

Federated

DEPARTMENT STORES, INC.

2002 ANNUAL REPORT





ONE OF THE NATION'S LEADING DEPARTMENT STORE RETAILERS, FEDERATED DEPARTMENT STORES, INC. CURRENTLY OPERATES MORE THAN 450 STORES IN 34 STATES, GUAM AND PUERTO RICO UNDER THE NAMES OF BLOOMINGDALE'S, THE BON MARCHÉ, BURDINES, GOLDSMITH'S, LAZARUS, MACY'S AND RICH'S-MACY'S. IT ALSO OPERATES MACYS.COM, BLOOMINGDALE'S BY MAIL, AND A NETWORK OF ONLINE BRIDAL GIFT REGISTRIES OPERATED IN CONJUNCTION WITH WEDDINGCHANNEL.COM.

COMMUNITY INVOLVEMENT

Each Federated department store division is well established in its operating areas. The company believes in giving back to the communities from which it draws strength and sustenance. Federated understands that stronger, healthier and more vibrant communities provide better environments for our stores to do business and for our employees and customers to live and work.

In 2002, cash contributions to charitable organizations by Federated, its divisions and subsidiaries – including those made by the Federated Department Stores Foundation – totaled approximately \$14.7 million.

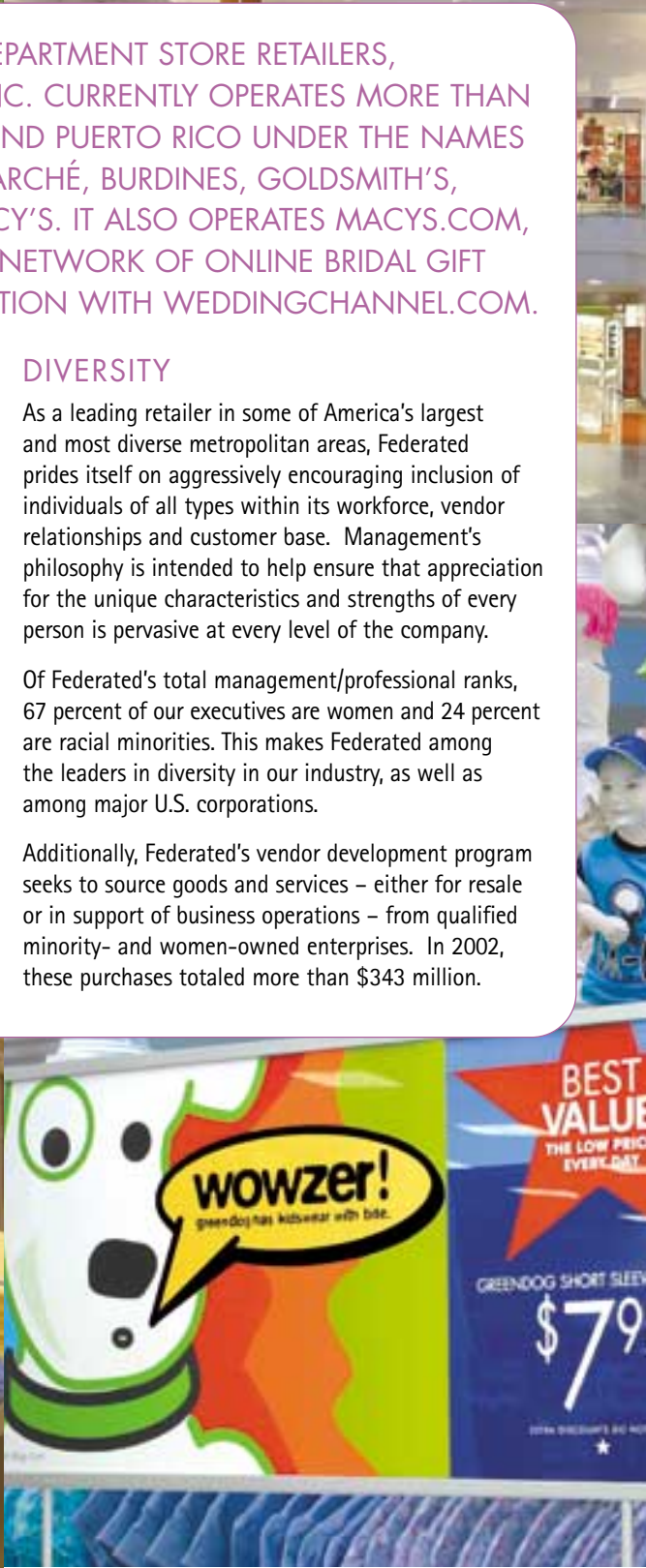
Partners in Time, the company's nationally recognized employee volunteer program, involves all divisions and support operations. In 2002, more than 60,000 volunteers gave more than 116,000 hours of time – valued at nearly \$2 million – touching nearly every segment of American society.

