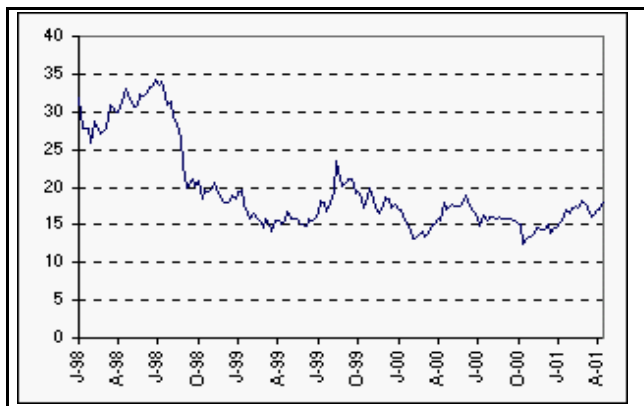


**THE COMPANY**

Having just celebrated its 330th anniversary, Hudson's Bay Company is the country's oldest corporation. Beginning as a fur trading business, it was not until the 20th century that Hudson's Bay turned to retailing. Hudson's Bay now runs Canada's largest retail-department store chain under the well-known banners of The Bay and Zellers. It operates 99 Bay stores, 300 Zellers stores and 28 Best Value stores across the country, as well as 105 Fields stores in Western Canada. Most recently, the company has begun to penetrate the big-box home decorating market with its three Home Outfitters mega-stores.

**FINANCIAL DATA**

	1998	1999	2000e
Earnings per Share (\$)	0.57	1.17	1.50
Price to Earnings (times)	29.8	14.5	11.3
Dividend (\$)	0.36	0.36	0.36
Dividend Yield (%)	2.12	2.12	2.12
Book Value (\$)	27.00	30.60	31.75
Price to Book Value (times)	0.63	0.56	0.54

**HISTORICAL SHARE PRICES**

**WHY ABC FUNDS BOUGHT HUDSON'S BAY**

The strong economy over the past year has been fuelled, in part by robust consumer spending and confidence. Unfortunately, this strength has not been reflected in the stock prices of Canadian retailers until recently. The current focus away from technology has begun to benefit the retailing sector.

Reflective of the current environment, Hudson's Bay hit an all-time low of \$12.50 in March 2000. Since that time it has rebounded to over \$17.00. In spite of this price recovery, Hudson's Bay is still an excellent value play, trading significantly below book value of \$30.60. Supporting its low valuation is a dividend yield of 2% and the company's improving balance sheet. With the help of strong cash flows, the company's debt has declined to \$852 million in fiscal 2000 from \$1.4 billion in fiscal 1999.

Both of Hudson's Bay key divisions, The Bay and Zellers, are in a battlefield full of intense competition. Led by President and CEO, George Heller, the company is implementing new strategies for its divisions. The Bay's major competitor, Sears has gained a strong foothold in the marketplace, especially with the demise of Eaton's last year. The Bay has also benefited from the Eaton's sell-off by purchasing nine Eaton's stores and switching to four new locations. Recognizing the needs of its customers, The Bay's approach has been to focus on customer service. It has begun converting its stores to a centralized checkout format, freeing up staff for customer service. By the end of summer 2000, 48 Bay stores should be converted to this new prototype.

Zellers has been competing for market dominance with Wal-Mart since Wal-Mart entered the Canadian market six years ago. Zellers has repositioned itself through its logo of, "Great brands, great prices". This innovative strategy is consistent with its numerous newly introduced private brands such as, Martha Stewart, Cherokee and its Truly brand. To promote its fresh image, it has upgraded its stores with enhancements such as wider aisles and brighter lighting. Zellers has built a competitive advantage through its use of private brands, and promoting itself as "mom's" store with "one stop shop" capability.

Hudson's Bay is not only attempting to improve its stance with its current banners, but has also begun building a niche in the home decorating market with its new Home Outfitters mega-store. This tactic is in line with the current trends of shoppers spending more on home decorating than on clothes. Hudson's Bay currently operates three of the big-box style stores with a 50 outlet objective by 2003.

