

Management's Discussion and Analysis

Of Financial Condition and Results of Operations

(dollars in millions, except per share data)

The New Albertsons

The Company's leadership team has identified many actions and programs with which to drive the Company's future competitiveness, profitability and return on invested capital. The Company continues to be focused on its five strategic imperatives that serve as a guide and a filter for all the Company's initiatives. These five imperatives, together with the major actions taken to date, follow:

1) Aggressive Cost and Process Control. Each main category of expense, including labor, is rigorously monitored by a member of executive management. By the end of 2002, the Company had achieved \$446 of the \$500 mid-2003 annual cost reduction goal. The Company is committed to achieve cost reductions of \$750 by the end of 2004. In the third quarter of 2002, the Company expanded its existing strategic sourcing program to realize additional cost reductions by engaging A.T. Kearney to leverage their sourcing expertise to assist with this program.

2) Maximize Return on Invested Capital. The Company has implemented a formal process to review and measure all significant investments in corporate assets. The goal of the Company is to hold a number 1 or 2 market share in an area, or have a plan of action which provides a reasonable expectation of achieving this goal in order to continue to maintain an investment in that area. This process involves thorough review at both the individual asset or store level and at the market area level.

As a result of the review initiated in 2001, the Company closed or disposed of 162 underperforming stores in 2001 and 2002. In addition, the Company formulated plans to accelerate the disposal of surplus property through an auction process for owned properties and aggressive

lease termination negotiations for leased properties. As a result of this initial restructuring, the Company reduced its divisions from 19 to 15.

- During the fourth quarter of 2001, the Company sold 80 non-core New England Osco drugstores.
- In the first quarter of 2002, the Company announced the second phase of its asset rationalization process. The Company exited four underperforming markets: Memphis, Tennessee; Nashville, Tennessee; Houston, Texas; and San Antonio, Texas. These market exits occurred through a combination of store closures and store sales and involved a total of 95 stores. In connection with this action, the Company reduced its divisions from 15 to 11 and the Tulsa, Oklahoma and Houston, Texas distribution facilities were sold.

3) Customer-focused Approach to Growth. The Company intends to invest many of the savings from the expense and process control programs back into the marketplace in order to drive sales and earnings growth. The Company's focus is on the following programs that are intended to drive customer loyalty and profitable sales growth. A company-wide "Service First, Second to None" program is reinvigorating the employees' focus on customer service. The "Focus on Fresh" initiative is improving the delivery of fresh foods throughout the Company's fresh departments. The Company's Jewel-Osco stores in Chicago, Illinois have a decade of experience operating a unique dual brand food and drugstore format. This unique format was rolled out to the Tucson, Arizona and Reno, Nevada markets during 2001 and was rolled out to the Phoenix, Arizona and Omaha, Nebraska markets during 2002. During the fourth quarter of 2001, the Company expanded its loyalty card program to

the Dallas/Fort Worth, Texas area. During 2002 the loyalty card program was rolled out to the following areas: Northern California, Northwest, Intermountain, and the Florida divisions. The loyalty card program was introduced in the Rocky Mountain division in March 2003, and the Company continues to evaluate additional markets for expansion of the preferred savings card program.

4) Company-wide Focus on Technology. Albertson's use of technology is designed to better serve customers and improve operating efficiencies. In 2002 Albertsons established an information technology plan, which calls for the replacement or upgrade of over three-quarters of the Company's current systems within the next five years. The Company initiated a project that will standardize all front-end point-of-sale systems; built a new data center resulting in the consolidation of two previous data centers; and started the process of implementing a new financial applications system that will lay the foundation for significant future improvements. Technology has been deployed in approximately 60 stores in "self-checkout" lanes, providing customers with the option to complete their shopping trips electronically.

5) Energized Associates. The Albertsons leadership team is charged with creating an uplifting atmosphere for associates everyday, and to inspire positive attitudes throughout the Company. To ensure that our 202,000 associates are energized and motivated to do their best work everyday, the Company realigned processes and programs to provide new opportunities for associates to achieve their professional career goals. The Company changed compensation programs to reward performance that delivers results, improved communications so associates are better informed, streamlined education programs to meet the needs of the business, and revised benefits plans to reduce costs. We are convinced that a team of energized associates who share a positive attitude will achieve Albertson's goal of becoming the best food and drug retailer in the world.

Critical Accounting Policies

The Company's discussion and analysis of its financial condition and results of operations are based upon the

Company's consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires the Company to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. On an ongoing basis, the Company evaluates its estimates, including those related to bad debts, inventories, vendor funds, intangible assets, income taxes, assets held for sale, impairment of long-lived assets, self-insurance, restructuring, benefit costs, contingencies, litigation and unearned income. The Company bases its estimates on historical experience and on various other assumptions and factors that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. The Company, based on its ongoing review, will make adjustments to its judgments and estimates where facts and circumstances dictate. Historically, actual results have not significantly deviated from those determined using the estimates described above.

The Company believes the following critical accounting policies are important to the portrayal of the Company's financial condition and results and require management's most difficult, subjective or complex judgments, often as a result of the need to make estimates about the effect of matters that are inherently uncertain.

Vendor Funds: The Company receives funds from the many vendors whose products the Company buys for resale in its stores. These vendor funds are provided to increase the sell-through of the related products. The Company receives funds for a variety of merchandising activities: placement of the vendor's products in the Company's advertising; placement of the vendor's products in prominent locations in the Company's stores; introduction of new products into the Company's distribution system and retail stores; exclusivity rights in certain categories that have slower-turning products; and to compensate for temporary price reductions offered to customers on

products held for sale at retail stores. The Company also receives vendor funds for buying activities, such as volume commitment rebates and forward buy credits.

