Management's Discussion & Analysis

REVIEW OF CONSOLIDATED RESULTS

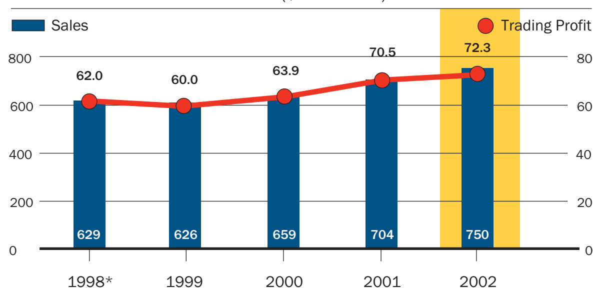
The consolidated results for the year are summarized below by the key productivity factors used by management.

KEY PRODUCTIVITY FACTORS ($ in thousands)

	2002	2001	2000
Sales	$749,759	$704,043	$659,032
Same store sales % increase	3.4%	4.4%	3.4%
Trading profit	$ 72,271	$ 70,535	$ 63,886
Net earnings	$ 34,469	$ 29,015	$ 28,134
Return on net assets	13.4%	12.7%	11.5%
Return on equity	15.8%	14.9%	15.2%

Sales for the 52 weeks ending January 25, 2003 increased 6.5% (3.4% on a same store basis) to $749.8 million from $704.0 million in 2001. Same store sales started the year slowly with only a 1.7% increase in the first quarter, but improved throughout the year with increases of 3.5%, 3.8% and 4.7% in the next three quarters. Same store sales improved due to stronger seasonal general merchandise assortments secured through alliance partners, Giant Tiger and *Dufresne Furniture and Appliances.* High markdowns to clear aged merchandise also stimulated fourth quarter sales. Food sales benefited from better quality and price management within the Company's perishable categories in Alaska. Canadian food sales growth reflected increased value SKU penetration and basic price inflation. NWF consolidated earnings increased 18.8% to $34.5 million or $2.14 per unit on a fully diluted basis from $29.0 million or $1.95 per unit in 2001. Canadian operations accounted for 75.5% of total sales (75.6% in 2001) while Alaska contributed 24.5% (24.4% in 2001).

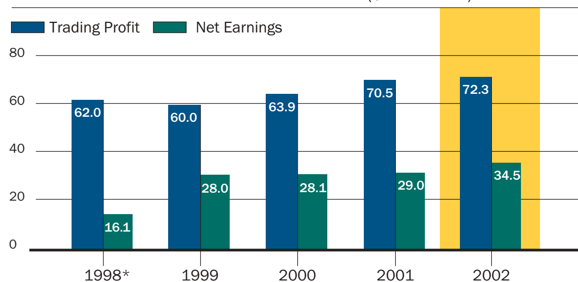
SALES & TRADING PROFIT ($ in millions)



Lower margins helped stimulate sales but reduced trading profit growth.

Trading profit (EBITDA) increased by 2.5% to $72.3 million from $70.5 million in 2001. Gross margin rate erosion in Canadian operations helped stimulate sales but diluted trading profit rates. Canadian expense rates excluding amortization were reduced by 0.6% with the majority of the improvement coming from financial services. Trading profit as a percentage of revenue was 9.6% and has consistently been in the 9.6% to 10.0% range over the last five years. Amortization costs were unchanged from last year at $22.7 million. Earnings before interest and income taxes (EBIT) increased 3.7% to $49.6 million from $47.8 million in 2001.

TRADING PROFIT & NET EARNINGS ($ in millions)



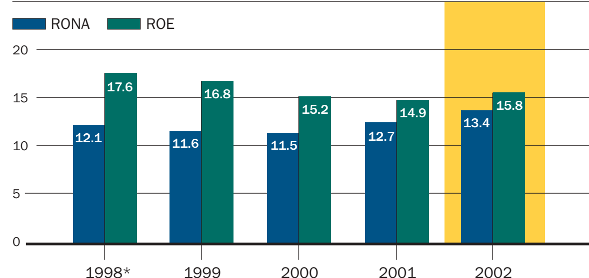
2002 net earnings increased faster than trading profit due to lower interest and tax expenses.

Interest expense decreased by 36.4% to $6.7 million compared to $10.5 million in 2001 due to lower interest rates and reduced average debt levels. The average cost of borrowing on interest bearing debt decreased to 4.45% from 5.76% in 2001. Average debt levels declined over the year by 17.6% to $150.0 million from $182.2 million in 2001. The Company took advantage of the low interest rates in 2002 having swapped all its debt to floating rates to August 28, 2002. The reduction in average debt levels in 2002 was primarily due to funds applied from the equity issue in December 2001 and the reduction in working capital during the year.

The effective income tax rate for 2002 was 19.7% of pre-tax earnings compared to 22.3% in 2001. Income taxes for Canadian operations declined to $5.5 million in 2002 from $6.2 million in the previous year due to increased interest paid to the Fund in 2002 as a result of the $30 million note issued on December 31, 2001. This reduced the Canadian tax rate to 15.7% of earnings pretax in 2002 compared to 19.2% in 2001. Alaska Commercial Company (AC) had a tax expense of $3.0 million, or 37.1% of pretax income, compared to $2.1 million in 2001, or 42.0% of pre-tax earnings. AC's tax decrease was due to the recovery of alternative minimum taxes paid in previous years and adjustments to the future tax asset.

Installation of industry-leading technology is expected to deliver annual benefits of $5 million.

RETURN ON NET ASSETS & EQUITY (%)



*Before unusual item

Return on net assets and return on equity performance was helped by higher inventory productivity.

Return on net assets employed increased to 13.4% from 12.7% in 2001 while the return on equity improved to 15.8% from 14.9% in 2001. Return on assets was higher due to better flow of seasonal merchandise and warehouse inventory being effectively outsourced to alliance partners. These initiatives were part of an increased emphasis on improving inventory turnover and other controllable net assets. The higher return on equity was mainly due to the 18.8% improvement in net earnings in 2002.