DIVERSITY

As a leading retailer in some of America's largest and most diverse metropolitan areas, Federated prides itself on aggressively encouraging inclusion of individuals of all types within its workforce, vendor relationships and customer base. Management's philosophy is intended to help ensure that appreciation for the unique characteristics and strengths of every person is pervasive at every level of the company.

Of Federated's total management/professional ranks, 67 percent of our executives are women and 24 percent are racial minorities. This makes Federated among the leaders in diversity in our industry, as well as among major U.S. corporations.

Additionally, Federated's vendor development program seeks to source goods and services – either for resale or in support of business operations – from qualified minority- and women-owned enterprises. In 2002, these purchases totaled more than \$343 million.



FINANCIAL HIGHLIGHTS

	2002	2001	2000	1999
Net Sales	\$ 15.435 billion	\$ 15.651 billion	\$ 16.638 billion	\$ 16.029 billion
Increase (decrease) in same-store sales <small>(Note 1)</small>	(3.0%)	(5.3%)	2.0%	4.5%
Operating Income	\$ 1.343 billion	\$ 1.104 billion	\$ 1.691 billion	\$ 1.693 billion
% of sales	8.7%	7.1%	10.2%	10.6%
Diluted Earnings (Loss) Per Share				
Income from Continuing Operations	\$ 3.21	\$ 2.59	\$ 3.97	\$ 3.76
Net Income (Loss)	\$ 4.12	\$(1.38)	\$ (.89)	\$ 3.62
Cash Inflow (Outflow) Before Financing Activities <small>(Note 2)</small>				
	\$ 1.455 billion	\$ 509 million	\$ 254 million	\$ (1.135) billion

Notes: (1) Represents the year-to-year percentage change in net sales from stores in operation throughout the year presented and the immediately preceding year, including for 2001 Stern's stores in operation throughout the first quarter of 2001 and 2000, and excluding for 2001 and 2000 the impact of the 53rd week in 2000.

(2) Reflects cash inflow (outflow) from continuing operations and discontinued operations. Represents net increase (decrease) in cash of \$80 million in 2002, \$414 million in 2001, \$49 million in 2000 and \$(134) million in 1999, as adjusted to exclude the effects of net cash used (provided) by continuing financing activities of \$1,375 million in 2002, \$95 million in 2001, \$205 million in 2000 and \$(1,001) million in 1999.



The Fabric of FEDERATED

A BUTTERFLY EMERGING FROM ITS CHRYSALIS IS A SYMBOL OF EVOLVING CHANGE. INTERWOVEN IN THE FABRIC OF A COMPANY IS THE STRENGTH TO EMBRACE AND MANAGE THAT CHANGE. THESE TWO ELEMENTS COME TOGETHER IN FEDERATED AS ANOTHER YEAR BEGINS, AS WE CONTINUE TO REDEFINE THE DEPARTMENT STORE AND EVOLVE OUR COMPANY. SUCH A TIME OFFERS PROMISE EVEN AS CHANGE BRINGS ITS INEVITABLE CHALLENGES. IT IS THE YIN AND YANG OF ANTICIPATING THE FUTURE. AND IT IS IN MEETING THESE CHALLENGES THAT THE MANY THREADS IN THE STRONG FABRIC OF FEDERATED CONSISTENTLY PROVE THEMSELVES TO BE A CUT ABOVE.

For a look at financial highlights, please open this flap.



DEAR FELLOW

Shareholder:

JUST THREE YEARS AGO, FEDERATED PRODUCED THE BEST ACROSS-THE-BOARD RESULTS IN THE HISTORY OF THE COMPANY.

Since then, the fundamental nature of our business has not changed. Unfortunately, the same cannot be said of the world around us.

2002 was a difficult year. A weak economy depressed retail sales across all sectors, and department stores suffered more than other formats. This has even caused some skeptics to question the validity of the department store – an exaggerated leap, in our view, given that despite disappointing sales, Federated produced improved earnings, solid gross margins and continued strong free cash flow last year.