Accounting for vendor funds is discussed in Emerging Issues Task Force "EITF" Issue 02-16: Accounting by a Customer (Including a Reseller) for Certain Consideration Received from a Vendor (EITF 02-16), in which the EITF reached consensus on two issues in November 2002 and provided transition rules on those issues in January 2003 and March 2003. As a result of this new guidance, the Company adopted a new method for recognizing the vendor funds for merchandising activities. As of the beginning of 2002, the Company recognizes vendor funds for merchandising activities when the related products are sold. Under the previous accounting method for merchandising vendor funds, these credits were recognized as an offset to cost of sales when the merchandising activity was performed in accordance with the underlying agreements. In connection with the implementation of this new accounting method, the Company recorded a charge in 2002 of \$94, net of tax benefit of \$60.

The vendor fund inventory offset recorded as of January 30, 2003 was \$152, which is a \$6 decrease from the balance as of the beginning of 2002. The inventory offset was determined by estimating the average inventory turnover rates by product category for the Company's grocery, general merchandise and lobby departments (these departments received over three-quarters of the Company's vendor funds in 2002) and by average inventory turnover rates by department for the Company's remaining inventory.

Long-Lived Asset Impairments: The Company assesses the impairment of long-lived assets when events or changes in circumstances indicate that the carrying value of the assets or the asset group may not be recoverable. The asset impairment review assesses the fair value of the assets based on the future cash flows the assets are expected to generate. An impairment loss is recognized when estimated undiscounted future cash flows expected to result from the use of the asset plus net proceeds

expected from the disposition of the asset (if any) are less than the related asset's carrying amount. Impairment losses are measured as the amount by which the carrying amounts of the assets exceed their fair values. The net proceeds expected from the disposition of the asset are determined by independent quotes or expected sales prices developed by internal specialists. Estimates of future cash flows and expected sales prices are judgments based on the Company's experience and knowledge of local operations. These estimates can be significantly impacted by changes in real estate market conditions, the economic environment, capital spending decisions and inflation.

For properties to be closed that are under long-term lease agreements, the present value of any remaining liability under the lease, discounted using risk-free rates and net of expected sublease recovery, is recognized as a liability and expensed. (Beginning on January 1, 2003, "expected sublease recovery" has been replaced by "estimated sublease rentals that could be reasonably obtained for the property.") The value of any equipment and leasehold improvements related to a closed store is reduced to reflect net recoverable values. Internal specialists estimate the subtenant income, future cash flows and asset recovery values based on their historical experience and knowledge of (1) the market in which the store to be closed is located, (2) the results of its previous efforts to dispose of similar assets and (3) the current economic conditions. The actual cost of disposition for these leases and related assets is affected by specific real estate markets, the economic environment and inflation.

Self-Insurance: The Company is primarily self-insured for workers' compensation, automobile and general liability costs. The Company records its self-insurance liability, determined actuarially, based on claims filed and an estimate of claims incurred but not yet reported. Any actuarial projection of ultimate losses is subject to a high degree of variability. Sources of this variability are numerous and include, but are not limited to, future economic conditions, court decisions and legislative actions. The Company's workers' compensation future funding estimates anticipate

no change in the benefit structure. Statutory changes could have a significant impact on future claim costs.

The Company's workers' compensation liabilities are from claims occurring in various states. Individual state workers' compensation regulations have received a tremendous amount of attention from state politicians, insurers, employers and providers, as well as the public in general. Recent years have seen an escalation in the number of legislative reforms, judicial rulings and social phenomena affecting this business. The changes in a state's political and economic environment increase the variability in the unpaid claim liabilities.

Legal Contingencies: The Company records reserves for legal contingencies when the information available to the Company indicates that it is probable that a liability has been incurred and the amount of the loss can be reasonably estimated. Predicting the outcomes of claims and litigation and estimating related costs and exposures involve substantial uncertainties that could cause actual costs to vary materially from estimates. In addition, the Company regularly monitors its exposure to the loss contingencies associated with these matters and may from time to time change its predictions with respect to outcomes and its estimates with respect to related costs and exposures. It is possible that material differences in actual outcomes, costs and exposures relative to current predictions and estimates, or material changes in such predictions or estimates, could have a material adverse effect on the Company's financial condition, results of operations or cash flows.

Pension Costs: Pension benefit obligations and the related effects on operations are dependent on the Company's selection of actuarial assumptions, including the discount rate and the expected long-term rate of return on plan assets. Actual returns on plan assets exceeded return assumptions over an extended period in the past, which kept pension expense and cash contributions to the plans at modest levels. Recent weaker market performance may significantly increase pension expense and cash contributions in the future unless asset returns again exceed the assumptions used. Changes in the interest rates used to

determine the discount rate may also cause volatility in pension expense and cash contributions. Actual results that differ from the Company's assumptions are accumulated and amortized over future periods and, therefore, generally affect the Company's recognized expense and recorded obligation in such future periods.

Recently Adopted Accounting Standards

The Company adopted Statement of Financial Accounting Standard ("SFAS") No. 142, "Goodwill and Other Intangible Assets" effective February 1, 2002. Under this new statement, goodwill and certain other intangible assets with indefinite lives are no longer amortized, but are subject to annual testing, or more frequently if impairment indicators arise, using fair value methodology. Intangible assets with finite, measurable lives continue to be amortized over their respective useful lives until they reach their estimated residual values, and are reviewed for impairment in accordance with SFAS 144, "Accounting for the Impairment or Disposal of Long-Lived Assets."

