# Management's Discussion & Analysis and Consolidated Financial Statements



Our purpose is to enhance peoples' lives by offering them shopping choices that are more convenient, more affordable, more dependable or more lifestyle appropriate compared to any other retailer.



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**As of March 17, 2005** Unless otherwise stated, the financial data in this Management's Discussion & Analysis (MD&A) has been prepared in accordance with Canadian generally accepted accounting principles (GAAP) and is in Canadian dollars.

**Forward-Looking Statements** This MD&A contains forward-looking statements. These statements relate to, among other things, sales growth, expansion, capital expenditures and the Company's business strategy. Forward-looking statements are subject to uncertainties and risks. These include industry and economic conditions; changes in our relationship with our communities and suppliers; pricing pressure and other competitive factors; the availability and cost of merchandise, fuels and utilities; the results of our efforts to improve cost effectiveness; the rates of return on the Company's pension plan assets; changes in regulations; and the availability and terms of financing. Many of these risks are outlined in the Risk Management section of this MD&A. The Company's results and events may vary significantly from those included in, contemplated or implied by the forwardlooking statements in this MD&A.

Additional information on the Company, including our Summary Annual Report, Annual Information Form and Management Information Circular, can be found on SEDAR at www.sedar.com or on the Company's website at www.northwest.ca.

# Management's **Discussion & Analysis**

### **VISION AND CORE BUSINESSES**

**Strong Values, Solid Returns** The North West Company (NWC) is a leading retailer and distributor of everyday consumer products and services to remote communities in northern Canada and Alaska and to rural towns and urban neighbourhoods in western Canada.

The Company's core strengths start with our unique understanding and experience in remote location retailing, our knowledge in serving Aboriginal customers and their communities and our ability to leverage these strengths to serve customers within other attractive niche markets.

Our purpose is to enhance peoples' lives by offering them shopping choices that are more convenient, more affordable. more dependable or more lifestyle appropriate compared to any other retailer. In striving to fulfill this purpose, we aim to:

- · Continually enhance our strengths to maximize our core business's long-term profitability and enable related new growth opportunities;
- Actively support the communities in which we operate, contributing to their long-term development;
- Foster a spirit of enterprise and growth for our people, within a work environment characterized by respect, openness, encouragement, learning, innovation and reward for performance;
- Deliver stable top quartile total returns to our unitholders; and
- · Demonstrate integrity in all facets of our business.

The Company's stores have served northern Canada and Alaska, through predecessor companies, for more than 300 years.

The Largest Remote Retailer The North West Company is the largest remote market retailer in North America with operations across northern Canada and rural Alaska. NWC's stores sell a broad range of products and services with an emphasis on food. Our value offer is to be the best local shopping choice for everyday household and northern lifestyle needs.

The Company's stores have served northern Canada and Alaska, through predecessor companies, for more than 300 years. These stores operate in markets with populations from 500 to 7,000. A typical store is 7,500 square feet in size and offers food, family apparel, housewares, appliances, outdoor products and special services like cheque cashing. catalogue ordering, money transfers and quick-service prepared food.

Since 2001, we have applied our expertise and infrastructure to new growth opportunities. These include wholesaling to independent stores and opening junior discount stores in rural communities and urban neighbourhoods in western Canada.

The North West Company operates the following retail banners and wholesale businesses in two reporting segments:

### **Canadian Operations**

- 133 Northern stores, a combination food and general merchandise format in remote, northern Canadian communities;
- 10 Giant Tiger junior discount stores offering family fashion, household products and food at convenient locations;
- 5 NorthMart stores, targeted at larger, regional markets and offering an expanded selection of fashion merchandise and fresh food:
- 6 Quickstop convenience stores, offering prepared foods. petroleum products and a full convenience assortment;
- The Selections catalogue, more than 240,000 of which are distributed each year across northern Canada, featuring everything from fashion and snowmobiles to computers and boats;
- Crescent Multi Foods, a distributor of produce and fresh meats to independent grocery stores in Saskatchewan, Manitoba and northwestern Ontario:
- 3 North West Company Fur Marketing Branches, that offer native handicrafts and authentic Canadian heritage products, as well as wild furs; and
- The Inuit Art Marketing Service, Canada's largest distributor of Inuit art.

### **U.S. Operations**

- 24 AC Value Centers, a combination food and general merchandise format in communities across rural Alaska;
- 1 Quickstop convenience store, offering prepared foods. petroleum products and a full convenience assortment; and
- Frontier Expeditors, a distributor of food and general merchandise to independent grocery stores in rural Alaska.

### **STRATEGIES**

The Company completed a new long-term plan in March 2004. Our plans are typically developed in five-year cycles and are reviewed and adjusted through an annual operating plan. The long-term plan sets operating and financial goals and key strategies.

The Company's strategy is first to ensure that our core business—retailing in northern Canada and Alaska—continues to deliver both stability and growth in earnings. Second, we aim to take advantage of related new opportunities through Giant Tiger store growth in western Canada and expansion of our wholesaling and distribution businesses in western Canada and Alaska.

Our remote store banners have produced modest, but consistent, profit growth over the past decade or so. We have increased our share in food markets and have been successful in achieving margin rate gains by improving our assortments and sharpening our retail practices through training, use of new technology and other initiatives. We have further new product and service opportunities for growth in the North. This growth potential is partially offset by a lack of new store locations and erosion in some existing general merchandise categories due to increased outshopping alternatives.

We continue to develop local management and staff and are the largest private sector employer of Aboriginal people in Canada. The number of Aboriginal people in management positions has increased steadily from 61 in 1992 to 217 in 2004. We continue to build upon existing Aboriginal community relations and work closely with local Aboriginal corporations in our store development projects.

Our remote store base provides us with the financial resources, stability and knowledge to pursue expansion into related opportunities.

Our merchandising strategy for remote stores is to continue to grow same store food sales while adjusting our general merchandise sales base to achieve greater profitability. Our productivity focus is on continuing to improve our store capability through investments in store technology, improvements in work methods and processes and upgrading the skills of our store managers. We also target operational cost streamlining through these activities.

Our remote store base provides us with the financial resources, stability and knowledge to pursue expansion into related opportunities. Our new ventures, primarily the development of the Giant Tiger format across western Canada, are not capital intensive and our strategy has been, and continues to be, to pursue growth in a measured, careful manner. We are focusing our plans on areas where we have a high degree of confidence in the potential return, both long and short-term. We place a heavy weighting on new ideas, clear principles, execution and the ability to track performance.

Giant Tiger stores are a junior discount format offering trend-right apparel and hardlines merchandise, an everyday food product mix and convenient locations. The value offering focuses on new products, everyday low prices, being in stock on basics, community involvement and friendly service.

We have a 30-year exclusive franchise agreement with *Giant Tiger Stores Limited*, based in Ottawa, Ontario, to develop stores in western Canada. Under the agreement, *Giant Tiger Stores Limited* provides product sourcing, merchandising, information systems and administration support to the Company's Giant Tiger stores in return for a royalty based on sales. We are responsible for developing and operating the stores, and for food procurement and distribution.

In 2004, three new stores were opened. We are focusing on recruiting and training store managers and field staff to support a faster roll-out beginning this year. We continue to find efficiencies to reduce the incremental freight-related cost of doing business in western Canada. We are also pursuing innovative real estate deal structures that ensure we can extract the traffic-generating value of our stores.

Our wholesaling and distribution expansion plans are centered on Crescent Multi Foods (CMF) in western Canada and Frontier Expeditors (FE) in Alaska.

Over the past few years, CMF sales have increased significantly as we have expanded our product range, centralized meat procurement and distribution for our core business in western Canada, and relocated to an expanded facility. We will continue to expand CMF's capabilities and assess its potential for a larger presence serving the western Canadian independent wholesale market.

We see potential to continue winning market share for FE in rural Alaska. FE is one of two food distributors in the state with a local warehouse facility. We see an opportunity to double its size within five years through a combination of internal growth and acquisitions.

We continue to develop local management and staff and are the largest private sector employer of Aboriginal people in Canada.

# KEY PERFORMANCE DRIVERS AND CAPABILITIES TO DELIVER RESULTS

The ability to protect and enhance the profitability of our remote store banners. These stores represent about 95% of our profitability. We expect to reduce this percentage over the next few years as we expand the Giant Tiger format across western Canada and grow our wholesale and distribution businesses. Nevertheless, our Canadian and Alaskan retail operations will remain the key driver of our performance for many years to come.

We maintain a conservative distribution payout ratio of about 50% of operating cash flow to ensure we have adequate resources to reinvest in both our remote stores and emerging businesses. In our remote stores, we continue to invest in improvements to our in-store capabilities through expanded staff training programs, new technology, and the adoption of Best Practice work processes.

A key to our success is protecting and enhancing our food market share. We measure and track our food performance by sales per capita, unit volume growth, transaction size, private label penetration and net contribution by food category. We take an opportunistic approach to our general merchandise business. Using similar performance measures to food, we tailor our product mix to local market needs that we can profitably serve. Our broad assortment of general merchandise products gives our stores maximum flexibility to adjust their product mix to meet local market needs.

The ability to continue the successful roll-out of the Giant Tiger format across western Canada. In each of the past two fiscal years, we opened three new Giant Tiger stores for a current total of 10 stores. We plan to open four stores in 2005.

Key performance drivers will include our ability to meet or exceed sales and margin levels achieved by *Giant Tiger Stores Limited* in eastern Canada. Our success will depend on managing product sourcing, operating and transportation expenses while building strong, entrepreneurial store teams and a sufficient store base to absorb field staff and new store opening expenses.

Our ability to achieve best selling practices and reinforce community relations in our remote stores. We began developing store capability initiatives in 2001. By the end of 2004 we had invested in most of the store technology that we required and we have a solid understanding of the new work methods and processes we want to teach. In 2005 and beyond, management and staff development will accelerate, concentrating on upgrading manager skills and improving recruitment. Because of the harsh climate and the remoteness of our store locations, attracting and retaining top quality retail managers is a continuing priority and a key source of our competitive advantage. Related to this is our continued ability to develop local management and to foster positive community relationships especially within the Aboriginal markets we serve.

Our ability to reduce costs in our core businesses, improve competitiveness and create more time to sell merchandise. Our goal is to shift more staff time and skill to selling while reducing the overall cost of our core retail businesses. We aim to become more efficient in non-selling facets of store work. Cost savings will be targeted, particularly in labour scheduling, energy usage and product shrinkage. Over the past few years, we have also developed alliances with other merchandisers to provide sales and distribution services for certain products and services. For example, under our alliance with *Dufresne Furniture and Appliances* of Winnipeg, Dufresne manages product assortment, marketing and distribution for the furniture and appliance categories in Northern stores. This has given us access to expertise and buying power and has allowed us to reduce inventories. We plan to continue to mature these alliances and complement them with direct sourcing opportunities across North America and Asia.