The essential fabric of Federated obviously is strong. The durable threads that comprise this company – our exceptional store nameplates, our private brands, our support operations, our people – are unequaled in all of retail.

We have confidence in the future of the department store, and in Federated in particular. It is a retail format that has changed and adapted to evolving consumer tastes for more than 160 years, and in this progression Federated has advanced further than most. Our reinvent process is an exciting new chapter in the life of the department store, and the resulting initiatives are meeting with positive customer response across the country. As they do, and as our

customers give us valuable feedback, we will continue to develop and test new ideas for our stores.

In the pages that follow, we attempt to answer some of the questions that you might have about our business. This includes how we are acting to win a greater portion of our customers' discretionary spending and regain market share as we position ourselves to take full advantage of the inevitable economic recovery to come. Before getting into these issues, however, we want to review with you the accomplishments of the past year, and take a look at some of our goals for the year ahead.

Progress in 2002

Federated produced improved earnings of \$638 million, or \$3.21 per share, from continuing operations in 2002, despite the weak economy and disappointing sales. This was well ahead of EPS from continuing operations of \$2.59 in 2001.

Achieving higher earnings despite a soft retail environment is evidence of exceptional efforts on the part of our stores and division management during the year, and an unabated focus on inventory management, expense and capital control for which Federated is well known.

THE DURABLE THREADS
THAT COMPRISE
THIS COMPANY –
OUR EXCEPTIONAL STORE
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OUR PRIVATE BRANDS,
OUR SUPPORT OPERATIONS,
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As noted in our Financial Highlights, cash inflow before financing activities was \$1.46 billion in 2002, compared with \$509 million in 2001. The company reduced debt by more than \$1 billion in 2002 and used approximately \$390 million of excess cash to repurchase 11.4 million shares of Federated common stock during the year. Even with these uses, we ended 2002 with \$716 million of cash on hand.

Managing receipts to reduce inventory levels helped to mitigate the margin impact of lower sales and positioned the company well for the start of the new retail year.

We also achieved clear progress last year in our strategy to offer more compelling merchandise assortments. We are more aggressively editing our customer offering to ensure the choice of goods on the sales floor is plentiful and appealing, but not overwhelming. We also further strengthened our private brand merchandise programs, which deliver exceptional value to the customer while proving to be a true differentiator for Federated.

In our quest to improve the customers' shopping experience, elements of Federated's reinvent strategy were rolled out in 2002 to approximately 40 stores nationwide, with additional rollouts planned for 2003.

One of our most significant accomplishments in 2002 was the continued development of Federated's people into the best team in the retailing business. By any measure, ours is an outstanding company of talented people with diverse backgrounds working to provide the best possible product and service to our customers. Our commitment to people is reflected in the growth of our Star Academy of top sales performers, as well as in the expansion of the Federated Leadership Institute and a renewed commitment to enhanced training at all levels. We are proud of our people, and believe them to be our greatest asset.

Focused on sales in 2003

We entered 2003 facing a stiff head wind of economic and competitive forces. Recognizing this, Federated has fortified its determination to drive top-line sales. We are listening intently to what customers are telling us about their needs and preferences, and we are making changes based on what they tell us. We are focusing more intensive efforts on reaching our best customers – the fashion-conscious consumer whose first choice for fashion and value is likely to be the department store.

As we move through the next year, we will be concentrating our efforts on:

- Offering compelling assortments through better editing of our merchandising offering, partnering with name-brand vendors to bring unique, exclusive and limited-distribution goods to our stores first, and further developing our own private brands.
- Simplifying our pricing through a program of everyday "Best Values," fewer coupon promotions and more emphasis on the value we deliver relative to the competition.
- Improving the customers' shopping experience, in part through ongoing rollout of reinvent elements such as simplified way-finding signage, the installation of convenient shopping carts and price-check scanners, and enhanced fitting rooms and sitting areas.
- Enhancing communication with customers to clarify our marketing messages and further leverage the company's powerful store brands and significant annual advertising investment.
- Continuing to refine existing and test new reinvent initiatives, investing in the rollout of those elements that customers tell us they like the most. To better gauge the impact of the

reinvent initiatives in a single market, we will be converting consolidated Rich's-Macy's stores in metro Atlanta to reinvent formats in 2003.

