



# Report to shareholders

12-week period ended December 18, 2004

1<sup>st</sup>  
quarter

## highlights

- 3.9% sales growth
- 13.5% increase in net earnings
- 17.6% increase in fully diluted net earnings to \$0.40 per share
- 17.6% increase in quarterly dividend to \$0.10 per share

# report to shareholders

I am pleased to present the report on our first quarter of fiscal 2005 ended December 18, 2004.

We achieved net earnings of \$38.6 million in the first quarter, up 13.5% from the previous fiscal year's first quarter net earnings of \$34 million. Fully diluted net earnings per share rose 17.6% to \$0.40 per share from \$0.34 last year.

Our sales increased 3.9% reaching \$1,446.1 million compared to \$1,392.4 million for the same quarter of the previous fiscal year. Despite strong competition which continued in the first quarter, our merchandising strategies and our retail investment program enabled us to sustain sales growth. We achieved an increase in sales of 3.2% in the food segment, 3% of which was on a same-store sales basis while the pharmaceutical segment sales grew by 11.9%.

Our earnings before interest, taxes, depreciation and amortization (EBITDA) for the first quarter rose to \$72.1 million or 5% of sales, compared to \$66.4 million or 4.8% for the same quarter last year.

We have invested with the retailers \$70 million, resulting in a net increase of 125,000 square feet, an increase of nearly 1.3% for our retail network. Major expansion and renovations were completed in eight stores, while seven new stores were opened.

On behalf of Management, I thank you for your continued trust and support. We are confident that we will continue, in the coming quarters, to benefit from our merchandising strategies and retail investment program aimed at maintaining our competitive position.



Pierre H. Lessard, FCA  
President and Chief Executive Officer

January 24, 2005

# management's discussion and analysis

The following Management's Discussion and Analysis sets out the financial position and results of METRO INC. on December 18, 2004. This discussion and analysis should be read in conjunction with the unaudited interim consolidated financial statements and accompanying notes in this quarterly report and the consolidated financial statements along with notes and Management's Discussion and Analysis presented in the Company's 2004 Annual Report. This analysis is based upon information as of January 14, 2005 unless otherwise stated. Additional information, including the Certification of Interim Filings letters for the quarter ended December 18, 2004 signed by the President and Chief Executive Officer and the Senior Vice-President Finance and Treasurer, are also available on the SEDAR website at [www.sedar.com](http://www.sedar.com).

## Projections

Any statement contained in the present quarterly Management's Discussion and Analysis which does not constitute an historic fact, may be deemed a projection. Verbs such as "believe", "foresee", "estimate" and other similar expressions appearing in this discussion and analysis generally indicate projections. These projections do not provide guarantees as to the future performance of METRO INC. and are subject to risks, both known and unknown, as well as uncertainties which may cause the outlook, profitability and actual results of METRO INC. to differ significantly from the profitability or future results stated or implied in these projections.

## Results of Operations

### SALES

The Company's sales increased 3.9% in the first quarter of fiscal 2005 to \$1,446.1 million compared to \$1,392.4 million in the same quarter of the last fiscal year.

Labour conflicts, in corporate stores, reduced by \$20 million our sales during the first quarter of 2005. This decrease was compensated by nearly \$10 million of sales increase linked to the purchase of 15 affiliated Metro supermarkets during the third quarter of last fiscal year. The sales growth, excluding these events, would have been 4.6%. The labour dispute at one of the corporate stores was settled and the store reopened on December 26, 2004.

### Food Segment

Despite continuing strong competition in the first quarter, our merchandising strategies and retail investment program enabled us to sustain our sales growth for this segment with a 3.2% increase compared to the corresponding quarter of 2004 and 3.9% excluding the impact of labour conflicts in corporate stores and the purchase of 15 affiliated Metro supermarkets. Same store sales rose 3% in the first quarter of fiscal 2005.

We have invested with the retailers \$70 million, resulting in a net increase of 125,000 square feet, an increase of nearly 1.3% for our retail network. Major expansion and renovations were completed in eight stores, while seven new stores were opened.