Our broad assortment of general merchandise products gives our stores maximum flexibility to adjust their product mix to meet local market needs.

### CONSOLIDATED RESULTS

### 2004 Highlights

- Sales rose 0.8% to \$788.7 million, led by a food sales increase of 1.5%.
- Trading profit in Alaska increased 13.2% to US\$10.8 million (excluding the gain from insurance proceeds in 2003), the ninth consecutive year of improvement.
- Return on net assets improved to 14.8% from 14.1% reflecting improved utilization of our assets.
- Return on equity improved to 16.2%, a key indicator of our ability to effectively use capital.
- Total returns to investors were 39% after a 24% total return in 2003 and 33% in 2002.
- Three Giant Tiger stores were opened, bringing the total number to 10.
- Our debt-to-equity improved to 0.51:1 down from 0.92:1 five years ago, providing North West with flexibility to invest for profitable growth and deliver higher distributions to unitholders.

The key performance indicators used by management to assess results are summarized in the following table:

### **Key Performance Indicators**

(\$ in thousands)	2004	2003	2002
Sales	\$788,693	\$782,720	\$749,759
Same store sales % increase 1	1.4%	2.1%	3.4%
Trading profit <sup>2</sup>	\$ 76,606	\$ 72,826	\$ 72,271
Net earnings	\$ 37,265	\$ 35,730	\$ 34,469
Net earnings per unit—basic	\$ 2.34	\$ 2.24	\$ 2.15
Net earnings per unit—diluted	\$ 2.32	\$ 2.22	\$ 2.14
Cash distributions in the year	\$ 1.80	\$ 1.90	\$ 1.56
Total assets	\$413,637	\$409,600	\$418,191
Return on net assets	14.8%	14.1%	13.4%
Return on average equity	16.2%	16.0%	15.8%

<sup>1 2003</sup> same store sales adjusted to an equivalent 52-week basis

Food sales continued to perform well, with an annual 52-week increase of 3.4%.

### **CONSOLIDATED SALES**

Sales for the 52 weeks ending January 29, 2005 increased 0.8% to \$788.7 million. When the previous year's sales are adjusted to an equivalent 52-week basis, the increase was 2.6%. Same store sales (excluding foreign exchange impact) on an equivalent 52-week basis increased 1.4%.

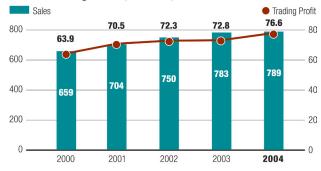
Food sales continued to perform well, with an annual 52-week increase of 3.4%. Quarterly same store increases were 4.7%, 3.3%, 2.0% and 4.1%. Canadian food sales increased 5.3% on an equivalent 52-week basis while Alaska's food sales increased 4.3%.

There was weakness in general merchandise sales with equivalent 52-week sales increasing only marginally over 2003. Same store sales decreased by 2.9% but strengthened guarter over guarter with decreases in the first three guarters of 7.4%, 5.9% and 1.2% and with a strong fourth quarter increase of 4.2%. General merchandise sales in the first half of the year were affected by a lack of exciting new merchandise, reduced clearance and promotional activity, and increased outshopping competition. The downward trend was reversed during the second half with the introduction of new programs, more current merchandise and better item selection in our northern Canada stores. The Company's merchandise clearance pricing was more limited as we focused on achieving controlled inventory levels and more profitable sales. In Alaska, a reduction of 16.9% in the Permanent Fund Dividend, paid out annually to state residents, reduced big-ticket general merchandise sales.

Canadian sales accounted for 79.9% of total sales (78.7% in 2003) while Alaska contributed 20.1% (21.3% in 2003). The Canadian dollar's appreciation versus the U.S. dollar in 2004 affected results as follows:

Sales	decrease of \$10.9 million
Trading profit	decrease of \$1.0 million
Net earnings	decrease of \$372,000

Sales & Trading Profit (\$ in millions)

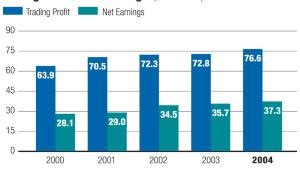


Both sales and trading profit were up in 2004.

<sup>2</sup> See Non-GAAP measures section on page 17

**Profitability** Trading profit (EBITDA) increased 5.2% to \$76.6 million. Included in 2003 results was a gain of \$2.0 million from insurance proceeds. Excluding the 2003 gain, trading profit increased 8.1%.

**Trading Profit & Net Earnings** (\$ in millions)



Net earnings benefited from savings related to our Best Practice training and our new in-store systems.

Giant Tiger store growth increased sales by \$28.6 million but reduced consolidated trading profit margins due to this format's discount pricing model and the costs associated with reaching a critical mass of mature stores.

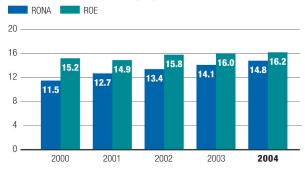
Amortization expense in the year increased by \$1.5 million to \$23.9 million.

Interest expense decreased 8.5% to \$5.8 million. The average cost of borrowing on interest bearing debt was 4.6% compared to 4.7% in 2003. The reduction in interest expense was due to a decline in borrowing resulting from lower average inventory and accounts receivable throughout most of the year. Our Alaskan subsidiary also paid down debt further reducing interest expense.

Consolidated net earnings increased 4.3% to \$37.3 million or \$2.32 per unit on a diluted basis. Excluding the impact of the 2003 net after tax insurance gain of \$1.2 million, consolidated net earnings increased 7.9%. Net earnings were reduced by \$372,000 or \$0.02 per unit due to the stronger Canadian dollar.

Return on net assets employed increased to 14.8% from 14.1% in 2003 while the return on equity improved to 16.2% from 16.0% in 2003. Return on net assets improved primarily due to lower average working capital throughout the year.

**Return on Net Assets & Equity** (%)



Our return on net assets has benefited from lower avereage receivables and inventories. **Taxes Consolidated** NWF recorded a provision for income taxes in 2004 of \$9.7 million, compared to \$8.4 million in 2003, for an effective rate of 20.6% in 2004 and 19.0% in 2003. The increase in the effective tax rate is due to U.S. withholding tax of CDN\$815.000 on dividends paid by Alaska Commercial Company (AC) to NWC. Excluding the withholding tax payment, the effective income tax rate would have been 18.9%.

Income taxes paid in cash were \$7.5 million in 2004 compared to \$4.5 million in 2003. Future income taxes on the balance sheet were reduced to \$10.4 million from \$11.1 million a year ago after adjusting for the EIC 144 Accounting for Certain Consideration Received from a Vendor (see note 17 in the notes to the consolidated financial statements). Loss carry forwards of \$1.4 million were utilized in 2004.

The Canada Revenue Agency has been conducting an audit on the years 1996 to 1999. It is the opinion of management that the pending reassessments will not have a material effect on the Consolidated Financial Statements.

A more detailed explanation of the income tax provision and future tax assets is provided in note 10 to the consolidated financial statements.

Fourth Quarter Highlights Fourth quarter consolidated sales decreased 3.3% to \$209.9 million compared to \$217.0 million in 2003 in 13 weeks of operations versus 14 weeks in 2003. On an equivalent 13-week basis, sales increased 4.5% (up 4.1% on a same store basis). Fourth quarter earnings were \$10.6 million, the same as in 2003. Diluted earnings per unit were \$0.66 which is consistent with 2003. Withholding taxes on dividends paid by the Alaska Commercial Company to the Canadian company reduced earnings by CDN\$815,000 or \$0.05 per unit. Excluding the tax impact of the dividend, fourth guarter earnings would have been \$11.4 million or an increase of 7.2% over 2003.

Cash flow from operating activities for the quarter decreased to \$19.5 million from \$38.4 million. The decrease is due to higher receivables and an increase in inventory. New accounts receivable programs offered in the fourth quarter were well received by our customers resulting in an increase in the year-end balance. Inventories increased in part due to the timing of food inventory shipments as more merchandise was shipped to stores over winter roads than last year. Other factors were direct buying of fresh meat in Canada, increased direct importing of general merchandise and higher warehouse inventories to supply new Giant Tiger store openings.

## **Canadian Operations**

### 2004 CANADIAN OPERATIONS STRATEGY

Strategy	Results
Develop Superior Store Selling Capability     Install information systems in 117 stores     Train 60 management level employees in Best Practice standards	Installed in 117 stores Trained 60 managers
Continue Giant Tiger Store Expansion     Open three Giant Tiger stores	Opened in Winnipeg, Manitoba; Moose Jaw and Saskatoon, Saskatchewan

**Financial Performance** Results of Canadian operations are summarized below by the key performance indicators used by management.

### **Key Performance Indicators**

(\$ in thousands)	2004	2003	2002
Sales	\$629,823	\$615,661	\$565,747
Same store sales % increase 1	0.9%	2.6%	3.6%
Trading profit <sup>2</sup>	\$ 62,629	\$ 57,663	\$ 59,163
EBIT <sup>2</sup>	\$ 42,652	\$ 39,250	\$ 40,187
Return on net assets	14.7%	14.0%	14.2%

- 1 2003 same store sales adjusted to an equivalent 52-week basis
- 2 See Non-GAAP measures section on page 17

**Sales** Canadian sales increased 2.3% (0.9% on a same store basis) to \$629.8 million. On an equivalent 52-week basis, sales increased 4.2%. Canadian food sales accounted for 68.5% (67.8% in 2003) of total sales. Total Canadian food sales were strong throughout the year with quarterly increases of 8.3%, 5.0%, 3.5% and 5.6% on an equivalent 13-week basis in the fourth quarter. The balance was made up of general merchandise sales at 27.5% (27.9% in 2003), other sales, primarily fuel sales, at 2.5% (2.7% in 2003) and consumer credit revenue at 1.5% (1.6% in 2003).

Northern Canada food sales were flat compared to last year, but increased 1.9% on a same store basis and increased 2.0% on an equivalent 52-week basis compared to 2003.

Small sales increases were achieved across most food categories. Categories having the largest increases were deli, confections and food service. Categories which had decreases were grocery non-food, chilled foods and meats. Vendor supply problems in the meat category reduced sales as a number of frozen meat products were not available for part of the year. Unit sales in food were marginally down compared to last year, but cost inflation resulting from higher fuel-related transportation expenses contributed to overall higher sales dollars. Lower pricing in non-perishable food categories was implemented during the first quarter of 2005 to help accelerate unit sales growth.

