-over-year progress and reaffirms the Company's commitment to the ideals of corporate responsibility. The report covers four critical areas: ethical sourcing, whereby we ensure products are supplied by vendors that respect fundamental labour and human rights; energy conservation; the health and well-being of our 70,000 associates; and support for communities across Canada in which Hbc operates.

Environmental Responsibility

Hbc is committed to limiting the impact of our operations on the environment. This commitment is realized through a concerted effort to reduce our use of non-renewable natural resources. The Company has established a comprehensive national energy strategy that focuses on reducing energy consumption and emissions from our over 500 stores and one of Canada's largest private fleet of vehicles.

The actions employed in pursuit of our strategic goals in our stores include retrofitting lighting systems, implementing sensitive energy-demand controls and the installation of high-efficiency motors in heating, ventilation and air-conditioning plants, which began in 2000 and continue. To date, retrofits and renovations have been completed in more than 300 stores, representing some 65 per cent of the Company's total floor area. We expect to have all the remaining stores retrofitted within three years. We are also going beyond building-code standards in construction of new stores, with each designed to consume at least 25 per cent less energy than required by law.

Hbc has reduced electricity use in its stores by more than 100 gigawatts and natural gas consumption by almost 10 million cubic metres. Combined savings of this size represent reductions in annual greenhouse-gas emissions of approximately 50 megatonnes – the equivalent of removing 10,000 cars from Canada's roads each year.

Corporate Emissions by Source

		2003	2002	2001	2000
Natural Gas	TCO_2e	62,258	56,569	67,133	74,855
Propane	TCO_2e	1,552	2,544	2,049	2,024
Electricity	TCO_2e	243,912	269,841	279,457	295,717
Steam	TCO_2e	2,044	1,223	1,504	3,688
Oil	TCO_2e	957	905	802	936
Transport	TCO_2e	24,376	25,231	24,311	25,431
Total Actual Emissions	**TCO_2e**	**335,099**	**356,313**	**375,256**	**402,651**
Emissions Intensity	TCO_2e/1,000 sq.ft.	6.47801	7.06402	7.15219	7.64035

TCO_2e = tonnes of CO_2 equivalent.

The Company's action plan to reduce greenhouse-gas emissions in our fleet includes the requirement that all vehicles meet or exceed new environmental protection standards for engines; eliminating the movement of empty trailers; using rail transportation whenever possible; and using technologies such as the Global Positioning System (GPS) to monitor vehicles everywhere in North America to better control speeding and idling.

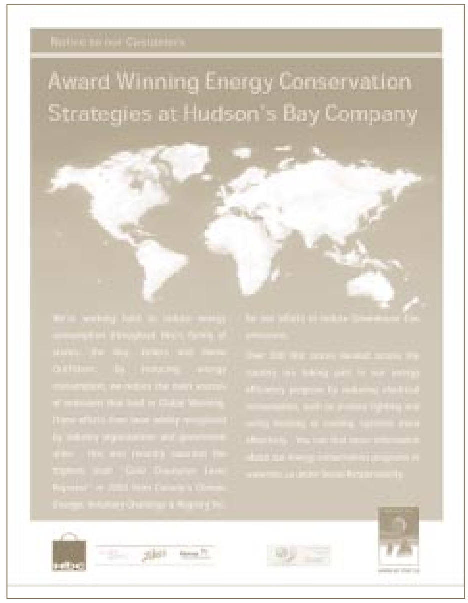
"It is the recognition of the need for social harmony and understanding that puts the Hudson's Bay Company in the forefront of good corporate citizenship."

Toni Silberman, Chair, *League for Human Rights, B'nai Brith Canada (Ontario Region)* corporate social responsibility

The latest component in Hbc's national energy strategy is an Energy Management Awareness Program for our 70,000 associates and customers at the Bay, Zellers and Home Outfitters. We hope to educate all our stakeholders that doing the little things to conserve energy can add up to big improvements.