CANADIAN OPERATIONS

Retail Environment The retail environment in northern Canada was relatively healthy in 2002. The government of Nunavut continued to put new infrastructure in place that stimulated the economies of larger communities. The Northwest Territories benefited from mining and oil exploration. Remote communities in the northern parts of the provinces were not as buoyant as those north of the 60th parallel.

2002 Canadian Operations Strategy

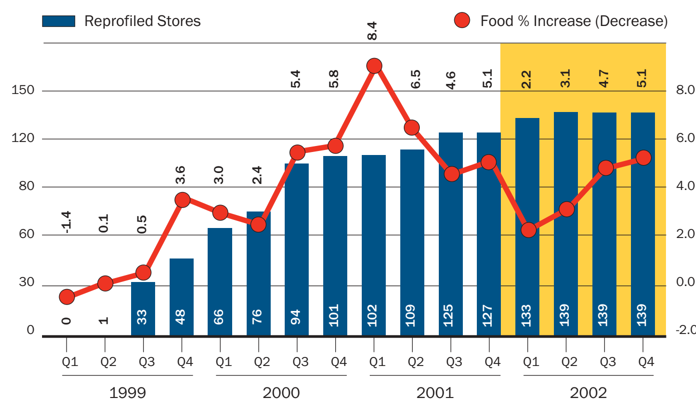
1. *Develop superior Store Selling Capabilities;*
2. *Complete the Reprofiling program;*
3. *Pursue Alliances to improve assortments and reduce costs; and*
4. *Complete the Giant Tiger stores test.*

Store Capabilities Store level selling capability will continue to receive the highest priority over the next two years. The foundation for improvements began with a revamping of store management and supervisory compensation, aimed at attracting and retaining higher quality local employees.

Replacement store information systems were selected in 2002. These new solutions will eliminate or automate non-selling activities such as time and attendance tracking, credit administration, receiving and store accounting. The systems were modified to meet the specific needs of our stores in Canada as well as Alaska and were tested in 2002. They will be rolled out over three years at a cost of $15 million and are expected to deliver annual benefits of $5 million once all stores have been converted. The plan calls for the conversion of 31 stores in Canada and 9 stores in Alaska during 2003 at a cost of $4.2 million with the remaining stores converted in 2004. Three *best practice* stores will be established in the spring of 2003 and will become training sites for existing and new store management teams. Our goal is to develop more streamlined work practices at the store level, to allow more time to be dedicated to selling activities. The performance target for 2003 is to train 91 management level employees at *best practice* store sites.

Reprofiling The Company completed the reprofiling project at the final 12 stores in 2002. Reprofiling ensures that each store has food and general merchandise assortments based on local market opportunities, as well as the required fixtures and equipment to satisfy customer needs. Reprofiling focused on addressing food needs first and making more effective use of the remaining selling space to meet the community's general merchandise requirements. There are several other stores that will incorporate the reprofiling concept when scheduled store upgrades are made over the next few years.

REPROFILING IMPACT ON FOOD SALES



Reprofiling has helped build the Company's leadership position in northern food retailing.

Alliance agreements reduced distribution costs by over $300,000.

Alliance Improvements to Plan/Buy/Move/Sell
A new alliance distribution agreement was completed in July 2002 with *A. De La Chevrotière Ltée* to supply the Company's stores in eastern Canada with food products replacing service from our food distribution centre in Winnipeg. The savings on distribution costs, freight and timelines of delivery are expected to exceed $200,000 per year while improving the in-stock position of these stores and reducing inventory levels by $1.5 million. Alliance agreements with *Giant Tiger Stores Limited, TruServ Canada Cooperative Inc., Dufresne Furniture & Appliances* and *Pratt's Wholesale Limited* reduced distribution costs by over $300,000 in 2002 with additional savings expected in 2003. The three-store test with *RadioShack* was discontinued in favor of partnering with a consolidated group of electronics vendors. The savings associated with these alliances vary by vendor but range from a minimum of 0.5% to just over 2.0% of the cost of purchases.

The development of alliance partners has enabled NWC to access a better blend of value priced, 'off-brand' items to meet the growing demand for these types of products among our necessity impulse shoppers. This has helped to increase unit sales and market share but has been deflationary during the transition period. We believe that we will continue to improve market share and generate sustainable growth by pursuing lower cost goods for our customers.

Giant Tiger Stores Expansion In June 2002, NWC completed testing of two franchise stores under a Master Franchise Agreement with *Giant Tiger Stores Limited,* based in Ottawa, Ontario. The performance of these stores exceeded expectations. Giant Tiger and NWC completed a 30-year Master Franchise Agreement that grants NWC the exclusive right to open and operate Giant Tiger stores in western Canada. Under this agreement, Giant Tiger provides product sourcing, merchandising, systems and administration support to NWC's Giant Tiger stores in return for a royalty based on sales. NWC will be responsible for opening, owning and operating the stores, as well as food procurement and distribution. NWC's exclusivity right requires that a minimum number of Giant Tiger stores be opened each year, based on an expected rollout of 72 stores over the term of the agreement. Giant Tiger stores' focus is to offer everyday low prices and great value on current fashions, home decorating, groceries, frozen food, dairy products, health and beauty supplies and toys — all within a convenient, clean, bright, affordable and friendly shopping environment. The Company believes that Giant Tiger's junior discount store format can uniquely satisfy an underserved market in western Canada by appealing to low and fixed income shoppers, as well as convenience-oriented consumers who cannot readily access larger discount stores located in suburban areas.

A third store was successfully opened in Winnipeg in October 2002. All three stores have exceeded their targets for sales and earnings. Four new Giant Tiger stores are scheduled to open in 2003 — two in Winnipeg, one in Regina and one in Edmonton.

2002 Operating Highlights

1. Sales increase of 6.3% (3.6% on a same store basis);
2. Opening a third Giant Tiger store;
3. Completion of Reprofiling program;
4. Development of Store Capabilities training program;
5. Introduction of new Best Practice stores training sites;
6. Development of an in-store systems platform to support Store Capabilities;
7. Reduction in the expense rate excluding amortization by 0.6%; and
8. Increase in inventory turns of 13%.