Northern Canada general merchandise sales were down 4.1% compared to 2003 (-2.3% on a same store and equivalent 52-week basis). The year started poorly with general merchandise sales down 7.9% in the first guarter. Quarterly decreases were reduced in the second and third guarter to 7.5% and 1.7% and rebounded strongly in the fourth quarter with an increase of 5.9% on an equivalent 13-week period.

Deflationary pricing, weak merchandise programs, less clearance and promotional activity, increased discount store competition and less discretionary income were all factors affecting first half general merchandise performance. A focus on lower-cost product sourcing, better balanced inventory levels and fewer deep discount promotions combined to increase general merchandise profitability in the second half of the year. This increase was achieved despite substantial upward pressure on freight costs.

Canadian sales per selling square foot were \$969 for food (\$829 in 2003) and \$267 for general merchandise (\$285 in 2003) reflecting continued strong food sales growth.

**Sales Blend** The chart below reflects the growing importance of food sales to the overall sales of the Canadian operations.

	2004	2003	2002	
Food	68.5%	67.8%	66.0%	
General merchandise	27.5%	27.9%	29.6%	
Other	2.5%	2.7%	2.8%	
Service charges	1.5%	1.6%	1.6%	

Same store food sales in the Company's core remote stores have generally performed at industry-leading levels while general merchandise sales have lagged.

### **Core Stores—Same Store Sales**

(% change)	2004	2003	2002	
Food	1.9%	5.0%	3.8%	
General merchandise	-2.3%	-4.4%	2.6%	
Total sales	0.7%	2.1%	3.4%	

Giant Tiger store sales increased 60.5% to \$75.8 million as we added three new stores in 2004. Same store sales increased by 3.5%. Food (including tobacco) accounted for 65.2% of total sales while general merchandise accounted for 34.8%.

Sales of the Diversified Business group decreased 6.4% (-5.4% on an equivalent 52-week basis) to \$17.9 million. This group consists of three Fur Marketing branches, our Inuit Art Marketing Service and fresh food wholesaler Crescent Multi Foods.

**Profitability** Gross profit dollars for Canadian stores increased by 3.1% (4.9% on an equivalent 52-week basis). Gross profit rate increased to 32.7% compared to 32.4% in 2003. More aggressive pricing in our non-perishable food categories and higher freight costs lowered food gross profit, but was more than offset by higher general merchandise rates due to better inventory control, lower buying costs and lower markdowns. Profitability was negatively impacted by higher occupancy expenses related to increasing energy costs, Giant Tiger store opening costs and associated costs to build the field infrastructure and train managers for the continued roll-out of Giant Tiger stores.

Trading profit from Canadian operations increased by \$5.0 million to \$62.6 million or 9.9% of sales.

**Operational Net Assets Employed** Operational net assets employed at January 29, 2005, increased 2.2% to \$283.0 million compared to \$277.0 million at the previous year end as summarized in the following table:

### **Operational Net Assets Employed**

(\$ millions at the end of the fiscal year	2004	2003	2002	
Property and equipment	\$147.3	\$151.3	\$142.1	
Inventory	102.3	93.3	102.0	
Accounts receivable	61.6	51.3	56.8	
Other assets	16.1	22.1	14.4	
Liabilities	(44.3)	(41.0)	(43.2)	
Total	\$283.0	\$277.0	\$272.1	

Property and equipment balances were lower reflecting reduced capital expenditures during the year. Major expenditures included the installation of a new in-store information system and the capital costs associated with opening three Giant Tiger stores. Net capital expenditures in 2005 are expected to be \$23.5 million, up \$6.7 million from 2004. The incremental capital will provide for two large store replacements in northern Canada, several major upgrades to existing stores, enhanced in-store merchandising programs, expanded gas outlets, upgraded communication systems and the opening of five Giant Tiger stores.

For the first nine months of 2004, inventory levels were lower than the previous year by an average of \$3.5 million. In the last guarter, inventories increased due to higher food sealift and winter road shipments, increased stock to support our spring catalogue launch and in-store seasonal programs, earlier buying of import general merchandise and fresh meat product due to a change to direct procurement and higher food warehouse inventory levels to support in-stock rates within our Giant Tiger stores.

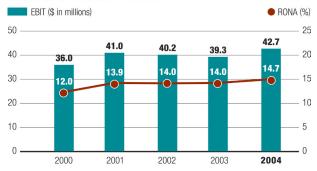
Accounts receivable throughout the first nine months also averaged lower than last year. In the third quarter, the allowance for doubtful accounts was reduced by \$2.0 million resulting from the ability of the Company's new central credit management system to better monitor accounts and initiate more proactive collection. New credit programs introduced in the fourth quarter resulted in an increase in the portfolio of over \$2.0 million.

Other assets decreased reflecting lower deposits in transit compared to 2003 and lower cash on hand at the store level. A concerted effort at the store level to improve the timeliness of deposit deliveries to the bank contributed the decrease. The increase in liabilities over the prior year is due to an increase in accounts payable related to the timing of inventory purchases.

Return on Net Assets The return on net assets employed for Canadian operations was 14.7%, up from 14.0% in 2003.

There is potential for more working capital productivity gains in Northern Canada stores. Giant Tiger stores will continue to deliver high inventory turns. Profit margin rates will erode due to the growing impact of Giant Tiger's discount pricing, offset by higher sales volumes.

### **Canadian Return on Net Assets**



We continue to improve asset utilization.

Trading profit from Canadian operations increased by \$5.0 million to \$62.6 million or 9.9% of sales.

### Alaskan Operations (Stated in U.S. dollars)

### 2004 ALASKAN OPERATIONS STRATEGY

Strategy	Results
1. Acquire and Develop New Store Locations	No new locations developed
2. Increase Sales in the Wholesale Division	Wholesale Division sales were flat to last year on an equivalent 52-week basis
3. Improve Cost Efficiencies	Cost efficiencies generated were offset by higher occupancy costs
4. Enhance Store Capabilities	Installed information systems in 20 stores

Financial Performance Alaskan results for the year are summarized below by the key performance indicators used by management.

### **Key Performance Indicators**

(\$ in thousands)	2004	2003	2002
Sales	\$122,813	\$120,856	\$117,542
Same store sales % increase 1	3.7%	-0.4%	2.6%
Trading profit <sup>2</sup>	\$ 10,805	\$ 10,969	\$ 8,373
EBIT <sup>2</sup>	\$ 7,768	\$ 8,084	\$ 6,012
Return on net assets	15.5%	16.1%³	11.6%

- 1 2003 same store sales adjusted to an equivalent 52-week basis
- 2 See Non-GAAP measures section on page 17
- 3 Return on net assets would be 13.1% if gain from insurance proceeds of \$1.4 million is excluded

**Sales** AC's total sales increased 1.6% (3.3% using an equivalent 52-week basis for 2003) to \$122.8 million. The rural Alaskan market had a stronger fishing season in 2004 which helped results in the first three quarters. Offsetting this was a 16.9% reduction in the Alaska Permanent Fund dividends. AC improved its market share in a number of markets as competitors weakened.

Food sales, which accounted for 80.1% of total revenue (79.5% in 2003), increased 2.4% (4.3% using an equivalent 52-week basis for 2003). On a same store basis, food sales increased 5.7%. AC's retail stores food sales were led by strong increases in grocery 5.4%, snack foods 3.7%, beverages 6.0%, meats 5.3% and deli 6.1%. All other food categories had increases except food service and produce. Less competitive pricing pressure in some markets and market share gains accounted for the sales increase.

General merchandise sales, which accounted for 18.9% of total sales (19.6% in 2003), decreased 1.9% (-0.8% on an equivalent 52-week basis). On a same store basis, general merchandise sales declined 3.5%. General merchandise sales continued to be weak as disposable income was severely affected by the reduction of Alaska Permanent Fund dividends. Sales declined in most general merchandise categories with home furnishings accounting for the largest decrease.

Other sales, primarily gasoline, increased 20.3%. Service charge income increased 5.5%.

Sales per selling square foot were \$684 for food (\$676 in 2003) and \$209 for general merchandise (\$211 in 2003) continuing the strong food sales performance. Food selling square footage accounted for 57% of total selling space compared to 56% in 2003. The percentage change for same store sales for the past three years are shown in the following table:

### Same Store Sales

(% change)	2004	2003	2002	
Food	5.7%	3.0%	3.9%	
General merchandise	-3.5%	-10.9%	-1.4%	
Total sales	3.7%	-0.4%	2.6%	

Frontier Expeditors' (FE) sales were flat to last year as food sales declined 3.8% on an equivalent 52-week basis. The food sales decrease was totally offset by an increase in general merchandise sales as FE became the state distributor of an electronic products line. Tighter credit policies and customer closings negatively impacted food sales. Gross profit rates were greater than in 2003, but increased occupancy and operating costs reduced the trading profit contribution.

**Profitability** Gross profit rates improved to 34.0% from 33.5% in 2003. Food rates improved in 2004 while general merchandise rates declined. With the higher food sales and improved margin rate, total gross profit dollars increased 3.1%. Operating expenses were flat to last year, but higher when compared to 2003 on an equivalent 52-week basis, primarily due to higher occupancy costs.





\*Excludes gains from insurance proceeds

Alaskan operations continue to improve due to increase in market share.

Trading profit decreased 1.5% to \$10.8 million. Excluding the gain from insurance proceeds of \$1.4 million in 2003, the increase in trading profit was 13.2%.

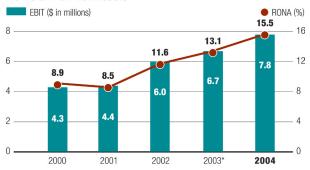
### **Operational Net Assets Employed**

(\$ in millions at the end of the fiscal year)	2004	2003	2002	
Property and equipment	\$31.3	\$30.8	\$30.3	
Inventory	15.9	16.1	16.7	
Accounts receivable	6.0	6.1	5.2	
Other assets	3.2	3.3	2.7	
Liabilities	(6.3)	(6.4)	(6.8)	
Total	\$50.1	\$49.9	\$48.1	

At January 29, 2005, AC's operational net assets employed were up marginally from the previous year. Property and equipment increased due to the major renovation of the Kotzebue store and the continued roll-out of store information systems. Amortization costs increased 5.3% to \$3.0 million in 2004.

Inventories decreased marginally from last year as did accounts receivable. Net other assets and liabilities remained the same as 2003 at \$3.1 million.

### **AC Return on Net Assets**



\*Excludes gain from insurance proceeds

Improving asset utilization provides better returns.