## **Pharmaceutical Segment**

For this segment, sales reached \$123.1 million compared to \$110 million last year, an increase of 11.9%. This increase is mainly the result of internal growth. At the end of the first quarter, the number of Brunet and Clini-Plus drugstores stood at 177 compared to 175 at the end of the corresponding quarter of the previous fiscal year.

## **EARNINGS BEFORE INTEREST, TAXES, DEPRECIATION AND AMORTIZATION (EBITDA)<sup>(1)</sup>**

Earnings before interest, taxes, depreciation and amortization for the first quarter of fiscal 2005 was \$72.1 million, representing 5% of sales, compared to \$66.4 million or 4.8% for the same quarter last year. These increases are due mainly to sales growth and equity earnings from our investment in Alimentation Couche-Tard Inc., which reached \$5.2 million compared to \$2.7 million for the same quarter last year. The equity earnings increase raised our EBITDA as a percentage of sales by 0.2%. However, labour conflicts in corporate stores reduced our EBITDA as a percentage of sales by 0.2%.

## **INTEREST, DEPRECIATION AND AMORTIZATION**

Total depreciation and amortization expense for the first quarter rose to \$17 million compared with \$15.9 million for the corresponding quarter of the previous fiscal year. This increase results primarily from investments in our retail network.

First quarter interest expenses totalled \$0.6 million compared to \$1.2 million last year. Financing costs averaged 3.6% for the first quarter compared to 3.5% for the corresponding period of the previous fiscal year. This decrease in interest expenses is due to a reduction of nearly \$122 million in average use of bank loans. The decrease in bank loans is due mainly to tax planning implemented in prior fiscal years, under which we had to finance government receivables of \$116 million that were collected at the end of the first quarter of the previous fiscal year.

## **INCOME TAXES**

First quarter income tax expense represents an effective tax rate of 29.2% versus 31% for the corresponding quarter of fiscal 2004. The rate decrease is due mainly to a lower tax rate on our equity earnings compared with other taxable income and to the 2% reduction in federal tax rates on January 1, 2004.

(1) Earnings are presented for information purposes only. They do not have a standardized meaning prescribed by Canadian GAAP and therefore may not be comparable to similar measures presented by other public companies.

## NET EARNINGS

First quarter net earnings reached \$38.6 million, up 13.5% from the previous fiscal year's first quarter net earnings of \$34 million. Net earnings as a percentage of sales stood at 2.7% in 2005 and 2.4% for the same quarter last year. Fully diluted net earnings per share increased 17.6% to \$0.40 from \$0.34 last year.

### Quarterly Highlights

(Millions of dollars, except earnings per share)

	2005	2004	2003	Variation (Percentage)
<b>Sales</b>				
Q1 <sup>(1)</sup>	<b>1,446.1</b>	1,392.4	–	3.9
Q4 <sup>(1)</sup>	–	1,406.2	1,344.8	4.6
Q3 <sup>(2)</sup>	–	1,878.2	1,802.2	4.2
Q2 <sup>(1)</sup>	–	1,322.1	1,268.8	4.2
<b>Net earnings</b>				
Q1 <sup>(1)</sup>	<b>38.6</b>	34.0	–	13.5
Q4 <sup>(1)</sup>	–	45.2	40.1	12.7
Q3 <sup>(2)</sup>	–	50.4	53.0	(4.9)
Q2 <sup>(1)</sup>	–	39.2	40.8	(3.9)
<b>Fully diluted net earnings per share</b>				
<i>(Dollars)</i>				
Q1 <sup>(1)</sup>	<b>0.40</b>	0.34	–	17.6
Q4 <sup>(1)</sup>	–	0.47	0.40	17.5
Q3 <sup>(2)</sup>	–	0.51	0.53	(3.8)
Q2 <sup>(1)</sup>	–	0.40	0.41	(2.4)

<sup>(1)</sup>12 weeks

<sup>(2)</sup>16 weeks

The food distribution market was very competitive for the last four quarters. To counteract this strong competition, we have, at the beginning of the second quarter in 2004, implemented new merchandising strategies along with decreased operating expenses and higher equity earnings from our investment subject to significant influence, resulting in renewed growth in net earnings of 12.7% in the fourth quarter of 2004 and 13.5% in the first quarter of 2005 as compared to corresponding quarters.