When SFAS No. 142 was adopted, the aggregate of the goodwill allocated to the stores in each reporting unit became the reporting units' goodwill balance. In order to determine if a reporting unit's goodwill was impaired, a combination of internal analysis, focusing on each reporting unit's implied EBITDA multiple, and estimates of fair value from valuation specialists were used. Based on these analyses, there was no impairment of goodwill at the adoption date. Subsequently, during the fourth quarter of 2002, the Company completed its annual impairment review based on November 1, 2002 balances and determined that there was no impairment as of that date. The fair value estimates could change in the future depending on internal and external factors.

The Company adopted SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," effective February 1, 2002. This statement replaces SFAS No. 121 regarding impairment losses on long-lived assets to be held and used or to be disposed of. The adoption of this statement did not have a material impact on the company's impairment policy. However, the statement broadens the

definition of what constitutes a discontinued operation and how the results of a discontinued operation are to be measured and presented. As a result, stores associated with the company's exit from a particular market are classified as discontinued operations in the Company's Consolidated Earnings Statements. Therefore, activity associated with the Company's market exit plan approved by the Company's Board of Directors in March 2002, involving the sale or closure of 95 stores, two distribution centers and the reduction of division offices from 15 to 11, has been presented as discontinued operations.

Results of Operations

Sales for 2002 were \$35,626 compared to \$36,605 in 2001 and \$35,501 in 2000. The following table sets forth certain income statement components expressed as a percent to sales, and the year-to-year percentage changes in the amounts of such components:

	PERCENT TO SALES			PERCENTAGE CHANGE OF DOLLAR AMOUNTS	
	2002	2001	2000	2002 VS. 2001	2001 VS. 2000
Sales	100.00	100.00	100.00	(2.7)	3.1
Gross profit	29.15	28.48	28.43	(0.4)	3.3
Selling, general and administrative expenses	24.15	23.85	23.79	(1.4)	3.4
Restructuring (credits) charges and other	(0.10)	1.28	—	n.m.	n.m.
Gain on sale of New England Osco drugstores	—	(0.15)	—	n.m.	n.m.
Interest expense, net	1.11	1.16	1.06	(6.8)	12.4
Earnings from continuing operations before income taxes	3.95	2.36	3.50	62.8	(30.6)
Net earnings from continuing operations	2.44	1.36	2.10	74.4	(33.5)
Net (loss) gain from discontinued operations	(0.80)	0.02	0.05	n.m.	(73.7)
Cumulative effect of change in accounting principle (net)	(0.26)	—	—	n.m.	n.m.
Net earnings	1.38	1.38	2.15	3.2	(34.5)

n.m. — not meaningful

Sales for 2001 and 2000 have been restated from previously reported amounts to exclude sales associated with discontinued operations which represent sales of the 95 stores included in the second phase of the Company's market exit plan. The decrease in reported sales is primarily attributable to the Company's restructuring plan initiated in July 2001, which included the sale or closure of 165 stores, and the sale of 80 New England Osco drugstores in the fourth quarter of 2001. (These stores' sales are included in the 2000, 2001 and 2002 periods until their

closure.) The sales decrease was offset in part by the Company's capital expansion program. Sales were also impacted by declining consumer confidence (as measured by The Conference Board Index: 78.8 in January 2003 vs. 97.8 in January 2002) and escalating competitive activity. Identical store sales, stores that have been in operation for two full fiscal years, decreased 0.9% in 2002 and increased 0.8% in 2001 and 0.3% in 2000. Comparable store sales, which uses the same store base as the identical store sales computation except it includes replacement stores, decreased 0.4% in 2002 and increased 1.3% in 2001 and 0.6% in 2000. During 2002 the Company opened 92 stores, remodeled 207 stores and closed or sold 226 stores, 177 of which are part of the Company's restructuring plans. Net retail square footage at continuing operations was 92.1 million square feet at the end of 2002 and 92.8 million square feet and 92.9 million square feet at the end of 2001 and 2000, respectively.

Management estimates that overall deflation in products the Company sells was 0.1% in 2002, 0.3% in 2001 and 0.4% in 2000.

Gross profit, as a percent to sales, increased in 2002 vs. 2001 as a result of improved Company-wide procurement practices and increased generic substitution in the pharmacy department. Gross profit, as a percent to sales, remained relatively flat between 2001 and 2000. The pre-tax LIFO adjustment (as a percent to sales) increased gross profit by \$2 (0.01%) in 2002, decreased gross profit

by \$5 (0.01%) in 2001, and increased gross profit by \$23 (0.06%) in 2000. The net pre-tax LIFO charge for 2001 was \$5, comprised of \$10 of charges recorded in cost of sales, \$3 of credits recorded with gain on sale of New England Osco drugstores and \$2 of credits recorded with restructuring and other.

Cost of sales includes merchandise, advertising, warehousing and transportation costs, offset by vendor funds and advertising expense related to the Company's buying and merchandising activities. Advertising expense (excluding advertising allowances) totaled \$527 in 2002, \$537 in 2001, and \$550 in 2000.

Selling, general and administrative (SG&A) expenses as a percent to sales increased in 2002, primarily due to the reduction in the Company's sales base, increase in employee benefits and rising insurance costs. The impact of the elimination of goodwill amortization in 2002 due to the adoption of SFAS 142 and a ten basis point reduction in labor costs as a percentage of sales was offset by increased depreciation and rent expense associated with the Company's capital expenditure programs. The increase in 2001 over 2000 was primarily due to workers' compensation costs and benefit expenses caused by sharply higher health care costs. The 2001 increase in SG&A expenses was partially offset by reductions in direct labor costs.

Other income, for the year ended January 31, 2002, includes \$16 of charges for a decrease in company-owned life insurance assets, offset by \$8 of credits for stock received from the demutualization of two insurance companies.