We expect to generate 2003 EPS of \$3.05 to \$3.25 during the year, including store-closing costs of \$45 million. Same-store sales for the year currently are forecasted to be flat to down 1.5 percent, with the latter half of the year expected to benefit from a strengthening economy overall. Cash flow is anticipated to remain strong in 2003.

Federated plans to open 12 new stores in 2003, and as always, the company will continue to monitor any under-performing locations that may be candidates for future closures. The new stores planned for 2003 openings include: two Bloomingdale's in Atlanta, a Bloomingdale's department store in the SoHo area of New York City, and Bloomingdale's home stores in downtown Chicago and Oakbrook, IL. New Rich's-Macy's furniture galleries will open in Atlanta and Augusta, GA. The Bon Marché will open a new department store in Redmond, WA, and a furniture gallery in Tacoma, WA. Macy's East will open a new furniture gallery on Staten Island, and Macy's West will expand its presence in Hilo and Maui, HI, with the addition of two new stores there. A total of \$650 million has been budgeted for capital expenditures in 2003.

Embracing change

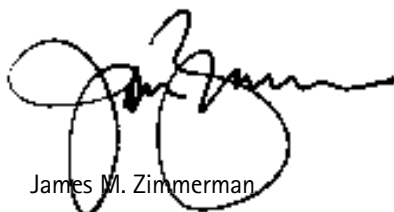
Federated is a company eager to embrace change, one that seeks and pursues new ideas, and that leads the way in a crowded retail field. We are committed to becoming even more aggressive and creative in identifying and serving the needs of our fashion-oriented target customers.

We also will work to ensure that Federated remains a stable financial performer, with effective operations and management continuity. Federated demonstrated this

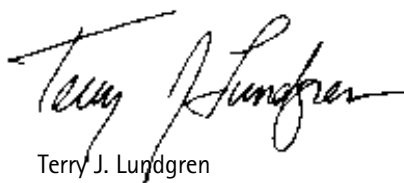
capacity earlier this year with the long-planned management transition under which President Terry Lundgren assumed CEO responsibilities, while Jim Zimmerman remains chairman of the board.

While some businesses might fray in times of challenge, today's Federated is sewn from stronger cloth – durable, flexible, resilient in the face of change. We are confident in our ability to overcome obstacles and to find opportunity in doing so. And we deeply appreciate the support of our shareholders, customers, employees, vendor partners and communities as we continue to improve the department store for all of the changing tomorrows to come.

Sincerely,



James M. Zimmerman
Chairman of the Board

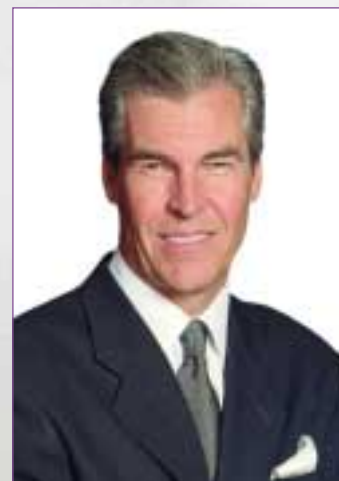


Terry J. Lundgren
President &
Chief Executive Officer

April 16, 2003



JAMES M. ZIMMERMAN
CHAIRMAN OF THE BOARD



TERRY J. LUNDGREN
PRESIDENT & CHIEF EXECUTIVE OFFICER

OUR VIEW OF THE DEPARTMENT STORE AND ITS FUTURE IN A COMPETITIVE RETAIL ENVIRONMENT.



Why do you believe so strongly in the department store?

Department stores offer the greatest flexibility of any retail format for selling fashion merchandise in a consumer society that's driven by change, newness and value. In a department store, we can offer an array of merchandise categories that expand or contract with consumer preferences and merchandise trends. We can capitalize on shoppers' interests in accessorizing and coordinating cohesive "looks" – all within the same four walls. Research and experience underscore that customers want access to the best brands, and many of Federated's best-selling designer and name brands, such as Kenneth Cole, Ralph Lauren, and Sean John, are sold only in department stores such as Macy's and Bloomingdale's.



Moreover, department stores – and the regional malls they anchor – remain magnet destinations with great appeal to many time-starved Americans. With one stop in a department store, shoppers can buy what's needed for themselves, every member of the family and their homes. Customers also can purchase wedding gifts through our nationwide gift registry, and access specialized services such as interior design, personal shopping and gift-wrapping. Malls are the preferred shopping destination for many customers because they can see and accomplish more in one trip without the hassle of driving all over town.