With the higher food sales and improved margin rate, total gross profit dollars increased 3.1%

### FINANCIAL CONDITION

### **Consolidated Net Assets Employed**

(\$ in millions at the end of the fiscal year)	2004	2003	2002
Property and equipment	\$186.1	\$192.4	\$188.2
Inventory	122.0	114.8	127.4
Accounts receivable	69.0	59.4	64.8
Other assets	33.3	41.0	35.6
Liabilities	(53.2)	(51.2)	(59.8)
Total	\$357.2	\$356.4	\$356.2

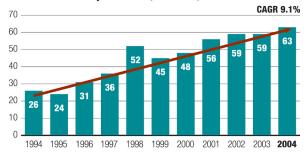
**Balance Sheet and Cash Flows** Property and equipment balances declined by \$6.3 million in 2004. Additional information on capital expenditures is included in the next section.

Inventories increased \$7.2 million or 6.3% to \$122.0 million. Accounts receivable increased \$9.6 million or 16.2% to \$69.0 million. Proceeds of \$2.0 million to be received from insurance policy deposits are included in the receivable balance as existing property and casualty insurance policies were replaced. Deposits to the insurance companies to cover a shared risk program are no longer required under the new policies. Please refer to the Canadian Operations and Alaskan Operations sections for additional information on inventories and accounts receivable.

Liabilities net of other assets increased by \$9.7 million due to a decrease in cash and an increase in trade accounts payable and accrued expenses.

Cash flow from operations improved by \$3.9 million to \$62.8 million reflecting improved net earnings and higher amortization amounts from 2003. The compound annual growth rate (CAGR) for cash flow from operations over the past 10 years is 9.1% as shown in the following chart:

### **Cash Flow from Operations** (\$ in millions)



The positive trend in cash flow from operations has permitted growing distributions to unitholders.

### **Capital Expenditures on Property and Equipment**

Total net capital expenditures (capital expenditures net of proceeds from disposals) in 2004 were \$21.6 million compared to \$30.2 million in 2003. Net capital spending on Canadian operations totalled \$16.8 million (\$27.2 million in 2003), and \$4.8 million in Alaska (\$3.0 million in 2003).

Capital expenditures in Canadian operations were \$17.5 million in 2004 versus \$28.3 million in 2003. Investments totalling \$3.9 million (\$6.8 million in 2003) were made to renovate existing stores, replace equipment, improve support facilities and replace one major store. Expenditures on information systems of \$5.9 million (\$12.7 million in 2003) were primarily directed at the development and upgrading of our in-store and corporate information systems, corporate software upgrades and corporate hardware.

A new store was opened in Sapotaweyak, Manitoba. Replacement stores were opened in Repulse Bay, Nunavut, and Wunnumin Lake, Ontario. Three new Giant Tiger stores were opened during the year in Saskatoon and Moose Jaw, Saskatchewan, as well as a third location in Winnipeg, Manitoba. Two NorthMart stores were closed in 2004, in Labrador City. Newfoundland and Labrador, and The Pas. Manitoba. The Burger King, which was part of the NorthMart store in The Pas, remains open. The Pas store will reopen as a Giant Tiger Store in the spring of 2005. Total selling square feet in Canada decreased to 1,093,121 from 1,105,748 in 2003.

Capital expenditures in Alaska were \$4.8 million compared to \$4.9 million in 2003. Alaskan selling square feet increased to 254,512 from 253,981 in 2003.

The following table summarizes the number of stores and selling square footage under NWC's retail formats:

	Number	Number of Stores		re footage	
	2004	2003	2004	2003	
Northern	133	133	772,301	785,213	
NorthMart	5	7	125,565	186,833	
Quickstop	7	6	11,272	10,229	
Giant Tiger	10	7	163,937	103,427	
Other formats	4	4	22,558	22,558	
AC Value Centers	24	24	252,000	251,469	
Total at year end	183	181	1,347,633	1,359,729	

Net capital expenditures are expected to be \$27.2 million in 2005 and will be funded entirely from cash from operations.

Financing Activities The Company has credit facilities with two Canadian chartered banks totalling up to \$85.0 million at favourable rates. At year end, we had drawn \$29.2 million on the credit facilities. AC has an operating loan facility of US\$4.0 million available and was drawing US\$2.3 million at January 29, 2005.

We continue to finance all of our capital expenditures and distributions with cash from operations. We expect that cash from operations and funds available from credit facilities are more than sufficient to meet all our obligations in 2005.

In August 2002, the Company successfully completed the refinancing of its long-term bonds by issuing US\$65.0 million 5.89% senior notes. Repayments of 20% of the original amount of the senior notes are required on June 15, 2007 and June 15, 2008 with the balance due June 15, 2009.

A swap was completed on September 11, 2002 to convert US\$14.0 million of the US\$65.0 million obligation from fixed to floating rates at three-month London Interbank Offered Rate (LIBOR)

The Company designated US\$45.0 million of its new U.S. dollar senior notes as a hedge against its U.S. dollar investment in AC. On November 7, 2002, US\$20.0 million fixed obligation was converted by a cross currency swap to a Canadian dollar-floating obligation at the Canadian Banker's Acceptance three-months rate plus 2.99%. On January 24, 2003, an additional US\$2.0 million of the fixed obligation was converted by a cross currency swap to a Canadian dollar-floating obligation at the Canadian Banker's Acceptance three-months rate plus 3.16%. This swap reduced the hedge to US\$43.0 million to recognize the earnings at AC in 2002 and the reduction of the investment due to repayments on inter-company notes.

This leaves US\$29.0 million of the original senior notes fixed at an interest rate of 5.89% and the remainder of the indebtedness subject to floating rates plus negotiated spreads. The Fund paid four distributions in 2004 totalling \$29.1 million compared to five distributions in 2003 totalling \$30.6 million.

### **Contractual Obligations and Other Commitment**

Contractual obligations of the Company are listed in the chart below:

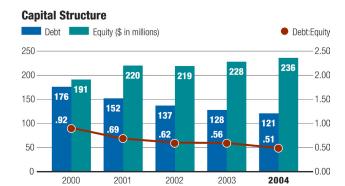
(\$ in thousands)	Total	0-1 Year	2-3 Years	4-5 Years	5 Years +
Long-term debt	\$ 87,484	\$ -	\$ 16,147	\$71,337	\$ -
Capital leases	1,425	106	247	304	768
Operating leases	99,355	11,169	20,220	16,151	51,815
Other long-term obligations	1,710	-	1,710	-	-
Total	\$189,974	\$11,275	\$38,324	\$87,792	\$52,583

**Director and Indemnification Agreements** The Company has agreements with its current and former directors and officers to indemnify them against charges, costs, expenses, amounts paid in settlement and damages incurred from any lawsuit or any judicial, administrative or investigative proceeding in which they are sued as a result of their service. Due to the nature of these agreements, the Company cannot make a reasonable estimate of the maximum amount it could be required to pay to counterparties. The Company has also purchased director and officer liability insurance. No amount has been recorded in the financial statements regarding these indemnification agreements.

Other Indemnification Agreements The Company provides indemnification agreements to counterparties for events such as intellectual property right infringement, loss or damages to property, claims that may arise while providing services, violation of laws or regulations, or as a result of litigation that might be suffered by the counterparties. The terms and nature of these agreements vary based on the specific contract. The Company cannot make a reasonable estimate of the maximum amount it could be required to pay to counterparties. No amount has been recorded in the financial statements regarding these agreements.

### **Capital Structure**

On a consolidated basis, North West Company Fund (NWF) had \$120.9 million in debt and \$236.3 million in equity at the end of the year as the debt-to-equity ratio improved to 0.51:1 versus 0.56:1 a year earlier. There was no new equity issued in 2004.



The strengthening of the Fund's capital structure is reflected in the above chart. Over the past five years, NWF's debt-to-equity ratio has improved to 0.51:1 from 0.92:1 while annual cash distributions to unitholders have increased to \$1.80 per unit in 2004 from \$1.44 per unit in 2000. Equity has increased by 23.7% to \$236.3 million over the past five years while interest-bearing debt was reduced by 31.2% to \$120.9 million from \$175.8 million in 2000.

In the past two years, the Company issued loans to officers under the unit purchase loan plan, which has the effect of decreasing equity. These loans are non-interest bearing and repayable from the after tax distributions or if the officer sells the units or leaves the Company. The loans are secured by a pledge of 225,998 units of the Company with a quoted value at January 29, 2005 of \$7.0 million. Loans receivable at January 29, 2005 of \$4.4 million (\$3.7 million at January 31, 2004) are recorded as a reduction of equity. The maximum value of the loans under the plan cannot exceed \$7.5 million.

Consolidated debt at January 29, 2005 decreased 5.4% or \$7.0 million to \$120.9 million. The reduction is partly due to a stronger Canadian dollar. The debt outstanding at the end of the fiscal year is summarized as follows:

### Debt

(\$ in thousands at the end of the fisca	al year) <b>2004</b>	2003	2002
Senior notes	\$ 87,484	\$ 91,432	\$ 99,597
Bank debt	32,023	30,313	28,157
Mortgages and notes payable	-	4,523	7,088
Capital leases	1,425	1,634	1,970
Total	\$120,932	\$127,902	\$136,812

Book value per unit, on a diluted basis, at the end of the year increased 3.4% or \$0.48 to \$14.65. Book equity was favourably affected by retained earnings of \$8.9 million (\$9.5 million in 2003) after distributions of \$28.4 million (\$25.1 million in 2003).

The coverage ratio of EBIT to interest improved to 9.1 times versus 8.0 times in 2003. Interest costs were reduced due to lower average debt levels in 2004 as a result of paying down long-term debt in Alaska.

### **Interest Costs and Coverage**

	2004	2003	2002
Coverage ratio	9.1	8.0	7.4
EBIT (\$ in millions)	52.7	50.4	49.6
Interest (\$ in millions)	5.8	6.3	6.7

We have a leading market position in the vast majority of communities that we serve.

### **RISK MANAGEMENT**

NWC is exposed to a number of risks in its business. These risks relate to our industry, the market environment and the successful execution of our key strategies.

**Store Selling Capability Initiative** This involves programs to improve training and change the work in our stores so we can be better at selling. The expected benefits are more time spent on selling rather than administration, more rewarding and balanced work at the store level and profitable sales growth. We are using Best Practice stores, new manager recruiting and training and new in-store systems technology to achieve our goal. The payback from this initiative will depend on our recruiting success and our ability to efficiently train our employees to use effective new practices within a reasonable time period.

**Competition** We have a leading market position in the vast majority of communities that we serve. Sustaining and growing this position depends on our ability to be more consistently in stock on a broader range of everyday products and services compared to our local competitors. To this end, we actively monitor competitive activity and take steps to protect and grow our market share in individual communities and regions. Outshopping competition from regional centres is significant and continues to grow. Competition in these markets is continuously assessed to ensure that our pricing, selection and service levels attract profitable local spending through our stores and catalogue.