Financial Performance Results of Canadian operations are summarized below by the key productivity factors used by management.

KEY PRODUCTIVITY FACTORS ($ in thousands)

	2002	2001	2000
Sales	$565,747	$532,349	$502,756
Same store sales % increase	3.6%	4.2%	3.6%
Trading profit	$ 59,163	$ 60,337	$ 54,534
Return on net assets	14.0%	13.9%	12.0%

Canadian sales increased 6.3% (3.6% on a same store basis) to $565.7 million compared to $532.3 million in 2001.

Canadian food sales accounted for 66.0% (65.2% in 2001) of total sales. The balance was made up of general merchandise sales at 29.6% (29.9% in 2001), 'other' sales that are primarily fuel sales at 2.8% (3.4% in 2001), and consumer credit revenue at 1.6% (1.5% in 2001).

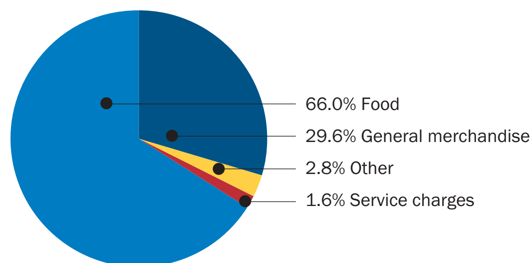
Core stores include the Northern and NorthMart store formats in Canada and exclude the Giant Tiger stores and non-core operations. Food sales in core stores increased 4.6% (3.8% on a same store basis) compared to an increase of 6.5% in 2001. This was less than our 6% target. We are encouraged by the

Food sales represent our most profitable growth opportunity.

strengthening of food sales through the year, which generated progressive quarterly sales increases of 3.2%, 3.8%, 5.4%, and 5.9% respectively. We have focussed on food as our most profitable growth opportunity and have allocated more selling space, improved fixtures and refrigeration and more expertise to this business, while increasing our mix of lower priced food items. Sales increases were achieved across all major categories with the strongest performances in tobacco, which was affected by higher government taxes imbedded in the price; deli, which is a growth opportunity in our larger stores; confectionary; frozen foods; and produce. The weakest category was food service, which was impacted by closures of unprofitable units and labour shortages in many locations due to extended hours of operations. New proprietary hot food offerings are being tested to refresh menus. These items have been well received and will be expanded in 2003.

General merchandise sales in core stores finished below plan with an increase of 3.1% over 2001 (2.6% on a same store basis). As was the case with food sales, general merchandise sales momentum accelerated through the year. After decreasing 1.6% in the first quarter, sales increased by 2.8%, 4.8% and 5.1% in the second, third and fourth quarters respectively. Sales were weaker in the first half of the year as a result of disruptions experienced in product flow and assortment planning during the transition to new procurement alliances in fashion clothing and home furnishings. These challenges were resolved and the in-stock position was improved which led to stronger sales later in the year. Sales were strongest in men's apparel, transportation and electronics. Hardlines sales were up 4.4%, while softlines sales were down 0.2% with footwear and ladies apparel the poorest performing groups. Sales from the *Selections* catalogue were up 6.9% to $43.1 million versus $40.3 million 2001.

CANADIAN SALES BLEND (%)



Food continued to increase its share of sales in 2002.

Same store sales in core stores for the past three years show an improved trend overall, led by strong food sales.

CORE STORES – SAME STORE SALES (% increase)

	2002	2001	2000
Food	3.8%	6.1%	4.2%
General merchandise	2.6%	0.0%	2.5%
Total sales	3.4%	4.2%	3.6%

On a regional basis, sales growth was strongest in Nunavut, the Northwest Territories and northern Quebec. Stores in larger communities did well as a result of government spending. Oil and mineral exploration activities provided a boost to stores in the Mackenzie River delta and around the Beaufort Sea.

Sales per selling square foot were $728 for food ($720 in 2001) and $299 for general merchandise ($280 in 2001) reflecting our strong food sales performance and the shift in additional square footage to food from general merchandise during the year. Food selling square footage accounted for 48% of total selling space of Canadian operations compared to 46% in 2001.

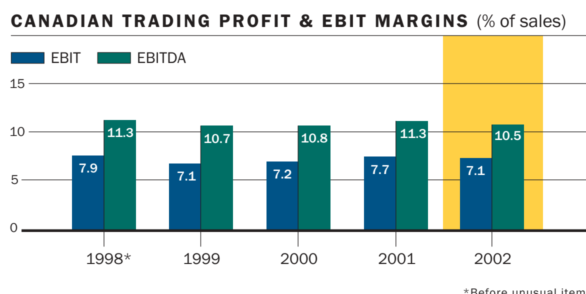
Gross profit dollars for the year were down 0.7% in core stores due to aggressive pricing in key markets, additional markdowns taken to eliminate aged stock and to support increased promotions to grow market share. Gross profit rates in core stores dropped to 34.6% in 2002 compared to 36.2% in 2001. The reduction was due to more aggressive pricing and promotions to gain local market share and additional markdowns taken to clear seasonal items. We also targeted selected communities where outshopping had become more of a concern and adjusted prices to try to reduce the spread between local prices and those prices in regional centres. Changes in buying arrangements have also reduced initial markup as alliance partners' markup have added to our costs. Savings for internal labor, distribution space, as well as inventory cost reductions have helped to offset these costs.

Inventory turnover in our core stores increased to 4.01 in 2002 from 3.63 turns in 2001. Year-end inventories were down 5.1% to $74.7 million compared to $78.7 million in 2001. Turnover for total Canadian operations, including goods in transit and distribution centres, improved to 3.39 turns from 3.00 turns due to the $6.8 million reduction to inventory levels in the stores and for the catalogue operations as merchandise was purchased much closer to the selling season.

Inventory turnover improved throughout 2002.

Canadian operating expense rate was reduced by 4.3% to 26.4% of sales in 2002 compared to 27.6% in 2001. The expense rate was reduced with only a 1.8% dollar increase over 2002. The improvements came from financial services and lower amortization costs.