Department stores today may look and feel different than the ones our parents shopped, but that's the point: department stores can and do change with the times. Our challenge is to embrace this change and continue to improve our execution of this proven retailing format.

What are your customers telling you they want most in your stores?

Convenience... Stores that are simple to shop... Focused, edited and differentiated assortments... Quality... Value... Service. That's what our customers want, and that's where we are channeling our energy and our efforts.

We're more focused than ever on the one-third of consumers who are responsible for driving three-quarters of our business. These are primarily fashion-conscious women, ages 25 and older, who also work outside the home. Our research shows that this segment represents our best opportunities for incremental growth in apparel and home merchandise as we improve our fashion/value equation.

Excitement, newness and value top the list of expectations among these targeted customers. They want to see the latest fashions in apparel and home merchandise and more than any other consumer segment they look to the department store to meet those needs. Our goal is to monitor closely what our customers want, and to have those brands and items available in their size and color at the store location where they shop.

Newness is a fundamental part of the equation. Department stores have a well-deserved reputation for providing consumers with "wear-now" fashion – fresh and interesting designs and styles that incorporate some of the aspirational trends they see in the fashion magazines and the media. Our goal is to bring to customers merchandise they won't find elsewhere, and Federated's private brands are an important vehicle for doing so. Our best customers trust us to provide them with fashion advice and to offer a variety of solutions, from modern to classic, which transcend seasonal trends and remain in their closets.

Of course, value is paramount today as consumers pursue the right balance between high-quality and fair prices. Shoppers



are determined to save money and the "thrill of the hunt" can be satisfied in a department store that offers great prices along with current fashion and fresh merchandise.

What are you doing to make shopping more convenient and inviting?

Federated has been working over the past several years to "reinvent" the department store by experimenting with new merchandising, improved visual presentation and signage, and additional conveniences such as upscale shopping carts, price-check scanners, enhanced fitting rooms and customer lounges. We recognize and understand the compelling mandate to enhance our product, pricing and in-store shopping experience, and that is our goal.



These concepts were included in a reinvent store opened in the fall of 2001 at Easton Town Center in Columbus, OH. Based on customer evaluation and feedback,

elements of the strategy were incorporated into 40 more Federated stores nationwide by the end of 2002, with the reinvent rollout continuing in 2003.

Customers who shop many of these reinvented stores today find more exciting and compelling junior's and young men's departments, stronger fashion viewpoints in women's and men's areas, open-sell cosmetics, and more space to pause and relax within the store.

Our research tells us customers value these improvements, and Federated is committed to continued innovation and experimentation in our quest to make the shopping experience as interesting and inviting as possible.

Can customers get real value in a department store?

Customers can get exceptional values in a Federated store. In fact, in a recently concluded survey, our customers confirmed that the prices they paid in our stores were very competitive. We are challenging ourselves to do a better job of making this value obvious to the customer.

We've adopted price simplification as a core strategy to demonstrate the value we deliver to customers. As part of this, we are working to reduce confusing multiple price promotions, such as offering fewer coupons on top of percentage discounts. Instead, we are migrating to sale pricing that is clearer and less complex, making the real value behind that pricing a lot easier to appreciate.



We've also initiated a Best Value program in which hot-selling items are offered at everyday low prices. When customers see a price tag ending in 98 cents, they know they need not wait for that quality item to go on sale – it's value priced already. Our job is to make sure customers understand when they're getting great deals from our stores, and Best Value pricing helps us do just that.

In reinvent stores, price scanners located throughout the sales floor calculate discounts and savings for the customer so there's no confusion about the out-the-door price of the item. Our customers love them, and so do we.

How do you win in a battle against discounters and specialty retailers?

Federated's most potent weapons in an over-stored retail environment are quality, fashion newness and customer service, combined with a much more obvious value presentation.

When customers select gifts for friends or loved-ones – or want a special-occasion item for themselves – department stores are a natural destination. The quality of department store merchandise exceeds what you'll find in discount stores – and the assortment is larger and more varied than in specialty stores. Fashion-oriented department store customers understand that they don't need to sacrifice the best quality, selection and service for value.