**Community Relations** About 37% of our sales are derived from communities and regions that restrict commercial land ownership and usage by non-Aboriginal owned businesses or which have enacted policies and regulations to support Aboriginal-owned businesses. We successfully operate within these environments through initiatives that promote positive community and customer relations. These include joint venture and store lease arrangements with community-based development organizations, initiatives to recruit local residents into management positions, increased Aboriginal participation on our Board of Directors and direct investment in the North West Company Fund by Aboriginal-owned entities.

**Consumer Income** Our largest customer group derives most of its income directly or indirectly from government transfer payments, in the form of social assistance, child benefits and old age security. These are stable sources of income, independent of economic cycles. A major source of employment income is generated from local government and spending on infrastructure projects. This includes new housing, schools, health care facilities, roads and sewers. Local government employment levels can fluctuate within a year depending on a community's fiscal health.

The infrastructure and social support needs of the North are immense and we expect to see some spending increases. The recent federal budget provided for \$1.4 billion over five years to help improve the health of Aboriginal Canadians as well as improve housing conditions and the quality of water and wastewater treatment on reserves. Additional income will be generated from the National Child Benefit Supplement for low-income families which increased by \$150 annually per child in July 2004, with another \$185 scheduled in each of July 2005 and July 2006. All or part of the supplement may be offset by reductions in social assistance payments by the provinces or territories.

**Interest Rate and Currency Fluctuations** NWC is exposed to fluctuations in interest rates and currency exchange rates under its borrowings. Through the use of certain financial instruments, US\$36.0 million of NWC's senior notes were effectively converted from fixed interest rate debt to floating interest rate debt and US\$43.0 million of NWC's senior notes were maintained in U.S. dollar obligations to hedge the Company's investment in AC. Fluctuations in the foreign exchange rates due to the stronger Canadian dollar reduced AC's earnings by \$0.4 million when converted to Canadian funds.

**Energy Costs** The Company is exposed to fluctuations in the price of energy, particularly oil. To the extent that escalating fuel costs cannot be offset by energy conservation practices or offsetting productivity gains, they may result in lower margins or higher retail prices. Consumer spending, especially on discretionary items, may also be adversely affected.

We believe that revenue and earnings growth will continue at modest rates in 2005.

### OUTLOOK

We believe that revenue and earnings growth will continue at modest rates in 2005. Emphasis is being placed on training and systems investments in our remote stores built around the principle of more local management responsibility for driving sales. The remote store general merchandise focus will be on profitability and opportunistic pockets of sales growth. Giant Tiger store expansion will continue with the planned opening of four stores in 2005. Alaskan operations are expected to show above average food growth, but a slight decline in general merchandise sales as we anticipate another payment decrease from the Alaska Permanent Fund.

**Quarterly Financial Information** The following is a summary of selected quarterly financial information. Each quarter represents a 13-week period, except the fourth guarter of 2003, which represents a 14-week period.

### **Operating Results—Consolidated**

(\$ thousands)	)	Q1		Q2	Q3		Q4		Total
Sales									
2004	\$	184,364	\$	197,483	\$ 196,989	\$2	209,857	\$7	788,693
2003	\$	179,396	\$1	192,376	\$ 193,998	\$	216,950	\$7	782,720
Trading pro	fit								
2004	\$	14,634	\$	19,293	\$ 21,165	\$	21,514	\$	76,606
2003	\$	13,234	\$	17,984	\$ 20,586	\$	21,022	\$	72,826
Net earning	s								
2004	\$	6,388	\$	9,320	\$ 10,993	\$	10,564	\$	37,265
2003	\$	5,543	\$	8,925	\$ 10,648	\$	10,614	\$	35,730
Earnings pe	rι	ınit—ba	sic						
2004	\$	0.40	\$	0.59	\$ 0.69	\$	0.66	\$	2.34
2003	\$	0.35	\$	0.56	\$ 0.67	\$	0.66	\$	2.24
Earnings pe	rι	ınit—dil	uted						
2004	\$	0.40	\$	0.58	\$ 0.68	\$	0.66	\$	2.32
2003	\$	0.35	\$	0.55	\$ 0.66	\$	0.66	\$	2.22

Historically, the Company's first guarter sales are the lowest and fourth quarter sales are the highest, reflecting the Christmas selling period. Weather conditions are often extreme and can affect sales in any quarter. Net earnings are historically lower in the first quarter due to lower sales. Net earnings generally follow higher sales but can be dependent on markdown activity in key sales periods to meet competitive pressures to reduce excess inventories.

### **ACCOUNTING STANDARDS IMPLEMENTED IN 2004**

In 2004 the Company implemented the following new accounting standards issued by the Canadian Institute of Chartered Accountants (CICA):

**Hedging Relationships** The Company adopted Accounting Guideline 13 "Hedging Relationships" (AcG 13), effective February 1, 2004. In accordance with the new guideline, the Company's hedging relationships are documented and subject to effectiveness tests on a quarterly basis for reasonable assurance that they are and will continue to be effective. Any derivative that does not qualify for hedge accounting is reported in earnings on a mark to market basis. The adoption of AcG 13 had no impact on the Company's financial statements.

**Asset Retirement Obligations** In the first quarter of 2004, the Company retroactively implemented CICA Section 3110 "Asset Retirement Obligations" (CICA 3110). Section 3110 establishes the standards for the recognition, measurement and disclosure of legal obligations associated with the costs to retire long-lived assets. A liability associated with the retirement of long-lived assets is recorded in the period in which the legal obligation is incurred at its estimated fair value and a corresponding asset is capitalized as part of the related asset and that asset is depreciated over its useful life. Subsequent to the initial measurement of the asset retirement obligation, the obligation is adjusted to reflect the passage of time and changes in the estimated future costs underlying the obligation.

Accordingly, the Company has recognized a discounted liability associated with the operation of petroleum dispensing units and specific provisions in certain lease agreements regarding the exiting of leased properties at the end of the respective lease terms. This standard was implemented retroactively with restatement of the prior year's consolidated financial statements. The cumulative effect of implementation was a decrease to opening retained earnings for 2003 of \$287,000 (net of future income taxes recoverable of \$165,000), an increase in property and equipment of \$586,000, an increase in other liabilities of \$1,033,000 and an increase in the cumulative translation adjustment of \$5,000. The impact on net earnings for each of 2003 and 2004 was not material.

### **Accounting for Certain Consideration Received from Vendors**

In the third guarter of 2004, the Company retroactively implemented Emerging Issues Committee Abstract 144 "Accounting by a Customer (Including a Reseller) for Certain Consideration Received from a Vendor" (EIC 144). EIC 144 requires a customer to record cash consideration received from a vendor as a reduction in the price of the vendor's products, and reflect it as a reduction of cost of goods sold and related inventory, when recognized in the income statement and balance sheet.

The Company receives allowances from certain of its merchandise vendors which it records as a reduction of cost of goods sold. EIC 144 has changed the timing of recognition of some vendor allowances. This standard was implemented retroactively with restatement of the prior year's consolidated financial statements. Accordingly, the Company recorded a decrease to opening retained earnings for 2003 of \$857,000 (net of current future income taxes recoverable of \$487,000), a decrease to inventory of \$1,324,000 and an increase of \$20,000 to the cumulative translation adjustment. The impact on earnings for each of 2003 and 2004 was not material.

**Variable Interest Entities** During the fourth quarter, the Company adopted in advance Accounting Guideline 15 "Consolidation of Variable Interest Entities" (AcG 15). This guideline requires the consolidation of variable interest entities (VIE) for annual or interim periods beginning on or after November 1, 2004. A VIE is any legal structure used to conduct activities or hold assets which are not controlled by voting interests, but rather by contractual or other interests that change with that entity's underlying net asset value. The Company has assessed the impact of the accounting guideline and determined that the Company is not the primary beneficiary of any variable interest entities and accordingly, the implementation of AcG 15 has not had any impact on the consolidated financial statements.

### **NON-GAAP MEASURES**

1 Trading Profit (EBITDA) is not a recognized measure under Canadian GAAP. Management believes that in addition to net earnings (loss), trading profit is a useful supplemental measure as it provides investors with an indication of the Company's ability to generate cash flows to fund its cash requirements, including distributions and capital investment. Investors should be cautioned, however, that trading profit should not be construed as an alternative to net earnings (loss) determined in accordance with GAAP as an indicator of NWF's performance. NWF's method of calculating trading profit may differ from other companies and may not be comparable to measures used by other companies. A reconciliation of consolidated net earnings to trading profit or EBITDA is provided below:

### **Reconciliation of Net Earnings to Trading Profit**

(\$ in thousands)	2004	2003
Net earnings	\$37,265	\$35,730
Add: Amortization	23,905	22,401
Interest expense	5,761	6,299
Income taxes	9,675	8,396
Trading profit	\$76,606	\$72,826

For trading profit information by business segment, see note 12 Segmented Information in the notes to the consolidated financial statements on page 25

2 Earnings Before Interest and Income Taxes (EBIT) is not a recognized measure under Canadian GAAP. Management believes that EBIT is a useful measure as it provides investors with an indication of the performance of the consolidated operation and/or business segments, prior to interest expense and income taxes. Investors should be cautioned, however, that EBIT should not be construed as an alternative to net earnings (loss), determined in accordance with GAAP, as an indicator of NWF's performance. NWF's method of calculating EBIT may differ and may not be comparable to measures used by other companies. A reconciliation of consolidated net earnings to EBIT is provided below:

### **Reconciliation of Net Earnings to EBIT**

(\$ in thousands)	2004	2003
Net earnings	\$37,265	\$35,730
Add: Interest expense	5,761	6,299
Income taxes	9,675	8,396
Earnings before interest		
and income taxes (EBIT)	\$52,701	\$50,425

For EBIT information by business segment, see note 12 Segmented Information in the notes to the consolidated financial statements on page  $25\,$ 

### **Management's Responsibility for Financial Statements**

The management of North West Company Fund and The North West Company Inc. are responsible for the preparation, presentation and integrity of the accompanying financial statements and all other information in this annual report. The consolidated financial statements have been prepared by management in accordance with generally accepted accounting principles in Canada and include certain amounts that are based on the best estimates and judgment by management.

In order to meet its responsibility and ensure integrity of financial reporting, management has established a code of business ethics, and maintains appropriate internal controls and accounting systems. An internal audit function is maintained that is designed to provide reasonable assurance that assets are safeguarded, transactions are authorized and recorded and that the financial records are reliable.

Ultimate responsibility for financial reporting to unitholders rests with the Trustees of the Fund and the Board of Directors of the Company. The Audit Committee of the Board, consisting of outside Directors, meets periodically with management, Trustees and with the internal and external auditors to review the audit results, internal controls and accounting policies. Internal and external auditors have unlimited access to the Audit Committee. The Audit Committee meets separately with management and the external auditors to review the financial statements and other contents of the annual report and recommend approval by both the Trustees and the Board of Directors. The Audit Committee also recommends the independent auditor for appointment by the unitholders.