CANADIAN TRADING PROFIT & EBIT MARGINS (% of sales)



Canadian trading profit declined slightly as gross margins were lower.

Trading profit from Canadian operations decreased 1.9% to $59.2 million or 10.5% of sales compared to $60.3 million or 11.3% of sales in 2001. The main variance from our plan occurred because of the erosion of gross profit margins.

The Diversified Business group consists of three Fur Marketing Branches, the Inuit Art Marketing Service and Crescent Multi Foods (CMF). Total sales for the group increased 8.2% to $14.6 million compared to $13.5 million in 2001. The Fur Marketing Branches and the Inuit Art Marketing Service had minor sales decreases for the year. CMF had a significant turnaround in 2002 with sales to external customers increasing 14.3% as a result of new customers added during the year. The Diversified Business group made a strong improvement in its operating contribution in 2002 led by an increase of just over $0.5 million from CMF.

Operational Net Assets Employed Operational net assets employed at January 25, 2003, decreased 0.6% to $272.1 million compared to $273.9 million at the previous year-end as summarized in the following table.

OPERATIONAL NET ASSETS EMPLOYED ($ in millions)

At the end of fiscal year:	2002	2001	2000
Property and equipment	$142.1	$144.6	$148.9
Inventory	102.0	108.8	101.7
Accounts receivable	56.8	57.6	49.8
Liabilities and other assets	(28.8)	(37.1)	(31.0)
Total operational net assets employed	$272.1	$273.9	$269.4

Property and equipment balances were down due to lower than expected capital expenditures in 2002 as a result of the delayed roll out of the new in-store system and the deferral of several store upgrades to 2003.

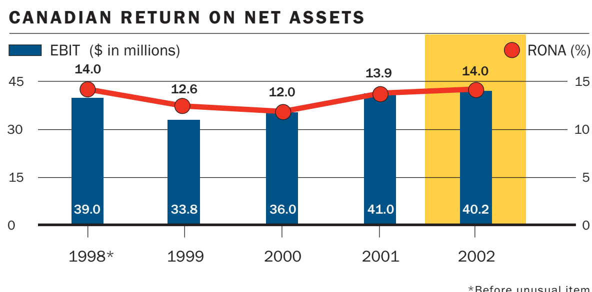
Inventory levels were reduced as part of a plan to eliminate chronic slow moving inventory pockets, improve merchandise flow, and reduce excess safety stock. This plan is expected to reduce average inventory levels by $10 million by the end of 2003 compared to average levels for the year 2000. We believe this plan is achievable and are encouraged by the improvement in inventory turnover in 2002. There are significant opportunities for even further gains through improved processes with alliance partners, more rapid ordering using electronic data interchange and better inventory management practices within our marketing group and at our stores.

Accounts receivable growth has leveled off after increases in the two previous years as customer accounts were converted to more flexible interest bearing accounts.

Other assets increased due to additional cash on hand to meet month-end cheque cashing and ATM requirements, a timing difference on the payment of insurance premiums and deferred financing charges related to the senior notes issued in August 2002. Liabilities were lower than last year due to lower reduced interest accruals of $5.4 million due to timing differences on scheduled interest payments on long-term debt and lower accruals for incentive payments.

Return on Net Assets The return on net assets employed for Canadian operations improved to 14.0% from 13.9% in 2001. The improvement was due to reductions in the average net assets employed during the year, particularly in inventory as a result of improved flow and increased emphasis on the importance of good inventory management techniques. During the year, we expanded our assisted replenishment system to all basic general merchandise. This improved the in-stock position, sales and allowed for inventory reductions without jeopardizing service levels.

CANADIAN RETURN ON NET ASSETS



Improved inventory management helped to increase return on net assets.

Alaska is adapting elements of the Canadian core business strategy.

EBIT was down by 2.1% to $40.2 million from $41.0 million in 2001 due to gross margin rate erosion. The reduction in average net assets employed during the year reduced debt levels and interest expenses.

ALASKAN OPERATIONS (stated in U.S. dollars)

Retail Environment The rural Alaskan market weakened in 2002 mainly due to poor conditions in the fishing industry which continued to struggle with low prices and poor supply. The other major economic factor that has hurt sales was the 17% reduction in the Alaska Permanent Fund (APF) dividends in 2002 to $1,541 per capita from $1,850 per capita in 2001. The dividends are based on the APF's average earnings over the last five years. Recent declines in the stock market have affected its investments. This trend is expected to continue into 2003. During the second half of the year, rural Alaska also felt the impact of unusually warm weather in the region, which has affected consumers' spending.

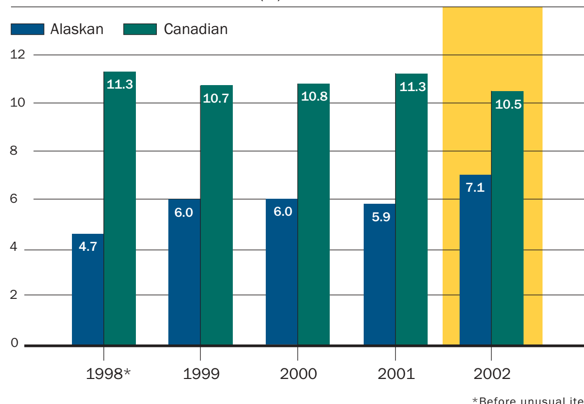
2002 Alaskan Operations Strategy *The strategy for the Alaskan operations (Alaska Commercial Company or AC) is to close the performance gap between AC stores and those in Canada through:*
1. *Acquisition and development of new store locations;*
2. *Focussing growth potential within the wholesale division;*
3. *Cost efficiencies achieved by leveraging investments made in head office support services and technology; and*
4. *Adapting elements of the Canadian core business strategy.*

The Alaskan operations stayed on course with these strategies in 2002. One new market was entered through an acquisition in the community of Mountain Village. AC's wholesale division (Frontier Expeditors or FE) rebounded in 2002, fully recovering its tobacco sales that were interrupted in 2001 due to a punitive municipal tax. It also added new customers previously serviced by other wholesalers that have abandoned the smaller villages that are FE's primary markets.