Through brochures our associates are reminded to reduce lighting by 50 per cent during stocking and cleaning times and to turn off lights at night when stores are empty. Thermostats are also important. Each degree too high in winter or too low in summer represents $1,000 a year in wasted electricity. As with any program, awareness is the key to success and we're proud of the response from every associate to safely reduce everyday energy consumption.

We're also proud of the recognition we have received for our environmental work. Among the recent awards presented to Hbc are the Gold Champion Level Reporter Award and Leadership Award for the Commercial Sector Category from Canada's Climate Change Voluntary Challenge and Registry Inc.; and BC Hydro's Power Smart Award of Excellence.

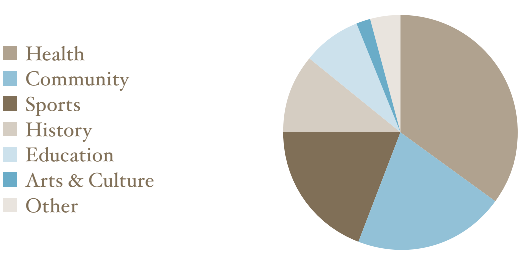


Community Investment

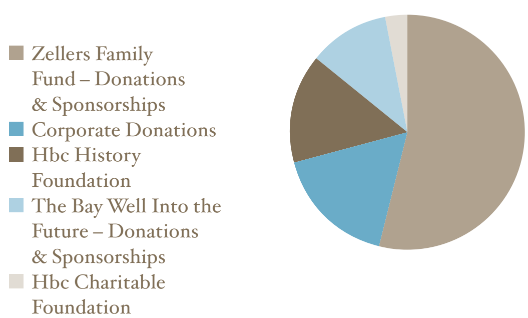
As part of the fabric of Canada, Hbc is committed to making a difference in the lives of Canadian families – from health and wellness to sport and education. In 2004, we will officially launch the Hbc Foundation, which consolidates all our charitable funds into one, reducing administrative costs and putting even more money where it's needed most.

The charts below indicate the areas of giving in 2003 and where the charitable funding originated.

Areas of Giving for 2003



Distribution of Charitable Funds



It is the Company's expectation and requirement that all associates (which includes all those employed by or under contract for the Hudson's Bay Company or any of its divisions, subsidiaries or affiliates) will conduct themselves in an honest, ethical manner in all of their dealings with the Company and when acting as a representative of the Company.

*Excerpt from **Hbc's Code of Business Conduct,** which all managers are required to sign annually.*

A Commitment to Health

The largest portion of our giving, some 35 per cent, goes to health initiatives. For example, the 18th annual Zellers Family Walk for Cystic Fibrosis raised more than $1.7 million. Zellers has contributed more than $25 million since the Walk started. This money supports research, which has helped to increase the life expectancy for people with CF from childhood to their mid 30s.

In support of the Canadian Cancer Society, Bay associates across Canada participated in a 12-hour overnight relay called "Relay for Life". This event took place in 139 communities across Canada and raised more than $16 million for cancer research, information, support programs and advocacy.

During the 2003 holiday season, Hbc organized two special fund-raising programs. The Zellers charity gift box program raised almost $1 million for Canadian charities through the sale of $1 holiday gift boxes in all its stores. And sales of the Bay's charity bear raised $300,000 in support of cancer wellness programs, including the Canadian Cancer Society, Wellspring, Look Good Feel Better and the Childhood Cancer Foundation – Candlelighters Canada.

The fifth annual Zellers charity golf tournament raised more than $325,000 for local and national Canadian charities in the areas of health, wellness and education. And, for the ninth year, the Bay was a title sponsor of the 2003 Fashion Cares event, helping to raise $800,000 for ACT (AIDS Committee of Toronto).

Helping Neighbours in Canada and Around the World

During a six-week campaign, customers from coast-to-coast donated their Hbc Rewards Points to the Canadian Red Cross B.C. Western Forest Fire Relief Fund. More than $100,000 was donated to help families whose lives were affected by the ravaging fires.

We donated in excess of $200,000 in support of women's shelters across Canada. These funds have helped provide women with the means to build new lives for themselves and their children.