## Cash Position

### OPERATING ACTIVITIES

Operating activities, which had been a source of \$51.8 million in funds in the first quarter of fiscal 2004, required outflows of \$51.9 million in the first quarter of 2005. These outflows in the first quarter of 2005 are due in large part to the holiday period and its resultant increase in debtors, inventory and creditors as compared to 2004 year-end. In the first quarter of 2004, government receivables of \$116 million collected in the quarter exceeded holiday funding requirements. In the first quarter of 2005, we also paid the \$40 million tax balance for fiscal 2004 arising from tax planning, which contributed to first quarter funding requirements.

### INVESTMENT ACTIVITIES

Investing activities required outflows of \$33.4 million in the first quarter of 2005 compared to \$55.9 million in the same quarter last year. This variation is due mainly to the \$23.6 million investment in Alimentation Couche-Tard Inc. in the first quarter of 2004. This investment had a book value of \$74.8 million on December 18, 2004, and a market value of \$389.2 million on January 14, 2005.

### FINANCING ACTIVITIES

Cash flows from financing activities totalled \$60.1 million in the first quarter of 2005 compared to an outflow of \$2.7 million in the same quarter last year. The variation is due mainly to the repayment of bank loans following the collection of \$116 million in government receivables at the end of the first quarter of fiscal 2004. In the first quarter, the Company redeemed 384,500 Class A Subordinate Shares for a total consideration of \$8.1 million at an average price of \$20.92 per share, whereas it had made no share purchases for the corresponding quarter last year.

## Financial Position

Our financial position is very solid. At the end of the first quarter of 2005, long-term debt was \$10.6 million, while shareholders' equity was \$877.2 million and total assets were \$1,648.2 million compared to \$9.4 million in long-term debt, \$852.1 million in shareholders' equity and \$1,560 million in total assets at the end of fiscal 2004 as stated in the Management's Discussion and Analysis section of the 2004 Annual Report. Contractual obligations at the end of the first quarter of 2005 have not changed significantly from September 25, 2004.

### CAPITAL STOCK

On January 14, 2005, the Company had 95,037,373 Class A Subordinate Shares (95,621,688 on September 25, 2004) and 977,040 Class B Multiple Voting Shares (977,040 on September 25, 2004) outstanding. At the same date, 5,065,000 stock options (5,072,180 on September 25, 2004) were outstanding at exercise prices between \$7.93 and \$23.34 (2004 - \$7.93 and \$21.75), for a weighted average per-share price of \$18.00 (2004 - \$17.91) with maturity dates until 2011.

## **STOCK BUYBACK PROGRAM**

Subject to regulatory approval, the Board of Directors has authorized the Company to purchase, in the normal course of its activities, from February 4, 2005 to February 3, 2006, up to 5 million of its Class A Subordinate Shares, representing approximately 8.8% of the outstanding public float of such shares on January 21, 2005 at the close of the Toronto Stock Exchange. The purchases will be made at market prices through the facilities of such exchange in accordance with its rules and policies. The Class A Subordinate Shares thereby purchased will be cancelled. Since February 4, 2004, the Company has purchased in the normal course of its activities 2,506,600 of its Class A Subordinate Shares at an average price of \$19.81 per share. Shareholders may obtain without charge a copy of the documents filed with the regulatory authorities concerning this program by writing to the legal department of the Company. The Company believes that the purchase of its Class A Subordinate Shares represents an effective use by the Company of its funds and is in the best interest of the Company and its shareholders.

## **DIVIDENDS**

On January 24, 2005, the Company's Board of Directors declared a quarterly dividend of \$0.10 per Class A Subordinate Share and Class B Share payable March 1, 2005, an increase of 17.6% over the dividend for the corresponding quarter last year. On a yearly basis, this dividend represents 23% of 2004 net earnings.

## **SHARE TRADING**

The value of METRO INC. shares remained in the range of \$18.50 to \$23.50 in the first quarter of fiscal 2005. During this period, a total of 7.9 million shares were traded on the Toronto Stock Exchange. The closing price on Friday, January 14, 2005 was \$23.60, compared with \$18.66 at the end of fiscal 2004, an increase of 26.5%.