The Company's effective income tax rate from continuing operations for 2002 was 38.4%, as compared to 42.6% for 2001 and 40.0% for 2000. The decrease resulted from the elimination of goodwill amortization and updated estimates of federal and state taxes which were lower than amounts previously estimated. The increase for 2001 over 2000 was due to lower earnings before income taxes, non-deductible restructuring expenses and increased non-deductible company-owned life insurance costs.

Restructuring and Other Non-Routine Items

The financial statement presentation includes the results of two significant restructuring initiatives that were implemented in 2001 and 2002. On July 18, 2001, the Company's Board of Directors approved a restructuring plan that included the closure of 165 underperforming retail stores, reduction of administrative and corporate overhead and consolidation and elimination of four division offices (refer to "Note F – Restructuring" in the notes to the accompanying consolidated financial statements). On March 13, 2002, the Company's Board of Directors approved the second phase of the restructuring plan which included the complete exit of four underperforming markets resulting in the sale or closure of 95 stores, two distribution centers, and reduction of division offices from 15 to 11 (refer to "Note E – Discontinued Operations/Market Exits" in the notes to the accompanying consolidated financial statements). Although these decisions were similar, the adoption of SFAS No. 144 "Accounting for the Impairment or Disposal of Long-Lived Assets" on February 1, 2002 caused the financial statement presentation of these actions to be dissimilar (SFAS No. 144 does not allow for the retroactive application of its provisions). The Company's 2001 and 2000 financial statements have been restated to classify the results of operations for the 95 stores and two distribution centers as discontinued operations. The operating results of the 165 stores are included in continuing operations of the Company's financial statements for the periods prior to their sale or closure.

Discontinued Operations/Market Exits

On March 13, 2002, the Company's Board of Directors approved the second phase of the Company's restructuring plan designed to improve future financial results and to drive future competitiveness. This phase of the plan included the complete exit of four underperforming markets: Memphis, Tennessee; Nashville, Tennessee; Houston, Texas; and San Antonio, Texas. This involved the sale or closure of 95 stores and two distribution centers, and reduction of division offices from 15 to 11. These sales and closures were evaluated for lease liability or asset impairment, including goodwill, in accordance with the

Company's policy. The operating results and gains and losses related to these market exits have been included in discontinued operations in the Company's Consolidated Earnings Statements. The prior years' operating activities for these 95 stores, two distribution centers, and reduction of division offices from 15 to 11 have been reclassified to discontinued operations: "Operating (loss) income" in the accompanying earnings statement.

The discontinued operations generated sales of \$290, \$1,326, and \$1,261 in 2002, 2001 and 2000, respectively, an operating loss of \$429 in 2002, and operating profit of \$10 and \$31 in 2001 and 2000, respectively. The discontinued operations operating loss of \$429 consisted of a loss from operations of \$50 and asset impairments, lease settlements and other costs of \$379 as described in the following table:

	NONCASH CHARGES	ACCRUALS	TOTAL CHARGES (CREDITS)
Asset impairments	\$ 401	\$ —	\$ 401
Lease settlements	—	26	26
Severance and outplacement	—	23	23
Other	—	2	2
Gain on asset sales	(63)	—	(63)
Favorable lease settlements	—	(10)	(10)
Loss on disposal			\$ 379
Cash payments during 2002		(30)	
Reserve balance at January 31, 2003		\$ 11	

The reserve balance of \$11 as of January 30, 2003 is included with the restructuring reserves in the "other current liabilities" line on the Company's Consolidated Balance Sheet.

Asset impairment adjustments resulted from the Company realizing sales proceeds in excess of amounts originally estimated on stores disposed of and increases to net realizable values for stores under contract for sale. Lease liability adjustments represent more favorable negotiated settlements than had been originally estimated.

Assets related to discontinued operations are recorded at their estimated net realizable value of \$25 as of January 30, 2003, and are reported as Assets held for

sale in the Company's Consolidated Balance Sheet. These assets include land, buildings, equipment and leasehold improvements and are being actively marketed. As of January 30, 2003, all 95 stores and both distribution centers were closed. In addition, the Company had either sold or terminated the leases related to 82 of the 95 stores and both distribution centers as of January 30, 2003.

Other costs consist of amounts paid in connection with notification regulations and negotiated contract terminations.

Restructuring

In the first half of 2001, the Company initiated a profitability review of all of its retail stores, utilizing a methodology based on return on invested capital. The Company also evaluated its division management structure and the efficiency of its transaction processing departments. Based on these reviews, in July 2001 the Company committed to the following restructuring activities: 1) close and dispose of 165 underperforming stores in 25 states; 2) eliminate four of the existing 19 division offices; 3) sell a store fixture manufacturing operation; 4) centralize certain transaction processing functions in Boise, Idaho; and 5) reduce general office head count.

These restructuring activities called for the elimination of 1,341 managerial and administrative positions (excluding store level terminations). The restructuring charge recorded in 2001 included the following: employee severance and outplacement costs of \$44; asset impairments of \$361; lease termination costs of \$57; and other costs of \$6.

In 2001 and 2002, 80 and 82 stores were closed or sold and 995 and 297 managerial and administrative employees were terminated, respectively. In 2002, management revised the planned restructuring activities as follows: the store fixture manufacturing operation's performance was re-evaluated and determined to be more cost-effective than purchasing like-fixtures from external sources in the future, so it will be held and used; one store's operating performance improved due to local market conditions, so it too will be held and used; and one part of the transaction processing consolidation was halted due to a decision to

replace the Company's human resource information systems (HRIS) over the next two to three years, which resulted in the reversal of the elimination of 50 positions. The remaining two stores in this restructuring plan will be closed in 2003.