The In-Store Systems (ISS) initiative will be rolled out to the eight AC large stores and one small store in 2003. The Canadian and Alaskan operations have common in-store processes, something that will be maintained to maximize support cost efficiency when the new systems are introduced.

Trading margin rates between Canadian and Alaskan operations narrowed in 2002 as AC's rate rose to 7.1% of sales from 5.9% last year compared to 10.5% in Canadian operations. Given the weak economic conditions in rural Alaska, AC's performance in 2002 was very encouraging.

TRADING PROFIT RATES (%)



AC continued to close the margin gap with Canada.

2002 Operating Highlights
1. *Same store sales increased 2.6% in a challenging economic climate;*
2. *One new store was opened in Mountain Village in December 2002;*
3. *Gross margin rates improved by 0.7% in the stores group; and*
4. *Frontier Expeditors sales increased 32.7%.*

Financial Performance Alaskan results for the year are summarized below by the key productivity factors used by management.

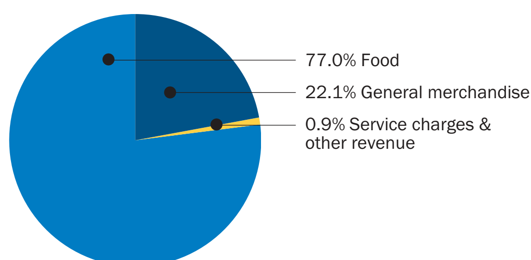
KEY PRODUCTIVITY FACTORS ($ in thousands)

	2002	2001	2000
Sales	$117,542	$110,308	$104,890
Same store sales % increase	2.6%	5.9%	2.2%
Trading profit	$ 8,373	$ 6,551	$ 6,277
Return on net assets	11.6%	8.5%	8.9%

Frontier Expeditors' sales increased 32.7% in 2002 due to increased market share.

AC continued its steady improvement in performance in fiscal 2002. Total sales were up 6.6% (2.6% on a same store basis) to $117.5 million for the year compared to $110.3 million in 2001. Food sales, which accounted for 77.0% of total revenue (76.2% in 2001), increased 7.6% (3.9% on a same store basis). General merchandise sales, which accounted for 22.1% of total revenue (22.8% in 2001), increased 3.0% (-1.4% on a same store basis). The sales increase in 2002 was largely driven by Frontier Expeditors, which had a 32.7% sales increase in 2002.

AC SALES BLEND (%)



Food sales in Alaska have a higher blend than in Canadian stores.

Gross profit rates for AC increased to 33.4% versus 33.3% in 2001 due to improved store margins, particularly in the perishable food categories, that offset the higher blend from wholesale operations. AC's expense rate declined to 28.3% of sales from 29.4% due to a recovery from unusual debt loss and accounting expenses incurred at FE in 2001.

AC stores delivered a strong food sales increase of 5.5% (3.9% on a same store basis) led by convenience categories such as deli up 19.4%, beverages up 14.6%, produce up 10.5% and snack food up 7.2%. Less competitive pressure on pricing and better recovery of freight increases allowed margins to increase. At the same time, AC stores remained competitive with local retailers and grew market share. General merchandise sales were down 0.9% (-1.4% on a same stores basis) for the year. The strongest performing categories were children's and ladies apparel, which increased 9.0% and 5.0% respectively. Transportation sales were up 0.9% following a strong increase of 38.6% in 2001. Hardware and sporting goods also registered a small increase in sales. Furniture sales were 11.2% below 2001 while men's apparel, footwear and outerwear also had sales decreases. Other sales, consisting primarily of gasoline, declined by 7.1%. Service charge income on customer accounts increased 19.3% due to the shift of customers to interest bearing accounts. Accounts receivable balances in Alaska increased 0.9% over the previous year.

Same store sales for the past three years are shown on the following table.

SAME STORE SALES (% increase)

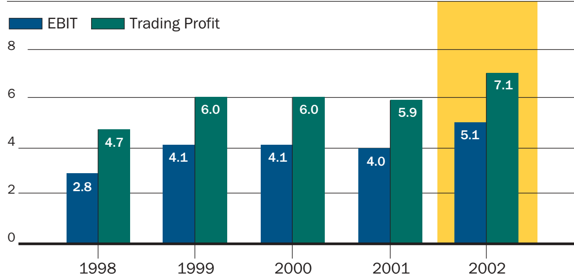
	2002	2001	2000
Food	3.9%	4.9%	2.9%
General merchandise	-1.4%	8.7%	0.4%
Total sales	2.6%	5.9%	2.2%

While same store sales increases were lower than those experienced in 2001, they are consistent with those of leading retailers in the U.S. and well ahead of many. We expected that the strong sales increase in general merchandise in 2001 would be difficult to match. General merchandise sales were positive through the spring but lost momentum in the fall when customers reacted to the reduction in the Permanent Fund Dividend payments.

Sales per selling square foot were $622 for food ($587 in 2001) and $268 for general merchandise ($257 in 2001) continuing the strong food sales performance per square foot. Food selling square footage accounted for 61% of total selling space of Alaskan operations compared to 60% in 2001.

Frontier Expeditors increased its trading profit by $1.8 million in 2002 after incurring a large debt loss in 2001 related to accounts receivable write offs for a major U.S. retailer that filed for bankruptcy protection, and tobacco taxes in prior periods that required a one-time charge against trading profit of $1.3 million. Frontier Expeditors' sales increased 32.7% in 2002 due to increased market share won from small independent retailers in rural Alaska, and a full year of tobacco sales.

AC TRADING PROFIT & EBIT MARGINS (% of sales)



AC's margins continued to improve in 2002.

AC remained competitive with local retailers and grew market share.