PricewaterhouseCoopers LLP, an independent firm of auditors appointed by the unitholders, have completed their audit and submitted their report as follows.

Edward S. Kennedy

PRESIDENT & CEO, THE NORTH WEST COMPANY INC.

Léo P. Charrière

EXECUTIVE VICE-PRESIDENT, CFO & SECRETARY, NORTH WEST COMPANY FUND

MARCH 16, 2005

### Auditor's Report PRICEWATERHOUSE COPERS

To the Unitholders of North West Company Fund: We have audited the consolidated balance sheets of North West Company Fund as at January 29, 2005 and as at January 31, 2004 and the consolidated statements of earnings and retained earnings and cash flows for the fiscal years then ended. These financial statements are the responsibility of 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 Fund as at January 29, 2005 and January 31, 2004 and the results of its operations and its cash flows for the fiscal years then ended in accordance with Canadian generally accepted accounting principles.

CHARTERED ACCOUNTANTS
WINNIPEG. CANADA

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MARCH 16, 2005

# **Consolidated Balance Sheets**

(\$ in thousands)	January 29, 2005	January 31, 2004 (Restated Note 17)
ASSETS		
Current assets		
Cash	\$ 11,438	\$ 16,627
Accounts receivable	69,040	59,414
Inventories	122,034	114,790
Prepaid expenses	2,663	3,083
Future income taxes (Note 10)	2,467	2,916
	207,642	196,830
Property and equipment (Note 3)	186,104	192,395
Other assets (Note 4)	11,959	12,153
Future income taxes (Note 10)	7,932	8,222
	\$413,637	\$409,600
LIABILITIES		_
Current liabilities		
Bank advances and short-term notes (Note 5)	\$ 32,023	\$ 30,313
Accounts payable and accrued liabilities	51,776	50,306
Income taxes payable	3,539	1,881
Current portion of long-term debt (Note 6)	106	640
	87,444	83,140
Long-term debt (Note 6)	88,803	96,949
Asset retirement obligations	1,105	1,033
	177,352	181,122
EQUITY		
Capital (Note 7)	165,205	165,205
Unit purchase loan plan (Note 8)	(4,429)	(3,650)
Retained earnings	70,560	61,679
Cumulative currency translation adjustments (Note 9)	4,949	5,244
	236,285	228,478
	\$413,637	\$409,600

See accompanying notes to consolidated financial statements

Approved by the Trustees and Board

lan Sutherland
TRUSTEE & DIRECTOR

Edward S. Kennedy DIRECTOR

# **Consolidated Statements of Earnings & Retained Earnings**

(\$ in thousands)	52 Weeks Ended January 29, 2005	53 Weeks Ended January 31, 2004 (Restated Note 17)
SALES	\$ 788,693	\$ 782,720
Cost of sales, selling and administrative expenses	(712,087)	(709,894)
Net earnings before amortization, interest and income taxes	76,606	72,826
Amortization	(23,905)	(22,401)
Interest, including interest on long-term debt of \$4,821 (2003 \$5,495)	52,701 (5,761)	50,425 (6,299)
Provision for income taxes (Note 10)	46,940 (9,675)	44,126 (8,396)
NET EARNINGS FOR THE YEAR	37,265	35,730
Retained earnings, beginning of year as previously reported Accounting changes (Note 17)	61,679 -	52,165 (1,144)
Retained earnings as restated Distributions	98,944 (28,384)	86,751 (25,072)
RETAINED EARNINGS, END OF YEAR	\$ 70,560	\$ 61,679
NET EARNINGS PER UNIT (Note 11) Basic	\$ 2.34	\$ 2.24
Diluted	\$ 2.34 \$ 2.32	\$ 2.24 \$ 2.22

See accompanying notes to consolidated financial statements

# **Consolidated Statements of Cash Flows**

(\$ in thousands)	52 Weeks Ended January 29, 2005	53 Weeks Ended January 31, 2004	
CASH PROVIDED BY (USED IN)			
Operating Activities			
Net earnings for the year	\$ 37,265	\$ 35,730	
Non-cash items			
Amortization	23,905	22,401	
Future income taxes	636	2,789	
Pension (credit) expense	(352)	(637)	
Amortization of deferred financing costs	186	186	
Loss (Gain) on disposal of property and equipment	1,158	(1,583)	
Cash flow from operations	62,798	58,886	
Change in other non-cash items	(13,873)	7,894	
Operating activities	48,925	66,780	
Investing Activities			
Purchase of property and equipment	(22,323)	(33,273)	
Proceeds from disposal of property and equipment	694	3,070	
Investing activities	(21,629)	(30,203)	
Financing Activities			
Change in bank advances and short-term notes	1,885	2,475	
Net purchase of units for unit purchase loan plan	(779)	(285)	
Repayment of long-term debt	(4,486)	(1,952)	
Distributions	(29,105)	(30,639)	
Financing activities	(32,485)	(30,401)	
NET CHANGE IN CASH	(5,189)	6,176	
Cash, beginning of year	16,627	10,451	
CASH, END OF YEAR	\$ 11,438	\$ 16,627	
Supplemental disclosure of cash paid for:			
Interest expense	\$ 6,076	\$ 6,410	
Income taxes	7,453	4,513	

See accompanying notes to consolidated financial statements

# Notes to **Consolidated Financial Statements**

**January 29, 2005** 

### 1. ORGANIZATION

The North West Company Fund (NWF or the Fund) is an unincorporated open-ended mutual fund trust, governed by the laws of the Province of Manitoba and the laws of Canada and created pursuant to a Declaration of Trust. The beneficiaries of the Fund (the "unitholders") are holders of trust units issued by the Fund (the "Trust Units"). The Fund is a limited purpose trust whose purpose is to invest in securities of its wholly owned subsidiary The North West Company Inc. (NWC), administer the assets and liabilities of NWF and make distributions to the unitholders all in accordance with the Declaration of Trust.

### 2. SIGNIFICANT ACCOUNTING POLICIES

**Basis of Presentation** The consolidated financial statements of the Fund are prepared in accordance with Canadian generally accepted accounting principles. All amounts are expressed in Canadian dollars unless otherwise noted. These consolidated financial statements include the accounts of NWF, NWC and its wholly owned subsidiaries (the "Company"), Alaska Commercial Company (AC) and the group of Tora companies, operating as Giant Tiger stores. All significant inter-company amounts and transactions have been eliminated on consolidation.

**Fiscal Year** The fiscal year ends on the last Saturday in January. Accordingly, the 2004 fiscal year ended January 29, 2005 (52 weeks) and the 2003 fiscal year ended January 31, 2004 (53 weeks). Approximately every five years an additional week of sales and expenses are included in the financial results to bring results back in line with the 52-week year.

**Revenue Recognition** Revenue on the sale of goods and services is recorded at the time the sale is made to the customer. Service charges on credit card receivables are accrued each month on balances outstanding at each account's billing date.

Accounts Receivable Accounts receivable classified as current assets include customer installment accounts of which a portion will not become due within one year.

**Inventories** Inventories are valued at the lower of cost and net realizable value less normal profit margins. The cost of warehouse inventories is determined by the average cost method. The cost of retail inventories is determined primarily using the retail method of accounting for general merchandise inventories and the cost method of accounting for food inventories.

**Property and Equipment** Property and equipment are recorded at cost. Amortization is provided using the straight-line method over their estimated useful lives, as follows:

Buildings	2%-5%
Leasehold improvements	5%-20%
Fixtures and equipment	8%
Computer equipment and software	12%-33%

**Impairment of Long Lived Assets** Impairment of long-lived assets is recognized when an event or change in circumstances causes the asset's carrying value to exceed the total undiscounted cash flows expected from its use and eventual disposition. The impairment loss is calculated by deducting the fair value of the asset from its carrying value.

**Other Assets** The investments in transportation companies are accounted for on the equity basis. Deferred financing costs are being amortized over the life of the instrument. Prepayments under lease agreements are being amortized over their respective lease terms.

**Unit Purchase Loan Plan** Loans issued to officers to purchase units of the Fund under the unit purchase loan plan are treated as a reduction of equity.

Foreign Currency Translation The accounts of Alaskan operations have been translated into Canadian dollars using the current rate method whereby assets and liabilities are translated at the year-end exchange rate and revenues and expenses at the average rate for the period. Foreign exchange gains or losses arising from the translation of the net investment in self-sustaining Alaskan operations and the portion of the U.S. denominated debt designated as a hedge against this investment are deferred and included in a separate component of equity as a cumulative currency translation adjustment. These cumulative currency translation adjustments are recognized in income when there has been a reduction in the net investment in the self-sustaining foreign operation.

**Income Taxes** The Fund is an inter vivos trust for income tax purposes. All income of the Fund is distributed to unitholders and, as such, no income tax is payable by the Fund.

The Company accounts for income taxes using the liability method of tax allocation. Under the liability method, future income tax assets and liabilities are determined based on the differences between the financial reporting and tax bases of assets and liabilities and are measured using substantively enacted tax rates and laws that are expected to be in effect in the periods in which the future income tax assets or liabilities are expected to be realized or settled. A valuation allowance is provided to the extent that it is more likely than not that future income tax assets will not be realized. The provision for income taxes is recorded in the Company at applicable statutory rates.

**Employee Future Benefits** The Company maintains both defined benefit and defined contribution pension plans for substantially all of its employees. The actuarial determination of the accrued benefit obligations for pension benefits uses the projected benefit method prorated on services which incorporates management's best estimate of expected plan investment performance, salary escalation, and retirement ages of employees. For the purpose of calculating the expected returns on plan assets, those assets are valued at market related value based on a five year moving average. Past service costs and the net transitional asset are amortized on a straight line basis over the average remaining service period of the employees expected to receive the benefits under the plan. The excess of the net actuarial gain or loss over 10% of the greater of the accrued benefit obligation and the market related value of the plan assets is amortized over the average remaining service period of active employees. The average remaining service period of active employees covered by the pension plan is 15 years (2003–15 years). Contributions to the defined contribution pension plan are expensed as incurred.

Unit Appreciation Rights (UARs) Plans Compensation expense under the Company's UARs plans is charged to operations as it accrues using the fair value method. No units of the Fund are issued under these plans.

**Financial Instruments** The Company uses various financial instruments to reduce its exposure to fluctuations in interest and U.S. currency exchange rates. The Company does not hold or issue any derivative financial instruments for speculative trading purposes. The interest differential to be paid or received under interest rate swap agreements is recognized over the life of the contracts as an adjustment to interest expense. The Company translates its U.S. denominated debt that is hedged by cross currency swaps at the rate implicit in the swap agreement.