## **Changes in accounting policies**

At the end of fiscal 2004, we have adopted two new accounting standards: "Consolidation of Variable Interest Entities" (AcG-15) and "Accounting by a Customer (Including a Reseller) for Certain Considerations Received from a Vendor" (EIC-144). The financial statements of prior fiscal and interim periods have been restated to reflect these changes.

## **Outlook**

We are confident that we will continue, in the coming quarters, to benefit from our merchandising strategies and retail investment program aimed at maintaining its competitive position.

Montréal, January 24, 2005

# consolidated statements of earnings

12-week periods ended December 18, 2004 and December 20, 2003

(Unaudited) (Millions of dollars, except for earnings per share)

	2005	Fiscal 2004 (Restated – note 2)
<b>Sales</b>	<b>\$ 1,446.1</b>	\$ 1,392.4
Cost of sales and operating expenses	<b>1,374.0</b>	1,326.0
<b>Earnings before interest, taxes, depreciation and amortization</b>	<b>72.1</b>	66.4
Depreciation and amortization	<b>17.0</b>	15.9
<b>Operating income</b>	<b>55.1</b>	50.5
Interest	<b>0.6</b>	1.2
<b>Earnings before income taxes</b>	<b>54.5</b>	49.3
Income taxes	<b>15.9</b>	15.3
<b>Net earnings</b>	<b>\$ 38.6</b>	\$ 34.0
<b>Earnings per share</b> (notes 2 and 4)		
Basic	<b>\$ 0.40</b>	\$ 0.35
Fully diluted	<b>\$ 0.40</b>	\$ 0.34

See accompanying notes

# consolidated statements of retained earnings

12-week periods ended December 18, 2004 and December 20, 2003

(Unaudited) (Millions of dollars)

	2005	Fiscal 2004 (Restated – note 2)
<b>Balance at beginning of period</b>	<b>\$ 690.6</b>	\$ 580.2
Adjustment due to adoption of a new accounting standard (note 2)	–	(0.1)
<b>Restated balance at beginning of period</b>	<b>690.6</b>	580.1
Net earnings	<b>38.6</b>	34.0
Dividends	<b>(8.2)</b>	(6.8)
Share redemption premium	<b>(7.5)</b>	–
<b>Balance at end of period</b>	<b>\$ 713.5</b>	\$ 607.3

See accompanying notes

# consolidated balance sheets

(Unaudited) (Millions of dollars)

	As at December 18, 2004	As at September 25, 2004
<b>Assets</b>		
Current assets		
Cash	\$ 17.8	\$ 43.0
Accounts receivable	268.8	237.8
Inventories	375.1	314.1
Prepaid expenses	4.0	4.3
Future income taxes	7.9	8.1
	673.6	607.3
Investments and other assets	87.0	82.5
Fixed assets	522.2	504.9
Intangible assets	175.4	175.3
Goodwill	190.0	190.0
	<b>\$ 1,648.2</b>	<b>\$ 1,560.0</b>
<b>Liabilities and Shareholders' equity</b>		
Current liabilities		
Bank loans	\$ 75.2	\$ 1.5
Accounts payable	599.0	572.1
Income taxes payable	6.9	46.9
Current portion of long-term debt	2.7	3.4
	683.8	623.9
Long-term debt	10.6	9.4
Future income taxes	76.6	74.6
	771.0	707.9
<b>Shareholders' equity</b>		
Capital stock (note 5)	162.7	160.8
Contributed surplus	1.0	0.7
Retained earnings	713.5	690.6
	877.2	852.1
	<b>\$ 1,648.2</b>	<b>\$ 1,560.0</b>

See accompanying notes

# consolidated statements of cash flows

12-week periods ended December 18, 2004 and December 20, 2003

(Unaudited) (Millions of dollars)