The following table presents the pre-tax restructuring credits and charges and the related restructuring reserves included in the Company's Consolidated Balance Sheets:

	NONCASH CHARGES	ACCRUALS	TOTAL CHARGES (CREDITS)
2001 ACTIVITY			
Asset impairments	\$ 361	\$ —	\$ 361
Lease settlements	—	57	57
Severance and outplacement	—	44	44
Other	—	6	6
Restructuring (credits) charges			<u>\$ 468</u>
Cash payments during 2001		<u>(46)</u>	
Reserve balance at January 31, 2002		61	
2002 ACTIVITY			
Retain store fixtures operation	(3)	(2)	\$ (5)
Halt part of consolidation — HRIS	—	(2)	(2)
Gain on asset sales	(17)	—	(17)
Favorable lease settlements	—	(14)	(14)
Severance and outplacement	—	2	2
Other	—	(1)	(1)
Restructuring (credits) charges			<u>\$ (37)</u>
Cash payments during 2002		<u>(16)</u>	
Reserve balance at January 30, 2003		<u>\$ 28</u>	

The reserve balances of \$28 at January 30, 2003 and \$61 at January 31, 2002 are included in the "Other Current Liabilities" line on the Company's Consolidated Balance Sheets.

Merger-Related Charges (Credits)

On June 23, 1999, the Company and American Stores Company consummated a merger (the "Merger"), which has been accounted for as a pooling-of-interests.

Merger-related (credits) charges for 2001 represents a credit of \$15 associated with the sale of an asset for an amount that was greater than originally estimated.

Merger-related (credits) charges for 2000 represents \$24 related to one-time asset impairment and severance charges.

In the future, any restructuring activity will be accounted for under the guidance of SFAS No. 146, which will primarily effect the timing of restructuring reserves.

Other Non-Routine Items

The Company recorded a \$54 pre-tax gain during the fourth quarter of 2001 resulting from the sale of 80 New England Osco drugstores.

The Company recorded, in selling, general and administrative expenses, a \$36 pre-tax gain during the fourth quarter of 2001 resulting from an amendment to the Company's long-term disability plan. The amendment changed the salary continuation feature from a cumulative benefit based on years of service, to a set percentage of salary benefit.

The Company recorded a \$20 pre-tax charge during the first quarter of 2000, which is included in selling, general and administrative expenses to reflect liabilities related to certain previously assigned leases and subleases to tenants who were in bankruptcy.

Summary of Discontinued Operations, Restructuring and Other Non-Routine Items

In the past three years, the Company's earnings from continuing operations have included certain non-routine items, including costs associated with restructuring activities and the 1999 merger of Albertsons and American Stores Company, and the cessation of goodwill amortization following the adoption of SFAS 142. The following table summarizes the non-routine items that management excludes when it analyzes the Company's operating trends over the past three years. Management also considers the restructuring (credits) charges and other, merger-related credits, gain on sale of New England Osco drugstores, and discontinued operations to be non-routine items.

	52 WEEKS ENDED JANUARY 30, 2003		52 WEEKS ENDED JANUARY 31, 2002		52 WEEKS ENDED FEBRUARY 1, 2001	
	AS REPORTED	ADJUSTMENTS	AS REPORTED	ADJUSTMENTS	AS REPORTED	ADJUSTMENTS
Sales	\$35,626	\$ —	\$36,605	\$ —	\$35,501	\$ —
Cost of sales	25,242	(1) ^(a)	26,179	(35) ^(c)	25,409	(37) ^(f)
Selling, general and administrative expenses	8,604	(8) ^(b)	8,731	(40) ^(d)	8,444	(110) ^(g)
Income tax expense	540	(11) ^(h)	367	181 ^(h)	497	66 ^(h)

^(a) In connection with the market exits classified as discontinued operations in 2002, the Company's distribution center in Fort Worth, Texas recorded inventory write-down costs and incremental labor and transportation costs of \$1.

^(b) The Company incurred professional fees of \$4, asset impairments of \$2 and other costs of \$2 in connection with the 2002 market exits.

^(c) In the 2001 restructuring activities, inventory losses due primarily to closeout price reductions and damage or spoilage at stores slated for closure were incurred. The estimated losses incurred were \$35.

^(d) In 2001, the Company recorded asset impairments of \$52 with respect to land and buildings held for sale, amended its long-term disability program resulting in a gain of \$36, recorded merger and integration costs of \$12, incurred sign-on bonus charges of \$8, and paid for legal and professional services of \$4 associated with the 2001 restructuring activities.

^(e) The Company recorded \$56 and \$57 of goodwill amortization in 2001 and 2000, respectively. With the adoption of SFAS 142 as of the beginning of 2002, the Company no longer recognizes a charge for goodwill (See Critical Accounting Policies above).

^(f) Following the June 1999 merger between Albertsons and American Stores Company, the Company incurred \$37 of incremental advertising costs related to the conversion of the Lucky banner in California to the Albertsons banner.

^(g) The Company incurred significant costs in 2000 in connection with the integration of Albertsons and American Stores Company. Direct costs incurred included salaries of \$27, legal and professional services of \$10, travel and moving expenses of \$10, facilities and equipment costs of \$12, asset impairment costs of \$9 associated with stores divested in connection with the 1999 merger and information technology equipment that was abandoned by the Company and other costs of \$22. In addition, the Company recorded a charge of \$20 due to the bankruptcy of a retailer that subleased certain of the Company's former retail stores.

^(h) Represents, for each of the years presented, the income tax effect of the other adjustments presented for such year.