**Use of Estimates** The preparation of financial statements in conformity with 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 reporting period. Future events could alter such estimates in the near term.

### 3. PROPERTY AND EQUIPMENT (\$ in thousands)

Year Ended		January 2005		January 2004
	Cost	Accumulated Amortization	Cost	Accumulated Amortization
Land	\$ 6,498	\$ -	\$ 6,310	\$ -
Buildings & leasehold improvements	201,775	93,385	198,105	84,961
Fixtures & equipment	121,051	73,223	118,656	67,430
Computer equipment & software	62,967	39,579	72,099	50,384
	\$392,291	\$206,187	\$395,170	\$202,775
Net book value		\$186,104		\$192,395

### 4. OTHER ASSETS (\$ in thousands)

Year Ended	January 2005	January 2004
Investments in transportation companies	\$ 5,036	\$ 4,315
Deferred financing costs	853	1,039
Prepayments under lease agreements	1,052	1,151
Long-term receivable	3,839	3,993
Other*	1,179	1,655
	\$11,959	\$12,153

<sup>\*</sup>Other includes redeemable deposits with suppliers and a mortgage receivable

### **5. BANK ADVANCES AND SHORT-TERM NOTES**

The Canadian operation has available operating loan facilities of \$85 million at interest rates ranging from prime to prime plus .75%. These facilities are secured by a floating charge against the assets of the Company on a parri-passu basis with the senior note holders. As at January 29, 2005, the Company had drawn on the facilities \$29,191,000 (2003-\$28,834,000).

The Alaskan operation has available an operating loan facility of US\$4 million at an interest rate of prime plus 1.0% secured by a floating charge against the assets of the Company. As at January 29, 2005, the Alaskan operations had drawn on the facility US\$2,281,000 (2003-US\$1,409,000).

### 6. LONG-TERM DEBT (\$ in thousands)

Year Ended	January 2005	January 2004
Senior notes <sup>1</sup>	\$ 80,679	\$ 86,704
Effect of foreign currency swaps 1	6,805	4,728
Real estate loans <sup>2</sup>	-	4,523
Obligation under capital lease <sup>3</sup>	1,425	1,634
	88,909	97,589
Less: Current portion of long-term debt	106	640
	\$ 88,803	\$ 96,949

- 1 The US\$65 million senior notes mature on June 15, 2009 and bear an interest rate of 5.89% payable semi-annually. Repayment of 20% of the principal is required on June 15, 2007 and June 15, 2008. The notes are secured by a floating charge against the assets of the Company. The Company has entered into various cross currency interest rate and interest rate swaps resulting in floating interest costs on US\$36 million of its senior notes. After giving effect to the interest rate swaps and cross currency interest rate swaps the effective interest rate for 2004 was 5.3%.
- 2 The Alaska Industrial and Economic Development Export Authority (AIDEA) and two Alaskan-based banks provided real estate loans to assist in the financing of new stores. The loans were fully repaid in 2004.
- 3 The obligation under a capital lease of US\$1.1 million (2003–US\$1.2 million) is repayable in blended principal and interest payments of US\$200,000 annually. The obligation will be fully repaid on October 31, 2013.

The Company's principal payments of long-term debt over the next five years are as follows:

Years Ending January	(\$ in tho	usands)
2006	\$	106
2007		117
2008		16,277
2009		16,291
2010 and thereafter		48.602

### 7. CAPITAL

**Authorized** The Fund has an unlimited number of units.

(units and \$ in thousands) Year Ended	Já	anuary 2005		January 2004
Issued and outstanding	16,126	\$165,205	16,126	\$165,205

### 8. UNIT PURCHASE LOAN PLAN

During the year the Company issued loans to officers to purchase units under the unit purchase loan plan. These loans are non-interest bearing and are repayable from the Company's after tax distributions or if the officer sells the units or leaves the Company. The loans are secured by a pledge of 225,998 units of NWF with a guoted value of \$7,006,000 as at January 28, 2005. Loans receivable at January 29, 2005 of \$4,429,000 (2003-\$3,650,000) are recorded as a reduction of equity. The loans have a term of five years. The maximum amount of the loans under the plan will not exceed \$7,500,000.

### 9. CUMULATIVE CURRENCY TRANSLATION ADJUSTMENTS (\$ in thousands)

Year Ended	January 2005	January 2004
Balance, beginning of year Movement in exchange rate	\$5,244 (295)	\$ 5,379 (135)
Balance, end of year	\$4,949	\$ 5,244

The cumulative currency translation adjustments account represents the net changes due to exchange rate fluctuations in the equivalent Canadian dollar book values of the net investment in self-sustaining Alaskan operations since the date of acquisition. A portion of the U.S. denominated senior notes in the amount of US\$43 million has been designated as a hedge against the Alaskan operations.

### 10. INCOME TAXES (\$ in thousands)

Significant components of the Company's future tax assets are as follows:

Year Ended J	January 2005	January 2004
Future tax assets		
Non-capital loss carryforwards Tax values of capital assets in excess of accounting value Provisions and other temporary differences	\$ 472 Jes 7,545 2,382	\$ 82 8,215 2,841
Net future tax asset	\$10,399	\$11,138
Comprised of		
Current Long-term	\$ 2,467 7,932	\$ 2,916 8,222
	\$10,399	\$11,138

Income tax expense differs from the amounts, which would be obtained by applying the combined statutory income tax rate to earnings due to the following:

uary 2005	January 2004
\$46,940 36.67%	\$44,126 38.20%
17,212	16,856
620 (160) (9,425) 815 (39) 652	674 93 (10,008) - (38) 819
\$ 9,675	\$ 8,396
20.61%	19.03%
	\$46,940 36.67% 17,212 620 (160) (9,425) 815 (39) 652 \$ 9,675

Significant components of the provision for income taxes are as follows:

Year Ended	January 2005	January 2004
Current income tax expense	\$ 9,039	\$ 5,607
Future income tax expense (benefit) relating to: Temporary differences and loss carryforwards Recognition of Canadian income tax rate changes	675	2,827
on future income taxes	(39)	(38)
Provision for income taxes	\$ 9,675	\$ 8,396

### 11. NET EARNINGS PER UNIT

Basic net earnings per unit are calculated based on the weighted-average units outstanding of 15,918,000 (2003–15,940,000). The diluted net earnings per unit takes into account the additional income that would have been earned by the Company had interest costs not been incurred on the unit purchase loan plan and had the respective units been outstanding during the year.

(\$ and units in thousands except
diluted earnings per unit)

Year Ended	January 2005	January 2004
Diluted earnings per unit calculation:		
Net earnings for the year (numerator for basic earnings per unit) After tax interest cost of unit purchase loan plan	\$37,265 163	\$35,730 128
Numerator for diluted earnings per unit	\$37,428	\$35,858
Weighted average units outstanding Effect of diluted unit purchase loan plan	15,918 208	15,940 186
Denominator for diluted earnings per unit	16,126	16,126
Diluted earnings per unit	\$ 2.32	\$ 2.22

### 12. SEGMENTED INFORMATION (\$ in thousands)

The Company operates predominantly within the retail industry in northern Canada and Alaska. The following information is presented for the two business segments:

Year Ended	January 2005	January 2004
Sales		
Canada	\$629,822	\$615,661
Alaska	158,871	167,059
Total	\$788,693	\$782,720
Net earnings before amortization, interest and income taxes		
Canada	\$ 62,629	\$ 57,663
Alaska	13,977	15,163
Total	\$ 76,606	\$ 72,826
Net earnings before interest and income taxes		
Canada	\$ 42,652	\$ 39,250
Alaska	10,049	11,175
Total	\$ 52,701	\$ 50,425
Identifiable assets		
Canada	\$293,254	\$289,825
Alaska	63,963	66,555
Total	\$ 357,217	\$356,380

### 13. EMPLOYEE FUTURE BENEFITS (\$ in thousands)

The Company sponsors defined benefit pension plans covering substantially all Canadian employees. The defined benefit pension plans are based on years of service and final average salary. The Company uses actuarial reports prepared by independent actuaries for funding and accounting purposes as at January 29, 2005 and January 31, 2004. The accrued pension benefits and the market value of the plans' net assets were last determined by actuarial valuation as at January 1, 2002. The next actuarial valuation is required for January 1, 2005. The Company also sponsors an employee savings plan covering all U.S. employees with at least six months of service. Under the terms of the plan, the Company is obligated to make a 50% matching contribution up to 3% of eligible compensation.

Total cash payments by the Company for future employee benefits, consisting of cash contributed to its pension plans and U.S. employees' savings plans, was \$2,395,000 (2003–\$2,368,000).

The following significant actuarial assumptions were employed to measure the accrued benefit obligations and benefit plan expense:

Year Ended	January 2005	January 2004
Accrued benefit obligations		
Discount rate	6.0%	6.5%
Rate of compensation increase	4.0%	4.0%
Benefit plan expense		
Discount rate	6.5%	7.0%
Expected long-term rate of return on plan assets	7.0%	7.0%
Rate of compensation increase	4.0%	4.0%

The Company's pension benefit expense is determined as follows:

Year Ended		January 2005 January			January 2004	
	Incurred in year	Matching Adjustments <sup>1</sup>	Recognized in year	Incurred in year	Matching Adjustments <sup>1</sup>	Recognized in year
Current service costs, net of employee contributions	\$ 2,244	\$ -	\$ 2,244	\$ 1,996	\$ -	\$ 1,996
Interest on accrued benefits	2,745	-	2,745	2,666	-	2,666
Return on plan assets	(2,979)	109	(2,870)	(2,304)	(484)	(2,788)
Actuarial (gain) loss	3,312	(3,240)	72	2,200	(2,200)	_
Past service costs	-	(11)	(11)	_	(11)	(11)
Amortization of net transition asset	-	(308)	(308)	-	(308)	(308)
Net benefit plan expense	\$ 5,322	\$ (3,450)	\$ 1,872	\$ 4,558	\$ (3,003)	\$ 1,555

<sup>1</sup> Accounting adjustments to allocate costs to different periods so as to recognize the long-term nature of employee future benefits

The expense incurred under the employee savings plan covering U.S. employees is US\$131,000 (2003–US\$127,000).