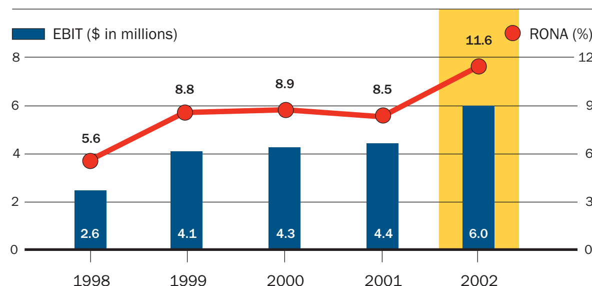
Trading profit increased 27.8% to $8.4 million from $6.6 million in 2001. EBIT in 2002 rose 37.5% to $6.0 million compared to $4.4 million in 2001. Trading profit margins improved to 7.1% from 5.9% in 2001 and have increased 240 basis points over the past four years. EBIT margins have shown a similar improvement as illustrated on the AC Trading Profit and EBIT Margins chart.

OPERATIONAL NET ASSETS EMPLOYED ($ in millions)

At the end of fiscal year:	2002	2001	2000
Property and equipment	$30.3	$30.9	$30.2
Inventory	16.7	16.0	14.1
Accounts receivable	5.2	5.2	4.7
Liabilities and other assets	(4.1)	(2.8)	(2.0)
Total operational net assets employed	$48.1	$49.3	$47.0

At January 25, 2003, AC's operational net assets employed were $48.1 million compared to $49.3 million at the previous year-end. Property and equipment decreased 2.0%, as capital spending declined to $1.8 million with the addition of only one store in 2002 compared to $2.9 million in 2001 when two stores were purchased. Amortization costs for the year increased 8.4% to $2.4 million compared to $2.2 million in 2001. Inventories increased 4.6% to $16.7 million from $16.0 million in 2001. The increase was mainly in general merchandise inventory in home furnishings, which were affected by the Permanent Fund Dividend reduction. Footwear/outerwear inventory was high due to unusually warm fall weather in Alaska that hurt sales. Our buyers have also taken advantage of weak demand in the lower 48 states to make early purchases of spring and summer footwear at substantial discounts, which should improve margins in the spring. Accounts receivable remained flat at $5.2 million. Other net liabilities of $4.1 million compared to $2.8 million in 2001. The increase was due to higher accruals for building expenditures for the new store and a replacement store, as well as higher bonus and long-term incentive provisions.

AC RETURN ON NET ASSETS



AC's return on net assets was more than double that of four years ago.

The return on net assets improved to 11.6% due to the improvement in trading profit.

On December 14, 2002, a fire that started in the adjoining post office destroyed the AC store in St. Michael, Alaska. The store was a total loss, however, there were no injuries to customers or staff. A temporary store was set up in a small community owned building and service was re-established on January 10, 2003. A new replacement store will be built and opened in September 2003 funded from insurance proceeds.

FINANCIAL CONDITION

CONSOLIDATED NET ASSETS EMPLOYED ($ in millions)

At the end of fiscal year:	2002	2001	2000
Property and equipment	$188.2	$194.0	$194.4
Inventory	127.4	134.4	123.0
Accounts receivable	64.8	65.9	56.9
Liabilities and other assets	(24.2)	(23.2)	(7.5)
Total net assets employed	$356.2	$371.1	$366.8

Balance Sheet & Cash Flows Property and equipment balances were reduced in 2002 due to capital expenditures that were $2.5 million less than amortization for the year, the foreign exchange effect from the strengthening Canadian dollar and disposals due to closures, sales or assets destroyed by fire. Additional information on capital expenditures is included in the following section.

Inventory levels reduced 6.3% or $6.8 million in Canadian operations as a result of the inventory reduction program. Inventory levels increased at AC and will be reduced in 2003. Accounts receivable were down 1.4% in Canada and up 0.9% in Alaska. Liabilities and other net assets increased by $1.0 million due mainly to the additional $6.3 million distribution payable at the end of the year less the reduction of $5.4 million for accrued interest payments due to the change in timing of semi-annual interest payments on long-term debt. Accounts payable were similar to last year. The net balance in 2001 also increased from 2000 due to recoveries of future income tax assets; increases for income taxes payable and accounts payable balances at the end of 2001.

Long-term debt was refinanced at favourable rates.

Cash flow from operations in 2002 increased 6.1% or $3.4 million to $59.2 million compared to $55.8 million 2001. The increase was due to an 18.8% or $5.5 million increase in net earnings for the year offset by a $1.5 million reduction in the recovery in future income taxes. The gain on disposal of property and equipment relates to insurance recoveries that funded the replacement on two stores that were destroyed by fire in 2001 and the sale of a Quickstop convenience store in Ashern, Manitoba. The changes on other non-cash items netted $0.2 million with reductions of inventory and receivables offset by foreign exchange adjustments as a result of the weakening of the U.S. dollar.

Capital Expenditures on Property & Equipment

Total net capital expenditures in 2002 were $18.2 million compared to $19.9 million in 2001. Net capital spending on Canadian and Alaskan operations, respectively, amounted to $15.4 million and $2.8 million for 2002 compared to $15.5 million and $4.4 million in 2001.

Capital expenditures in Canadian operations were $17.3 million in 2002 versus $15.9 million in 2001. The reprofiling project, which refreshed store layouts by adding upgraded standardized fixtures and new refrigeration equipment, was completed in 2002 at a cost of $235,000, bringing the total stores reprofiled to 139. Investments totaling $8.4 million ($8.6 million in 2001) were made in renovations of existing stores, equipment replacement, support facilities and the replacement of one major store. Expenditures on information systems of $6.6 million ($2.6 million in 2001) were primarily directed at upgrading in-store processes and corporate hardware and the development and upgrading of our in-store and corporate merchandise information system.

New Northern stores were opened in the communities of God's River, Manitoba and Fort Ware, British Columbia. Major upgrades were made to stores in Inuvik, Northwest Territories; Kashechewan and Webequie in Ontario; and Kangirsuk, Quebec. One new Giant Tiger store was opened in Winnipeg, Manitoba. A Quickstop convenience store in Ashern, Manitoba was sold in March 2002 and a small Northern store in Fort Alexander, Manitoba was closed in May 2002. Proceeds from disposals also included $1.0 million from insurance recoveries for two stores which were destroyed by fire in Canada in 2001 and replaced in 2002. The selling square feet in Canada increased to 1,070,468 from 1,050,211 in 2001.