Liquidity and Capital Resources

Cash provided by operating activities during 2002 was \$2,063, compared to \$2,009 in 2001 and \$1,771 in 2000.

Cash provided by operating activities in 2002 was primarily impacted by increased earnings before change in cumulative effect of accounting principle. Cash provided by operating activities in 2001 was primarily impacted by noncash restructuring charges when compared to 2000.

The Company's financing activities for 2002 included payments on long-term borrowings of \$143, stock purchased and retired of \$862, and dividend payments of \$306. The Board of Directors, at its March 2003 meeting, maintained the regular quarterly cash dividend of \$0.19 per share, for an effective annual rate of \$0.76 per share.

The Company utilizes its commercial paper and bank line programs primarily to supplement cash requirements for seasonal fluctuations in working capital and to fund its capital expenditure program. Accordingly, commercial

paper and bank line borrowings will fluctuate between reporting periods. The Company had no commercial paper or bank line borrowings outstanding at January 30, 2003 or January 31, 2002.

The Company had three credit facilities totaling \$1,400 during 2002. The first agreement for \$100 expired in February 2003 and was renewed for an additional year to expire in February 2004. The second agreement for \$350 expired in March 2003 and was renewed for an additional year to expire in March 2004. The third agreement for \$950 expires in March 2005. All of the credit agreements contain an option which would allow the Company, upon due notice, to convert any outstanding amounts at the expiration dates to term loans. The agreements in place at year end also contain certain covenants, the most restrictive of which requires the Company to maintain consolidated tangible net worth, as defined, of at least \$3,000 and a fixed charge coverage, as defined, of no less than 2.7 times. As of

January 30, 2003, the Company was in compliance with these requirements. No borrowings were outstanding under the credit facilities as of January 30, 2003 or January 31, 2002.

Albertsons filed a shelf registration statement with the Securities and Exchange Commission ("SEC"), which became effective on February 13, 2001 ("2001 Shelf Registration") to authorize the issuance of up to \$3,000 in debt securities. In May 2001 the Company issued \$600 of term Notes under the 2001 Shelf Registration. The Notes are composed of \$200 of principal bearing interest at 7.25% due May 1, 2013 and \$400 of principal bearing interest at 8.0% due May 1, 2031. Proceeds were used primarily to repay borrowings under the Company's commercial paper program.

During 2002, no securities were issued under the 2001 Registration Statement. As of January 30, 2003, \$2,400 of debt securities remain available for issuance under the 2001 Registration Statement.

The Board of Directors adopted a program on April 25, 2000, authorizing, but not requiring, the Company to purchase and retire up to \$500 of the Company's common stock. This program was increased by an additional \$1,000 by the Board of Directors on December 6, 2000, for a total of \$1,500. The revised program enabled the Company to purchase stock from April 25, 2000 through December 6, 2001. During 2000, the Company purchased and retired 18.7 million shares at a total cost of \$451 or an average price of \$24.15 per share. No shares were purchased during 2001. The Board of Directors adopted a program on December 3, 2001, authorizing, at management's discretion, the Company to purchase and retire up to \$500 of the Company's common stock beginning December 6, 2001 through December 31, 2002. On September 5, 2002, the Board of Directors authorized an increase of \$500 to this program for a total of \$1,000 of the Company's common

stock that could be purchased and retired by the Company through December 31, 2002. The Board of Directors adopted a stock buyback program on December 9, 2002, authorizing, at management's discretion, the Company to purchase and retire up to \$500 of the Company's common stock beginning January 1, 2003 and ending December 31, 2003. During 2002, the Company purchased and retired 35.1 million shares for \$862 at an average price of \$24.54 per share under these programs. The Company may continue or, from time to time suspend, purchasing shares under its stock purchase program without notice, depending on prevailing market conditions, alternate uses of capital and other factors.

The Company's operating results continue to enhance its financial position and ability to continue its internal expansion program. Cash flows from operations and available borrowings are adequate to support currently planned business operations, stock repurchases, acquisitions and capital expenditures. The Company has short-term financing capacity in the form of commercial paper or bank line borrowings up to \$1,400 and long-term capacity under the 2001 Registration Statement of \$2,400.

As of January 30, 2003, the Company's credit ratings were as follows:

	S & P	MOODY'S	FITCH
Long-term debt	BBB+	Baa1	BBB+
Short-term debt	A2	P2	F2

There are no payment acceleration provisions in the Company's fixed-term debt portfolio related to a downgrade in the Company's credit ratings. Similarly, a downgrade in the Company's credit ratings would not affect the Company's ability to borrow amounts under the revolving credit facilities. However, any adverse changes to the Company's credit ratings could limit the Company's access to the commercial paper market and increase the cost of debt.

Contractual Obligations and Commercial Commitments

Albertsons has assumed various financial obligations and commitments in the normal course of its operations and financing activities. Financial obligations are considered to represent known future cash payments that the Company is required to make under existing contractual arrangements, such as debt and lease agreements. The following table represents the scheduled maturities of the Company's long-term contractual obligations as of January 30, 2003:

	YEAR 1	YEARS 2-3	YEARS 4-5	AFTER 5 YEARS	TOTAL
Long-term debt	\$ 105	\$ 704	\$ 14	\$ 4,232	\$ 5,055
Capital lease obligations ⁽¹⁾	47	88	79	531	745
Operating leases ⁽¹⁾	330	637	545	2,275	3,787
Contracts for purchase of property and construction of buildings	176	—	—	—	176
Other ⁽²⁾	96	136	6	—	238
Total contractual cash obligations	\$ 754	\$ 1,565	\$ 644	\$ 7,038	\$ 10,001

⁽¹⁾ Represents the minimum rents payable and includes leases associated with closed stores accrued for under the Company's restructuring and closed store reserves. Amounts are not offset by expected sublease income.