Information on the Company's defined benefit plans, in aggregate, is as follows:

Year Ended	January 2005	January 2004
Plan assets		
Fair value—beginning of year	\$ 37,026	\$ 34,852
Actual return (loss) on plan assets	2,870	2,514
Employer contributions	2,212	2,192
Employee contributions	46	52
Benefits paid	(2,955)	(2,584)
Fair value—end of year	\$ 39,199	\$ 37,026
Plan obligations		
Accrued benefit obligation—beginning of year	\$ 43,704	\$ 39,373
Current service cost	2,277	2,049
Accrued interest on benefits	2,745	2,666
Benefits paid	(2,955)	(2,584)
Actuarial loss	3,312	2,200
Accrued benefit obligation—end of year	\$ 49,083	\$ 43,704
Funded status		
Fair value plan assets	\$ 39,199	\$ 37,026
Accrued benefit obligation	49,083	43,704
Plan deficit	(9,884)	(6,678)
Unamortized experience gains/losses	12,941	9,701
Unamortized net transitional asset	(2,690)	(2,998)
Unamortized past service costs	(73)	(84)
Accrued benefit asset (liability)	\$ 294	\$ (59)

The accrued benefit asset (liability) is included in accounts payable and accrued liabilities in the Company's consolidated balance sheet.

The accrued benefit obligation of all of the Company's defined benefit pension plans exceeds the fair value of plan assets as noted above.

Year Ended	January 2005	January 2004	
Plan assets consist of:			
Equity securities	51%	48%	
Debt securities	38%	42%	
Other	11%	10%	
Total	100%	100%	

The pension plans have no investment in the units of the Company.

### 14. COMMITMENTS, CONTINGENCIES AND GUARANTEES

### **Commitments**

a) In 2002, the Company signed a 30-year Master Franchise Agreement with *Giant Tiger Stores Limited*, based in Ottawa, Ontario which grants the Company the exclusive right to open Giant Tiger stores in western Canada. Under the agreement, *Giant Tiger Stores Limited* provides product sourcing, merchandising, systems and administration support to the Company's Giant Tiger stores in return for a royalty based on sales. The Company is responsible for opening, owning, operating and providing distribution services to the stores. The Company's exclusivity right requires that a minimum number of Giant Tiger stores be opened each year, based on an expected roll-out of 72 stores over the term of the agreement. As at January 29, 2005 the Company has opened 10 Giant Tiger stores.

b) In 1992, the Company entered into an agreement to lease the land on which the Winnipeg Logistics Service Centre is located from the City of Winnipeg for \$1 per year for 15 years subject to attaining agreed-upon job creation targets. Management anticipates that the agreed targets will be met; accordingly, no additional lease payments have been accrued. The Company is obligated to buy the land for the greater of \$1,710,000 or fair market value at August 31, 2007.

c) The Company has future commitments under operating leases as follows:

Years Ending January	Minimum Lease Payments (\$ in thousands)
2006	\$11,169
2007	10,390
2008	
2009	8,850
2010	
Thereafter	51,815

**Contingencies** Canada Revenue Agency is currently conducting an audit for the taxation years 1996–1999. It is the opinion of management that the pending reassessments will be resolved without material effect on the financial statements.

**Guarantees** The Company has provided the following significant guarantees to third parties:

a) The Company has entered into indemnification agreements with its current and former directors and officers to indemnify them, to the extent permitted by law, against any and all charges, costs, expenses, amounts paid in settlement and damages incurred by the directors and officers as a result of any lawsuit or any judicial, administrative or investigative proceeding in which the directors and officers are sued as a result of their service. These indemnification claims will be subject to any statutory or other legal limitation period. The nature of the indemnification agreements prevents the Company from making a reasonable estimate of the maximum potential amount it could be required to pay to counterparties. The Company has purchased director and officer liability insurance. No amount has been recorded in the financial statements with respect to these indemnification agreements.

b) In the normal course of operations, the Company provides indemnification agreements to counterparties for various events such as intellectual property right infringement, loss or damages to property, claims that may arise while providing services, violation of laws or regulations, or as a result of litigation that might be suffered by the counterparties. The terms and nature of these indemnification agreements vary based on the specific contract. The nature of the indemnification agreements prevents the Company from making a reasonable estimate of the maximum potential amount it could be required to pay to counterparties. No amount has been recorded in the financial statements with respect to these indemnification agreements.

### 15. UNIT APPRECIATION **RIGHTS (UARs) PLANS**

The Company has two UARs plans, non-contingent and performance contingent, which form part of the long-term incentive program for senior management. The UARs program was discontinued in 2000, however previously issued UARs continue to vest until 2005 and expire in 2006. The expense incurred during the year under the plan was \$252,000 (2003-\$842,000).

**Non-Contingent Plan** A summary of the Company's non-contingent plan and changes during the year is presented below:

Year Ended	January 2005		January 2004	
	UARs (000's)	Price*	UARs (000's)	Price*
Outstanding at beginning of year	128	\$13.55	294	\$13.79
Exercised	(113)	25.66	(156)	23.16
Forfeited	(6)	10.50	(10)	14.00
Outstanding at end of year	9	\$12.34	128	\$13.55
UARs exercisable at year end	4		94	

<sup>\*</sup>Weighted-average

The non-contingent UARs vest over five years and expire after six years. As of January 29, 2005, the 9,000 non-contingent UARs outstanding under this plan have exercise prices between \$10.50 and \$15.00.

**Performance Contingent Plan** The Company granted qualifying senior management UARs where vesting was contingent upon reaching predetermined financial targets by January 26, 2002 and the personal ownership of units equal to the number of UARs granted. These contingent UARs commenced vesting in 2002 and vest over three years and expire after four years.

A summary of the Company's performance contingent plan and changes during the year is presented below:

Year Ended January 2005		Janua	January 2004	
	UARs (000's)	Price*	UARs (000's)	Price*
Outstanding at beginning of year	17	\$14.88	30	\$14.53
Exercised	(17)	26.33	(13)	23.78
Forfeited	-	-	_	_
Outstanding at end of year	-	-	17	\$14.88
UARs exercisable at year end	_		12	

<sup>\*</sup>Weighted-average

As of January 29, 2005, there are no performance UARs outstanding under the plan.

### 16. FINANCIAL INSTRUMENTS (\$ in thousands)

**Short-Term Financial Instruments** Short-term financial instruments which include cash, accounts receivable, bank advances and short-term notes, accounts payable and accrued liabilities, and income tax payable are valued at their carrying amounts included in the balance sheet, which are reasonable estimates of fair value due to the relative short period to maturity of the instruments.

**Long-Term Financial Instruments** The Company has the following long-term financial instruments outstanding as at January 29, 2005:

	Maturity	Interest Rate	<b>Carrying Value</b>	Fair Value
Debt				
US\$65 million Senior notes	2009	5.89% ¹	\$80,679	<sup>2</sup> \$83,877
				Unrealized Gain(Loss)
Swaps				
US\$14 million Interest rate	2007–2009	LIBOR <sup>3</sup> plus 1.87%		\$60
US\$22 million Cross currency Interest rate	2007–2009	B.A. <sup>4</sup> plus 2.99% to B.A. plus 3.16%		\$(7,905)

<sup>2</sup> The senior notes (note 6) recorded on the balance sheet includes unrealized losses of \$6,805 on the foreign currency portion of the US\$22 million cross currency interest rate swaps

<sup>3</sup> London Interbank Offered Rate

<sup>4</sup> Bankers' Acceptances

Interest Rate Risk The Company has exposure to interest rate fluctuations on the swapped amount of its senior notes.

**Credit Risk** The Company is exposed to credit risk, primarily in relation to credit card customer accounts and notes receivable from First Nations governments. The Company performs regular credit assessments of its customers and provides allowances for potentially uncollectible accounts receivable.

### 17. ACCOUNTING POLICY CHANGES

In 2004 the Company implemented the following new accounting standards issued by the Canadian Institute of Chartered Accountants (CICA):

**Hedging Relationships** The Company adopted Accounting Guideline 13 "Hedging Relationships" (AcG 13), effective February 1, 2004. In accordance with the new guideline, the Company's hedging relationships are documented and subject to effectiveness tests on a quarterly basis for reasonable assurance that they are and will continue to be effective. Any derivative that does not qualify for hedge accounting is reported in earnings on a mark to market basis. The adoption of AcG 13 had no impact on the Company's financial statements.

**Asset Retirement Obligations** In the first quarter of 2004, the Company retroactively implemented CICA Section 3110 "Asset Retirement Obligations" (CICA 3110). Section 3110 establishes the standards for the recognition, measurement and disclosure of legal obligations associated with the costs to retire long-lived assets. A liability associated with the retirement of long-lived assets is recorded in the period in which the legal obligation is incurred at its estimated fair value and a corresponding asset is capitalized as part of the related asset and that asset is depreciated over its useful life. Subsequent to the initial measurement of the asset retirement obligation, the obligation is adjusted to reflect the passage of time and changes in the estimated future costs underlying the obligation.

Accordingly, the Company has recognized a discounted liability associated with the operation of petroleum dispensing units and specific provisions in certain lease agreements regarding the exiting of leased properties at the end of the respective lease terms. This standard was implemented retroactively with restatement of the prior year's consolidated financial statements. The cumulative effect of implementation was a decrease to opening retained earnings for 2003 of \$287,000 (net of future income taxes recoverable of \$165,000), an increase in property and equipment of \$586,000, an increase in other liabilities of \$1,033,000 and an increase in the cumulative translation adjustment of \$5,000. The impact on net earnings for each of 2003 and 2004 was not material.

### **Accounting for Certain Consideration Received from Vendors**

In the third guarter of 2004, the Company retroactively implemented Emerging Issues Committee Abstract 144 "Accounting by a Customer (Including a Reseller) for Certain Consideration Received from a Vendor" (EIC 144). EIC 144 requires a customer to record cash consideration received from a vendor as a reduction in the price of the vendor's products and reflect it as a reduction of cost of goods sold and related inventory when recognized in the income statement and balance sheet.

The Company receives allowances from certain of its merchandise vendors which it records as a reduction of cost of goods sold. EIC 144 has changed the timing of recognition of some vendor allowances. This standard was implemented retroactively with restatement of the prior year's consolidated financial statements. Accordingly, the Company recorded a decrease to opening retained earnings for 2003 of \$857,000 (net of current future income taxes recoverable of \$487,000), a decrease to inventory of \$1,324,000 and an increase of \$20,000 to the cumulative translation adjustment. The impact on earnings for each of 2003 and 2004 was not material.

**Variable Interest Entities** During the fourth quarter, the Company adopted in advance Accounting Guideline 15 "Consolidation of Variable Interest Entities" (AcG 15). This guideline requires the consolidation of variable interest entities (VIE) for annual or interim periods beginning on or after November 1, 2004. A VIE is any legal structure used to conduct activities or hold assets which are not controlled by voting interests. but rather by contractual or other interests that change with that entity's underlying net asset value. The Company has assessed the impact of the accounting guideline and determined that the Company is not the primary beneficiary of any variable interest entities and accordingly, the implementation of AcG 15 has not had any impact on the consolidated financial statements.

### 18. COMPARATIVE AMOUNTS

The comparative amounts have been reclassified to conform with the current year's presentation.

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