Net capital expenditures in Alaska during 2002 were $2.8 million compared to $4.4 million in 2001. One new store in Mountain Village, Alaska was opened in December 2002 when the community invited AC to operate their local store. The AC store in St. Michael was destroyed by fire in December 2002 and will be rebuilt in 2003 from insurance proceeds. There were no closures in Alaska in 2002. Alaskan selling square feet increased to 245,343 from 244,206 in 2001.

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

	NUMBER OF STORES		SELLING SQ. FOOTAGE	
	2002	2001	2002	2001
Northern	136	136	803,093	819,493
NorthMart	6	5	178,328	151,041
Quickstop — Cdn.	5	6	18,831	23,684
Giant Tiger	3	2	47,658	33,435
Other Formats	4	4	22,558	22,558
AC Value Centers	25	24	245,343	244,206
Total at Year End	179	177	1,315,811	1,294,417

Financing Activities In August 2002, the Company successfully completed the refinancing of its long-term bonds by issuing US$65 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. Three large U.S.-based life insurance and pension funds, including one previous lender, provided the new financing. The Company's NAIC (National Association of Insurance Commissioners) debt rating in the U.S. remained unchanged at investment grade 2 in 2002. The Company's debt is not rated in Canada. The net proceeds of the senior note offering, together with funds drawn from the secured credit facilities, were used to retire the previous bonds of the Company that matured on August 28, 2002.

A swap was completed on September 11, 2002 to convert US$14 million of the US$65 million obligation from fixed to floating rates at three-month London Interbank Offered Rate (LIBOR) plus 1.87%.

The Company designated US$45 million of its new U.S. dollar senior notes as a hedge against its U.S. dollar investment in AC. On November 7, 2002, a US$20 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%.

Debt to equity improved to 0.6:1.

On January 24, 2003, an additional US$2 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 million to recognize the earnings at Alaska Commercial Company in 2002 and the reduction of the investment due to repayments on inter company notes.

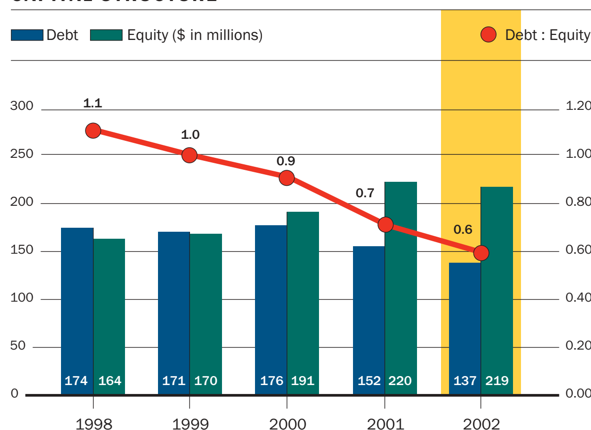
This leaves US$29 million of the original senior note fixed at an interest rate of 5.89% and the remainder of the indebtedness subject to floating rates plus negotiated spreads.

The Company also completed negotiations with two Canadian chartered banks and secured credit facilities totaling up to $85 million at favorable rates.

Capital Structure On a consolidated basis, NWF had $136.8 million in debt and $219.4 million in equity at the end of the year as the debt to equity ratio continued to improve to 0.6:1 versus 0.7:1 a year earlier. There was no new equity issued in 2002.

The strengthening of the Fund's capital structure is reflected in the following chart. Over the past five years, NWF's and NWC's debt to equity ratio has improved to 0.6:1 from 1.1:1 while annual cash distributions to unitholders have increased to $1.56 n 2002 from $1.00 in 1998. Equity has increased by 33.7% to $219.4 million from $164.1 million over the past four years while interest-bearing debt was reduced by 21.4% to $136.8 million from $174.0 million in 1998.

CAPITAL STRUCTURE



The strength of the Fund's balance sheet provides flexibility to maintain and grow distributions.

In addition to the $99.6 million (US$65.0 million) in senior notes outstanding, NWC has $91.0 million in operating lines of credit with banks in Canada and the U.S., of which $28.2 million was drawn at the end of the year compared to $26.1 million at the end of 2001.

Consolidated debt at January 25, 2003 decreased 9.8% or $14.8 million to $136.8 million compared to $151.6 million at January 26, 2002. The debt outstanding at the end of the fiscal year is summarized as follows:

DEBT ($ in thousands)

At the end of fiscal year:	2002	2001
Senior notes	$ 99,597	$ –
Bonds	–	112,000
Deferred warrants and swaps	–	2,090
Bank debt	28,157	26,071
Mortgages and notes payable	7,088	9,282
Capital leases	1,970	2,172
Total debt	$136,812	$151,615

In August 2002, the bonds were repaid and new senior notes were issued as described earlier. The deferred warrants and swap credits related to the bonds were realized during the first seven months of the fiscal year. The bank debt was increased to retire the old bonds. No new mortgage notes or capital leases were executed in 2002 and all scheduled payments were made on time.

Book value per unit at the end of the year increased 1.1% or $0.15 to $13.76 from $13.61 a year earlier. Book equity was favorably affected by retaining $3.0 million in earnings ($7.6 million in 2001) after declaring distributions of $31.4 million ($21.4 million in 2001). A fifth distribution was declared on December 24, 2002 for $0.39 per unit to replace the distribution normally declared in February.

The number of units outstanding at January 25, 2003 was 15,947,543 compared to 16,126,000 a year earlier. The average number of units outstanding during 2002 was 16,007,481 compared to 14,896,000 in 2001.

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 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 178,457 units of the Company with a quoted value at January 25, 2003 of $3.7 million. Loans receivable at January 25, 2003 of $3.4 million are recorded as a reduction of equity. Additional loans may be made on an annual basis over the next four years. The maximum value of the loans under the plan will not exceed $7.5 million.