⁽²⁾ Includes transportation contracts with third parties. Also, the Company has entered into energy supply agreements which have terms through 2006. These agreements include certain provisions that could potentially require the Company to pay additional amounts if the actual usage is less than the minimum usage per the contract documents or if the contracts were terminated. This number is difficult to estimate due to the uncertainty of future energy usage and change in the market value of energy, therefore no amounts have been included above.

The Company is contingently liable as a guarantor of certain leases that were assigned to third parties in connection with various store closures and dispositions. The Company believes the likelihood of a significant loss from these agreements is remote because of the wide dispersion among third parties and remedies available to the Company should the primary parties fail to perform under the agreements.

Albertsons commercial commitments as of January 30, 2003, representing possible commitments triggered by potential future events, are as follows:

	YEAR 1	YEARS 2-3	YEARS 4-5	AFTER 5 YEARS	TOTAL
Available lines of credit	\$ 450	\$ 950	\$ —	\$ —	\$ 1,400
Letters of credit — standby	95	—	—	—	95
Letters of credit — commercial	13	—	—	—	13
Potential commercial commitments	\$ 558	\$ 950	\$ —	\$ —	\$ 1,508

Letters of Credit

The Company had outstanding Letters of Credit of \$108 as of January 30, 2003, all of which were issued under separate bilateral agreements with multiple financial institutions. Of the \$108 outstanding at year end, \$95 were standby letters of credit covering primarily workers' compensation or performance obligations. The remaining \$13 were commercial letters of credit supporting the Company's merchandise import program. The Company

paid issuance fees that varied, depending on type, up to 0.70% of the outstanding balance of the letter of credit.

Off Balance Sheet Arrangements

The Company has no significant investments that are accounted for under the equity method in accordance with accounting principles generally accepted in the United States. Investments that are accounted for under the equity method have no liabilities associated with them that would be considered material to Albertsons.

Capital Expenditures

The Company continues to retain ownership of real estate when possible. As of January 30, 2003 the Company held title to the land and buildings of 41% of the Company's stores and held title to the buildings on leased land of an additional 10% of the Company's stores. The Company also holds title to the land and buildings of most of its administrative offices and distribution facilities.

The Company is committed to keeping its stores up to date. In the last three years, the Company has opened or remodeled 527 stores representing 25% of the Company's retail square footage as of January 30, 2003. The following summary of historical capital expenditures includes capital leases, stores acquired in business and asset acquisitions, assets acquired with related debt and the estimated fair value of property financed by operating leases:

	2002	2001	2000
New and acquired stores	\$ 688	\$ 875	\$1,066
Remodels	455	348	423
Retail replacement equipment, technology and other	221	247	170
Distribution facilities and equipment	70	64	174
Total capital expenditures	1,434	1,534	1,833
Estimated fair value of property financed by operating leases	150	153	99
	\$1,584	\$1,687	\$1,932

Total capital expenditures include capitalized lease obligations incurred of \$75 in 2002, \$79 in 2001 and \$62 in 2000.

The Company's strong financial position provides the flexibility for the Company to grow through its store development program and future acquisitions. The Company's capital expenditure budget for 2003 is approximately \$1,400 and approximately \$100 in new lease obligations.

Related Party Transactions

Transactions with related parties were not considered material. See "Note U — Related Party Transactions" in the Notes to Consolidated Financial Statements.

Recent Accounting Standards

In July 2001 the Financial Accounting Standard Board ("FASB") issued SFAS No. 143, "Accounting for Asset Retirement Obligations." SFAS No. 143 will become effective for Albertsons on January 31, 2003. This statement addresses financial accounting and reporting for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs. The Company is currently analyzing the impact that this standard will have on its financial statements, but believes it will not have a material impact on the Company's consolidated financial statements.

In April 2002 the FASB issued SFAS No. 145, "Rescission of FASB Statements No. 4, 44 and 64, Amendment of FASB Statement No. 13, and Technical Corrections." The statement rescinds SFAS No. 4, "Reporting Gains and Losses from Extinguishment of Debt," and an amendment of that statement, SFAS No. 64, "Extinguishments of Debt Made to Satisfy Sinking-Fund Requirements." As a result, gains and losses from extinguishment of debt will no longer be aggregated and classified as an extraordinary item, net of related income tax effect, on the statement of earnings. SFAS No. 145 is effective for fiscal years beginning after May 15, 2002, with earlier application encouraged. The provisions of SFAS No. 145 will be effective for fiscal year beginning January 31, 2003. The adoption of SFAS No. 145 will not have a material impact on the Company's consolidated financial statements.

In June 2002 the SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities" was issued. This statement nullifies existing guidance related to the accounting and reporting for costs associated with exit or disposal activities and requires that the fair value of a liability associated with an exit or disposal activity be recognized when the liability is incurred. Under previous guidance, certain exit costs were permitted to be accrued upon management's commitment to an exit plan, which is generally before an actual liability has been incurred. The

provisions of this statement are required to be adopted for all exit or disposal activities initiated after December 31, 2002. This statement will not impact any liabilities recorded prior to adoption. As required the Company will adopt SFAS No. 146 effective in 2003. The Company does not expect that the adoption of this statement will have a material impact on the Company's consolidated financial statements.

In December 2002 the FASB issued SFAS No. 148, "Accounting for Stock-Based Compensation, Transition and Disclosure." SFAS No. 148 provides alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. The accompanying Note Q – Stock Options and Stock Awards – satisfies the disclosure requirements of SFAS No. 148.