Our challenge is to offer the best possible merchandise assortment for shoppers, and to clearly demonstrate and communicate the value we offer for the price. Both are core strategies for Federated.

Differentiated product also represents an advantage for department stores over national-chain discount and specialty stores. Federated is working more closely than ever with

national brand vendor resources to identify exclusive and limited-distribution items and lines that can be found first by customers at our department stores. We are

supplementing national brands with our own distinctive and highly popular private brands that are, by definition, exclusive to us and represent fashion, quality and recognizable value – a combination that no discounter can match and no specialty store can beat.



What's your answer to fashion sameness?

Two words: unique product.

Fashion has become much more complex in recent years with the emergence of more casual dressing and the diffusion of mass media that create and lead trends. Federated is addressing this issue in two principal ways.



First, we have fortified and accelerated our exclusive-to-Federated private brand development. Each of our 10 private brands is designed and marketed to appeal to a specific customer segment. For example, I-N-C offers updated casual fashions for a more contemporary woman, while Charter Club attracts more classic, traditional customers.

We also are working with key vendors to develop fashion lines and product that are exclusive to Federated. Conviction is the key. When we believe in a particular fashion trend, we are going to do a better job of making that statement to our customers with the force of our conviction.

As a shareholder, what does Federated offer me?

Federated offers its shareholders a strong financial position and the opportunity for continuous improvement. And while trend- or niche-based retailers rise and fall with the fads, Federated offers relative stability.

Even in the difficult economic environment of 2002, Federated generated significant free cash flow. A long and proven track record provides us the planning sophistication to adjust our buying and store operations to fluctuating business levels – thus insulating Federated from erratic swings in financial performance.

Federated has invested consistently over time in technology, systems, logistics, store improvements and brand development. We pride ourselves on being an industry leader, and the strong operating foundation we have in place provides Federated the ability to simultaneously reduce

and contain costs, deliver enhanced value to customers and improve earnings.



What does the future hold for Federated?

We believe Federated will achieve continued success as a focused department store retailer because we have the best store nameplates, the best private brands and the best store locations.

Yet perhaps our greatest asset is our people. We have worked hard to field the most talented and experienced team in all of retailing. Our deep



reservoir of talent has allowed us to overcome obstacles and pursue new opportunities within an organization rich in expertise, enthusiasm and diversity. Federated's deep belief in training and individual development helps sustain high quality talent at all levels of the organization, and we will continue to nourish our people through tools such

as the Federated Leadership Institute and an intensified curriculum for all associates in business skills, product knowledge and sales techniques.

Federated also will continue to invest appropriately in each component of success. We will maximize our two national nameplates – Macy's and Bloomingdale's – with new and improved stores, as well as through integration with e-commerce and catalog channels, and with the cachet of high-visibility events such as the Macy's Thanksgiving Day Parade. We also will support and strengthen our regional store brands in a manner that fully capitalizes on more localized market opportunities.

Our private brand program will be further developed with new concepts, collections, line extensions and marketing support as customer demand drives us to differentiate our assortments with distinct merchandise that delivers ever-more value for the money.

Prospects for new full-line stores in the most promising regional malls and lifestyle centers, as well as more focused strip center locations to fill gaps in larger markets and serve smaller markets, are among the future opportunities we will pursue, along with unique urban stores in selected locations. The exciting new Bloomingdale's home store in downtown Chicago and the upcoming SoHo Bloomingdale's department store in New York are two such examples of how Federated can leverage its financial strength to get the most from its unparalleled retail nameplates.

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VISIT: Our website at www.fds.com/financial to

- Sign up to have Federated's news releases sent to you via e-mail by subscribing to News Direct
- Get the latest stock price and chart, or take advantage of the historical price look-up feature

CALL: Federated Investor Relations Department, Monday-Friday, 8:30 a.m.- 5 p.m. (ET):

1-513-579-7028

Federated News & Information Request Hotline:
1-800-261-5385

WRITE: Federated Department Stores, Inc.

Investor Relations Department

7 West Seventh Street, Cincinnati, OH 45202

Transfer agent for Federated shares:

The Bank of New York
Shareholder Relations Department
Church Street Station
P.O. Box 11258
New York, NY 10286-1258
1-800-524-4458

Annual Meeting:

The next annual meeting of shareholders will be held at 11 a.m. (ET), on Friday, May 16, 2003 at Corporate Headquarters in Cincinnati, OH.

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