The Bay and Zellers pharmacies across Canada continue to collect eyeglasses that are refurbished and donated to needy people around the world. Since 1999, our stores have helped more than 20,000 people to receive much-needed glasses with total donations at more than $5 million.

Education, Sport and Fitness

In 2003, Hbc's History Foundation supported the promotion and preservation of our Canadian heritage with a $1.8 million investment in the Provincial Archives of Manitoba, the Manitoba Museum and Canada's National History Society.

Last year was the fourth of a five-year, $1 million commitment to Ryerson University's School of Retail Management. This commitment supports the development of future Canadian retail leaders.

Hbc supports amateur sport in Canada at both the local and national levels. We call it the "from the playground to platform" program. In 2003, Hbc was honoured by the Retail Council of Canada with an Excellence in Retailing Award for Community Outreach for our sponsorship of Team Canada in the 2002 Commonwealth Games. The third annual Hbc golf tournament raised approximately $320,000 for the Canadian team heading to the 2006 Commonwealth Games in Melbourne, Australia. And in celebration of the opening of the new Bay store in Victoria, B.C., Hbc gave the local community a $100,000 donation to the Pacific Sport Centre, an elite athlete training centre. We also recognize how sport instills self-esteem in youngsters and encourages fitness. That's why Zellers sponsors 320 hockey teams and 640 soccer teams with 15,000 kids aged 12 and under.

Our Associates

Fundamental to Hbc's culture of loyalty, trust and respect is our commitment to our associates. We believe every associate deserves to be treated with fairness and respect at all times. Hbc's Associate Charter of Rights and Responsibilities outlines our commitment to this philosophy.

The Charter of Rights and Responsibilities highlights the following values:

- Communication
- Career Opportunities and Succession Planning
- Performance Management
- Scheduling
- Health and Safety Programs and Policies
- Harassment Protection

The following programs and practices ensure the Company's commitment to these principles is realized.

Communication

We require associates and their managers to maintain open dialogue at all times through formal and informal communication mechanisms, such as an open door policy, yearly associate surveys, regular performance reviews and coaching, Company update meetings, Hbc.net, the Company's Intranet, and much more.

Opportunity

We encourage personal growth and development through educational reimbursements, e-learning, in-class workshops and customized learning in support of our strategic growth plans.

Performance

Our current focus and commitment extends to competitive benefits and performance-based compensation plans, talent management, succession planning and leadership development programs designed to attract and retain the best people in the industry. This approach creates an environment for associates to contribute to our business success and their personal development.

Scheduling

The Company has a scheduling policy that ensures a fair allocation of working hours available to all classifications of associates.

Health and Safety

Based on the principle that all accidents are preventable, Hbc is committed to providing a safe work environment. Through regular communications and active associate involvement through Health and Safety committees (consisting of both management and associates), we strive to create a safe and secure workplace for everyone.

Harassment Protection

Every Hbc associate has a right to freedom from harassment in the workplace by any agent of the Company or by another associate on any prohibited human rights grounds. These grounds include race, ancestry, place of origin, colour, ethnic origin, citizenship, creed, age, sex, marital status, family status, handicap or sexual orientation.

Ethical Sourcing

Hbc's progress in 2003 in the area of ethical sourcing of products is represented in three areas:

i) Pursuit of Hbc's internal ethical sourcing and procedures.
ii) Pursuit of a global system for retailers to enhance the efficiency and effectiveness of ethical sourcing activities.
iii) Education of the public on the commitment of Canadian retailers to the issue of ethical sourcing.

Hbc's Programs and Procedures

Full details of Hbc's Vendor Compliance and Monitoring program can be obtained on our website at www.hbc.ca. In brief, the program requires all vendors supplying Hbc with private brand merchandise to undergo an audit of their operational compliance with the Hbc Code of Vendor Conduct (CVC). The Hbc CVC is based on the International Labour Organisation (ILO) conventions and principles. The audits are conducted by third-party social compliance monitoring firms.

The chart below outlines the results of our Vendor Compliance and Monitoring program in 2003 compared to 2002.