In November 2002 the FASB issued FASB Interpretation No. 45 ("FIN 45"), "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others." FIN 45 requires that upon issuance of a guarantee, a guarantor must recognize a liability for the fair value of an obligation assumed under a guarantee. FIN 45 also requires additional disclosures by a guarantor in its interim and annual financial statements about the obligations associated with guarantees issued. The recognition provisions of FIN 45 are effective for guarantees issued after December 31, 2002, while the disclosure requirements were effective for financial statements for periods ending after December 15, 2002. At January 30, 2003, the Company had not entered into any material arrangement that would be subject to the disclosure requirements of FIN 45. In addition, the Company does not believe that the adoption of FIN 45 will have a material impact on the Company's consolidated financial statements.

In January 2003 the FASB issued Interpretation No. 46 ("FIN 46"), "Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51." FIN 46 requires certain variable interest entities to be consolidated by the primary beneficiary of the entity if the equity investors in the entity do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. FIN 46 is effective for all new variable interest entities created or acquired after January 31, 2003. For variable interest entities created or acquired prior to February 1, 2003, the provisions of FIN 46 must be applied for the first interim or annual period beginning after June 15, 2003. The Company is currently evaluating the impact that the adoption of FIN 46 will have on the Company's consolidated financial statements.

Environmental

The Company has identified environmental contamination sites related primarily to underground petroleum storage tanks and groundwater contamination at various store, warehouse, office and manufacturing facilities (related to current operations as well as previously disposed of properties). The Company conducts an ongoing program for the inspection and evaluation of potential new sites and the remediation/monitoring of contamination at existing and previously owned sites. Undiscounted reserves have been established for each environmental contamination site unless an unfavorable outcome is believed to be remote. Although the ultimate outcome and expense of environmental remediation is uncertain, the Company believes that the costs of required remediation and continuing compliance with environmental laws, in excess of current reserves, will not have a material adverse effect on the financial condition, results of operations or cash flows of the Company. Charges against earnings for environmental remediation were not material in 2002, 2001 or 2000.

Quantitative and Qualitative Disclosures about Market Risk

The Company is exposed to certain market risks that are inherent in the Company's financial instruments, which arise from transactions entered into in the normal course of business. From time to time, the Company enters into certain derivative transactions allowed by the Company's risk management policy. The Company does not enter into derivative financial instruments for trading purposes. The Company uses derivatives primarily as cash flow hedges to set interest rates for forecasted debt issuances, such as interest rate locks.

The Company is subject to interest rate risk on its fixed interest rate debt obligations. Commercial paper borrowings do not give rise to significant interest rate risk because these borrowings generally have maturities of less than three months. Generally, the fair value of debt with a fixed

interest rate will increase as interest rates fall, and the fair value will decrease as interest rates rise. The Company manages its exposure to interest rate risk by utilizing a combination of fixed rate borrowings and commercial paper borrowings.

As of January 30, 2003, the Company had no foreign exchange exposure and no outstanding derivative transactions. There have been no material changes in the primary risk exposures or management of the risks since the prior year. The Company expects to continue to manage risks in accordance with the current policy.

The table below provides information about the Company's debt obligations that are sensitive to changes in interest rates. For debt obligations, the table presents principal cash flows and related weighted average interest rates by expected maturity dates:

	2003	2004	2005	2006	2007	THEREAFTER	TOTAL	FAIR VALUE
Fixed rate debt obligations	\$105	\$502	\$202	\$2	\$12	\$4,232	\$5,055	\$5,675
Weighted average interest rate	7.1%	6.6%	7.4%	8.1%	6.9%	7.5%	7.4%	—

Cautionary Statement for Purposes of "Safe Harbor Provisions" of the Private Securities Litigation Reform Act of 1995

All statements other than statements of historical fact contained in this and other documents disseminated by the Company, including statements regarding the Company's expected financial performance, are forward-looking information as defined in the Private Securities Litigation Reform Act of 1995. In reviewing such information about the future performance of the Company, it should be kept in mind that actual results may differ materially from those projected or suggested in such forward-looking information since predictions regarding future results of operations and other future events are subject to inherent uncertainties.

These statements may relate to, among other things: investing to increase sales; changes in cash flow; increases in insurance and employee benefit costs; attainment of cost reduction goals; achieving sales increases and increases in identical sales; opening and remodeling stores; and the Company's five strategic imperatives; and are indicated by words or phrases such as "expects," "plans," "believes," "estimate," and "goal." In reviewing such information about the future performance of the Company, it should be kept in mind that actual results may differ materially from those projected or suggested in such forward-looking information.

Important assumptions and other important factors that could cause actual results to differ materially from those set forth in the forward-looking information include changes in the general economy; changes in interest rates; changes in consumer spending; actions taken by new or existing competitors (including nontraditional competitors), particularly those intended to improve their market share (such as pricing and promotional activities); and other factors affecting the Company's business in or beyond the Company's control. These factors include changes in the rate of inflation; changes in state or federal legislation or regulation; adverse determinations with respect to litigation or other claims (including environmental matters); labor negotiations; the cost and stability of energy sources; the Company's ability to recruit, retain and develop employees; the Company's ability to develop new stores or complete remodels as rapidly as planned; the Company's ability to implement new technology successfully; stability of product costs; the Company's ability to integrate the operations of acquired or merged companies; the Company's ability to execute its restructuring plans; and the Company's ability to achieve its five strategic imperatives.

Other factors and assumptions not identified above could also cause the actual results to differ materially from those projected or suggested in the forward-looking information. The Company does not undertake to update forward-looking information contained herein or elsewhere to reflect actual results, changes in predictions, assumptions, estimates or changes in other factors affecting such forward-looking information.