	2005	Fiscal 2004 (Restated – note 2)
<b>Operating activities</b>		
Net earnings	\$ 38.6	\$ 34.0
Non-cash items		
Equity earnings in a company subject to significant influence	(5.2)	(2.7)
Depreciation and amortization	17.0	15.9
Future income taxes	2.2	(5.9)
Stock-based compensation cost	0.2	0.1
Excess of amounts paid for employee future benefits over expenses recognized	0.1	0.1
	52.9	41.5
Net change in non-cash working capital related to operations	(104.8)	10.3
	(51.9)	51.8
<b>Investing activities</b>		
Net change in investments	0.6	(25.9)
Purchase of fixed assets	(35.5)	(15.6)
Disposal of fixed assets	7.7	0.1
Purchase of intangible assets	(6.2)	(14.5)
	(33.4)	(55.9)
<b>Financing activities</b>		
Net change in bank loans	73.7	3.7
Issue of shares	0.6	1.4
Redemption of shares	(8.1)	–
Disposal of treasury shares (note 5)	2.0	–
Increase of long-term debt	1.0	0.2
Repayment of long-term debt	(0.9)	(1.2)
Dividends paid	(8.2)	(6.8)
	60.1	(2.7)
<b>Net change in cash and cash equivalents</b>	<b>(25.2)</b>	<b>(6.8)</b>
Cash and cash equivalents at beginning of period	43.0	22.5
Cash and cash equivalents at end of period	\$ 17.8	\$ 15.7
<b>Other information</b>		
Interest paid	\$ 0.6	\$ 1.2
Income taxes paid	\$ 53.6	\$ 34.8

See accompanying notes

# notes to interim consolidated financial statements

12-week periods ended December 18, 2004 and December 20, 2003

(Unaudited) (Millions of dollars, except for data per share)

## 1) Statement presentation

The unaudited interim consolidated financial statements were prepared by management in accordance with Canadian generally accepted accounting principles. The accounting policies and procedures used in assembling these interim consolidated financial statements are the same as those used in preparing the audited annual consolidated financial statements for the year ended September 25, 2004, except for the changes in accounting policies described in note 2. The unaudited interim consolidated financial statements should be read along with the audited annual consolidated financial statements and notes to the statements in the Company's 2004 Annual Report. The operating results for the interim period covered do not necessarily reflect overall results for the fiscal year. Certain comparative figures have been reclassified to conform with the presentation being used in the current fiscal year.

## 2) Changes in accounting policies

### **Section 3870 "Stock-based Compensation and Other Stock-based Payments"**

In the first quarter of 2004, the Company adopted the change to chapter 3870 "Stock-based Compensation and Other Stock-based Payments" published in November 2003 by Canadian Institute of Chartered Accountants (CICA). Under this change, a compensation cost based on the fair value method has to be accounted for all awards of stock options granted since the introduction of chapter 3870. The Company chose to apply the fair value method retroactively, without restatement of prior years, for awards of stock options granted since September 29, 2002. The retroactive application of this accounting policy change reduced by \$ 0.1 the opening balance of retained earnings and an increase of contributed surplus for the same amount.

### **AcG-15 "Consolidation of Variable Interest Entities"**

At the end of fiscal 2004, the Company adopted in advance the Accounting Standards Board Guideline AcG-15, "Consolidation of Variable Interest Entities" and has applied it retroactively and restated the prior interim financial statements. The impact in the application of this accounting principle has been disclosed in the 2004 Annual Report and the effects for the fiscal year ended September 25, 2004 are as follow:

	1 <sup>st</sup> quarter	2 <sup>nd</sup> quarter	3 <sup>rd</sup> quarter	4 <sup>th</sup> quarter	Fiscal year
Sales	33.6	41.4	50.4	38.5	163.9
Total assets	18.3	15.3	12.2	9.1	9.1
Total liabilities	18.3	15.3	12.2	9.1	9.1

## notes to interim consolidated financial statements

### 2) Changes in accounting policies (cont'd)

#### **EIC-144 "Accounting by a Customer (Including a Reseller) for Certain Considerations Received from a Vendor"**

At the end of fiscal 2004, the Company adopted EIC-144, "Accounting by a Customer (Including a Reseller) for Certain Considerations Received from a Vendor" and has applied it retroactively and restated the prior interim financial statements. The impact in the application of this accounting principle has been disclosed in the 2004 Annual Report and the effects for the fiscal year ended September 25, 2004 are as follow:

	1 <sup>st</sup> quarter	2 <sup>nd</sup> quarter	3 <sup>rd</sup> quarter	4 <sup>th</sup> quarter	Fiscal year
Sales	10.3	10.0	13.7	9.9	43.9
Net earnings	(3.6)	4.0	(0.4)	0.2	0.2
Net earnings per share <i>(Dollars)</i>	(0.03)	0.04	(0.01)	–	–
Fully diluted net earnings <i>(Dollars)</i>	(0.04)	0.04	–	–	–
Inventories	(23.5)	(17.4)	(17.9)	(17.7)	(17.7)
Tax liabilities	(8.1)	(6.0)	(6.1)	(6.1)	(6.1)
Retained earnings	(15.4)	(11.4)	(11.8)	(11.6)	(11.6)

#### **Section 3110 "Asset retirement obligations"**

At the beginning of the first quarter of fiscal 2005, the Company adopted a new accounting principle contained in Section 3110 "Asset retirement obligations". This section establishes standards for the recognition, measurement and disclosure of liabilities for asset retirement obligations and the associated asset retirement costs. The adoption of this new standard did not have any effect on the Company's results, financial situation or cash flows.

### 3) Employee future benefits

The Company offers several defined benefit and defined contribution plans that provide most employees with pension, other retirement and other post-employment benefits. The Company's defined benefit and defined contribution plan expenses are as follows:

## notes to interim consolidated financial statements

### 3) Employee future benefits (cont'd)

	2005		2004	
	Pension plans	Other plans	Pension plans	Other plans
<b>Defined contribution plans</b>	\$ 1.7	\$ 0.1	\$ 1.7	\$ 0.1
<b>Defined benefit plans</b>				
Current service cost	1.1	0.1	1.1	0.1
Interest cost	1.4	0.1	1.2	0.1
Projected return on plan assets	(1.4)	–	(1.1)	–
Amortization of actuarial losses and past service cost	0.1	–	0.1	–
	<b>\$ 1.2</b>	<b>\$ 0.2</b>	<b>\$ 1.3</b>	<b>\$ 0.2</b>

### 4) Earnings per share

Basic earnings per share and fully diluted earnings per share were calculated based on the following number of shares:

	2005	2004
Weighted average number of shares outstanding		
Basic (Millions)	96.6	97.8
Dilutive effect of stock option plan (Millions)	0.7	1.0
Weighted average number of shares outstanding		
Fully diluted (Millions)	97.3	98.8

### 5) Capital stock

#### Issued and outstanding

As at December 18, 2004, the issued and outstanding capital stock was 95,389,508 Class A Subordinate Shares and 977,040 Class B Shares. During the first quarter, 44,162 Class A Subordinate Shares were issued, 384,500 Class A Subordinate Shares were redeemed and none of Class B Shares were converted into Class A Subordinate Shares. During the first quarter, the 108,158 treasury shares held on September 25, 2004 have been disposed. The excess of proceeds over purchase price of \$0.1 is presented in the contributed surplus.

## notes to interim consolidated financial statements

### 5) Capital stock (cont'd)

#### Stock option plan

As at December 18, 2004, 5,093,240 stock options had been granted to certain employees at exercise prices varying from \$7.93 to \$23.34, with expiry dates up to 2011. Of these stock options, 3,440,760 could be exercised for an average weighted exercise price of \$19.10. During the first quarter, the Company granted 58,900 stock options (2004 – 61,300). The weighted average exercise price was \$22.81 (2004 – \$19) and the weighted average fair value of \$7.01 (2004 – \$5.90) was established at the time of grant using the Black & Scholes model and based on the following weighted average assumptions:

	<b>2005</b>	2004
Risk-free interest rate (%)	<b>3.80</b>	3.95
Expected year term	<b>6</b>	6
Anticipated volatility (%)	<b>30.0</b>	30.0
Anticipated dividend yield (%)	<b>1.5</b>	1.5

The compensation cost for these stock options amounted to \$0.2 for the first quarter (2004 – \$0.1).

### 6) Segmented information

The Company operates primarily in the Canadian food distribution industry segment. The Company's sales in this segment amounted to \$1,323 for the 12-week period ended December 18, 2004 (December 20, 2003 – \$1,282.4). The Company also operates in the Canadian pharmaceutical distribution industry.

## information

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METRO INC.'s corporate information and press releases are available on the Internet at the following address: [www.metro.ca](http://www.metro.ca)