Fiscal 2003 Vendor Compliance and Monitoring Program Results

	2003	2002
Vendors that supply private brands to Hbc[1]	875	998
Factories audited	535	581
Factories that did not pass the first audit	526 or 98%	517 or 89%
Audited factories compliant[2]	469 or 88%	494 or 85%
Factories Hbc chose not to do business with due to their unwillingness or inability to meet our standards[3]	66 or 12%	87 or 15%

[1] *On average vendors have three to four factories*
[2] *Includes factories that took corrective action and those that passed at first audit*
[3] *Includes zero-tolerance violations*

Hbc's Social Compliance and Monitoring program is managed within the Company's Global Sourcing operations. In 2003, the team engaged in an educational campaign with our merchant groups to ensure the importance of the program was understood and integrated into the operations that buy the products we sell in our stores. In addition, the Social Compliance team developed and distributed a "vendor starter kit" to support the execution of the program.

The kit provides details on what vendors must do to be a compliant Hbc supplier; it also reinforces with our vendors that compliance with Hbc's CVC is mandatory and a requirement prior to obtaining an Hbc vendor number. A special initiative was also launched with Hbc's top 100 vendors to ensure understanding and participation in the program.

International Action

In 2003, Hbc continued to be a catalyst among retailers from around the world in seeking a global system for retailers to share social compliance audit information while maintaining the proprietary nature of individual retailer's sourcing operations.

Working with retailers from around the world, Hbc has been instrumental in bridging the efforts of the National Retail Federation (NRF) in Washington, D.C., the Retail Council of Canada (RCC) in Toronto, Foreign Trade Association (FTA) in Brussels, International Association of Department Stores (IADS) in Paris, the Intercontinental Group of Department Stores (IGDS) in Zurich and the United Nations Global Compact in New York. We anticipate that an international agreement will be reached by the spring of 2004 that will dramatically enhance the effectiveness and efficiency of individual retailers in ensuring sourcing activities contribute to the improvement of compliance to human or labour rights in their supply chains.

THE GLOBAL COMPACT

Educating Canadians

Customers and members of government play an important role in the evolution of ethical sourcing. This is why Hbc has been active in the development of Canadian Retailers Advancing Responsible Trade (CRART). CRART is an initiative of the Retail Council of Canada and is led by the Honourable Barbara McDougall. The activities of CRART are focused on raising awareness of the efforts of retailers in the area of ethical sourcing, to provide a forum for the exploration of the issue and consideration of how stakeholders can work together to continually improve programs and activities.

Canadian Retailers Advancing Responsible Trade
www.retailcouncil.org/crart

> **"At the heart of these initiatives is the realization that we, as retailers, understand that through our order books, we can and must be a component in creating positive change. The choices we make have the potential to improve the working conditions of hundreds of thousands of people around the world – a far greater return than simply establishing good business practices."**
>
> ***George Heller,** Remarks to the United Nations Global Compact, New York City, June 2003*

board of directors

David W. Colcleugh
Corporate Director,
Mississauga, Ontario
Elected 2000 [2,3,4]

L. Yves Fortier
Governor,
Hudson's Bay Company
Chairman & Senior Partner,
Ogilvy Renault
Montreal, Quebec
Elected 1993 [1,2,3,4]

David A. Galloway
Corporate Director,
Toronto, Ontario
Elected 2003 [2,4]

Paul Gobeil
Vice Chairman of the Board,
Metro Inc.
Chairman of the Board,
Export Development Canada (EDC)
Montreal, Quebec
Elected 2003 [1]

Kerry L. Hawkins
President,
Cargill Limited
Winnipeg, Manitoba
Elected 1998 [2,4]

George J. Heller
President & CEO,
Hudson's Bay Company
Toronto, Ontario
Elected 1999 [3]

Barbara R. Hislop
President & CEO,
Genus Resource Management
Technologies, Inc.
Vancouver, British Columbia
Elected 1993 [5]