While Hudson's Bay's stock price has been under severe price pressure in this difficult retailing environment, its strong fundamentals and aggressive strategies for The Bay and Zellers will assist in its stock price recovery. Though competition is fierce, HBC has taken the opportunity to enter the home decorating market which it believes will provide strong growth. Moreover, with no controlling shareholder and the potential for U.S. entry into the Canadian retail market, we believe that another potential catalyst for share price improvement is a corporate takeover.

## UPDATE

In the second quarter of 2000, Hudson's Bay Company, faced with a difficult fashion season due to bad weather, managed to report a 4.8% increase in revenues over the comparable quarter of 1999. Reported earnings per share were \$0.19 versus \$0.12, representing a 58% increase. This contributed to the best first half performance in six years. Showing significant improvement was The Bay division, while Zellers, albeit improving, continues to lose market share to Wal-Mart.

Clearly, the underlying strength behind Hudson's Bay is The Bay. While the demise of Eaton's has proven to be beneficial, its new store prototype with centralized checkouts and decreased discounting is key to The Bay's future. During the second quarter The Bay opened seven prototype stores and converted 50 floors in 33 stores to the new centralized concept. Another major aspect of its restructuring program is Hudson's Bay discount division, Zellers. Selling private label merchandise that is not available anywhere else, including Wal-mart, is part of Zellers' unique marketing strategy. In the quarter Zellers opened one store and renovated and expanded another 12 locations to its prototype model.

Not only is Hudson's Bay restructuring its two main retail divisions but it is also introducing many innovative business concepts. For example, in early November the company plans to launch a new e-commerce site, hbc.com that will carry up to 4,000- 5,000 items. In addition, Hudson's Bay continues to penetrate the home decorating market with the opening of three Home Outfitters stores in the quarter.

In light of its operational strategies and steady progress, Hudson's Bay remains extremely undervalued. It is presently trading at only 0.5 times its book value with a 2% dividend yield. The company has recognized its low market valuation and as a result has instituted a 3.5 million or 5% share buyback plan. To date Hudson's Bay has bought back 2.51 million shares. These purchases, at a huge discount to book value are anti-dilutive and will increase Hudson's Bay's \$31.02 book value. Hudson's Bay's overall corporate debt now stands at \$962 million, which is \$69 million less than last year.

In a nutshell we believe that Hudson's Bay's current management plan is progressing well in an extremely difficult and challenging retail market. With continued concrete signs of improvement we expect this very undervalued retailer's share price to come back into favour with investors.

ABC Funds  
May 2000

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Despite a slowing economic environment and fears of diminishing consumer confidence, Hudson's Bay recently surprised investors with better than expected earnings. Hudson's Bay reported third quarter 2000 earnings of \$0.24 versus \$0.16 in the same quarter last year. This improvement is largely attributed to The Bay division's increase in comparable store sales of 6.9% in third quarter relative to one year ago. Zellers however, continues to struggle with comparable store sales down 0.8%. We believe that Hudson's Bay will continue to improve at both its Bay and Zellers divisions. At some point investors will take notice of this extremely undervalued stock and we expect the share price will appreciate considerably at that time. In the meantime, the uncertain economy may create a great deal of price volatility and test investor's patience. We expect the company to continue to buy back stock as it trades at a deep discount to book value.

ABC Funds  
February 16, 2001

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We recently sold our position in Hudson's Bay Company between \$17.50 and \$18. While we still favour the company over the longer term, we have a number of short-term concerns. They include:

- The negative consumer wealth effect caused by a declining stock market.
- The impact of a softening economy on the merchandising sector.
- Increased competition with the introduction of Old Navy into Canada.
- The recent poor performance of its competitor, Sears Canada, could foreshadow Hudson's Bay's prospects.

Hence, we feel that this was a timely sale based on the current economic environment.

ABC Funds  
April 20, 2001