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

NWF's return on average net assets (RONA) was 13.4% in 2002 compared to 12.7% in 2001. The improvement was due to improved earnings before interest and income taxes and reductions in average net assets employed during the year. Return on equity (ROE) of NWF was 15.8% in 2001 versus 14.9% in 2001. The improvement was mainly driven by improved earnings resulting from higher EBIT, lower interest expenses and reduced income taxes in 2002.

The coverage ratio of EBIT to interest improved significantly to 7.40 times versus 4.55 times in 2001. Interest costs were reduced due to lower average debt levels and lower interest rates in 2002.

INTEREST COSTS & COVERAGE

At the end of fiscal year:	2002	2001	2000	1999	1998*
Coverage ratio	7.40	4.55	3.20	3.40	3.12
EBIT ($ in millions)	49.6	47.8	42.3	39.8	42.8
Interest ($ in millions)	6.7	10.5	13.2	11.7	13.7

*Before unusual item

Taxes NWF recorded a provision for income taxes in 2002 of $8.4 million compared to $8.3 million in 2001 for an effective rate of 19.7% in 2002 compared to 22.3% in 2001. The decrease in the effective rate was due to several factors. The first was as a result of a new $30.0 million subordinated note issued December 31, 2001 by the Company to the Fund that reduced pre-tax income of the NWC by $3.9 million in 2002. This note had little impact on the fiscal year ending January 26, 2002. The Company also benefited from the reduction in Canadian federal income tax rates that decreased to 26.12% from 28.12% effective January 1, 2002. These factors were partially offset by a higher blend of AC pre-tax earnings in 2002. Income taxes paid in cash were $7.0 million in 2002 compared to $1.2 million in 2001.

Future income taxes on the balance sheet were reduced by 18.5% or $3.2 million to $14.3 million from $17.5 million reported a year ago. Loss carryforwards of $5.1 million ($13.5 million a year earlier) are available until 2007 for Canadian operations. There are no loss carryforwards for AC. Management is confident that substantially all of these assets will be realized in the near future.

The Canada Customs Revenue Agency has been conducting an audit on the years 1996 to 1999. The audit has not been concluded and management has made provisions for items that will likely be reassessed and has included this in its income taxes payable.

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

RISK MANAGEMENT

NWC is exposed to a number of risks in the normal course of 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 changing the work in our stores so that we can be better at selling. Most of the changes will take place over the next three years, however, the groundwork started in 2002. 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 and new in-store systems technology to achieve our goal. The payback from this initiative will depend on our ability to efficiently train our people 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 necessary steps to protect and grow our market share in individual communities and regionally. Outshopping competition from regional centres is significant but stable, with key markets fully developed with major retail food and discount merchandise chains. 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 60% 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, affirmative steps taken to recruit local residents into management positions, increased Aboriginal participation at our Board level 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. These payments are in the form of social assistance, child benefits and old age

Revenue and earnings growth appear to be sustainable.

security. We consider these sources to be stable and independent of economic cycles within the broader North American economy. A major source of employment income is generated from local government and from spending on infrastructure projects. This includes new housing, schools, health care facilities, roads and sewers. Local government employment levels will fluctuate within a year depending on a community's fiscal health, especially near the end of a budget year. Project spending by community varies and corresponds to the northern spending allocations of the various levels of government.

The infrastructure and social support needs of the North are immense and we expect to see some spending increases as politicians recognize the need to deal with the problem. In the federal budget speech of February 18, 2003 the Canadian minister of finance acknowledged "the unacceptable gap in health status between Aboriginal and other Canadians… This budget therefore provides $1.3 billion over the next five years for measures that will help improve the health of Aboriginal Canadians; and an additional $600 million is being targeted to improving the quality of water and wastewater treatment on reserves." Additional income will be generated from the National Child Benefit Supplement that will increase by $150 per child in July 2003, $185 in July 2005 and $185 in July 2006 for low-income families.

Alliance Initiative Under this initiative, we are "outsourcing" major buying and distribution activities through partnerships with non-competing retailers and distributors. The benefit is lower product sourcing costs, improved product sourcing knowledge, a reduction in our inventory investment, sales growth and, over the long term, lower overhead expenses. Each alliance we enter into requires that we connect effectively with another organization. The cultural, technology and strategic fit with each partner and the disruption created by the transition to each alliance are risks of this initiative. The Company also assumes increased risks as the volume of business increases with alliance partners with less direct control over assurance of their performance than internally controlled processes.

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 million of the NWC's senior notes were effectively converted from fixed interest rate debt to floating interest rate debt and US$43 million of NWC's senior notes were maintained in U.S. dollar obligations to hedge the Company's investment in AC. Increases in interest rates would increase NWC's cost of borrowing. Interest rate and exchange rate fluctuations are beyond NWC's control and there can be no assurance that such fluctuations will not have a material effect on NWC's business, financial condition and results of operations.

Energy Costs The Company is exposed to fluctuations in the price of energy — particularly oil. Recent international oil price increases have resulted in escalating fuel costs, a major cost component of our products. To the extent that these increases result in higher retail prices, consumer spending, especially on discretionary items, will be adversely affected.

OUTLOOK

We believe that we will sustain our revenue and earnings growth in 2003. In Canada, we expect this growth to be driven by continued above-average increases in same store food sales and a modest improvement in our general merchandise business. Our Alaskan operations are expected to show modest growth due to reduced payments from the Alaska Permanent Fund. Our working capital position is also expected to improve as we reduce average inventory investment through our alliance initiative and other supply chain efficiencies. Overall, we expect margin rates to improve in Canada with slower growth in Alaska.

In 2003, we expect to reinvest about $25 million in our business. Our usual annual investment will be made in replacement and expanded stores, fixtures and equipment. The three-year $15 million investment in new in-store information systems which started in 2002 will ramp up in 2003 and is excepted to be completed in 2004. We plan to open four Giant Tiger stores in 2003 and six in 2004 at a cost of $2.6 million and $4.0 million respectively. Our capital spending projections do not include any potential investments in complementary acquisitions.

Funding sources for our growth will be from internally generated funds.

The effective tax rate is expected to be between 21.0% to 22.0% in 2003 dependent on growth in pretax earnings compared to 19.7% in 2002.