James B. Hume
President & CEO,
Kanesco Holdings Ltd.
Calgary, Alberta
Elected 2003 [1,5]

Donna Soble Kaufman
Lawyer & Corporate Director,
Toronto, Ontario
Elected 2000 [1,2]

Peter T. Kaursland
Corporate Director,
Oxfordshire, England
Elected 2002 [1]

Thomas A. Knowlton
Dean, Faculty of Business
Ryerson University
Toronto, Ontario
Elected 2003 [4]

Walter F. Loeb
President,
Loeb Associates Inc.
New York, New York
Elected 1998 [3,5*]

Peter W. Mills
Company Director &
Business Consultant,
Toronto, Ontario
Elected 1985 [1,2,3]

1 *Audit Committee*
2 *Corporate Governance Committee*
3 *Executive Committee*
4 *Human Resources Committee*
5 *Pension Committee*
* *Not standing for re-election*

For a full statement of Hbc's Corporate Governance Practices please see the Hbc Management Proxy Circular.

senior officers

L. Yves Fortier, C.C., Q.C.
Governor,
Hudson's Bay Company

George J. Heller
President & Chief Executive Officer,
Hudson's Bay Company

Michael S. Rousseau
Executive Vice-President &
Chief Financial Officer,
Hudson's Bay Company

Marc R. Chouinard
Executive Vice-President,
Hudson's Bay Company
President & Chief Operating Officer,
The Bay

Thomas Haig
Executive Vice-President,
Hudson's Bay Company
President & Chief Operating Officer,
Zellers Inc.

Peter A. Kenyon
Executive Vice-President,
Managed Services
Hudson's Bay Company

Deborah A. Edwards
Senior Vice-President,
Hbc Procurement
Hudson's Bay Company

Robert M. Kolida
Senior Vice-President,
Human Resources
Hudson's Bay Company

Donald C. Rogers
Senior Vice-President,
Real Estate & Development
Hudson's Bay Company

J. Gregory Armstrong
Vice-President,
Audit Services
Hudson's Bay Company

Harold J. Chmara
Vice-President,
Tax & Risk Management
Hudson's Bay Company

Gary B. Davenport
Vice-President &
Chief Information Officer,
Hudson's Bay Company

James A. Ingram
Vice-President, Secretary &
General Counsel,
Hudson's Bay Company

Mark C. Kinnin
Vice-President,
Hbc Global Sourcing
Hudson's Bay Company

Stephen F. Knight
Vice-President,
Credit & Loyalty Management
Hudson's Bay Company

Arthur N. Mitchell
Vice-President & Controller,
Hudson's Bay Company

Robert R. Moore
Vice-President,
Corporate Communications
Hudson's Bay Company

Gillian L. Platt
Vice-President,
Human Resources Planning
& Development
Hudson's Bay Company

Robert J. Shields
Vice-President,
Customer Relationship Management
Hudson's Bay Company

Michael J. Thomas
Vice-President,
Hbc Logistics
Hudson's Bay Company

Kenneth C. Wong
Treasurer,
Hudson's Bay Company

corporate information

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Bank of America, NA (Canada Branch)
CIT Business Credit Canada Inc.
HSBC Bank Canada

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Rob Moore
Vice-President,
Corporate Communications
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Stock Exchange Listings
Common shares are listed on the Toronto Stock Exchange under the trading symbol "HBC."

Transfer Agents and Registrar
Investors are encouraged to contact our Transfer Agent and Registrar, CIBC Mellon Trust Company, for information regarding their security holdings. They can be reached at:

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Toronto, Ontario M5C 2W9

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Email: inquiries@cibcmellon.com

Internet
Hudson's Bay Company provides up-to-date financial information to investors on the performance section at www.hbc.ca. Investors have access to news releases, financial reports, stock charts, audio webcasts and Hbc executive profiles.

Annual Meeting of Shareholders
The 335th Annual Meeting of Shareholders will be held at the Arcadian Court, 8th Floor, 401 Bay Street, Toronto, Ontario Friday, May 28th, 2004 at 1:00 p.m.

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www. hbc .ca

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